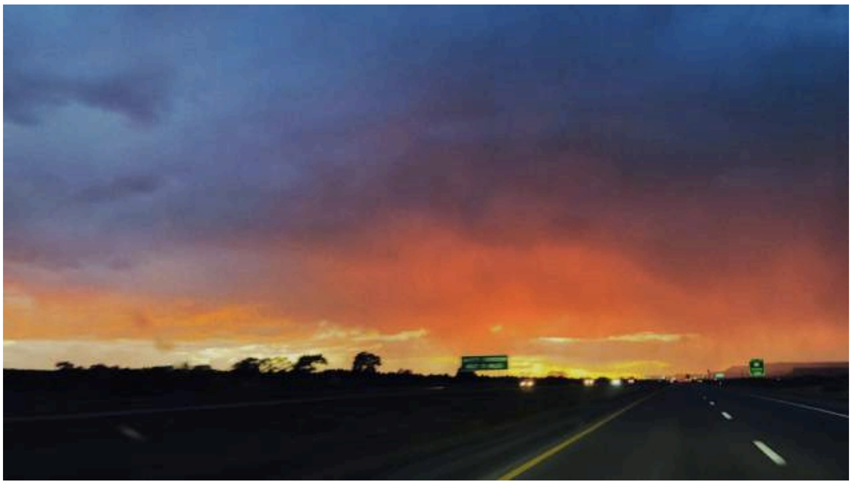
INSIDER Weekly

Issue 121 (10 JUL 2019)

LAZY INVESTING GONE MAD

Hello, and welcome back!

Sunset from one of our team here. Taken somewhere in New Mexico, USA.



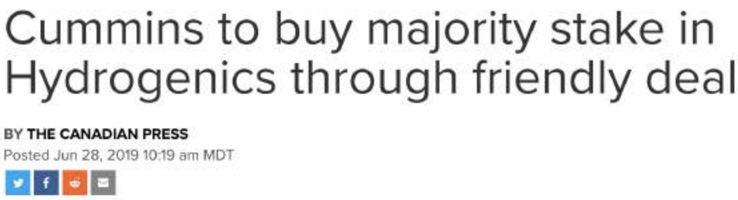
THIS WEEK

- Cummins buys Hydrogenics
- PLASMA R Hydrogen Gas?
- No thinking/lazy investing gone mad
- Don't forget shipping
- The upside of trade wars
- Don't take any notice of US crude inventories
- The fracking mess continues
- The Big Five:
    1. MTQ Corporation
    2. Peninsula Energy
    3. CGG
    4. Stratasys
    5. Archer Exploration

CUMMINS BUYS HYDROGENICS

One of the world's premier manufacturers of heavy engines just bought Hydrogenics.

This is a big deal! To us this signals that we are about to see big trucks and heavy machinery powered by hydrogen over the next few years.


Cummins to buy majority stake in Hydrogenics through friendly deal

BY THE CANADIAN PRESS
Posted Jun 28, 2019 10:19 am MDT

And just when it looked like "thunderbirds are go", the rug gets pulled from underneath us.

We bought Hydrogenics at $C11.24 on May11th as one or four stocks we invested in to gain exposure to the hydrogen theme. We should make about 80% on the trade. You may be jumping for joy but we aren't! There goes another potential 10 bagger. Hydrogenics was Bugger!

Perhaps the big reason why we aren't so happy about the 80% gain on Hydrogenics is that we didn't make this money for the right reasons. We certainly didn't buy it on the idea that it was a great takeover candidate!

Well, if there is any consolation, at least we are doing something right as others are getting in on deep value or strategic investments after we have identified them.

So Hydrogenics is on its way to become part of Cummins, but we still have a few other tricks up our sleeves.

We're looking at two companies to replace Hydrogenics and maintain our exposure to Hydrogen. French company, McPhy (€70m market cap), who manufactures hydrogen fueling stations and electrolysers.

And the UK's ITM power (£112m market cap), also manufacturer or electrolysers and fueling stations.

ITM, in conjunction with Shell, is building the world's biggest "green" hydrogen plant in Germany.

You may think this is a big step forward, and it is, but it will only supply 1% of Shell's hydrogen needs for its Rhineland oil refinery. In other words, a tiny drop in the ocean. Interestingly what they don't tell us is where the electricity is coming from to power the electrolyser.

