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Transcript: Oil -- Why There's a Debate Going on About Its Price

Bloomberg TV interview with Jerry Swank of Cushing Asset Management, Dec. 2, 2015

David (CNBC): [00:21] There are two things that I've run across in the last two days. First, we had Jim Tisch here, who knows something about oil.

F1 (female CNBC co-host): Just a little.

DAVID (CNBC): Who said very confidently -- he didn't know when, but, "Oil has to go to $65 a barrel because there's just a natural need from depletion and some modest growth to replenish, and it has got to be at $65 to make it happen." Today, in the *Financial Times*, Martin Wolf has a piece saying pretty much the opposite, that the world has changed. It's never coming back. Help us.

JERRY SWANK: So Jimmy Tisch is a smart guy, and he knows the oil business very well, and I think his analysis is a lot closer to the truth than Martin's is. You know, we're out of balance a little bit, but people talk about this horrible oil glut we have. It's only about a million barrels of 96 million, so it's less than a couple percent. And at current prices, where we are at $40, nobody can make money, so you're going to -- we think the numbers are something like $200 billion in underinvestment right now. And it does --

F1 (female CNBC co-host): What does that mean?

JERRY: So it means projects -- $200 billion of projects which maybe represents four or five or six million barrels reduction that would start today, and come on the next four or five years won't be there. So this window -- sometimes in '17 and '18 and '19 -- it's the first time, I think, in 15 years worries me, because we aren't going to have enough production. We didn't invest to have this production come on. Now, the difference in shale play, which Martin points out, is that it's quicker. It can turn around faster. But you know, it's just a model. It has never happened before that prices have gone down in the oil part of the shale play, so we really don't know how fast it will respond. Obviously, it's going to respond faster than an [Anadarko?] dealer offshore -- Gulf of Mexico -- but that underinvestment for a long period of time is going to come back to haunt us. And where, in the '80s, the Saudis -- the OPEC had 10 million barrels of spare capacity, nobody thinks they have hardly any spare capacity at all, so we're pretty close to the tipping point if we get demand continuing to increase. And I think the markets are a little wrong. In fact, we see demand growth even in China. I don't -- believe it or not, we see demand growth in China continues to be very strong, and the US has had the best gasoline demand in 18 years.

DAVID (CNBC): So Steve, you invest a lot of money for Mr. Bloomberg, actually.

STEVE Rattner, (Willett Advisors Chairman): Yes, I do, full disclosure.

DAVID (CNBC): So what does this mean for you? What does this low oil price mean for you?

STEVE RATTNER, (WILLETT ADVISORS CHAIRMAN): Well, we invest a lot in the energy sector, so we have a dog in this fight, and we have been -- we've certainly been on the more bullish side of the argument on oil and continue to be for all the reasons you said, that essentially sooner -- the lower prices stay for longer, the bigger the increase will be later because of the number of capital projects that will be canceled as prices stay at these low levels. And I agree that the supply-demand imbalance is very small. The only asterisk I would put on all this is there are a bunch of unknowns, and they -- well, they go in both directions. What's going to happen with the Iran's production? Iraq's production is going up. Libya's production at the moment is going down because it's basically a failed state. So in a world where a million barrels a day will make a big difference, you have a number of large producers who could go either way and tip the balance.

F1 (female CNBC co-host): Matt, take us in the terminal. In terms of M&A, what could we see happen, given that there are these producers, there are rigs, and there's not necessarily business to be done?

MATT (CNBC analyst): Well, I've put in -- I've been playing around with [MA-<Go>] on the terminal, and I've put in the entire oil and gas universe. Maybe I've included too much. I've got pipelines in here as well as drillers, integrateds, everything I can find that's connected to oil and gas. The blue here is the actual volume of deals, and the green is the deal count. This is over the last five years. You can see that we've had a big volume in the past, but right now, it's pretty heavy as far as volume, and deal count is also peaking here. It's only coming down in Q4 because we're not through that yet. So it looks like this has really spurred -- the low prices, obviously, have spurred more M&A. It's just not peaking as much as you might expect.

F1 (female CNBC co-host): Where are you seeing deals? I've got to say -- you've got to go back to China. We have not heard anyone say, "Demand out of China." I'm going to need you to elaborate on that.

