



January 4, 2022

## Global Energy Best Ideas

**Our view:** In December, the RBC Global Energy Best Ideas List was up 2.8% compared to the iShares S&P Global Energy Sector ETF (IXC) up 3.6% and a hybrid benchmark (75% IXC, 25% JXI - iShares Global Utilities ETF) up 4.8%. Since its inception in February 2013, the RBC Global Energy Best Ideas List is up 68.0% compared to the S&P Global Energy Sector ETF down 6.3%.

Total Return Comparison	December	YTD	Inception
iShares S&P Global Energy (IXC)	3.6%	40.8%	-6.3%
Hybrid Benchmark (75% IXC, 25% JXI)	4.8%	30.7%	18.4%
RBC Global Energy Best Ideas	2.8%	70.2%	68.0%

**December List Changes:**

Additions: SLB  
Removals: N/A

RBC GLOBAL ENERGY BEST IDEAS LIST								
	Ticker	Rating <sup>1</sup>	Analyst	Mkt Cap (mn)	Date Added	Add Price	Current Price	Price Target
<b>Integrated Energy</b>								
Royal Dutch Shell	RDSB-LON	OP	Borkhataria	\$124,595	7/1/20	1,224p	1,622p	2,500p
Cenovus Energy	CVE-CA	OP	Pardy	C\$31,294	6/1/21	C\$10.09	C\$15.51	C\$20.00
<b>Exploration &amp; Production</b>								
ConocoPhillips	COP-US	OP	Hanold	\$95,202	12/1/20	\$39.56	\$72.18	\$100.00
Canadian Natural Resources	CNQ-CA	OP	Pardy	C\$62,901	9/1/15	C\$29.65	C\$53.45	C\$60.00
Santos Limited	STO-AU	OP	Ramsay	A\$21,371	6/1/19	A\$6.74	A\$6.31	A\$8.50
Tourmaline Oil	TOU-CA	OP	Harvey	C\$13,482	1/1/20	C\$15.08	C\$40.84	C\$54.00
ARC Resources	ARX-CA	OP	Harvey	C\$8,196	5/1/21	C\$7.73	C\$11.50	C\$17.00
Range Resources	RRC-US	OP	Hanold	\$4,632	7/6/21	\$16.76	\$17.83	\$32.00
California Resources Corporation	CRC-US	OP	Hanold	\$3,434	6/1/21	\$29.01	\$42.71	\$70.00
Tamarack Valley Energy	TVE-CA	OP	Davis	C\$1,564	7/6/21	C\$2.57	C\$3.85	C\$5.00
<b>Oilfield Services</b>								
Schlumberger Ltd.	SLB-US	OP	Mackey	\$42,009	1/4/22	\$29.95	\$29.95	\$42.00
Secure Energy Services	SES-CA	OP	Mackey	C\$1,621	8/4/21	C\$4.22	C\$5.26	C\$8.50
<b>Midstream</b>								
Cheniere Energy Inc	LNG-US	OP	Scotto	\$25,719	5/1/20	\$46.69	\$101.42	\$116.00
AltaGas Ltd.	ALA-CA	OP	Kwan	C\$7,651	7/6/21	C\$26.02	C\$27.31	C\$31.00
Rattler Midstream LP	RTL-R-US	OP	Schultz	\$454	12/1/21	\$10.65	\$11.38	\$15.00
Targa Resources Corp.	TRGP-US	OP	Schultz	\$11,961	12/1/21	\$51.63	\$52.24	\$69.00
<b>Utilities &amp; Infrastructure</b>								
The AES Corp.	AES-US	OP	Tucker	\$16,201	12/1/21	\$23.38	\$24.30	\$31.00
Azure Power Global	AZRE-US	OP	Scotto	\$875	7/6/21	\$26.92	\$18.15	\$42.00
Algonquin Power & Utilities	AQN-US	OP	Ng	\$9,718	6/1/21	\$15.28	\$14.45	\$18.00
Drax Group plc	DRX-LON	OP	Musk	\$2,415	5/1/21	409p	605p	750p

1-OP = Outperform, R = Restricted. 2-Indicates Speculative Risk. 3-Opening price given is the closing price of the trading day prior to which the stock was added. 4-Return assumes all dividends and distributions are reinvested.

Note: Performance returns do not take into account relevant costs, including commissions and interest charges or other applicable expenses that may be associated with transactions in this Equity Best Ideas list. Past performance is not, and should not be viewed as, an indicator of future performance.

Source: RBC Capital Markets estimates, FactSet

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## This Month's Additions and Removals from Energy Best Ideas List

### Exhibit 1 - This Month's Additions

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#### **Schlumberger Ltd. (SLB)**

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- We are adding Schlumberger to the RBC Global Energy Best Ideas List. We believe that Schlumberger's size, scale, geographic diversification, and exposure to new energy sources leave it favourably positioned under prevailing industry trends, while its digital evolution should drive margin accretion and reduce capital intensity over time. SLB could also be a primary beneficiary of investor flows into the sector as the upcycle takes hold.
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## Investment Highlights

Below, we provide a summary of our analysts' views on each *Best Idea*.