Side note: this is a recurring and common theme that we're seeing across the energy sector. New technologies being touted, even developed and deployed with all manner of projections, and yet bugger all second order thinking. The electricity that would be needed, for example, for this above plant has to come from something other than unicorn farts. The batteries required to bring about the EV volumes now mandated by governments. Where are the battery metals going to come from? What supply?

The opportunities across the entire energy space right now are nothing short of mind boggling to us.

Moving right along, the fuel for the future:


Technology

Hydrogen Is the Fuel of the Future. For Real This Time, IEA Says

By Dan Murtaugh
14 June 2019, 17:00 GMT+10

- Agency calls on governments to support fuel to bring down cost
- Hydrogen can decarbonize everything from transport to steel

We have to keep things in perspective.

If hydrogen is the fuel for the future, then there needs to be a revolution in how it is stripped out from water. Remember a "little" quote from an article last week?

> *Producing all of the world's dedicated hydrogen output from electricity would result in an electricity demand of 3 600 TWh, more than the total annual electricity generation of the European Union.*

Our own calculations here: the world consumes about 25,000 TWh of electricity (2017), 7% of that (1,750 TWh) is produced by wind and solar.

So if we humans wanted to produce all of the world's hydrogen requirements (which is essentially from oil refining and ammonia production) from wind and solar, then **we would need roughly twice the wind and solar generating capacity that the world currently has.**

And what natural resources would it consume to achieve that? And this doesn't take into account future requirements of hydrogen for transport.

OK, let's approach this from a slightly different perspective.

To produce all of the world's current annual requirements for hydrogen from electrolysis, it would take 14.4% of the world's yearly production of electricity.

Hmm, this looks like government math. It just doesn't add up.

We keep coming back to one of our fundamental propositions. **It is going to take way longer to get the world off its addition to fossil fuels,** and even then the alternatives such as batteries are nowhere near pricing the materials required for even a modest adoption curve let alone one whereby fossil fuels cease to be used.

So by all means, have an exposure to hydrogen stocks. But for every $1,000 you have invested in hydrogen stocks, we figure that $10,000 should be invested in oil service stocks, especially offshore as it's been absolutely decimated.

PLASMA R HYDROGEN GAS?

We aren't technical nuts or specialists. We would like to think of ourselves as generalists looking for deep value out of favor themes or developing "strategic" themes.

But increasingly we find ourselves being dragged deeper into the inner workings of a sector. This isn't so difficult with established sectors like offshore oil. But developing sectors like hydrogen it is "tricky" to say the least due to technological innovation.

Now what is this all about?


Eneco Holdings announces new hydrogen gas technology

June 26, 2019 0 By ERIN KILGORE

Share this...

A new tech makes it possible to manufacture hydrogen gas at scale using a revolutionary water electrolysis process.

As per usual the details are "thin" to say the least. But it does look really interesting:

> *Eneco Holdings, Inc. today announces to global audiences Eneco PLASMA R Hydrogen GAS, a device that generates HHO (oxyhydrogen) gas utilizing an evolved application of the principle of water electrolysis. This technology makes it possible to manufacture high-concentration HHO gas at scale through the chemical reaction of small volumes of water and a proprietary catalyst.*

> *It uses very little electricity and is capable of high output at low temperatures. The price of hydrogen fuel in Japan currently stands at about 100 yen per cubic meter. This technology is expected to cut that price by more than two thirds, to less than 30 yen.*
>
> *Eneco PLASMA R Hydrogen GAS requires no resource imports or transportation and no large-scale capital investment; the only material input is water, an easily available resource. Through sales and maintenance of the hydrogen generator and sales of the catalyst, Eneco Holdings, Inc. will contribute to tangible reductions of carbon dioxide emissions and thus a more sustainable society.*
>
> *The day will soon come when 65 kWh of electricity (enough to power one household for a week) can be generated with just 2 liters of water and Eneco Holdings hydrogen fuel technology.*

We do acknowledge we are not industry specialists. Great, now the complication... **Eneco is a private Japanese company.** Once again we reiterate, investing in the hydrogen sector is way more difficult than it appears from the outside.

"NO THINKING" INVESTING GONE MAD

And stark raving lunatic mad! Is no one bothering to think these days or are they too scared to do so? So what is the next step? 85%? 90%?

