EQUITY RESEARCH

Capital Markets

**RBC Energy & Utilities Equity Team**
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May 1, 2023

# Global Energy Best Ideas

**Our view:** In April, the RBC Global Energy Best Ideas List was down 0.3% compared to the iShares S&P Global Energy Sector ETF (IXC) up 4.1% and a hybrid benchmark (75% IXC, 25% JXI – iShares Global Utilities ETF) that rose 3.9% on a sequential basis. Since its inception in February 2013, the RBC Global Energy Best Ideas List is up 126.4% compared to the S&P Global Energy Sector ETF up 27.3%.

| Total Return Comparison | April | YTD | Inception |
|---|---|---|---|
| iShares S&P Global Energy (IXC) | 4.1% | 0.8% | 27.3% |
| Hybrid Benchmark (75% IXC, 25% JXI) | 3.9% | 1.6% | 43.3% |
| RBC Global Energy Best Ideas | -0.3% | -4.7% | 126.4% |

**April List Changes:**
**Additions:** N/A
**Removals:** REP-ES, TVE-CA

**RBC GLOBAL ENERGY BEST IDEAS LIST**

| | Ticker | Rating[1] | Analyst | Mkt Cap (mn) | Date Added | Add Price | Current Price | Price Target |
|---|---|---|---|---|---|---|---|---|
| **Integrated Energy** | | | | | | | | |
| Shell | SHEL-LON | OP | Borkhataria | £167,748 | 7/1/20 | 1,224p | 2,452p | 2,900p |
| Suncor Energy | SU-CA | OP | Pardy | C$56,076 | 3/1/23 | C$45.86 | C$42.42 | C$54.00 |
| **Exploration & Production** | | | | | | | | |
| Topaz Energy | TPZ-CA | OP | Davis | C$2,799 | 11/1/22 | C$23.04 | C$19.41 | C$26.00 |
| California Resources Corporation | CRC-US | OP | Hanold | $2,879 | 6/1/21 | $29.01 | $40.50 | $60.00 |
| Diamondback Energy | FANG-US | OP | Hanold | $26,107 | 12/7/22 | $138.21 | $142.20 | $175.00 |
| Permian Resources Corporation | PR-US | OP | Hanold | $5,841 | 12/7/22 | $8.99 | $10.45 | $14.00 |
| Range Resources | RRC-US | OP | Hanold | $6,382 | 7/6/21 | $16.76 | $26.45 | $35.00 |
| ARC Resources | ARX-CA | OP | Harvey | C$10,304 | 5/1/21 | C$7.73 | C$16.83 | C$22.00 |
| Tourmaline Oil | TOU-CA | OP | Harvey | C$20,575 | 1/1/20 | C$15.08 | C$60.87 | C$80.00 |
| Canadian Natural Resources | CNQ-CA | OP | Pardy | C$91,034 | 4/1/22 | C$77.41 | C$82.56 | C$85.00 |
| Enerplus Corporation | ERF-US | OP | Pardy | $3,234 | 6/1/22 | $14.84 | $14.96 | $20.00 |
| Santos Limited | STO-AU | OP | Ramsay | A$23,283 | 6/1/19 | A$6.74 | A$7.07 | A$9.00 |
| **Oilfield Services** | | | | | | | | |
| Liberty Energy | LBRT-US | OP | Mackey | $2,256 | 8/3/22 | $14.20 | $12.81 | $22.00 |
| SLB | SLB-US | OP | Mackey | $70,340 | 1/4/22 | $29.95 | $49.35 | $67.00 |
| **Midstream** | | | | | | | | |
| Pembina Pipeline Corporation | PPL-CA | OP | Kwan | C$24,545 | 9/1/22 | C$46.38 | C$44.60 | C$58.00 |
| Targa Resources Corp. | TRGP-US | OP | Schultz | $17,118 | 12/1/21 | $51.63 | $75.53 | $110.00 |
| Cheniere Energy Inc | LNG-US | OP | Scotto | $37,287 | 5/1/20 | $46.69 | $153.00 | $200.00 |
| Energy Transfer LP | ET-US | OP | Scotto | $39,858 | 2/1/22 | $9.57 | $12.88 | $17.00 |
| **Utilities, Refiners, Infrastructure & Renewables** | | | | | | | | |
| Superior Plus | SPB-CA | OP | Ng | $2,027 | 12/7/22 | $9.82 | $10.05 | $15.00 |
| Marathon Petroleum Corporation | MPC-US | OP | Schultz | $54,357 | 12/7/22 | $109.29 | $122.00 | $148.00 |
| PG&E Corporation | PCG-US | OP | Tucker | $34,011 | 9/1/22 | $12.33 | $17.11 | $20.00 |
| Drax Group plc | DRX-LON | OP | Wheeler | £2,527 | 5/1/21 | 409p | 630p | 1,050p |