### The AES Corp. (AES)

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- **Transformational profile could lead to ESG premium.** AES has become one of the largest solar developers in the world, with a current backlog of 9.2 GW and 38 GW pipeline. It has been reducing its coal-fired generation exposure from 45% at the end of 2019 to 20% in July 2021. By 2025, its coal exposure should be less than 10%. Its investments in ways to integrate energy technologies should enhance the stock value. As an example, the recent IPO of Fluence Energy (FLNC, Outperform) values AES' ownership at ~\$2 billion, though the company invested less than \$150 million into the business.
- **Stable core business.** AES' earnings and cash flows are very predictable, as 85% of pre-tax earnings contribution is highly contracted or regulated. The vast majority of new generation projects are contracted through long-term purchased power agreements (PPAs). The average life of PPAs are 13 years. AES also generates a large amount of cash flows, with 2020 parent free cash flow being at \$777 million. We expect free cash flow to grow at 7%-9%, in line with earnings per share. This provides management growing funds to redeploy in its pipeline of projects. It will also allow the company to grow its dividend at least 5% a year.
- **Valuation attractive.** AES trades at a discount to the utilities and to the market. On 2022 estimates, its P/E multiple is 14.2x versus the utility peer group at 20.4x with NEE and 18.1x without; the S&P 500 2022 P/E stands at 23x. The same applies on an EV/EBITDA basis, as AES trades at a 9.5x 2022E multiple versus the utility comp group at 12.9x. We believe that the stock will benefit from a re-rating as the profile shifts increasingly toward renewables. Our \$31 price target assumes an 18.5x 2022E P/E multiple and a 10.7x 2022E EV/EBITDA multiple, though it is based on a sum-of-the-parts methodology.

### Algonquin Power & Utilities (AQN)

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- **Strong growth profile.** Algonquin has a \$12.4 billion 5-year capital investment program focused on growing its regulated utility rate base and renewable energy generation capacity, supporting management's forecast 7-9% EPS growth profile. The company has been successful in growing its regulated utility business organically and through M&A, and the company also has a large renewable energy development pipeline. Management has a good track record of adding renewable energy capacity inside (greening the grid) and outside (on a contracted basis) of its regulated utility footprint. We believe the pending acquisition of Kentucky Power provides significant opportunities to green the grid.
- **Very supportive greening initiatives in the U.S. can drive upside.** Algonquin has a large regulated utility and renewable energy footprint in the U.S. that should benefit from the Biden Administration's decarbonization objectives. Biden has a 2050 carbon net zero target, and a very ambitious target of a carbon-free electricity grid by 2035. The company has signed power purchase agreements with corporations to green its energy consumption, and has partnered with Chevron to jointly develop some renewable projects.
- **A good balance of regulated utility and renewable energy operations.** Algonquin operates a diversified regulated utility business providing electric/gas/water services to over 1 million customers primarily in the U.S. In addition, Algonquin has a renewable energy division with ~2.3 GW of generation capacity in North America with ~80% of the electricity generated contracted over an average term of 13 years. We estimate that the regulated utility division will contribute about two-thirds of the company's EBITDA in 2022.

### AltaGas Ltd. (ALA)

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- **Is AltaGas a utility or a midstreamer? The market seems to be saying “neither”.** AltaGas’s guidance is for 56% of 2022 EBITDA to come from the U.S. regulated gas distribution utilities (Maryland, Virginia, Michigan, Alaska, and Washington, D.C.) and the remainder from midstream assets (net of corporate costs). With relative balance, we find that utility investors, particularly those looking to play defence, are not enamoured with the higher-risk midstream business, while we find that WCSB-focused midstream investors have historically looked to pure-play stocks levered to industry trends. We believe this disconnect has created an opportunity for investors based on our sum-of-the-parts valuation and our view that the shares are attractively valued.
- **Catalyst-rich into 2022.** We believe the next 12 months offer a number of potential positive catalysts including: (1) additional opportunities to delever and highlight value via asset monetizations; (2) increasing the percentage of tolling contracts for West Coast LPG exports as well as sustaining and increasing overall export volumes; (3) strong commodity prices, particularly frac spreads, driving growth into 2022, particularly as unfavourable hedges in 2021 roll off; (4) better visibility for the long-term economics of the Blythe power plant given the environment in California, particularly with respect to resource adequacy contracts; and (5) discussions about strategic transactions to unlock value, although this would likely be toward the end of 2022, if not into 2023.