MARKETS

80% of the stock market is now on autopilot

PUBLISHED SAT, JUN 29 2019 · 8:30 AM EDT

Yun Li
@YUNLI626

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So just 20% of investors still believe in the old ways (classical value investing). Gundlach said this some 6 months ago.

MARKETS

Jeffrey Gundlach says passive investing has reached a 'mania' – investors should avoid index funds

PUBLISHED MON, DEC 17 2018 · 12:55 PM EST | UPDATED MON, DEC 17 2018 · 4:41 PM EST

Michael Sheetz
@THESHEETZTWEETZ

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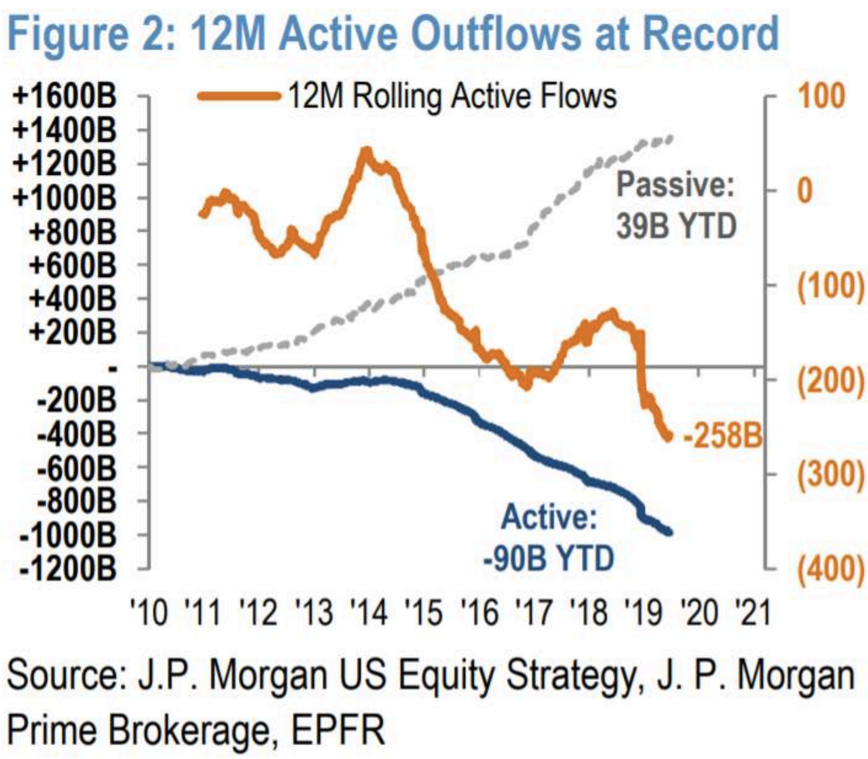
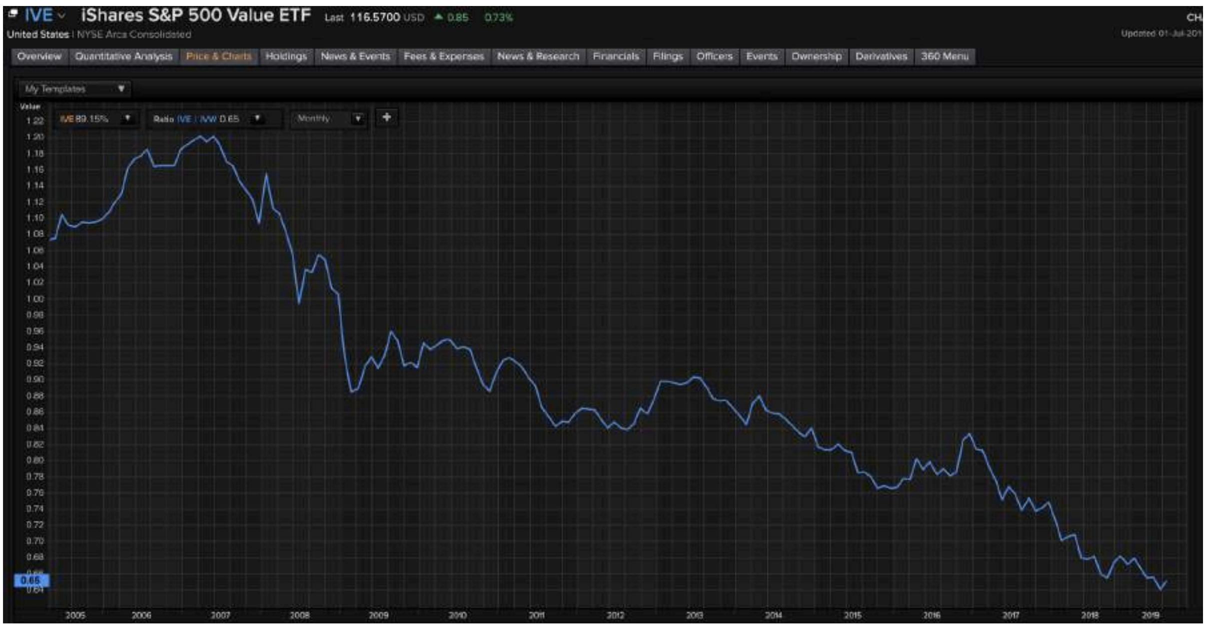
Yet another example of extreme behavior. Or when everyone thinks alike, the opposite is most likely to happen because there is no one left to think alike (or in this case, no one left to not think). We could (and probably did) say this at the start of last year… and still the "gap" continues to open up.