1-OP = Outperform, 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 1: 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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Priced as of prior trading day's market close, EST (unless otherwise noted). All values in USD unless otherwise noted

**Disseminated: May 1, 2023 07:20EDT; Produced: May 1, 2023 07:20EDT**
**For Required Non-U.S. Analyst and Conflicts Disclosures, see page 17**

**RBC Capital Markets appreciates your consideration in the 2023 Institutional Investor All-America and All-Canada Research Team**

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

Exhibit 1 - This Month's Removals

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| **Repsol SA (REP)**<br>Biraj Borkhataria, Analyst<br>(+44) 20-7029-7556<br>biraj.borkhataria@rbccm.com | • While spot refining margins have moved lower recently, we still assume Repsol can generate healthy premiums above its theoretical refining margin indicator each quarter, although reducing through the year. This, along with the company's commitment to competitive shareholder returns, underpins our positive stance on Repsol but we remove the company from the Energy Best Ideas list given weakness in refining margins driving a more modest valuation discount vs peers going forward. We continue to rate the shares Outperform. |
| **Tamarack Valley Energy (TVE)**<br>Luke Davis, Analyst<br>(403) 299-5042<br>luke.davis@rbccm.com | • Tamarack has solidified its position as a top Clearwater producer through an aggressive M&A strategy, vastly improving its corporate sustainability profile with a ~US$37/bbl breakeven (inclusive of the base dividend). While we believe the company remains well positioned as one of the most economic plays in North America, recent operational headwinds combined with volatility in commodity prices and differentials are likely to extend the timeline to reach debt targets, which trigger incremental RoC thresholds. We expect this leaves limited near-term catalysts (outside of strong operational performance) that are likely to move the stock materially higher over the next quarter or so. As a result, we are removing Tamarack Valley from our Global Energy Best Ideas list, though we maintain our favourable medium to long term outlook. |

# Investment Highlights

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

**ARC Resources (ARX)**
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- **FCF generation - ample.** 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 50-100% of FCF via base dividend tied to earnings growth (now at $0.60/share), and share buyback. 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%. See our recent quarterly note here.
- **Western Canada's largest Montney player.** ARC's production base of circa 350,000 boe/d, makes it what we view as a Montney Champion with top decile supply costs and deep project inventory. This benchmarks ARC as the largest Montney producer, 3rd largest outright gas producer and 6th largest E&P by volume amid the WCSB producer landscape, with operated facilities network of ~1.5bcf/d - second only to CNQ and TOU. 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 CNQ 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. See our note here.
- **LNG - The key to long term value creation.** ARC's existing 2P reserve book contains sufficient resource to sustain an entire 2-train LNG project (1.8 bcf/d) for 10+ years, and when adding future drilling could increase to 40-50 years. Accordingly, the company should be viewed as a key supplier, or alternatively as a strategic asset for operators looking for vertical integration. The owners of LNG Canada now collectively hold enough product to support Phase 1 of the development (~1.8 bcf/d), but any expansion (Phase 2, +1.8 bcf/d) would need to be augmented. ARX signed a Memorandum of Understanding with the proposed Cedar LNG Project for a 20-year LNG supply agreement to send 200 mmcf/d of natural gas, which is expected start in 2028/2029. See our notes here and here.

**California Resources Corp. (CRC)**
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- **Attractive value proposition.** We expect CRC shares to outperform the peer group over the next 12 months. CRC has a combination of a high-quality, low-decline conventional asset base, an experienced management team, and a good balance sheet. Its assets are located entirely in California and CRC is the largest producer in the state. A majority of its operations are conventional developments that produce high-margin, low-decline production, translating to more stable cash flows.
- **Midstream and power exposure.** CRC owns and operates integrated midstream assets, a 550 MW power plant which sells a portion of its generation to the grid, and more than 565 MMcf/d of gas-processing facilities.
- **Conventional asset base provides consistency.** The company operates essentially all of its investment capital and production and also owns a large portion of its mineral and surface rights, translating to high net revenue interest. The low base decline nature of its conventional asset development strategy makes CRC less capital-intensive relative to peers and provides a framework for more stable production/cash flow generation.
- **ESG exposure in a U.S. E&P.** CRC's large surface rights ownership and premium geology position it to opportunistically pursue front/back of the meter solar and carbon-capture projects that could translate to improved operating costs and cash flow uplift. The company continues to advance on an industry-first, commercial-scale carbon-management business segment in addition to entering into multiple behind-the-meter solar projects. CRC receives premium commodity realizations relative to peers/NYMEX benchmark pricing.