### ARC Resources (ARX)

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- **FCF generation – ample.** ARC is set to generate \$1.8 billion in 2022 on our numbers. With a strong balance sheet and large M&A on hold (for now), the focus remains on Attachie development and RoC initiatives. ARC targets return of capital in the range of 50-80% of FCF via base dividend tied to earnings growth (now at \$0.40/share or 3.3%), and share buyback (could easily buy back 10% of float annually). Production growth is not a specific target but rather an outcome of the most efficient way to execute projects (Sunrise, Attachie) paired with the Basin’s capacity to absorb new product, and is unlikely to exceed 5%.
- **Western Canada’s largest Montney player.** ARC’s all-stock merger with Seven Generations creates a player with a production base of circa 340,000 boe/d, building what we view as a Montney Champion with top decile supply costs and deep project inventory. This benchmarks ARC as the largest Montney producer, 3<sup>rd</sup> largest outright gas producer and 6<sup>th</sup> largest E&P by volume amid the WCSB producer landscape, with operated facilities network of ~1.5bcf/d – second only to CNRL and Tourmaline. See our notes [here](#) and [here](#).
- **Facility portfolio adds scale and optionality.** Following the absorption of 7G assets, ARC’s owned and operated facility portfolio roughly doubles to about 1.5 bcf/d – now third in the basin behind CNRL and TOU. This larger strategic footprint allows for continued top-quartile operating metrics and optimized marketing, and it establishes critical mass, opening the door for other potential strategic options in the future. A simplified analysis implies that a Topaz-like entity could be valued at around \$1.5 billion with a 9% FCF yield, driving meaningful accretion and/or utilized as a funding vehicle for future projects. See [note](#).
- **Improved scale and history of consistently delivering on quarterly numbers.** Comparative metrics of the ‘new’ ARX relative to other Montney players (especially Tourmaline) shifts into sharper focus. We argue that ARC’s liquids, FCF outlook and strategic position/scale makes it comparable to U.S. peers. Throughout the time we have covered ARC, the company’s ability to meet or exceed guidance figures is amongst the most favourable in the group – see our recent note [here](#). This is all backstopped by the company’s high quality acreage and a conservative mindset – ingredients we see continuing amid the combined entity.



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**Azure Power Global (AZRE)**

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- **AZRE is a leading developer of mostly utility scale solar power in India that we expect to benefit from India's growing economy and electricity demand.** Importantly, the Government of India aims to increase its non-hydro renewable power generation over the next several years, which should benefit AZRE given its scale and strong record of execution. In the near term, AZRE has highly visible cash flow growth potential through its recent power auction wins. Importantly, AZRE generates the majority of its revenues from investment grade, primarily Government of India entities.
  - **Power consumption in India is set to grow; government is highly supportive of solar.** Population growth, urbanization and economic growth should drive power demand growth in India. The IEA estimates India power generation will grow ~145% through 2040. Given this increase, desire for greater energy independence and cleaner air, India targets 450GW of non-hydro renewable electricity capacity by 2030, including 300GW of solar (implies ~25-30GW of solar capacity additions through 2030), which we believe provides significant growth opportunity for AZRE.
  - **First-mover advantages and vertically integrated model provide competitive advantages.** AZRE developed India's first utility scale solar project in 2009. As a first mover, AZRE has gained scale (provides supply chain advantages), expertise and a strong reputation. In addition, AZRE has a vertically integrated business model, which provides AZRE control over its projects and can also lower overall costs. Specifically, given the challenges in securing land in India, we believe AZRE's experience and capabilities in land acquisition provide it with a significant competitive advantage.
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**California Resources Corp. (CRC)**

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- **Attractive value proposition.** CRC shares offer an attractive entry valuation point, strong balance sheet and peer-leading FCF outlook. The company's low break-even point, which we estimate at \$38-39/bbl (WTI), and 50% reinvestment framework positions the company to generate robust FCF of \$2+ billion from 2022-2025. FCF priorities include returning large portions of cash to shareholders, maintaining its already strong balance sheet and looking for accretive, opportunistic additional reinvestment back into the business or A&D. The company instituted a fixed dividend at 3Q21 earnings building upon the \$250 million share repurchase program. The plan is to remain flexible but there is a desire to have a growing dividend. CRC plans to return 50% of FCF back to shareholders providing upside to returns longer term.
  - **ESG exposure in a U.S. E&P.** The company's large surface rights ownership, premium reservoir geology in close proximity to emitting parties and being located in 'green energy' friendly California provide CRC the unique opportunity to economically participate in energy transition opportunities. Management is rapidly moving on its initially identified CCS/solar project set. We think signing up its first LCFS eligible third-party emitter is a catalyst to derisking value from its carbon management projects and should come in early 2022. The State of California has established attractive credit programs to incentivize green energy development in order to meet the state's ambitious climate targets. Accordingly, these credits enhance project economics for CRC as it expands into renewable/carbon management projects being able to take advantage of both in-state and federal credit programs. We think the value of these projects could eclipse the value of the upstream business over time.
  - **Getting started on energy transition opportunities.** CRC filed for its first two CCS permits comprising its Carbon TerraVault I project. Additionally, the company is advancing discussions for its first set of behind-the-meter solar projects with SunPower that are expected online by 2023. We think solar projects will materialize sooner, however the larger value opportunity is in the company's identified CCS/CCUS project pipeline. The company plans to have permitted 200 MMT of storage capacity by 2025 and targets injecting 5 MMT/annually by 2027. We think these initially identified CCS projects can translate to \$30-40/share of value that's largely not being reflected in the stock today. Its first CCS project, Carbon TerraVault I, is targeted for FID by mid/late-2023 and first injection by mid-2025. See our note post CRC's Carbon Management event in early October which provided high-level project economics consistent with our prior value assessment, but importantly our valuation assumed a higher capital cost implying more upside to our analysis ([note](#)).
  - **Conventional asset base provides consistency.** The company's conventional asset base has a low capital intensity with base decline rates at ~15%, far lower than shale E&P peers at 35-40%. Its conventional low-risk, low-decline asset development strategy drives more stable production and cash flow generation which help underpin our FCF outlook. We estimate CRC has over a decade of remaining core drilling opportunities in its core fields which should position the company for repeatable, robust FCF generation for years to come.
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### Canadian Natural Resources (CNQ)

