INSIDER Weekly

Issue 114 (13 May 2019)

DID WARREN BUFFETT JUST RIP A PAGE OUT OF THE INSIDER PLAYBOOK?

Hello, and welcome back!

A warning: This week's edition is a beast. Don't say I didn't warn you.

To kick things off this week a purely magical sunset from subscriber Tanner. Spring evening in east Texas.

I love the way your eye is drawn across the landscape and skies to the centre of the sun.

And thanks to subscriber Nick, a stunning sunset from above the clouds on the crater of Haleakala in Maui.

Grab a drink and put your feet up. Let's get going.

THIS WEEK

- Dividends cut
- Occidental warrants
- Tesla: Told you so
- Korea's hydrogen push
- Bushwacking with hydrogen
- Shippers keep rising
- Do shipping/freight rates help us?
- Front covers
- Offshore drilling: Testing one's resolve
- Copper capex is up but discoveries down
- Ship financing sinks
- What you can buy for $47bn
- The Big Five
    1. Modec
    2. Hilong
    3. Petrofrac
    4. Oceaneering International

5. Waddel and Reed

NAB CUTS DIVIDEND: A SIGN OF THINGS TO COME

We long warned that one of the things holding up Australian banks has been their super high dividends paid. It's also why, when constructing our trades on this, we were pretty gun shy to step out of the saloon and face a showdown directly.

So rather than shorting outright and directly, we constructed a long/short position so that the dividends paid and received help net out our cost of maintaining the position.

Well, this looks to now be working in our favour.

Australia's NAB cuts dividend for first time in decade as economy slows

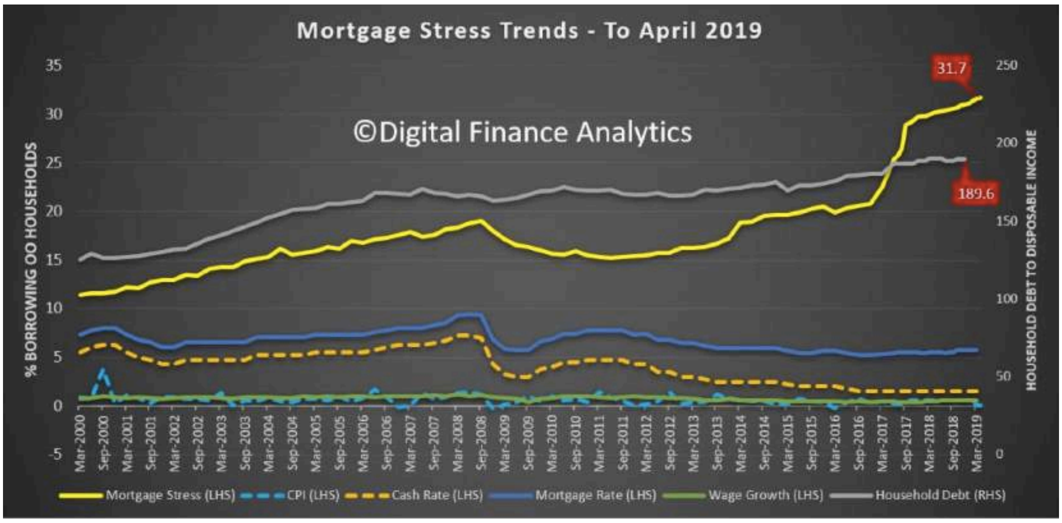
> *"Australia's top four lenders dominate about 80 percent of the country's consumer and commercial banking market. They are highly leveraged to any economic downturn, and are grappling with record low credit demand, falling house prices and stricter regulatory oversight."*

As we predicted, the deteriorating housing market is to blame:

> *"Mortgage arrears leapt 18 percent from a year ago to A$4.77 billion, representing 0.79 percent of total loans. Home lending delinquencies was at the highest level in over 6 years, the bank said."*

What is interesting to note is that home loan delinquencies are the highest in 6 years, but this is taking place while the economy hasn't entered a recession and home loan rates haven't gone up very much.

For NAB, home lending delinquencies may "only" be at a 6-year high, but in the broader scheme of things it is more like "generational" highs.



Hmmm... One wonders what sort of carnage there will be if/when the heat really goes on?

OCCIDENTAL WARRANTS

Last week we discussed the Chevron Occidental deal. Upon further inspection we uncovered something pretty darn interesting.

We were wondering why Buffett is getting involved with Occidental. Should Occidental acquire Anadarko, Berkshire would invest $10 billion in new preferred shares that have an 8 percent annual dividend.

That's a respectable dividend, but you know what is really interesting?

The warrants.

Berkshire Hathaway will also receive the option to buy **80 million more Occidental shares (about 10 percent of the company) at $62.50 a share, potentially further diluting existing shareholders.**

Time frame? 11 years. Eleven frickin years!

It seems Uncle Warren just ripped a page out of the Insider playbook.

It's not the first time he's done this though. Take a look:

- 2019: Occidental Petroleum, $10 billion of preferred stock yielding 8%, plus warrants to purchase 80 million shares of OXY common stock
- 2013: H.J. Heinz, $8 billion of preferred stock yielding 9%
- 2008: Mars Inc., $2.1 billion of preferred stock yielding 5%, plus $4.4 billion of bonds yielding 11.45%
- 2011: Bank of America, $5 billion of preferred stock yielding 6%, plus warrants to purchase 700 million shares of BAC common stock
- 2008: Goldman Sachs, $5 billion of preferred stock yielding 10%, plus warrants to buy $5 billion of GS common stock
- 2008: General Electric, $3 billion of preferred stock yielding 10%, plus warrants to buy $3 billion of GE common stock