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| **Canadian Natural Resources (CNQ)**<br>Greg Pardy, Head of Global Energy Research<br>(416) 842-7848<br>greg.pardy@rbccm.com | • **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 superior free cash flow generation throughout the cycle.<br>• **Impressive shareholder returns**. CNQ's shareholder returns policy revolves around a net debt floor of $10 billion. The company is currently allocating 50% of its free cash flow (after dividends and base capital) towards share repurchases, with the balance (less strategic growth capital/acquisitions) earmarked for debt reduction. Once CNQ's net debt falls to $10 billion the company will allocate 100% of its free cash flow as incremental returns to shareholders. This could come in the form of further base dividend growth, accelerated share repurchases and/or special/variable dividends. Free cash flow will be defined as adjusted FFO less dividends and total capital expenditures in the year (excluding A&D). To the extent that the company's net debt rises above $10 billion, it would revert to its prevailing 50/50 policy. Additionally, alongside fourth-quarter results, CNQ raised its common share dividend by 6% to an annualized rate of $3.60 per share. We think it is important to point out that CNQ has never cut its common dividend, which has grown at a CAGR of circa 21% over the past 23 years.<br>• **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.<br>• **ESG—lots of progress**. CNQ has established a GHG emissions reduction target of 40% of total corporate absolute Scope 1 and 2 GHG emissions by 2035 (vs. a 2020 baseline). Not to be overlooked, CNQ also continues to make progress towards its initiatives with respect to the Oil Sands Pathways to Net Zero Alliance. CNQ also continues to target a 50% reduction in North American 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). |
| **Cheniere Inc. (LNG)**<br>Elvira Scotto, Analyst<br>(212) 905-5957<br>elvira.scotto@rbccm.com | • **Highly contracted cash flow with strong counterparties.** Cheniere has a weighted average contract duration of 17 years on its long-term take-or-pay contracts and is 90% contracted on its nine-train portfolio 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.<br>• **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 2024 run-rate scenario, on a consolidated basis, liquefaction fees represent ~90% of Cheniere's total EBITDA while lift represents ~5% and marketing ~5%.<br>• **Long-term FCF and capital return story with a growth option.** We believe long-term take-or-pay contracts with high credit quality counterparties provide cash flow visibility. After completing its 2021 capital allocation strategy ahead of schedule, Cheniere updated its capital allocation strategy, which now includes: (1) continued debt pay-down to hit a long-term run rate leverage target of ~4.0x Debt/EBITDA; (2) an incremental $4BN of share repurchase over 3 years; (3) annual dividend growth of ~10% through the mid-2020's and target ~20% payout ratio once Corpus Christi Stage 3 hits run-rate cash flow. In addition, Cheniere continues to pursue potential growth opportunities with Corpus Christi Midscale Trains 8 and 9 as well as the Sabine Pass Liquefaction Expansion project in FERC pre-filing. |

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| **Diamondback Energy (FANG)**<br>Scott Hanold, Analyst<br>(512) 708-6354<br>scott.hanold@rbccm.com | • We believe FANG shares should outperform its peer group over the next 12 months. Management has built a solid Permian Basin position with a deep inventory of liquids-rich development opportunities. The company is one of a few that have amassed a combination of quality assets, strong economic growth, minerals ownership, and a water business, which collectively help to provide a competitive advantage.<br>• **Defining low-cost operator.** We believe FANG has one of the lowest cost structures in the basin and a corporate cash flow break-even (including dividend) that is among the best in the industry.<br>• **Robust shareholder return proposition.** A shareholder-friendly return proposition that includes at least 75% of FCF in the form of a fixed dividend, variable dividend, and stock buybacks. Management plans to be opportunistic on buybacks when FANG shares trade at or below the implied mid-cycle valuation ($60-65/bbl based).<br>• **Depth of tier-1 inventory.** The company has a runway of tier-1 inventory projects that extend more than a decade. FANG has a track record of achieving its growth targets while spending within cash. It has a willingness and demonstrated ability to adjust activity levels quickly in response to challenging market conditions. |
| **Drax Group plc (DRX)**<br>Alexander Wheeler, Analyst<br>+44 (20) 7653 4481<br>alexander.wheeler@rbccm.com | • **Financials remain above consensus post EGL, biomass cost adjustment a big plus.** Clarity on the Electricity Generator Levy (EGL) provides greater visibility for Drax going forward, whilst the government's decision to allow for the changing cost of biomass within the EGL further removes uncertainty from the investment case. We think overall the EGL was significantly less draconian than the market anticipated and the allowance for changing biomass costs above a £65/MWh threshold is a key positive. We continue to take a conservative view on power prices, assuming a 20% discount to the forward curve and therefore see further upside on a mark to market basis.<br>• **Three-pronged growth strategy continues to take shape.** Drax retains a number of growth options going forward, which include BECCS, new pumped storage capacity at Cruachan and continued expansion of upstream pellet facilities. The development of BECCS continues to progress both domestically and internationally. In the UK successful track 1 BECCS projects will be shortlisted in Q1-23 and we should also get further clarity on the government's investment framework, which is likely to include a CfD mechanism for both power generation and negative emissions. Internationally, the regulatory framework in the US appears to be increasingly favourable for expansion of BECCS going forward. Additionally, new pumped storage capacity through the 600MW expansion of the Cruachan II pumped storage facility should be completed by the end of the decade. We see the £3bn capex growth plans as fully funded under the current balance sheet, with FCF yields averaging ~25% across the remainder of the decade.<br>• **Sustainability paramount to Drax's strategy.** Biomass continues to be a key part of the UK government's strategy to achieve net zero, whilst Drax is leading the way on BECCS, which has growth potential both in the UK and internationally. We think criticism of Drax's sustainability credentials was inaccurate in the BBC Panorama documentary towards the end of last year, and we were reassured by a recent trip to see Drax's pellet operations first hand. Drax retains an active aim of ensuring any biomass sourced will have positive outcomes for climate, nature and the communities in which it operates. |