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- **Globally distinguished.** Canadian Natural Resources' management committee structure and shareholder alignment are unique factors which distinguish the company globally. CNQ's long-life, low-decline portfolio—anchored by low sustaining capital—affords the company with superior free cash flow generation throughout the cycle.
- **FCF & buybacks.** We peg CNQ's free cash flow (before dividends of \$2.65 billion) at \$10.9 billion in 2022 under our base outlook (US\$77 WTI). CNQ is targeting an absolute debt level of \$15 billion (expected in the fourth-quarter of 2021). Thereafter the company plans to allocate one-half of its free cash flow (post dividends) to share repurchases, with the other half allocated to net debt reduction. Our 2022 outlook incorporates share repurchases of \$4.0 billion. In conjunction with 3Q results, CNQ raised its common share dividend by 25% to an annualized rate of \$2.35 per share. We think it is important to point out that CNQ has never cut its dividend—which has grown at a CAGR of 20% over the past 22 years.
- **Strong alignment.** CNQ has no CEO. Instead, the company is stewarded by a management committee. This group meets weekly, and oversees all matters ranging from marketing, finance, ESG, operations and technology amongst others.
- **ESG—lots of progress.** CNQ continues to target a 50% reduction in North America E&P (including thermal in-situ) methane emissions by 2030 (vs. 2016), and a 40% reduction in both thermal in-situ fresh water usage intensity and mining fresh river water usage intensity by 2026 (from a 2017 baseline). CNQ also continues to work through details with respect to the Oil Sands Pathways to Net Zero initiative.

### Cenovus Energy (CVE)

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- **Integration on track.** The company's merger with Husky Energy was strategically sound in our eyes, fusing Husky's diverse upstream/mid-stream/downstream operations with Cenovus' bitumen-weighted upstream portfolio. Under one roof, Cenovus-Husky has become a more balanced integrated oil company with increased cash flow diversification. Our bullish stance towards Cenovus reflects its strong leadership and favourable rate of operational/financial improvement which is already underway—and set to continue.
- **5-year plan sets the course.** Cenovus' recent 2021 [investor open house](#), where it unveiled a 5-year outlook, laid a path which emphasized balance sheet strength, capital discipline, free cash flow generation and further movement towards increasing shareholder returns. The company plans to allocate circa 50% of excess free funds flow in 2022, and will target net debt below \$8.0 billion—to a range of \$6.0-\$8.0 billion—which equates to a net debt/adjusted EBITDA ratio of 1.0-1.5x at US\$45 WTI. The company continues to execute its normal course issuer bid, which allows share repurchases up to 146.5 million common shares. Our 2022 outlook factors in 100% execution of Cenovus' issuer bid.
- **Portfolio reshaping an opportunity.** Non-core asset dispositions could also accelerate the pace at which Cenovus' balance sheet deleverages and were explored in our recent ["The Coming Yard Sale"](#) report. In our minds, what stood out most from Cenovus' strategic plan is the potential for further upstream-downstream portfolio reshaping through acquisitions & dispositions. Cenovus appears to have appetite for further non-core asset sales over time. It would not surprise us to see the company reshape its U.S. Manufacturing operations, where only two of its five refineries align with its preference for an operated 100% working interest.





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**Cheniere Inc. (LNG)**

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- **Highly contracted cash flow with strong counterparties.** Cheniere has long-term take-or-pay contracts on 73% of its nine-train portfolio capacity (eight trains now operational), and 90% including mid-term and short-term SPA and IPM agreements. All of Cheniere's Sale and Purchase Agreement customers are investment grade rated or have investment grade credit metrics. Importantly, utilities or state-owned utilities/oil and gas companies represent 68% of Cheniere's contracted capacity.
- **Liquefaction fees represent most of Cheniere's EBITDA.** Cheniere's customers have the contractual right to cancel cargoes but must still pay fixed liquefaction fees. In our 2023 run-rate scenario, on a consolidated basis, liquefaction fees represent ~90% of Cheniere's total EBITDA while lift represents ~5% and marketing ~5%.
- **Long-term FCF and capital return story.** We believe long-term take-or-pay contracts with high credit quality counterparties provide cash flow visibility. The four pillars of Cheniere's capital allocation strategy include (1) annual debt pay down of \$1 billion through 2024 to achieve investment grade ratings; (2) dividend declaration of \$0.33/share (\$1.32/share annualized, ~1.5% yield) starting in 3Q21 with mid-single-digit annual growth; (3) share repurchase program restarted in 3Q21, reset to 3-year, \$1 billion program starting in 4Q21; and (4) invest in accretive growth with a potential FID of Corpus Christi Stage 3 in 2022.