And the value underperforming growth mega trend (longest on record) continues.



The iShares S&P 500 Value ETF vs. the iShares S&P 500 Growth ETF

We can take the role of being a victim… or we can say, to hell with that, let's get out there.

It's so easy to find washed up stocks/markets/themes. Value's time in the sun will come again, the downtrend depicted above will come to an end for reasons we cannot know ahead of time. We're happy to be early to the train station. Furthermore, the more extended the valuation differences become the greater the resultant readjustment.

I vividly remember the dot-com boom. Everyone, and I mean everyone, managed to become convinced that "this time it was different". And I'm not talking retail folks. I was working in the fund management business at "top tier" investment banks in London. So we're talking about well educated, extremely highly paid money managers. And collectively they all lost their bloody minds.

Now, to be fair I was in my 20's, and I never fully realised the insanity of it all while being immersed in it. It was however a baptism of fire and one I'll never forget.

The same thing has happened again and again, the most notable and widespread time being the housing bubble. And again, I was immersed in it having built a real estate holding, trading, and investment business. But the signs were as clear as day, and while I got out early in 2006, missing some pretty good gains through mid-2007, I do believe that my having my own capital on the line and having been "educated" to look and think independently saved a helluva lot of pain.

Is today any different? We don't think so, but that doesn't mean it ends tomorrow. What it does mean, however, is that going along with the crowd is riskier and riskier with every passing day.

DON'T FORGET SHIPPING

As each month goes by shipping stocks give off a more beautiful glow!

Oh, if only I had more money to invest in these stocks. Such beauty.