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| **Energy Transfer (ET)**<br>Elvira Scotto, Analyst<br>(212) 905-5957<br>elvira.scotto@rbccm.com | • **Energy Transfer is a publicly traded partnership that owns and operates a portfolio of assets across the natural gas, natural gas liquids, and crude oil value chain.** We believe ET is well positioned to generate meaningful cash flow growth as large-scale growth projects come online and as we expect growth capex to slow. With a stronger balance sheet, ET should be in position to return more cash to unit-holders via distribution increases and/or unit repurchase.<br>• **Significant synergy potential from recent Enable Midstream acquisition:** (1) Enable brings additional demand pull transportation and storage assets in the Mid-Con and ArkLaTex regions. (2) Enable's Gathering and Processing assets in the Mid-Con complements ET's Gulf Coast fractionation and export assets. (3) Enable's Haynesville Gathering and Processing assets and its Gulf Run pipeline increase exposure to the global liquefied natural gas markets. (4) In the Bakken, Enable provides crude gathering that connects into DAPL. ET expects the Enable acquisition to generate $100MM of cost and efficiency synergies, which we view as achievable given the complementary asset bases.<br>• **Strong balance sheet FCF generation potential positions the company for capital return.** ET lowered its outstanding debt by ~$6BN in 2021, and exited 2021 with leverage of 3.9x (credit facility calculation) while targeting leverage of 4.0-4.5x. We forecast ET exits 2022/2023 with Net Debt/TTM Adjusted EBITDA of 3.7x/3.6x while paying $6.6BN in distributions. |
| **Enerplus Corporation (ERF)**<br>Greg Pardy, Head of Global Energy Research<br>(416) 842-7848<br>greg.pardy@rbccm.com | • **Solid all-around.** Enerplus remains our favourite intermediate producer given its capable leadership team, solid execution, strong balance sheet and rising shareholder returns.<br>• **FCF & shareholder returns.** Enerplus has always maintained a strong balance sheet and is now bolstering its shareholder returns offering. Commensurate with fourth-quarter results, the company reaffirmed its commitment to distribute at least 60% of free cash flow in 2023, with an accent on share buybacks. The company's net debt (debt less cash) stood at $221.5 million as of December 31. Execution of a substantial issuer bid (SIB) also remains an option for Enerplus as market conditions dictate. We peg Enerplus' free cash flow (before dividends) at approximately $531 million in 2023.<br>• **Bakken positioning.** Enerplus recently framed 655 drilling locations in its core/extended core areas of the Bakken—or greater than a decade of drilling inventory at the development pace factored into its five-year plan.<br>• For our most recent update on Enerplus, please see Finishing Strong. |
| **Liberty Energy (LBRT)**<br>Keith Mackey, Analyst<br>(403) 299-6958<br>keith.mackey@rbccm.com | • **Improving operational execution.** Completion of integration efforts from the company's 2021 acquisitions alongside improved operational execution have enabled the company to materially outperform Street expectations in 2022. We expect strong results to continue into 2023 given strong demand for the company's pumping, sand, and logistics businesses.<br>• **Tight frac market drives strong profitability.** Liberty has been able to capitalize on a tight pressure pumping market and expects to generate 40-50% y/y adj. EBITDA growth in 2023. We estimate the US horsepower market to remain relatively tight at approximately 14.5MM demand vs 15.8MM supply in 2023.<br>• **Compelling valuation.** Liberty is trading at a discount to its historical range and our frac services coverage peer set. Liberty should trade at a premium to frac peers given larger scale, increasing vertical integration, strong balance sheet and broad exposure to key North American basins.<br>• See our latest Liberty Energy note here. |