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**ConocoPhillips (COP)**

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- **COP offers a returns-focused value proposition, a strong balance sheet, and peer-leading distributions.** The company is well positioned to maintain competitive FCF generation through various commodity price cycles with a sub-\$30/bbl (WTI) average cost of supply.
  - **RDS Permian acquisition enhances returns proposition.** The \$9.5 billion cash acquisition announced in mid-September lowers the corporate cost of supply, increases the resource base, and improves FCF generation. We estimate this adds over \$2.0 billion of FCF in 2022 at \$80/bbl. Leverage remains ultra-low at sub-1x.
  - **A well-defined and attractive investment proposition.** COP was an early leader in committing and demonstrating high returns of capital back to shareholders. The priorities are: (1) sustain production and pay its fixed dividend; (2) annual dividend growth; (3) A-rated balance sheet; (4) 30+% CFO total shareholder payout; and (5) disciplined investment for CFO expansion. Management has demonstrated its commitment to industry-leading returns of capital to shareholders that includes a minimum cash flow payout of 30%. We think this could translate to returning 80+% of the current market cap back to shareholders over the next decade through fixed dividends, stock buybacks, and potentially a variable dividend.
  - **A global and diverse footprint across the commodity spectrum mitigates unsystematic risk.** This also allows capital to shift toward projects that can deliver high returns through commodity price and economic cycles.
  - **COP is the fifth-largest natural gas marketer in the U.S.** This creates opportunities to enhance transportation and sales mechanisms for margin improvement.
  - **Energy transition opportunities.** We think there is a growing effort to evaluate energy transition options. COP has a low carbon team that is focused on emission reduction initiatives and opportunities relevant to its core business and competencies. This could include CCS/CCUS and blue/green hydrogen.
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**Drax Group plc (DRX)**

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- **Higher power prices, and clarity on BECCS drive our Outperform rating and 750p/sh price target.** Drax is a preferred name within European Utilities with a cemented strategy in the biomass value chain, and strong prospects to create the UK's first BECCS units at Drax Power Station. Annualized power prices for 2022 and 2023 are up substantially YTD, driving higher EBITDA in the coming years. We also see Drax's dividend as attractive and robust having increased 10% for 2021, with the underlying business set to benefit from higher cash flow generation over the medium term.
  - **Power price strength a near-term tailwind.** We see positive exposure from power prices on ~2TWh in 2022, ~6TWh in 2023, and ~9-10TWh in 2024 of open volumes across the ROC biomass and hydro portfolio. We do not believe the market has fully appreciated the high power price environment on open volumes, and with continued volatility in energy markets into the new year, we see Drax positioned well to take advantage of higher commodity costs.
  - **Biomass strategy is working short and longer term.** Drax is set up well to deliver on its ambitions to reach 5mn tonnes of self-supply of pellets (vs. ~2m trajectory for 2022) and to hit the targeted \$100/t & £50/MWh pellet cost by 2027 vs. a 2020 cost in Drax of \$154/t (and proforma ~\$141/t). We assume Drax is able to deliver on this strategy resulting in EBITDA in Pellet Production growing more than 3x over 2020-27 to in excess of £300 million.
  - **UK Cluster Decision is promising for BECCS at Drax.** The East Coast Clusters inclusion in the UK Track 1 CCS cluster has a positive outcome for Drax and its ambitions to develop BECCS at Drax Power Station. The preliminary Biomass Strategy paper from the UK government released in November gives us increased confidence in Drax eventually delivering BECCS through a commercial framework within the UK, with BECCS a core part of the UK's ambitions to reach net zero. We also see an opportunity for Drax to become a global leader in BECCS, providing thought leadership and build expertise to projects globally, bolstered by the partnership with Bechtel to explore options and locations to construct BECCS plants globally.
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**Range Resources (RRC)**

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- **Strong upside to historically tight NGL/natural gas markets.** RRC is our preferred equity to express bullishness in NGL and natural gas prices with NGLs representing ~30% of total production volumes. The company exports a large portion of its NGL production which translates to premium realizations above peers and allows RRC take advantage of both strong international and domestic demand trends.
- **Rapid organic deleveraging.** The near-term focus remains on running the business for FCF to use for debt reduction with continued strength in commodity prices accelerating efforts. RRC exited 2020 with leverage at 5.3x net debt-to-EBITDA, however after strong 3Q21 results, we model leverage exiting 2021/2022 at 2.1x/1.0x based on our commodity price outlook.
- **Shareholder returns just around the corner.** We think conversations on a shareholder return strategy could start early-to-mid 2022 given the current line of sight on achieving leverage targets. We think a competitive fixed dividend is a likely first step, with variable dividends or buybacks to supplement returns during higher price cycles. At strip commodity prices a 10% all-in (fixed dividend, variable dividends and buybacks) return strategy could start in late 2022/early 2023 that can be sustained while still keeping leverage sub-1.0x.
- **Defining low cost operator.** RRC has one of the largest tier-1 inventories remaining in the Appalachian Basin which coupled with its strong technical expertise and low base decline supports a highly efficient maintenance capital program that can be sustained for years to come. This provides a resilient FCF outlook over the next several years which we estimate RRC generating over \$3.5 billion of cumulative FCF from 2022-2025, roughly 75% of its current market cap.