TESLA: TOLD YOU SO

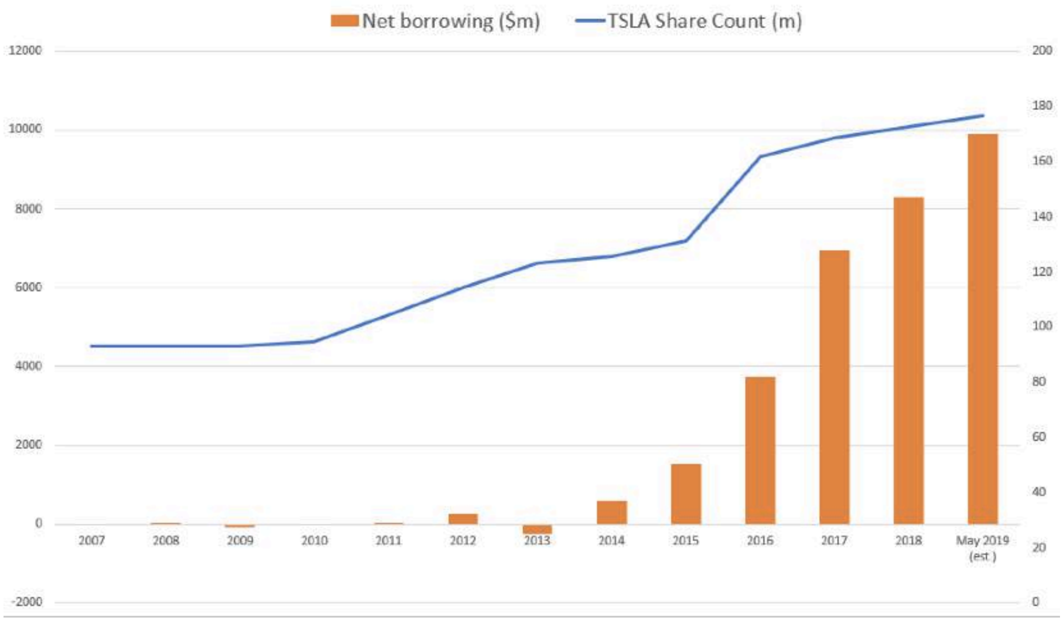
Only last week we mentioned that Tesla would need to raise capital. And yeah, we know… Musk repeatedly told us they wouldn't need to.

The fact of the matter is that Tesla needed to raise capital long ago. The only reason I can think of as to why they didn't is because Elon has such a massive ego that he felt that he could do so at a higher valuation, perhaps after his take private pump. Certainly this would have allowed him to borrow even more money against his stock (this is how he's been financing his lavish lifestyle, by the way).

In any event, this week all that changed.

Tesla now reports that they want to issue both bonds ($1.35 billion of 2024 convertibles) and equity (net proceeds of $740 million):

> *"One thing is for sure: Tesla has been extraordinarily successful, throughout its 16-year history, at raising capital – see the chart below. To me, the company is an enormous pile of wasted and burning capital, created in the midst of an extraordinary tech bubble and lit on fire by the false promises of a cult-like figure. And I believe that it will eventually run out of people who are willing to keep it alive, at least as far as the existing equity is concerned."*



The streets reaction was positive. Perhaps because even those who hang on every word this charlatan pronounces they, too, can do basic math… and upon doing so have come to a startling conclusion: Tesla is screwed without fresh capital.

The problem here is that I think this has come too late. The narrative has been changed too many times, the credulity of folks has been pushed too far, and there is an increasing wave of folks saying, "Hang on a second, that's just horse shit!"

Here are a couple of recent gems from Elon.

- *"It's financially insane to buy anything other than a Tesla. They will be like owning a horse in three years."* – Elon Musk, April 22, 2019
- *"A Tesla will be worth $150,000 to $250,000 in 3 years."* – Elon Musk, May 2, 2019

Now, you may not remember it so I'll remind you that Musk promised us that solar roof tiles would cost less than asphalt. I remember marvelling at how nobody turned around and laughed at the obvious nonsense of it all. Today SolarCity is bankrupt and all but ceased to exist.

Now, here's what I find interesting. Musk has said so many things that are complete nonsense – and so obviously so – and he's done so in public. If he's prepared to lie and cover up things at such an outrageous pace in public, I do wonder what really is under the hood of Tesla?

Americans like to think that massive frauds aren't that common in the US, and to an extent they're right. Still, there's been a decent stack of them regardless.

I do wonder how much "overestimated" things are in Tesla financial land. Perhaps here's a glimpse into that.

STREET
MMENTARY
WSJ.

OVERHEARD

The shareholders of Chinese medicine manufacturer **Kangmei Pharmaceutical** Co. woke up to a health warning Tuesday.

The company didn't quite have the 34.15 billion yuan ($5.07 billion) in cash that it reported in its annual results last year, according to a filing to the Shanghai Stock Exchange. It had overestimated the figure by 29.94 billion yuan. Oops!

The admission was attributed to an accounting error and as soon as trading began, the company's stock fell 10%, the automatic trigger level that causes stocks to be suspended.

Kangmei is no minnow: The company is listed on the MSCI China Index, and had a market capitalization just north of 50 billion yuan before the collapse.

Of course, people in glass houses shouldn't throw stones: Who hasn't overstated their cash balances by 700%?

There but for the grace of God go any of us.

s Next Rainy Day

And yes, though the options aren't nearly as cheap as they first were when we bought them, it's probably a less risky short now.

The trend is now solidly negative.

KOREA'S HYDROGEN PUSH

Now, moving onto things that few are looking at, but which you've since received in your inbox: Hydrogen.


Korea Gas announces multi-million dollar hydrogen production investment

May 2, 2019 0 By ERIN KILGORE

Share this...

Some big rumblings:

> *""Through the road map, we expect to create 50,000 jobs by 2030 and grow the hydrogen industry as the nation's key industry," said Kogas CEO Kim Young-doo, reported the Korea Herald.*
>
> *The hydrogen production investment will help with the Korean government's efforts to establish a national hydrogen economy. The country's large-scale expansion project will, among other things, call for a huge increase in the number of fuel cell vehicles (FCVs) produced in South Korea. While only about 2,000 FCVs were built last year, this number is expected to increase to 100,000 by 2025 and 6.2 million by 2040. During the same time frame, the nation's government plans to boost the number of hydrogen refueling stations from the current 14 to 310 by 2022 and to 1,200 by 2040."*

We highlighted 4 ways to play the hydrogen theme in our recent alert.

However, the article above does highlight the "trickiness" of this trade. The developing industry is dominated by big conglomerates where hydrogen is a very small part of their overall operations.

Nevertheless, we are seeing dedicated hydrogen plays gain momentum to the upside, and we'll be keeping our hairy eyeballs on this space. We suspect we'll be changing up and investing in other opportunities as things progress and develop.