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| **Marathon Petroleum Corp. (MPC)**<br>TJ Schultz, Analyst<br>(512) 708-6385<br>tj.schultz@rbccm.com | • **Capital returns.** MPC has remained focused on returning capital to shareholders in the form of dividend payments and share repurchases. MPC increased its quarterly dividend by 29% to $0.75/share (from $0.58/share) in 3Q22, which is ~$370mm/quarter. MPC has repurchased a significant number of shares, which has resulted in multiple incremental increases of its share repurchase authorization, and has ~$7.6B remaining as of 1/31/23. We continue to expect MPC to be active on the incremental buyback authorization near term, with a clear preference for buybacks as a means to return capital.<br>• **Renewable fuels.** MPC has continued to progress on the Martinez renewable fuels conversion project, with MPC expecting the first phase to reach full capacity of 260mm gal/yr by the end of 1Q23 and capacity reaching 730mm gal/yr by the end of 2023. MPC is well into its pre-fill strategy, pre-filling since mid-summer.<br>• **Constructive refining margins.** Along with the rest of the refiner group, MPC has benefited from improved refining margins from higher cracks and wider spreads. We expect these positive margins to continue into 2023 above historical mid-cycle levels. |
| **Pembina Pipeline Corporation (PPL)**<br>Robert Kwan, Analyst<br>(604) 257-7611<br>robert.kwan@rbccm.com | • **Positioned to benefit from higher WCSB production.** Whether it be uncontracted capacity or within its contract structures that blend minimum take-or-pay levels with fee- for-service upside as volumes grow, we expect Pembina to benefit from growing gas and liquids volumes in the Western Canada Sedimentary Basin (WCSB). Further, growing volumes could result in contracted infrastructure opportunities including NGL fractionation expansion and/or pipeline expansion projects.<br>• **Free cash flow generation after all capex and dividend payments provides a range of capital allocation opportunities.** In 2022, the company prioritized share buybacks with the strategy going forward focused on creating balance sheet optionality by reducing leverage. Lower debt levels should position the company to pursue a wide range of growth initiatives on an equity self-funded basis.<br>• **Solid base of business with a commodity kicker.** Pembina's guardrails target over 80% of EBITDA coming from fee- based revenues, primarily underpinned by take-or-pay or cost-of-service contracts, which underpin the dividend. As upside optionality, Pembina's Marketing division can benefit from leveraging its asset base to take advantage of various commodity spreads. |
| **Permian Resources Corporation (PR)**<br>Scott Hanold, Analyst<br>(512) 708-6354<br>scott.hanold@rbccm.com | • We believe PR shares should outperform the peer group over the next 12 months. The company has large, contiguous acreage positions in the core of the southern and northern Delaware Permian with a 10-15 year inventory.<br>• **Strong free cash flow**. We forecast that PR is capable of generating among peer-leading FCF yields that can support a robust shareholder-return strategy.<br>• **Balance sheet strength and shareholder returns.** Balance sheet leverage is at a sustainable sub-1.0x ratio. Management is prioritizing shareholder returns, particularly with dividends and plans a strong fixed dividend along with a minimum 50% variable payout of FCF. Dividends are more the focus, but buybacks will occur opportunistically, especially if private equity sponsor selling occurs. Asset optimization is a priority and should add to shareholder value. |

**PG&E Corporation (PCG)**
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- **Continued reduction of wildfire risk.** The company continues to execute on its wildfire mitigation plan. Mitigation actions include system hardening, undergrounding, vegetation management, enhanced powerline safety settings and public safety power shutoffs.
- **Steep discount not warranted given CA wildfire protections limit financial risk**. We believe the Wildfire Fund provides meaningful protections against financial liabilities associated with wildfires. While it seems the market remains apprehensive around the mechanics of the fund, we believe the multi-turn discount is overly punitive when considering the financial risks associated with a catastrophic fire.
- **PG&E slowly rebuilding trust.** While the name remains overly sensitive to headlines, we have also seen a meaningful shift in tone from media and stakeholders. We believe is a result of PG&E's continued efforts to engage stakeholders and communities and we are encouraged by positive signals from the CA legislature and regulator.
- **Robust capex plan drives earnings growth.** PG&E expects above-average rate base growth at a 9% CAGR. Growth opportunities come from system hardening, undergrounding, electrification opportunities and other wildfire mitigation investments. Management targets 2% O&M reductions should act to help offset customer bill increases.