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**Rattler Midstream LP (RTLRLP)**

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- **Acquisitions/divestiture.** RTLRLP has completed multiple strategic transactions that increase its asset mix to the Northern Midland Basin and further deepens line of sight to FANG production. Acquisitions consisted of a G&P JV with 925 mmcf/d processing capacity and a PSA with FANG in a drop-down transaction for water midstream assets. Additionally, RTLRLP increased financial flexibility with a divestiture of non-core assets in Pecos County.
  - **Unmatched line of sight.** The relationship with FANG provides an unmatched line of sight to RTLRLP operations. This relationship allows for easier planning of operations going forward and less risky capital investments. RTLRLP further deepened this relationship via its acquisitions in 4Q21. We believe this relationship validates our higher assumed EBITDA multiples in our valuation than current trading levels.
  - **Capital allocation.** RTLRLP has continually repurchased common units under its repurchase authorization. The BOD increased the repurchase authorization to \$150 million with an indefinite term, which leaves a significant amount remaining available under the program.
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**Royal Dutch Shell PLC (RDSB)**

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- **Advantaged portfolio.** In our minds, Shell has three franchise businesses within the group, all of which are #1 in their respective areas. Global deepwater, integrated gas and marketing form Shell's key competitive advantages, in our view. Shell's marketing business in particular generates >20% ROACEs consistently and is the highest return business within the group. While we understand the company values integration highly in its strategy, we believe there are some valuable parts of Shell's business that are not reflected in the share price today—something that has not escaped the eye of some in the market (see [“talk to me”](#)). A look at Shell's SOTPs would suggest a valuation closer to \$250 billion (>3,000p share price).
  - **Free cash flow giant.** On our bullish commodity price deck, Shell's advantaged portfolio generates significant amounts of cash, supported by the company's oil leverage and #1 LNG presence. This leaves it well positioned to deleverage meaningfully over the coming years with cash to spare for higher shareholder returns.
  - **Closing the gap.** On our estimates, Shell generates a 14% FCF yield on average over 2022-25E—ahead of the sector average—but trades at a discount to peers on a DACF multiple basis. We think increasing shareholder returns should help drive a re-rating versus peers, while continued de-leveraging sets up Shell to become a more stable business through the cycle.
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## Santos Limited (STO)

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- **Santos merger with Oil Search** creates a top 20 global energy company with 2P reserves of 1.378 billion boe and 2021 production of ~116 mmbbl. The combined company will have a more diversified production base (47% LNG, 35% gas and 18% liquids) and a stronger and longer growth profile (Dorado, Papua LNG, Pikka Alaska oil). This will create one of the largest Asian LNG suppliers and aligns partners in PNG LNG and Papua LNG. The larger combined balance sheet provides increased flexibility from >US\$5.5 billion of liquidity and an investment grade credit rating that enables self-funding of development projects. Initial pre-tax synergies of US\$90-115 million pa (excluding integration and other one-off costs) looks conservative with potential to unlock additional value.
- **Barossa final investment decision** achieved in March 2021, with a first production target of 1H 2025. The Santos operated Barossa project rates as the most attractive Australian brownfield LNG development as back fill for Darwin LNG based on a cash cost of production of ~US\$2.00/mmBtu and breakeven cost of LNG supply at ~US\$5.50/ mmbtu. In early December 2021, Santos completed its upstream and downstream project equity alignment goals after concluding the sale of a 12.5% stake in the Barossa project to JERA.
- **Dorado** consists of a relatively simple, shallow-water Western Australian oil field development. Santos is forecasting initial production of ~100,000 bopd (gross) and operating costs of <US\$5/bbl. Dorado Phase 1 oil project FEED entry has been achieved, with project FID targeted in 1H 2022 after drilling the nearby Apus and Pavo exploration prospects that offer low cost and production extending tie-back potential.
- **Papua LNG** has obtained fiscal stability and the revised project pre-FEED work was being finalized for FEED entry in 2022 for potential production start-up in 2027.
- **Alaska Pikka Oil** achieved FEED entry in 2021 with plans to commence production from Phase 1 at 80,000 bopd (gross) of oil from 2025. Further phases of this Oil Search project have potential to deliver two additional 40,000 bopd (gross) projects. The Alaskan gross 2C oil resource is 936 mmbbls.
- **Moomba CCCS Phase 1 (STO 66.7% and operator)** is a low-cost 1.7 mtpa CO2 storage project in the Cooper Basin with capex estimated at ~US\$165 million gross and a full life cycle cost <A\$30/t CO2. A FID decision was announced in November 2021 after Santos successfully registered the project with the Australian Clean Energy Regulator, which enables it to qualify for Australian Carbon Credit Units for emissions reduction for a period of 25 years.