Sticking with hydrogen...

Audi renews hydrogen powertrain development scheme

Firm ramps up fuel cell efforts with new prototype amid EV development concerns

> *"The decision to push ahead with fuel cell development comes in the middle of a broader £12 billion offensive in which Audi will launch up to 12 pure-electric battery-driven models by 2025.*
>
> *Schot, who succeeded Rupert Stadler as Audi chairman in January, pointed to the scarcity of materials and subsequent doubts over the high-volume supply of batteries as just two concerns facing car makers."*

BUSHWACKING WITH HYDROGEN

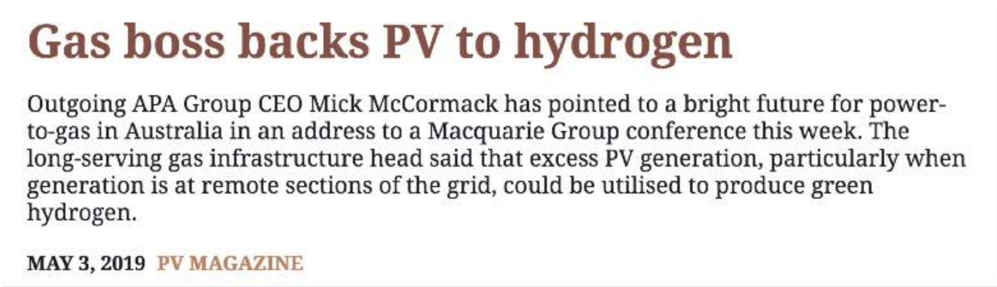
Just quietly hydrogen is making inroads in Australia.

Australia's first solar to hydrogen-based microgrid gets nearly $1 million in federal funding

A grant of nearly $1 million has been announced for a 100% renewable energy project which will see the World Heritage-listed Daintree Rainforest reduce its reliance on diesel fuel to generate power.

MAY 7, 2019 MARIJA MAISCH

Someone else echoing our thinking:



Gas boss backs PV to hydrogen

Outgoing APA Group CEO Mick McCormack has pointed to a bright future for power-to-gas in Australia in an address to a Macquarie Group conference this week. The long-serving gas infrastructure head said that excess PV generation, particularly when generation is at remote sections of the grid, could be utilised to produce green hydrogen.

MAY 3, 2019 PV MAGAZINE

We are still intrigued that hydrogen hasn't been embraced by the investment community (fund managers etc).

As we discussed in the hydrogen Alert, there are some 11 listed hydrogen stocks, but they don't seem to have any fund management shops who are significant shareholders. And yet the technology works, and the implementation is taking place.

SHIPPERS KEEP RISING

We are seeing strength across various classes of shipping.

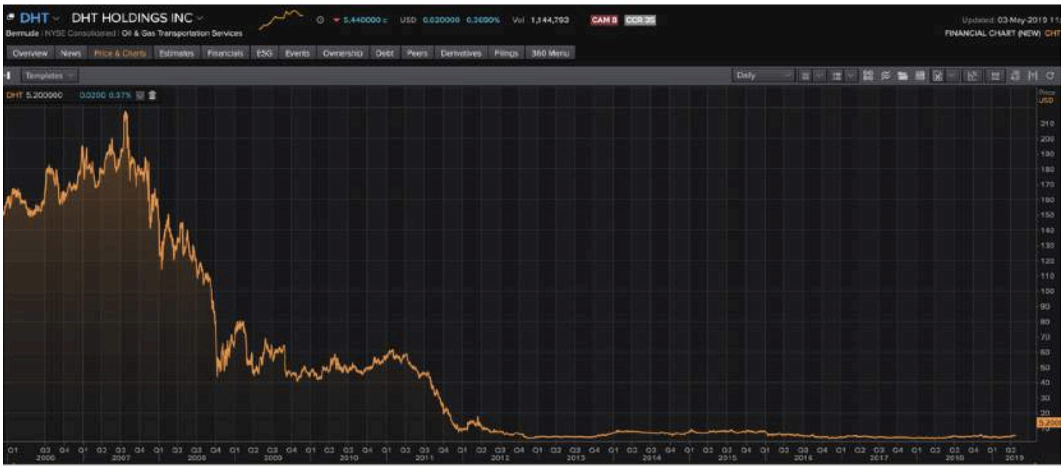
From product tankers:

Crude oil tankers:

Containerships:

And dry bulkers:

Granted these are short term 2-year charts, though if we look at longer-term charts, they all take on the appearance of that below — down goodness knows what.



And this is why I've said in the past that I really don't give an isht if we buy something at multi-year, even generational lows, and see it move 40, 50 or more percentage points in either direction.

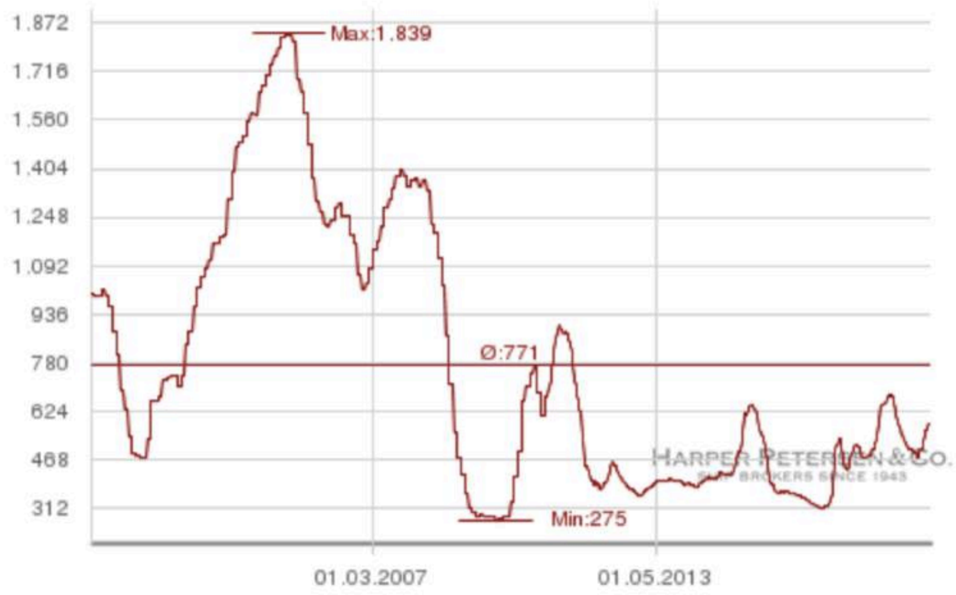
As we can see in the shippers on the 2-year charts, we look to be in a solid bull market (and indeed our thesis is that we likely are) but really we ain't seen nuthin' yet.