**Range Resources (RRC)**
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- We expect RRC shares to outperform its peer group over the next 12 months. The company's large legacy asset in the core of Marcellus in the Appalachia Basin provides the ability to efficiently maintain its production base for more than a decade.
- **Improved balance sheet**. Balance sheet leverage sat above peers and in recent years was an investor overhang; however, this has been rapidly improving recently with FCF generation used for debt reduction.
- **Selling portfolio and export agreements.** RRC benefits from a robust selling portfolio and export agreements, which cover a large portion of its NGL/natural gas production and result in premium realizations relative to peers and local pricing.
- **Deleveraging goal.** Debt reduction remains a top priority for RRC and we see a rapid path toward the $1.0–1.5 billion of aggregate debt.
- **Operational expertise.** The company has a top-class technical team, in our view, that continues to push lateral lengths longer after successfully drilling multiple 19k laterals in recent years. We believe RRC has some of the lowest D&C costs among peers.
- **ESG track record.** RRC has a strong ESG track record of being an industry leader on environmental best practices and safety. The company is targeting a 15% GHG intensity reduction by 2025 relative to 2019 levels and additionally is targeting net zero emissions by 2025 through continued emission reduction efforts and carbon offsets.

**Santos Limited (STO)**
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- **Santos has a diversified production base** (47% LNG, 35% gas, and 18% liquids) and improved growth profile (Pikka Alaska oil, Papua LNG, Dorado oil and gas) after merging with Oil Search last year. Santos balance sheet has also strengthened post merger, gaining increased flexibility that enables self-funding of development projects.
- **Focused on capital management.** We see strong potential for future capital management initiatives, particularly after the sale of 5% of PNG LNG to Kumul Petroleum, and other potential asset equity sell-downs (e.g. Dorado). In December 2022, Santos increased its on market buyback by US$350m. Santos capital management is based on at least a 40% payout of FCF from operations (excludes major growth) per annum and the company will consider additional returns from asset divestments. Once Barossa and Pikka Phase 1 commence production, Santos Board intends to consider increasing returns to at least 50% of FCF.
- **Largest acreage holder and producer of hydrocarbons in PNG.** Santos has 42.5% equity exposure to the long life Exxon Mobil operated PNG LNG project and has agreed to sell 5% of PNG LNG to Kumul Petroleum for US$1.1bn (net). We now expect this transaction to settle in 2H 2023, subject to Kumul financing (Kumul's exclusivity was recently extended for a second time to 31 August). Santos has 22.8% equity (pre back-in) in the proposed TotalEnergies operated Papua LNG project. The four mini eLNG train Papua downstream development offers operating efficiencies and capex savings in comparison to the prior two train conventional design.
- **One of Australia's largest LNG suppliers to Asia.** Santos LNG portfolio (PNG LNG, DLNG, GLNG, and proposed Papua LNG) provides attractive long-term cash flows, with a balance of oil linked contracts and Asian spot JKM LNG pricing. The Barossa project provides new backfill gas that materially extends the life of the Darwin LNG plant, with first production expected in 2025 despite an environmental challenge that has suspended drilling activities. The Papua LNG joint venture has committed to project FEED, expected to be FID ready by the end of 2023 / early 2024, and targeting start-up by the end of 2027 / early 2028.
- **Two major oil developments in progress.** The Pikka Alaska oil project (STO 51% and operator) reached FID in August 2022, with project drilling planned to commence in 2Q 2023 and modular facility construction in 1H 2023. Santos is targeting first Pikka oil in 2026 at an expected production rate of 80,000 bopd gross. The Dorado integrated oil and gas development (STO 70% and operator) offshore Western Australia has achieved regulatory approval and is targeting to be FID ready in 2023/24. Santos has forecast initial Dorado oil production of ~100,000 bopd (gross).
- **A leading global CCS developer.** Moomba CCS Phase 1 is a low-cost 1.7 mmtpa CO 2 storage project in the Cooper Basin with capex estimated at ~US$165m gross and a full life cycle cost <A$30/t CO 2. Moomba CCS is expected to achieve first gas injection in 2024. Bayu-Undan CCS plans to capture Barossa CO2 and FEED is nearing completion with Santos engaged on delivering regulatory and commercial frameworks. Santos has executed Bayu-Undan CCS MOUs with three potential customers for the maximum sequestration capacity of 10 MtCO2pa.

**Shell PLC (SHEL)**
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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.
- **Substantial free cash flow.** 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 FCF yield ahead of the sector on average over 2023-25E 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.

**SLB (SLB)**
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- **Leading size, scale, geographic reach.** SLB's size, scale, geographic diversification, and exposure to new energy sources leave it favorably positioned under prevailing industry trends, in our view. We believe SLB is well-positioned to benefit from the next leg of growth in International markets. International short and longer cycle investment is increasing, led by Latin America, the Middle East, and key offshore basins.
- **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.
- **International upcycle: less nascent.** SLB is well-positioned to benefit from the next leg of growth in International markets. In 4Q22 SLB's y/y North American revenue increased 27%, while International grew 26%, led by Middle East, and offshore. The company noted the Middle East is set to lead growth with this cycle characterized by the region's plans to add oil and gas productive capacity.
- **Potential for long-term valuation accretion.** We believe SLB's exposure to a large addressable New Energy market should drive accretion to its valuation multiples over time. Key target markets include: carbon capture, hydrogen, geothermal, critical minerals, and energy storage.
- See our latest SLB note here.