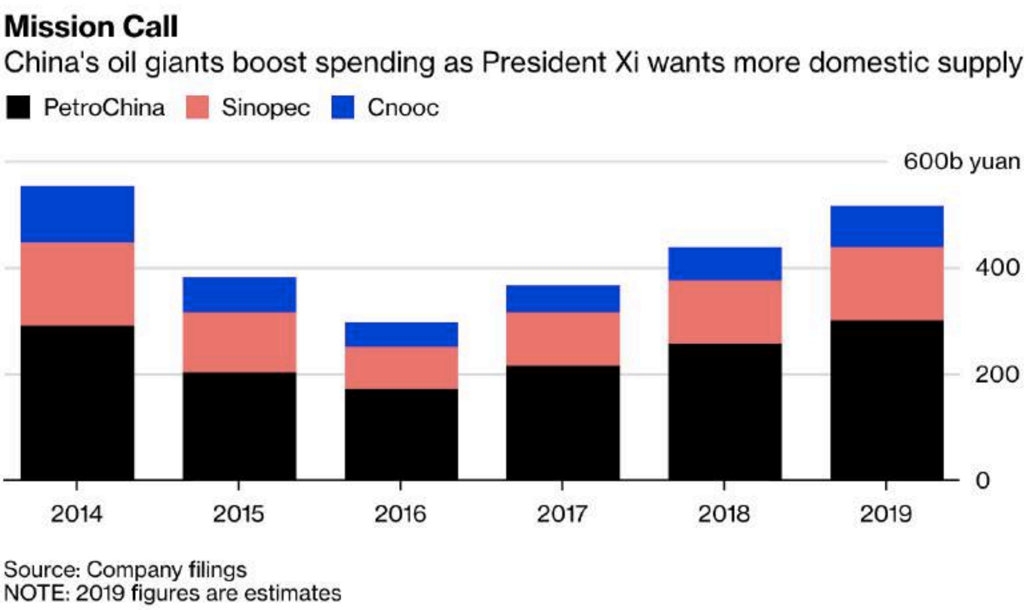
THE UPSIDE OF TRADE WARS

Here's something that is an unintended but rather interesting consequence of the trade war between the US and China. It is something I've mentioned in the past.

I have said that one of the consequences of the political fragmentation, which was so obvious to us, would be that energy would become VERY important. No country has any level of security without energy security. We promised it would lead to resource nationalism and put energy directly in the cross hairs, right at a time when energy as a whole has been left for dead.

Well, in August last year President Xi called for higher output as China (the world's biggest importer of petroleum) became locked into an escalating trade war with the United States.

Chinese oil companies responded with a big spending program which should take capex spend in 2019 to 2014 levels.

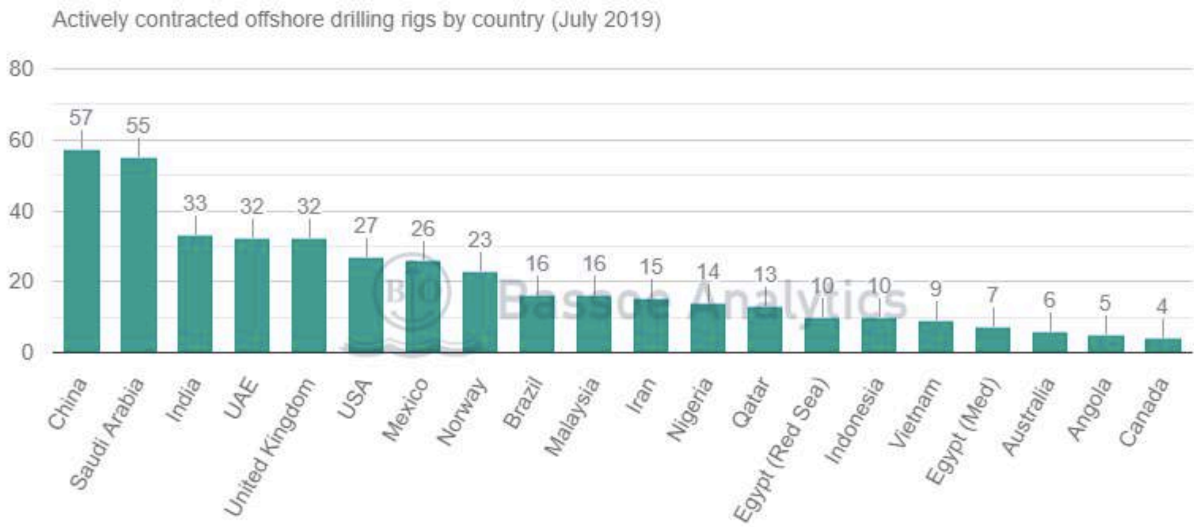


To spend you have to drill, so Chinese companies have been quietly recalling assets.

David Carter Shinn
Jul 02, 2019

With nearly 60 offshore rigs, China is doing everything it can to boost oil and gas production. And the country's energy independence policy is keeping rig supply out of the global market.

The article above (another great article from DC Shinn) highlights where rigs are deployed:



I bet no one would have guessed that India has more offshore rigs working than the Gulf OM, Norway, the UK, or even Brazil.