DO SHIPPING/FREIGHT RATE INDICES HELP US?

Often "Baltic freight rates" are referenced when it comes to shipping. When this name is mentioned, most folks think it an index of the "cost of all ships". But it only refers to dry bulk carrier ships.

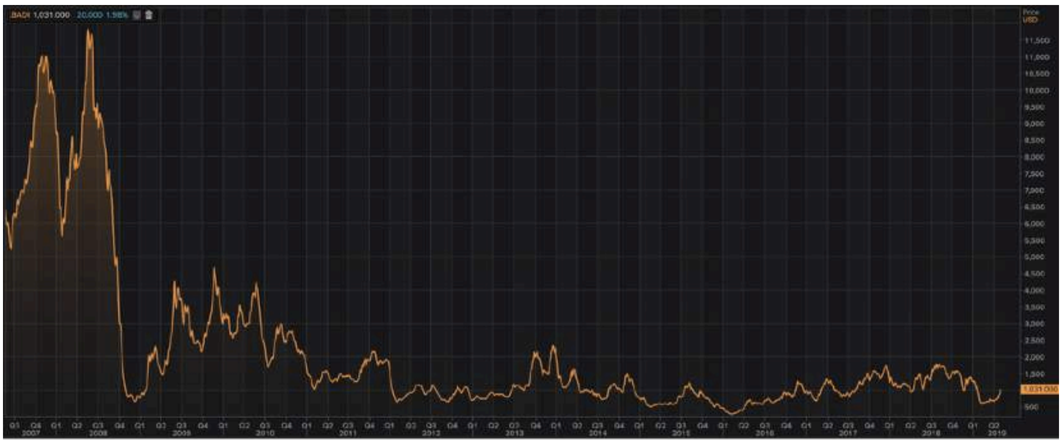
Anyway, that is just a bit of trivia. The real deal is that many pundits try to perform technical analysis on the freight indices and suggest that "because Baltic freight rates are rising, this is a bullish sign for shipping stocks." Or vice versa.

Take a look at the charts below. Do you see anything in these? Any observable trends? Does this provide us any insight?



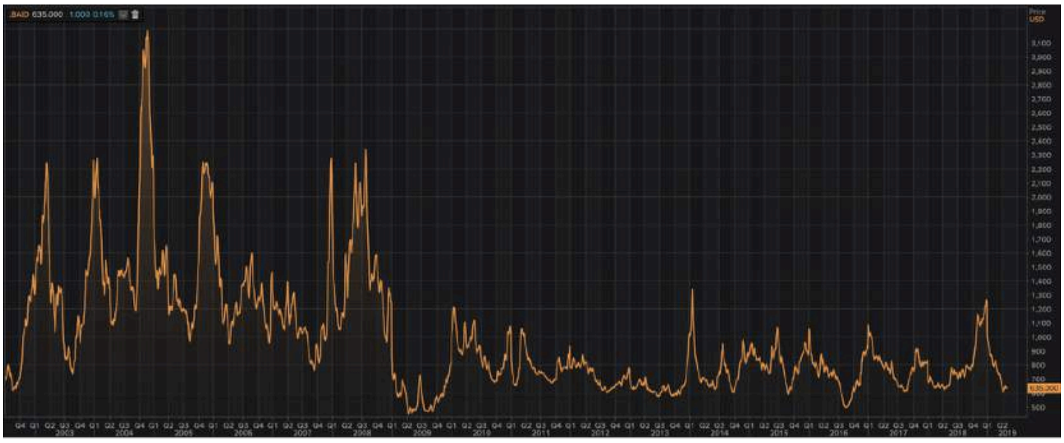
The HARPEX Shipping Index

An index put together by Harper Petersen & Co. It is a composite of time charter rates across varying containership classes — what the Baltic Dry Index is to dry bulkers.



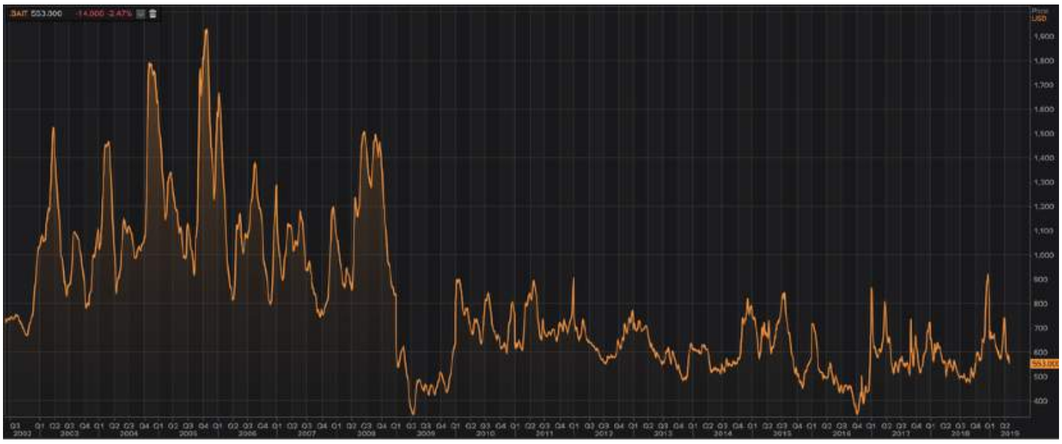
The Baltic Dry Index

An index of 4 dry bulk shipping classes.



The Baltic Dirty Tanker Index

An index of various classes of “dirty” tankers (i.e. crude oil tankers).



The Baltic Clean Tanker Index

An index of various classes of “clean” tankers — product carriers be it refined petroleum, vegetable oils, chemicals, etc.