**Suncor Energy Inc. (SU)**

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- **New leadership in place.** On February 21, Suncor announced Rich Kruger as its new President & CEO. The new leadership change became effective as of April 3, 2023. We know Rich well from his days at Imperial Oil and we are pleased that Kris Smith will remain in a leadership role with Suncor as he plans to take the reins as CFO—laying a clear CEO succession path in our minds. We are also pleased that current CFO, Alister Cowan will remain on until the end of 2023 to ensure a smooth transition.
- **TotalEnergies Canada Acquisition.** Suncor's recently announced $5.5 billion acquisition of TotalEnergies Canada included the additional 31.23% working interest in Fort Hills and 50% (non-operated) interest in the Surmont in-situ assets, which is a sound strategic move from our point of view. The deal removes the company's longer-term risk as it relates to bitumen supply into its upgrading operations and affords optionality with respect to replacing the balance of Base Mine production.
- **Unlocking higher shareholder returns.** Suncor's TotalEnergies Canada acquisition will be funded by cash on hand and debt, thus its net debt levels will temporarily exceed its intermediate $12-$15 billion target range. However, the company has pledged to maintain its current allocation of excess funds flow of 50% to share repurchases, with the balance earmarked for ongoing debt reduction. The company expects it will return to within its target net debt range in 2024 under current expected commodity prices. Upon reaching $12 billion of net debt, the company will then allocate 75% of excess funds to share buybacks. In conjunction with the transaction, the company also indicated it plans to increase its base dividend to an annualized rate of $2.28 per share once the deal has closed, which is expected in the third quarter.
- **Strong free cash flow profile.** We peg Suncor's free cash flow (before dividends, excluding A&D and capitalized interest) at $11.6 billion in 2023 under our base outlook (US$84 WTI, US$18.19 WCS-WTI, US$34 NYH 3-2-1). Our outlook factors in a refining & marketing (pre-tax) FFO of $6.4 billion in 2023.

**Superior Plus (SPB)**

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- **Adding value through sector consolidation.** Management continues to see attractive propane acquisition opportunities, and we expect the company to continue to execute on acquisitions. In general, management targets to deploy $200-300 million (lower in 2023 due to pending Certarus acquisition) in capital per year and has been able to realize synergies that improve the EBITDA of acquired assets by ~25%+.
- **Strategic acquisition expands business into CNG/RNG/H2.** The pending $1.05 billion Certarus acquisition (expected Q2/23 close) ticks many of the boxes with respect to having a strategic and complementary fit (reduces seasonality and provides opportunities to cross sell propane), is double-digit accretive to distributable cash flow per share and has a strong organic growth profile, while also reducing the company's leverage. We expect the business to meet or exceed management expectations in Q1/23. Please click here for our note covering the transaction.
- **Limited downside from a recession.** Weather is a much larger driver for the financial results compared to economic activity (a warm Q1/23 could be a near-term headwind). The company's U.S. operations (contributes ~45% of EBITDA, including the pending acquisition of Certarus) mostly serves residential customers, where propane consumption is driven by heating needs. We also note that the company tends to earn higher margins from residential customers, so the company could benefit from a declining propane price (lag in pass-through) and a higher U.S. dollar. The company has also completed a number of acquisitions and we expect realized synergies to be a tailwind in 2023.

**Targa Resources Corp. (TRGP)**
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- **Best way to play Permian and commodity upside.** Among midstream, we think TRGP will correlate best to constructive commodity tape into 2023. We like TRGP's top-tier platform in the Permian, coupled with integration to the docks on the Gulf Coast.
- **Growth projects.** TRGP has announced numerous organic growth projects that are expected to supplement and grow its cash flow. These projects include multiple processing plants in the Permian, Train 9 fractionator in Mont Belvieu under construction and Train 10 now permitted, and the Daytona NGL pipeline (twinning of the west leg of Grand Prix) that will support NGL volume growth from the Permian G&P assets and new plants under construction.
- **Financial flexibility.** Maintaining its healthy investment grade balance sheet is a key focus point for TRGP when making decisions. Flexibility has improved as leverage is trending lower and the structure simplification (DevCo repurchase and redemption of outstanding Series A Preferreds) has allowed for more impactful progress. This flexibility allows for TRGP to continue investing in organic growth projects, while returning meaningful capital to shareholders.
- **M&A.** TRGP contributed to some midstream consolidation during the year with multiple acquisitions. In July 2022, TRGP completed its acquisition of Lucid Energy's Permian Delaware Basin G&P assets for $3.55B (TRGP estimates a 2023E EBITDA multiple of 7.5x), which include 1,050 miles of natural gas pipelines and 1.4 Bcf/d of processing capacity in New Mexico. TRGP also acquired South TX assets from Southcross which have performed as expected and was an ideal acquisition given the stickier volumes provided from gathering to the wellhead. M&A will remain part of TRGP's strategy with location and potential for immediate synergies being the key, but is not needed for the company to experience growth.
- **FCF and capital allocation.** Outlook for FCF is solid at our price deck, as we expect that TRGP can generate >$1B of FCF in 2024 even with ~$50mm/quarter of estimated stock buybacks through 2024 and another step-up in the dividend to $2.40/share, which should allow for debt leverage (post Lucid) to be back below 3x. In addition to debt reduction, TRGP will have many options for usage of the FCF including (i) additional dividend growth, (ii) additional common stock buybacks, and (iii) higher capex.