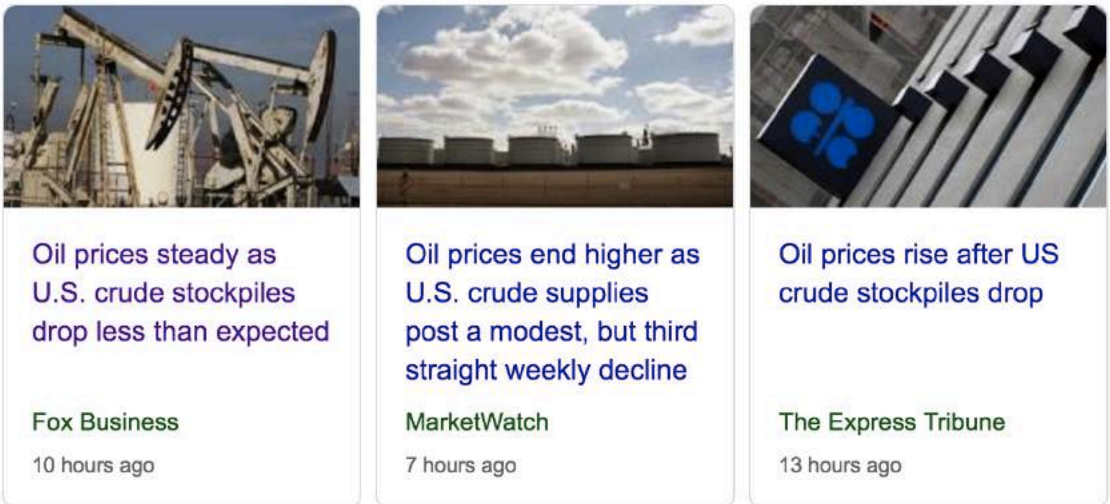
The article highlights the idea of "energy independence", and we couldn't agree more.

Countries will begin to have a hard look at their energy assets, especially in light of Trump's antics. Right now NONE of this is priced into the market. None if it.

And what is all this "South China Sea Dispute" about? We've discussed it previously, and you don't need a degree in political science to work that one out.

DON'T TAKE ANY NOTICE OF US CRUDE INVENTORIES

You're all probably well aware of "crude oil inventory" headlines like these:



Oil prices steady as U.S. crude stockpiles drop less than expected

Fox Business

10 hours ago

Oil prices end higher as U.S. crude supplies post a modest, but third straight weekly decline

MarketWatch

7 hours ago

Oil prices rise after US crude stockpiles drop

The Express Tribune

13 hours ago

And you are also probably "well informed" of the crude pouring out from the Permian:

This Texas area is expected to double oil output to 8 million barrels in just four years, boosting US exports

PUBLISHED FRI, MAR 8 2019 • 8:43 AM EST | UPDATED FRI, MAR 8 2019 • 5:13 PM EST

Patti Domm
@PATTIDOMM

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We don't take US crude inventories or the Permian too seriously. Why? Oil currently produced in the Permian basin is increasingly too light in density for domestic refiners or for foreign buyers.

Over the past year, production from the Permian has changed, with **more super-light oil coming from the ground, as producers increase drilling in the western part of the Basin.** This will have serious implications for the future of shale oil production which is increasingly being concentrated in the Permian Basin.

As production of light shale oil expands and heavy crude supplies contract, oil refineries are struggling with the mismatch in the density of oil they require and what the US produces. US refineries, which are designed to process mostly heavier and medium crudes, are struggling to blend the lighter oil efficiently.

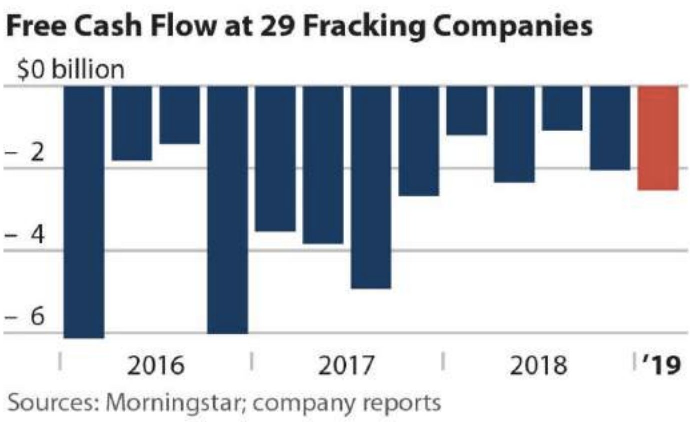
The problem has grown more acute this year with heavier crude in short supply after US sanctions on Venezuela, production declines in Mexico, and transportation bottlenecks in Canada.