Maybe you can see something that we can’t. We certainly wouldn’t rely on any of these to provide any insights into a coming bull or bear market in shipping stocks.

Of these, the Baltic Dry Index is the most talked about, but really I think it’s hogwash. Here’s why...

The problem we have with using the Baltic Dry Index for forecasting is that, like correlation, it does not equal causation.

Let's say, for example, that commodity demand is falling. One may expect the Baltic Dry Index to fall. But what if the supply of ships is contracting faster than the fall in commodity demand? Well, you'd have a favourable pricing environment for shipping. That's what.

We think it makes more sense to look at nominal demand for commodities and to independently look at shipping supply, financing and the myriad other factors.

Another kink in the Baltic Dry Index forecasting armor is that it measures spot rates for dry bulk commodities consumers, and if you think about it, these folks pay whatever the hell it costs to get materials shipped. For instance, a steel plant needs their ore, and if the costs to transport it are higher... well, without it they've no business, so pay it they will.

Ship owners are much the same. Have you ever seen those absurdly low priced holidays where you can, if you can drop things and fly in a day or two, you can fly for a fraction of the normal cost. Or those bit beastly cruise ships which offer absurdly low rates to go from A to B. You run the math on it and realise that your dining costs alone would typically run for more than they're offering you board and lodging and travel. The reason this takes place is because a ship is just a fixed cost and filling it — even at a loss — is better than not filling it at all.

What this all means is that because of the inelasticity of supply and demand... and because the Baltic Dry Index measures spot rates, they can be more volatile than a flea on acid.

We think the Baltic Dry Index is a poor indicating measure because it measures spot in a market where typically both sides of the transaction HAVE TO close a transaction because they're running operations with huge fixed costs.

What we can say is **that freight rates remain very near generational lows and have been in a relatively narrow trading range for the last 10 years.**

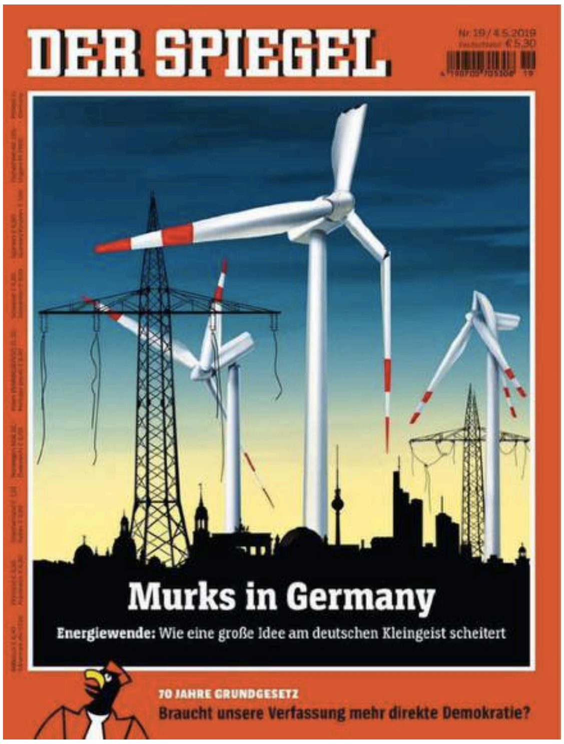
We also know that shipyards have shut up shop and gone home, meaning supply will be constrained. We also know that many of our picks have been through restructurings and those poor debt holders have become equity holders, and equity holders — what's left of them — have been decimated. All in all, a beautiful thing.

FRONT COVERS

Take a look at the front cover of Bloomberg Businessweek.

And did I see “a new era” above? Hmmm, so this time it is different? Have we heard those words before?

Sticking with magazine covers, the cover of Der Spiegel.



From the article:

> *"Solar farms take 450 times more land than nuclear plants, and wind farms take 700 times more land than natural gas wells, to produce the same amount of energy."*

What a fustercluck. Solving mass energy generation with alternative energy is like trying to saw your arm off with a wooden spoon. You're just not going to get there, and the energy you take to even try is only going to wear you down and leave you looking stupid with a sore arm.

OFFSHORE DRILLING: TESTING ONE'S RESOLVE

It is easy to look like a genius when the market goes your way. But when it doesn't... well, that is the sort of stuff that sorts the men from the boys.

You would be forgiven for thinking that Ensco is about to get to a new low. Well, maybe it does.

It is important to understand exactly your time frame and trading strategy before going into any trade.

For us, we have a very long-term time frame. We're positioning for where we believe the market will be 5 years out. We believe that one of the big competitive advantages we have is having a longer time frame than everyone else and having the patience (and resolve) to see it through and doing so in sectors which are critical to modern civilization.

We're not worried (but at the same time not amused) at the latest pull back in offshore oil drillers. The weakness seems to be driven by Transocean's latest earnings report, which didn't tell us anything we didn't already know, though it's unclear that was the catalyst.

One of the reasons why were aren't worried about the "breakdown" in offshore oil drillers is that **the weakness isn't being supported by many other stocks involved in the offshore space.** And it certainly isn't being supported by outlooks being posted by other companies in the offshore space. Here are just a few examples.

From the CEO of Petroleum Geo Services:

> *"Norwegian seismic surveyor Petroleum Geo Services (PGS) PGS.OL expects to have "significantly" higher profitability in 2019 as demand and prices are increasing, despite lower earnings in the first quarter, the company said on Thursday. With oil prices rising after a downturn in 2014-2016, oil companies are more keen to invest in exploring for new barrels and need seismic data to pinpoint spots to drill. "We have seen a strong order book increase, and that has continued into April," PGS Chief Executive Rune Olav Pedersen told a news conference. "The seismic market is recovering, and we expected gradual recovery to continue in 2019." The company's order book rose by $75 million to $238 million, including $90 million relating to multi-client sales, where data is acquired for sale to a number of clients, compared to last quarter of 2018, PGS said in its first-quarter report. Pedersen also said prices for contract seismic acquisitions, where data is acquired under exclusive rights and is owned by oil companies, were 35 percent higher than in 2018, driven by demand from oil supermajors. Two-thirds of the contract seismic work were so-called 4D or regular surveys over the producing oilfields to improve recovery, which have higher profit margins, Pedersen added."*