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**Schlumberger Ltd. (SLB)**

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- **Leading size, scale, geographic reach.** Schlumberger's size, scale, geographic diversification, and exposure to new energy sources leave it favourably positioned under prevailing industry trends, in our view. Recent dispositions have also reduced its leverage to fast-cycle U.S. shale activity, a benefit as producer capital discipline rules the day. We see the company's strong international footprint as an advantage as the global commodity supply/demand dynamic becomes increasingly intertwined.
- **Digital evolution to drive financial results.** Growing contribution from the Digital and Integration business line should drive margin accretion over time. Integrated digital platform adoption also improves revenue stability and provides competitive advantage as the E&P industry increasingly embraces efficiencies. Over time, we believe the reduced capital intensity should drive improvement in the company's financial metrics.
- **Free cash flow profile improving; dispositions may accelerate de-leveraging.** We expect the company to generate \$2.0 billion in post-dividend FCF through 2022, reaching its targeted 2.0x net debt/EBITDA leverage ratio. We see lower debt loads as crucial to improving the stability of shareholder returns in oil & gas businesses, and would like to see further absolute de-leveraging as debt matures through the decade. Dispositions could also accelerate de-leveraging.
- **Energy transition leader.** Schlumberger New Energy is on the leading edge of CCUS, hydrogen, and other potential growth avenues. Schlumberger estimates its total addressable market at \$50-75 billion by 2030. Its approach to creating partnerships with oil & gas customers as well as adjacent industries reduces implementation risk and capital requirements as the revenue opportunity becomes clearer, in our minds.

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**Secure Energy Services (SES)**

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- **Consolidated footprint unlocks asset potential.** Secure is poised to unlock value from its expanded waste processing network through enhanced operating scale, FCF generation capability, and ultimately investor attention, while the larger footprint also expands Secure's level of tuck-in and tie-in opportunities.
  - **Targeting debt reduction in the near term, but strong FCF provides optionality.** Secure is targeting leverage of sub-2.5x within the next 1.5-2 years of closing. We see this as achievable based on our FCF estimate of \$291 million over the next 15 months. FCF generation should be buoyed by increasing activity levels in the WCSB, cost efficiencies, and a largely maintenance capital spending profile as the company re-assesses its expanded opportunity set. We believe the company also has FCF optionality to implement share repurchases or issuer bids, but debt reduction is the top priority.
  - **Merger cost-reduction initiatives on track.** Secure has achieved approximately 40% of its targeted \$75 million annual cost savings. The company remains on track to hit its overall target by YE22. Focus areas to date have included operational optimizations, reduced public company costs, and headcount. Total reductions are split 60%/40% operational optimizations/corporate initiatives.
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### Tamarack Valley Energy (TVE)

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- **Regional development likely provides drilling catalysts.** Tamarack's 2021 capital program of \$165-180 million is weighted to Clearwater development with regional production surpassing 5,500 bbl/d in Q3/21. Management also expects Clearwater assets to produce approximately 12,000 bbl/d in 2022 following Spur and Crestwynd acquisitions in the region (see our note [here](#)). Initial wells are performing in line with or better than type curve expectations with 8 (7 net) additional wells expected to be drilled through year-end. The company also completed the Nipisi gas-gathering project alongside conserving 2 mmcf/d of natural gas and plans to initiate a waterflood project in Q1/22 at West Nipisi.
- **Return of capital framework well defined.** Tamarack will initiate a base dividend of \$0.0996/sh annually (paid monthly), beginning February 15, 2022. The initial payout is set at 25% of free funds flow at US\$55/bbl and will be evaluated annually. Management has also set a net debt target of \$250-300 million, which we expect will be reached by mid-2022. At this point, the company plans to return 50% of free funds flow to shareholders (trailing quarterly basis) through buybacks and/or special dividends.
- **Five-year plan underscores robust FCF profile.** The company mapped out \$1 billion in FCF generation over the next 5 years at US\$55/bbl WTI and C\$2.50/GJ AECO, with annual capital spend of \$200-\$250 million supporting volumes of 41-43 kboe/d plus the potential for 2-3% organic growth. Additionally, recent M&A activity has shifted the corporate break-even to the mid-US\$30/bbl range, providing flexibility and material FCF generation potential to enhance total shareholder returns. See our note [here](#).
- **Strong balance sheet able to support further M&A.** Based on our updated estimates, we forecast Tamarack to carry approximately \$205 million/\$107 million in net debt at year-end 2022E/23E, representing a D/CF ratio of 0.3x/0.2x, compared to peers at 0.6x/0.3x. We currently model full NCIB utilization and a 25% dividend increase in 2023. We do not currently model special dividends or incremental M&A, though we view both as likely given material FCF generation.