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**Topaz Energy (TPZ)**
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- **Diversified royalty model with a natural gas tilt.** Topaz's 2023E/24E production profile remains 70%/69% gas-weighted. Topaz is supported by some of the top operators in the WCSB. Notably, Tourmaline Oil has outlined a 5-year plan in NEBC Montney that is estimated to increase Topaz's regional volumes from 6,800 boe/d in 2022 to over 10,000 boe/d by 2028 (13% 8-year CAGR). Topaz's latest acquisition, Deltastream (note here), has positioned the company as a top Clearwater royalty producer, now holding 52% of pro-forma OOIP at Marten Hills and Nipisi. The team now anticipates averaging 2,850 bbl/d of total Clearwater production in 2023, exceeding 3,000 bbl/d by 2024E. The royalty business model is insulated from industry cost inflation, providing margin stability.
- **Resilient infrastructure model.** Topaz holds working interests in five facilities backed by long-term take-or-pay commitments, a contracted interest in a portion of Tourmaline's third-party revenues, and a 49.5% interest in two water handling facilities. The company's infrastructure portfolio is currently expected to generate 2023E revenues of $65 million and FCF $55 million, covering 38% of the 2023E dividend. Growth in the Infrastructure portfolio remains an area of focus as management continues to target a long-term 50-50 EBITDA split between the infrastructure and royalty business. As a result, we expect management to continue to evaluate infrastructure M&A opportunities to expand the portfolio.
- **FCF allocation balanced between RoC and debt reduction.** Topaz increased its annual dividend to $1.20/sh (~6% dividend yield) with the Deltastream acquisition; we estimate a 60%/49% effective payout ratio in 2023E/24E. The company is able to balance its RoC program with continued deleveraging efforts, with our model pointing towards roughly $30 million in quarterly post-dividend FCF, on average, through 2023.

**Tourmaline Oil (TOU)**
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- **Natural gas weakness provides buying opportunity.** Weaker natural gas prices provide a buying opportunity for the Western Canada Sedimentary Basin (WCSB) natural gas producer that is returning meaningful capital to shareholders plus still growing modestly (+7%/year CAGR in the current plan), while being mindful that basin growth much beyond this figure could start to drive egress constraints.
- **Cheniere export agreement - a well-timed deal.** We estimate US$1 increase in JKM pricing to result in roughly C$50-55 mm of incremental after-tax cash flow in 2023. TOU has hedged approximately 10% of the JKM volumes at an average price of ~US$23/mmbtu, and we would expect the company to take advantage of the current strength by layering on additional hedges at even more attractive prices. See our note here.
- **Return of capital, with the vast majority of FCF to be returned.** TOU announced special dividends for Q1/23, with $2.00/sh payable on Feb 1. Our outlook now calls for one base dividend increase in 2023 (to $1.01/share annualized) on top of $4.75/sh specials annualized in 2023. As of April 27 on strip pricing, TOU is expected to generate $2.0-$2.1bn in FCF in 2023 (or about $2.5bn at the RBC Deck). (see more here).
- **High quality asset base, with North Montney driving the growth.** TOU's 5-year plan now includes development of its Northern Montney asset - Conroy, pushing corporate volumes to 700,000 boe/d by 2028. TOU expects Conroy to grow to ~100,000 boe/d in 2 tranches, with on-stream dates of 2026 and 2028 (set to coincide with the startup of LNG Canada). The plan incorporates capex spend of roughly half of forecasted cash flows, leaving meaningful capacity for RoC programs. TOU remains well situated as it relates to LNG exposure in NE BC, a topic we explored in recent reports here (1,2,3,4).

# 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).

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- 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.
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- 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

Repsol SA (SIBE: REP SM; €13.35; Outperform)
Tamarack Valley Energy Ltd. (TSX: TVE CN; C$3.74; Outperform)

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