From the CEO of Oceaneering International:

> *"CEO Rod Larson commented on the quarter by stating that: "We are very pleased that our first-quarter results exceeded expectations. Higher-than-expected activity and good execution within our energy-focused businesses were key factors in achieving this performance."*
>
> *After several years, the offshore drilling market is finally starting to improve. Oil companies approved several new drilling projects in recent months, which is driving activity levels higher as well as sales of offshore-related products. One area where that's noticeable is in Oceaneering's ROV segment, where utilisation and rates continue to improve as more drilling rigs go back to work.*
>
> *Oceaneering expects continued improvement in its ROV, subsea projects, and advanced technologies segments during the second quarter. That should more than offset the expectation for flat sequential results at subsea products and asset integrity. Meanwhile, the company anticipates that subsea projects' activity levels will accelerate during the second half of 2019 based on the orders it has taken in so far this year. Those factors, along with its better-than-expected first-quarter results, led the company to narrow its guidance range for adjusted*

> *EBITDA. It now foresees that number coming in between $150 million to $180 million, a $10 million increase at the low end from its initial view."*

From the CEO of Hornbeck:

> *"By the end of the first quarter, utilization had picked up across all of our active vessel types and sizes in each of the geographic markets in which we operate. The number of FIDs in 2019 is projected to be at the highest level since 2013, assuming oil prices remain at or above current levels. The recovery should begin to take shape mid-this year. There should be approximately 15 to 16 incremental floaters working or available to work in the Greater Gulf of Mexico region by the end of the year."*

Then Todd Hornbeck had this to say:

> *"We learned that the major global manufacturer of the component part that we needed had only single technician working in Brazil who was occupied with several other customer problems stemming from operators in Brazil increasing their activities. We have said before that the reliability and robustness of our supply chain and technical support may prove to be a significant bottleneck for the offshore industry as activity picks up in all of our markets. A shortage of qualified technical personnel whether working for vendors or working on our vessels is a challenge that all offshore companies will face."*

I think the comments highlight a very important factor that markets currently fail to understand — personnel issues.

If you want to put an offshore rig or an offshore service vessel back to work, one that has been warm stacked or particularly cold stacked you're left with a problem: **Where is the personnel going to come from? An offshore rig can take up to 200 people and these are all skilled folks, that you can't just drag off the street.** If you lay workers off for long enough, they leave the industry and it is hard (expensive) to get them back. The same can be said of shipbuilding, for example.

So it would seem that the offshore market is improving. Of course. it won't happen overnight and things won't go up in a straight line.

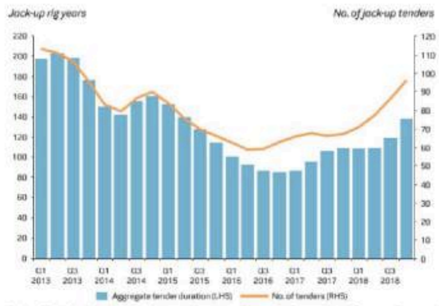
Want a great summary of our thinking of offshore oil? Well, here it is courtesy of Third Avenue, and it is exactly our thinking (in a concise narrative):

Offshore Oil Services - Within these quarterly letters we go to some effort to share each of our investments theses, communicating our thinking about each new purchase in the quarter in which it was purchased. However, we would like to take the opportunity to provide an update on fundamental progress as it relates to one of the Fund's largest exposures, offshore oil and gas services. Per the table above, the Fund's aggregate exposure to this area is estimated to be 13.2%. In order of size, this figure includes Tidewater, Borr Drilling, a portion of our position in Royal Boskalis Westminster ("Boskalis"), Transocean, Petroleum Geo-Services ("PGS") and Subsea7.

A concise version of our investment thesis is that offshore oil and gas production is critical to the global energy mix and is extremely likely to remain so for some time. Further, we believe that for several years following a rapid oil price decline in 2014 and 2015, the reduced level of spending on offshore oil and gas exploration and production fell to levels clearly below that required to sustain production at these levels. If industry austerity persists, then production declines will result in the not too distant future. The makings of this scenario can be seen in the offshore oil and gas industry's extremely low reserve replacement ratios and falling reserve lives. We believe that oil and gas producers share this view and are beginning to act in order to stave off the otherwise inevitable production declines. However, during these extremely lean last five years, service providers were forced into survival mode and have scrapped huge numbers of drilling rigs, seismic vessels and platform supply vessels, a process which continues today. This industry attrition will make previous levels of exploration and production activity very difficult to achieve without far higher prices for the services. In other words, the supply and demand balance for offshore oil services is likely to become tight (driving prices higher) at activity levels well below the highs of the last cycle. This pattern of events is very much in keeping with previous offshore oil service cycles, whereby increasing asset utilization leads to rising service prices. In early 2019, the process of recovery appears to have begun in earnest but has quite a long way to go in order to reach industry normalization.

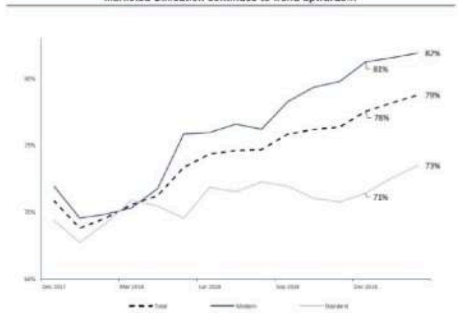
These dynamics have become clear and present as evidenced by recent operating performance reports. For example, PGS recently reported that "Pricing for 2019 contract work booked to date remains strong and is now more than 35% higher than the average rate in 2018." In a recent meeting with Borr Drilling, management projected that they would have their entire rig fleet sold out by the end of the year while recently contracted day rates for modern jack-up rigs - the type Borr owns - are currently running in the neighborhood of 60% higher than one year ago, in some cases meaningfully more.

Tender activity and duration is increasing for jack-ups...