*RBC Capital Markets is acting as financial advisor to Tamarack Valley Energy Ltd with respect to its acquisition of Crestwynd Exploration, as announced in the press on December 15, 2021.*

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### Targa Resources Corp. (TRGP)

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- **Volumes and FCF.** We recently increased our 2022+ cash flow estimates largely on a more constructive view on volume outlook within TRGP's Permian footprint and our commodity outlook. Our estimates assume ~12% Permian inlet growth in 2021 and 2022 and our 2022 FCF outlook after growth capex and dividends is >\$1 billion. FCF generation is being utilized to drive balance sheet improvements, by utilizing capital to start buying back preferred equity outstanding.
  - **Structure simplification.** TRGP plans to simplify its corporate structure through devco buy-ins in 2022. Although leverage will move up at the time of buy-in, TRGP will benefit from the increased EBITDA the devcos provide, followed by reducing leverage thereafter.
  - **Dividend.** TRGP re-based its dividend higher to \$1.40/share annually beginning with the 4Q21 distribution, which implies a ~2.5% yield. The distribution accounts for ~30% of 2021E FCF, and allows for modest annual increases post 2022. We now model a \$2/share dividend in 2023, which would imply a 2.9% yield at our price target.
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### Tourmaline Oil (TOU)

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- **Key beneficiary of an improved natural gas outlook.** Strong commodity prices provide the firepower for [Western Canada Sedimentary Basin \(WCSB\) natural gas](#) producers to return meaningful capital to shareholders plus still grow modestly (+3-5%), while being mindful that basin growth much beyond this figure could start to drive egress constraints. See our deep dive report [here](#) and recent gas price sensitivities [here](#).
  - **High quality asset base, with North Montney driving the growth.** With Gundy P2 nearly on stream, we would anticipate future development dollars targeted at Conroy – both as it relates to bolt-ons and organic development. We’ve explored Tourmaline’s North Montney area in our recent work [here](#), [here](#) and [here](#). Tourmaline has a top-decile cost structure and industry-leading capital efficiencies. We now model Tourmaline’s 2021 capital efficiencies at approximately \$7,500/boe/d. Ownership of facilities remains a key ingredient to the story, and could represent an additional avenue to surface value in the future.
  - **Sizeable consolidation complete, focus on amalgamation and margin improvement.** TOU has been active on the M&A front over the last year, highlighted by transactions involving Modern, Jupiter, Saguaro, and Black Swan. We expect that large-scale M&A is complete for now; that said, we do not factor out the possibility of bolt-ons in core focus areas where it makes sense. Focus shifts to amalgamation and initiatives that maximize cost savings and minimize environmental impact. The company estimates each \$1/boe of margin improvement to yield roughly \$180 million of annual cash flow in 2022 (staff reductions are not part of this initiative). See our recent note [here](#).
  - **Return of capital accelerates, with the vast majority of FCF to be returned.** Our 2021 and 2022 outlook and forecast for FCF distribution continues to call for two additional dividend increases through 2022 (to \$0.96 annualized by year-end) plus roughly \$3.00/share in additional special dividends. Incrementally, our outlook calls for the buybacks totaling ~\$660 million. See our recent notes [here](#) and [here](#).
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## Portfolio tracking

The RBC Capital Markets Global Energy Best Ideas List highlights our Research Analysts' highest conviction names across the global energy sector at the time of their addition into the list. Our objective is to highlight individual stocks that are expected to outperform the iShares Global Energy ETF (IXC) and a hybrid benchmark with a weighting towards the iShares Global Utilities ETF (JXI).

A long-only portfolio, the RBC Capital Markets Global Energy Best Ideas List is set up as follows:

- There is no limit to the number of names included in the RBC Capital Markets Global Energy Best Ideas List.
- Individual holdings are deemed to be weighted equally, with weights reset every month or any time that there is a change to the list.
- Names added to the list will remain on the list for at least one full month, i.e., there will be no mid-month additions/deletions. If we discontinue research coverage of a company included on the RBC Global Energy Best Ideas List, the stock will be removed from the list as of the next monthly publication.
- The RBC Global Energy Best Ideas has a mandatory stop loss mechanism as follows: a stock will be removed from the list if it is down 20% in the current year or down 20% since being added to the list.
- We will use the most recent closing price prior to the list being published, unless noted otherwise, as the price used for performance calculations. Therefore, any additions to or deletions from the list are recorded as have being made at their most recent closing price.
- Dividends will be added to returns from stock price movements on the day that stocks go ex. dividend.
- We will provide a monthly update on the constituent names of the list as well as past performance on or around the start of each month.
- We will include only stocks on which we have research coverage.
- We do not make provisions for taxes and/or trading commissions when adding or removing stocks from the portfolio.

**Note:** Total return data for the list as well as relevant indices are from Bloomberg and FactSet.



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## Companies mentioned

Fluence Energy, Inc. (NASDAQ: FLNC US; \$34.87; Outperform)

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