The export market for super-light oil is limited because there are only a few refineries designed to handle light crude in Europe. Some Asian petrochemical plants can process very light crude. So US crude stockpiles are increasingly having little correlation with global demand and supply.

There is another complication. OPEC sees "high US stockpiles" and cuts production. Other oilers hold back on exploration and development. But this is the oil that the bulk of refineries can use. You get what we mean? **Long-term supply deficit of heavy crude oil is fast looming.**

THE FRACKING MESS CONTINUES

I think it was mid last year we talked about the cash that shale oilers continue to gobble up. *"Once a crook always a crook,"* as the saying goes. Ain't nothing has changed!



A survey of 29 oil and gas companies that focus on shale oil reported some $2.5 billion in negative free cash flows in the first quarter of 2019. These results were even worse than in the fourth quarter of 2018 when the same group of fracking-focused firms suffered $2.1 billion in negative cash flows.

This "performance" came despite a 16% quarter-over-quarter decline in capital expenditures.

From 2010 through early 2019, the companies booked aggregate negative cash flows of $184 billion.

Since 2015, 174 North American oil and gas producers have filed for bankruptcy protection, restructuring nearly $100 billion in debt, mostly through write-offs.

Oil and gas bankruptcies have continued in 2019. At least eight oil and gas producers have filed for bankruptcy since January, restructuring another $3 billion of debt. The oilfield services sector has gone through nearly 180 bankruptcies, involving more than $64 billion in debt since 2015. Bang, rather than boom comes to mind!

This delusion cannot continue too much longer (one would think). Hence the reason why we think big surprises to the downside are coming for US shale oil production.

The shale oil boom would have to be one of the most bizarre booms we have ever seen, because it has only ever lost money for most involved. And this doesn't take into account environmental issues.

But there is perhaps a bigger issue and this is the "cheap" natural gas in the US. Is it really that cheap? Has it been underpriced? If so, a shock is coming. The US is now heavily reliant on natural gas for electricity production. Cheap gas has put a number of nuclear power, and many coal plants out of action. We don't think it'll remain cheap forever.

The more one looks at the shale oil and gas "boom," the more it looks like a giant pandora's box of worst nightmares. Sleep well folks!

THE BIG FIVE

FROM OUR TRADING DESK

Five stocks that look to be hammering out long-term bottoms and coming out of long-term bear markets. **These aren't trade alerts** but rather invitations to take a closer look because the charts are suggesting the start of a long term bullish move.

OK, while these aren't official trade alerts we do think **you would be insane to short these stocks in equal amounts** and hold those short positions for 5 years.

1. MTQ Corporation
2. Peninsula Energy
3. CGG
4. Stratasys
5. Archer Exploration

MTQ CORPORATION

A Singapore listed offshore oil stock. The company has two divisions:

1. MTQ Engineering: offers an integrated range of services which includes fabrication of steel structures, component manufacturing, advanced coating and equipment rental services, repairs and refurbishments of oil drilling equipment.
2. Neptune Marine Services: provider of inspection, repair and maintenance solutions to the oil and gas, marine and renewable energy industries. Headquartered in Perth, Western Australia, with operations primarily off the west coast of Australia.

It's small, with a market cap of SG$45m. We're mentioning MTQ because it looks interesting and also to bring to folks attention the offshore sector in Singapore. Those companies that have survived (thus far) have stock prices that look similar to MTQ's — down some 90%.

PENINSULA ENERGY

A uranium miner listed on the ASX with operations in the US (Wyoming). One of the only US miners operating on a commercial scale.

We're mentioning Peninsula because it is one of those uranium miners that everyone seems to overlook.