Note: Data includes tender and pre-tender only based on "Open demand", three moving quarter average
Source: IHS Markit

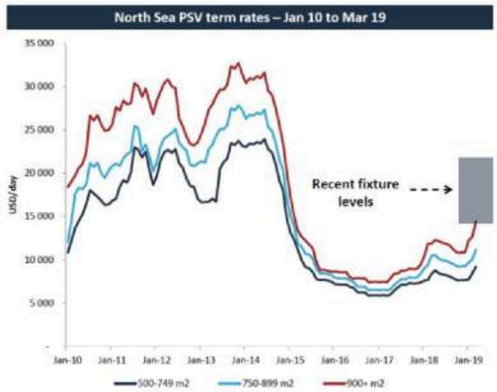
Marketed Utilisation continues to trend upwards...



...and utilisation even higher for rigs built after 2010

With regard to the platform supply vessel ("PSV") market, where Tidewater is the world's largest operator, oil services specialist Fearnley's Securities recently commented "The spring/summer season in the North Sea is really starting to take shape for PSVs. The spot market remains close to sold out, rates are hovering at levels not seen since the downturn and term requirements continue to build." Oil service specialist Clarksons Platou Securities tracks the same dynamic in analysis of the North Sea PSV market where it estimates that 2019 rates are running 56% higher on average than 2018. The light at the end of the cyclical tunnel appears to be shining brighter and brighter each day with a wide range of supporting data points.

North Sea PSV term rates – Jan 10 to Mar 19



Source: Clarksons Research Services, Clarksons Platou Offshore

Third Avenue Value Fund | As of March 31, 2019
3

In an April 5th report, Morgan Stanley suggests buying oil field services companies (OFSs), saying **the market is too pessimistic about global oil industry spending because of its focus on capital discipline at international oil cos (IOCs) and U.S. exploration and production firms.** Morgan Stanley expects international upstream spending to accelerate, adding more than USD 100bn to global spend by 2022:

> *"We see the market missing the international opportunity for Oil Services, given the misconception of equating global spending with IOC and US E&P capital discipline," the report authors write. "Yet NOCs represent more of global spending and are growing. Buy OFS on depressed valuation/sentiment. Top pick: TechnipFMC."*

Other market predictions and highlights from the report include:

> ***The myth of flat capex:*** *We see equity markets mistakenly equating the 'capital discipline'/ flat capex message from the majority of western public companies (e.g. European Majors and US E&P guidance) as indicative of global spending.*
>
> ***Overly bearish Oil Services view priced in:*** *Global Oil Services EV/EBITDA multiples are at, or below, mid-cycle levels and close to P/BV support levels. This suggests the market is reflecting little improvement in activity or profitability/returns, which is consistent with the market's view of stagnant industry spending. US and European oil field service (OFS) stocks have fallen ~60% vs Brent oil prices -38% and underperformed respective markets by 121%/56%.*
>
> ***Industry spending is growing:*** *International upstream spending started rebounding in 2018, and we expect it to accelerate, adding >$100 billion to global spend by 2022. Most of this opportunity is outside of shale, highlighting the opportunity in international markets. We also see growing evidence of international recovery across Offshore, MENA and LNG markets. Improving demand fundamentals support our positive views on stocks exposed to the Oil & Gas supply chain.*
>
> ***Driven by the forgotten money of capex:*** *Our new analysis highlights that national oil company directed spending is twice that of international oil companies, at 33% of global upstream, and we expect this segment to grow above the industry pace in coming years. We also see growth from internationally focused E&Ps and certain IOCs, e.g. Exxon.*
>
> ***Significant upside opportunity as market prepares for lift off:*** *We see the market as yet to embrace this cyclical outlook, although investor interest is growing (28% YTD rally in oil prices helps). Previous cycles suggest that multiple expansion from mid-cycle to peak levels delivers ~30% upside. Further upside is generated by earnings upgrades, especially from operating gearing (see 2017 'Phases' note and 2018 reiteration). This is consistent with the average ~40%*

> *upside to our global basket of Overweights for this theme (~100% to Bull cases). This includes TechnipFMC, Tenaris, BHGE, Transocean, Borr Drilling, Petrofac, Saipem, Subsea 7, Sembcorp Marine, Samsung Engineering, Larsen & Toubro, Hilong, JGC, Nabors and Modec. We raise forecasts and price targets for TechnipFMC, Petrofac, Saipem. Subsea 7 and Hilong.*

The research piece from Morgan Stanley highlights that the majors like Exxon, Shell, Total, BP aren't the whole industry, yet everyone talks about capex spend from the majors as if it was the whole industry.

COPPER CAPEX IS UP... BUT DISCOVERIES DOWN

More confirmation for what we already know.

> **Copper discovery rates at decade lows**
>
> Despite an increasing amount spent on exploration copper discoveries have fallen away, according to Kevin Murphy, senior research analyst at S&P Global Market Intelligence.

It's getting harder and more costly to discover additional resources of copper. From the article:

> *Exploration spend over the past 10 years totalled US$25.8 billion, well above the $15.4 billion allocated from 1990 to 2008. Yet, that spend yielded 102.4 million tonnes of copper in 21 major discoveries, compared with 992.5Mt in 199 discoveries in the preceding 19 years.*
>
> *"Even after adjusting for copper in recently identified deposits that we expect eventually to surpass our major discovery threshold, and the addition of further copper at recent major discoveries, we forecast copper in discoveries to remain historically low," he said.*
>
> *Worryingly, in a break from the past, the amount of copper discovered annually no longer trends in line with the amount spent on exploration. Murphy partly attributes that to a shift in focus within the exploration sector as since the 1990s, the industry has almost halved its share of copper budgets devoted to grassroots exploration.*

SHIP FINANCING SINKS

Last week Norway's DNB released its quarterly earnings.

Nothing exciting in that, except for the finer details. DNB, regarded as the world's biggest ship financing house, shrunk its loan book by some 17% year-on-year. Perhaps this isn't a surprise, as we already knew that a number of financing houses have cut their ties to ship finance.

So not only do we have huge shipbuilding capacity shut downs, but also the means to finance ships. Shipping is setting itself a huge comeback.

The Dow Jones Global Shipping Index is down some 76% from its 2008 highs (it was down about 80% at one stage). Even from its 2015 highs, it is down some 50%.

WHAT YOU CAN BUY FOR $47BN

WeWork is likely to IPO for $47bn. Hey, let's round it up to $50bn (near enough).