JERRY: So look at Platts yesterday. Platts Oilgram puts out, and they had a deal -- implied demand is up 7.9 percent, and it comes from the teapot refineries. It comes from needing naphtha, which comes from oil, for their petrochemical plants. So it's there. You know, from a big picture, it's good for the economists to say, "The economy in

China is going to slow. Everybody (inaudible), and so let's put it in our model, and gasoline demand and energy growth [are going?] to slow." It just hasn't happened. And so our job, as investors, is to say, "Here's the truth. Here's what's really happening." So that's where it is on the demand side. Just to get back to the M&A, I think what's happening maybe -- you've seen a lot of different M&A. When things go bad, it takes a while for the market-- the bid offers for -- the guy still thinks the stock is worth 50, and it's worth 20, so he's not going to -- he's not selling at 20 yet. It takes an extended period of time to pain, when the bankers come in and tell you, "You've got to do something." So I think that's just starting, and the energy area -- you're just starting to have banks go back and say, "Your reserves aren't that. You've got to mark down." So I think you're going to see, on the upstream side, a lot of deals. That bid offer market is finally starting to get narrow. So you know, all of the -- I think all of the major independents likely will be bid. You've already heard the mer-- the rumors about Apache - Anadarko. I think all of those will be in play in the next couple of years. The oil service business -- massive consolidation, massive oversupply, and you're going to end up with just a couple people. In the business we're most involved, which is the pipeline business, which has been incredibly explosive as we replumbed America, you've just seen a massive deal where Energy Transfer bought Williams. I think you'll see several more transactions like that as people want to be in basins, want to be in areas. They haven't been able to do it, but the stocks have gone down. The people who want to buy [in founder?], they're going to be able to buy people at (inaudible).

F1 (female CNBC co-host): We have an Instant Bloomberg question coming at you from Jim Butler at Seaport Securities saying, “Master limited partnerships are getting killed. What can the future of MLPs be with oil at $40 or $50?”

JERRY: So remember, for a vast majority of the master limited partnerships, it’s a toll road business, so it doesn’t mean -- and I’ve said this -- it doesn’t mean if oil’s $100 or $40, you get paid. But the market -- so you know, there are times in the market where good news is good news and bad news is bad news, but sometimes good is bad and bad is bad, and that’s where we are in MLPs. People are taking --

F1 (female CNBC co-host): And quantitative easing.

JERRY: -- exactly. So people are taking a few data points on people that are very close to the wellhead in the master limited partnerships and are having issues, and extrapolating it to the companies that have absolutely no exposure.

_: Steve, as Jerry says, you know a fair amount about mergers and acquisitions. Do you agree with his analysis that we ain’t seen nothing yet?

STEVE RATTNER, (WILLETT ADVISORS CHAIRMAN): Well, I certainly agree with at least the first part of his analysis. When you have this major of a price dislocation, there’s a period of time in which things just stop until the buyers and the sellers get back into equilibrium, and then the deals will start. And yeah, I generally agree. There’s going to be a lot of consolidation in this industry because of people who simply have -- so just one brief comment on MLPs. MLPS -- I think there are a couple of things that affect MLPs in a negative way. One is, of course, interest rates and what’s going to happen at the Fed, and the second is that US production is declining and is projected to continue to decline, and so, obviously, the toll road is going to see perhaps a few fewer tolls, at least over the next couple of years.

JERRY: Yeah, so we're talking about production in the US. It might decline a million barrels, and I'll give you that. A lot of that is already [subscribed?], but I would say if you look at the four major basins, it's going to be primarily -- it's going to come out of the hides of the railroads right now. Two-thirds of the production in the Bakken is railroads. It costs $14 bucks to get that to St. James, Louisiana. Energy Transfer is building a pipeline. It's going to cost you $5. So I hear what you're saying. I think that's it, and that your first point on interest rates -- I think capital markets, in general -- the cost of capital has gone up, so it has to be less good, but it's not where the upstream MLPs are, where they're cutting the distributions. We just think the rate of growth is going to change from 7 or 8 percent to 5 or 6 percent.

F1 (female CNBC co-host): Jerry, great to get your thoughts. And when you talk about the lag, those investors who have their positions marked at $50 when they're really at $20 and getting real, maybe if those guys were actually women who had those positions, they'd be a lot more realistic -- just saying. Jerry?

JERRY: I've been married for 40-plus years. I'm not going to say anything.

F1 (female CNBC co-host): There you go. Jerry Swank --

_: Smart.

F1 (female CNBC co-host): -- he's a founder -- a managing partner of Cushing Asset Management. Thank you so --

END OF AUDIO FILE

Definitions:

Apache – Anadarko are two separate companies in the news the last few weeks since Anadarko has approached Apache about a takeover offer.

Bid-Ask is the spread between what someone is willing to sell (ask) vs. what someone is willing to pay (bid). In context, upstream are marking down their reserves, lowering their "ask," compressing the spread.

MA <GO> are keystrokes on the Bloomberg Terminal that will go to Mergers & Aquisitions (MNA) Analysis.

Master limited partnership (MLP) is a limited partnership that is publicly traded on an exchange. It combines the tax benefits of a limited partnership with the liquidity of publicly traded securities.

Platts Oilgram Price Report is a daily report published by Platts McGraw-Hill Financial that covers market changes, market fundamentals and factors driving prices.

Quantitative easing: the introduction of new money into the money supply by a central bank.

Teapot refineries are smaller refineries that use cheap feedstock.

Upstream MLPs are focused on the exploitation, development, and acquisition of oil and natural gas producing properties. These partnerships produce oil and natural gas at the wellhead for sale to various third parties.