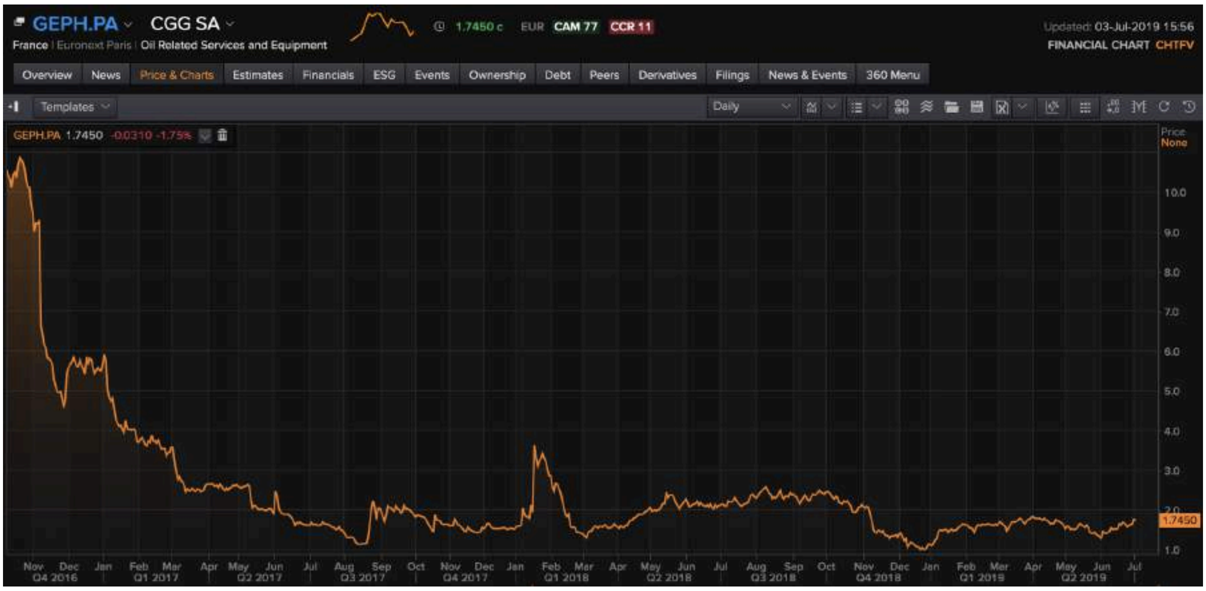
CGG

Seismic mapping primarily for the oil and gas sector. CGG was one of the stocks that featured in our offshore oil and gas Alert we published last year.

What was really attractive about this stock was the 2024 4.02 3/2 (ratio) warrants that were listed when the company came out of bankruptcy early last year.

We note that CGG was recently awarded a multi-year processing contract by ADNOC for the world's largest ocean bottom seismic project. In addition, they also won a multi-year project with Equinor for Johan Sverdrup PRM Project.

Finally, after a very long time, things are looking up for this company! The prosperity of this company is a leading indicator of the prosperity of the offshore oil and gas industry in general.



STRATASYS

3D imaging company. We don't profess to be 3D imaging experts and are hesitant to get caught up in narratives because they are so compelling.

However, we can say the company has no debt, lots of cash (25% of its market cap is cash).

Furthermore, having fallen by 80% from its high and gone nowhere for some 4 years, it is highly unlikely to be crowded on the long side or have too many weak/impatient hands in its shareholder register.

ARCHER EXPLORATION

Sometimes even we get caught up in a "story". I guess we are all kids at heart who like a good bedtime story.

We're great at listening to stories but rather hopeless at telling them. But here is an appetiser (in the hope that it interests you to take a closer look).

Archer is in the process of developing a carbon-based quantum computing chip capable of operating at room temperature. The company also has a graphite mining operation in South Australia (the source of their materials used to manufacture the chip).

That's all we will say, otherwise it will become way too obvious that we're operating above our pay grade. In short, it's likely an interesting speculation.

REFER A FRIEND

Much of our subscriber base love our work and refer their friends. For this we're extremely grateful as we're isht at marketing, dislike it, and prefer to spend our time on things that make us happy. Markets basically.

I'd hate for any of you to refer friends and not get something out of it, which is why we have a 30% discount both for your friends, colleagues, and even your enemies if you send them this way. And you'll score yourself a bonus 4-month subscription, which amounts to the same thing.

Nobody wants to feel like they're selling their mates something only so they can get something in return. That's not how friends work.

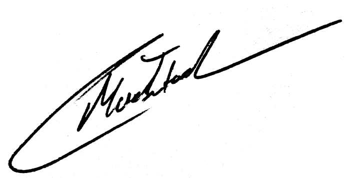
In any event, below is the link for this so when you're singing the praises to your friends, please use this link to ensure they get a better deal… and you do, too.

INSIDER COMMUNITY

As per usual, a gentle reminder to join us on the Slack community. Just go here.

As always, thanks for reading and being part of Insider.

Sincerely,



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