For those of you who don't know this creature was formed... In 2010, WeWork began renting out office spaces at wholesales price and refurbishing them to create a hip/mod shared workspace for companies and individuals looking for a place to "answer emails" without the commitment of a commercial lease.

They've never made a profit but grown like kudzu. How this has been achieved is because the market has rewarded "growth". So long as they are growing, investors have been willing to throw more money at them. And so, in order to grow faster, they've simply undercut competitors (who need to make a profit to stay alive), thus ensuring they lose money on each deal. I mean, who can compete with that right?

The company reported $1.8 billion in revenue in 2018, twice that of the previous year, but it reported a loss of $1.9 billion.

And how is this one:

> *"Our valuation and size today are much more based on our energy and spirituality than it is on a multiple of revenue,"* cofounder and CEO Adam Neumann told Forbes in 2017.

"Energy and spirituality." WTF is that? It sounds like I'm signing up for a Buddhist retreat complete with warm foot bathing and long periods of sitting on my ankles humming.

What I find even more amusing is what you could buy with $47bn.

Let's say you won the national lottery/lotto or whatever you call it in your corner of the world… and went shopping. Here's what you can buy:

- All the offshore oil drilling stocks in the world. Yes, every single one. That would come to about $13bn. And so once you'd filled your boots with that, you could then go out and buy...
- The entire Greek equity market. That's about $17bn, so you've still got a wee bit of spare change. And so you look around and snap up….
- Every uranium stock. Every frickin' one. That's about $10bn. Having tried your hardest to get rid of this annoying pile of dough, you're still not outta bullets. And so you rush out and buy...
- All, yes all, the wet (crude oil) tanker stocks. That's about $8bn (dry bulk carriers come to about the same market cap).

So t**he uranium, crude oil tanker, and offshore oil drilling sectors and the Greek equity market... or WeWork for the same dollar amount** (+/- a billion or two).

Crazy times indeed!

THE BIG FIVE

FROM OUR TRADING DESK

Five stocks that few would know about, let alone be invested in, putting their hand up begging for someone to take a closer look. These aren't official trade alerts or even ideas but rather invitations to take a closer look.

1. Hilong
2. Modec
3. Petrofrac
4. Oceaneering Int
5. Waddel & Reed

Hilong Holdings

A little known Chinese company operating in the offshore oil and gas services field primarily in the provision of tubing and pipelines and various products and services that do with it. Interesting in that it is profitable with an ROE of 4.5% (not great, but huge given the industry conditions), P/E 9x, forward P/E 6x and P/book of 0.4x.

Modec Inc

Modec constructs floating solutions for the offshore oil and gas industry, namely floating production storage and offloading (FPSO) vessels, floating storage and offloading (FSO) vessels, floating LNGs (FLNGs), tension leg platforms (TLPs), and production semi-submersibles.

To the layman, floating oil and gas refineries like this thing:

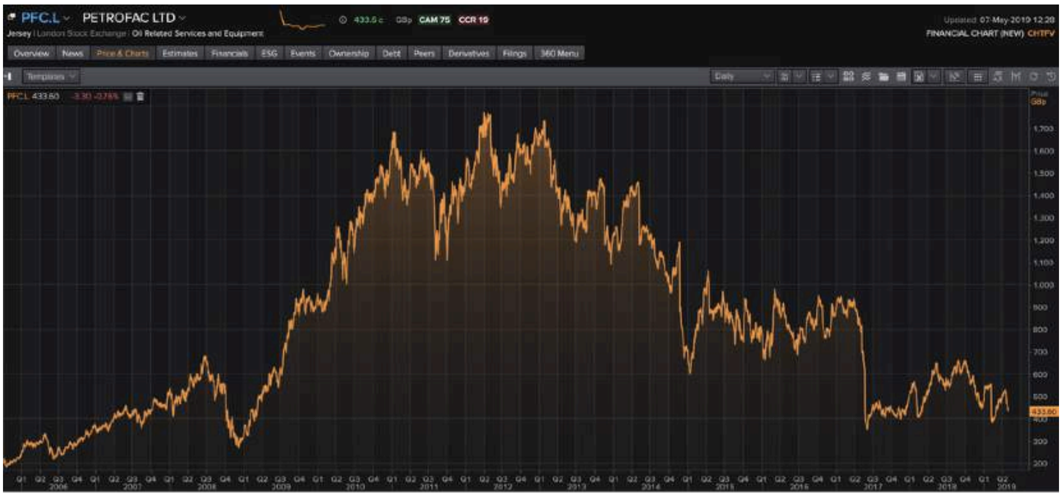
Granted, the chart isn't so compelling.

However, when you look at its fundamentals: ROE 15%, P/book 1.26x, P/E 9x, market cap 192bn JPY, cash 50bn JPY, and debt 30bn JPY. It was a gift at the start of the year and still remains a very attractive value even now.

Petrofrac

The company designs, builds, operates and maintains oil and gas facilities.

Granted, not the technically most pleasant looking chart. However, the company has a positive ROE, is well financed, and sits on a forward P/E of 6.4x.



Oceaneering International

One of the bigger operators of ROVs and everything that goes with it. Also provider of various undersea tools and equipment. They expressed a positive outlook for the offshore sector last week (as discussed above).

One could have bought it at $12 at the start of the year.

Now it is closing in on $20. But to be honest, we thought it offered great value this time last year when it was trading at about $20.

Waddel & Reed

An interesting technical setup.

And let me fall off my deep value chair when I take in the fundamentals: P/E 9x, forward P/E 12, P/book 1.62, ROA 13%, and ROE 19%. And then there is the capital structure:
So much cash!

CAPITAL STRUCTURE			
MARKET CAP	1,395	SHAREHOLDERS EQUITY	869
- Cash & Short Term Invest...	827	TOTAL CAPITAL	--
+ Short Term Borrowing	--	Debt to Equity	--
+ Short Term Debt	0	Debt to Capital	--
+ Current Long Term Debt	--		
+ Long Term Debt	95		
+ Preferred Stock	0		
+ Minority Interest	13	* Price as of 06-May-2019. All Financials in USD million. Date filed 31-Mar-2019.	
= ENTERPRISE VALUE	677		

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Chris MacIntosh

Founder & Editor In Chief, Capitalist Exploits Independent Investment Research
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