OCTOBER 2023 • ISSUE 32

JEFF D. OPDYKE'S

Global Intelligence

Mideast Volatility is Good News for This Niche Energy Stock

I wasn't sure what to expect when the Austrian Airlines A321 touched down in Tel Aviv over the summer. Though I've traveled through the Middle East several times—Saudi Arabia, Oman, Qatar, Lebanon—something about Israel touched a nerve.

How safe is this place, really?

That's the thought that ran through my head more than a few times.

See, I know what terrorism feels like.

On the morning of September 11, 2001, I was on Manhattan's West Side Highway, maybe six or seven blocks away, when the Twin Towers collapsed on the walk to my office at *The Wall Street Journal*. My train from northern New Jersey was 10 minutes late heading into the World Trade Center's subway station. Any other day, I'd have been exiting the subway in the basement when the planes hit.

Walking the streets of Tel Aviv this past summer, I wondered if I and those around me might be targets of Hamas militants or their brethren in south Lebanon. I'd make an easy target—sitting at an *al fresco* cafe writing or snacking on a *sabich* (the Israeli national sandwich). All those terrorists would have to do is decide to lob a few missiles into the heart of the city—just to remind Israelis they're surrounded by mortal enemies who want to eradicate their existence.

Nothing happened, in the end. And I enjoyed Tel Aviv (aside from the heinous traffic).

Still, when my wife entered my office earlier this month to tell me that Hamas had attacked Israel, I immediately returned to those summer thoughts...

Truth is, I had no intention of writing about Israel and Hamas in this month's *Global Intelligence Letter*. War in the Middle East was not on my bingo card for 2023. Instead, I was in the middle of writing about another investment opportunity I want to share with you, but which I have temporarily put on hold because of the Israel/Hamas conflict.

Conflict in the Middle East is big news for oil.

Texas tea, black gold, crude, whatever you want to call it, oil is the most conflict-sensitive asset on the planet, particularly if said conflict is anywhere in the Middle East. The direction oil prices go once a conflict emerges says a lot about tensions and expectations.

In the immediacy of the Hamas attack, the two primary oil benchmarks—West Texas Intermediate and Brent Crude—both rose about 5%. The message: Concern—though not yet outright

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fear—that Hamas has unleashed an event that could very well draw in Iran, a country seething with hate for Israel. Or it could see Israel bomb Iran for purportedly funding/orchestrating Hamas' aggression. Iran would likely retaliate.

And, of course, if Iran were to openly involve itself in this conflict, then the U.S. would step in to protect Israel... and suddenly all the power dynamics of the Middle East are in motion as today's relative stability cedes to regional chaos and, potentially, regional war that sends oil prices moonward.

Just so you know here at the top, this month's issue has nothing to do with those Middle East power dynamics. I'm not going to bore you with the chasm between Shi'ite and Sunni Islam, the role Britain and the West played in creating the Palestinian/Israeli conflict more than a century ago, or U.S. hypocrisies that infuriate the region.

I'm just going to tell you that all of that baggage litters the Middle East, and it's at the heart of the oil story.

And oil is what I really care about in this month's issue. Because that's where opportunity still remains.

It's All About the Oil, Regardless of the Green-Tech Revolution

If green energy was the dominant source of the world's energy consumption, the West wouldn't care so much about what happens in the Middle East.

Such a comment seems overly callous, but it actually highlights the fact that if not for oil, the Middle East would be a tertiary thought at best and U.S. administrations would (probably) be less-inclined to take sides. And frankly, that would be great for the Middle East, Arabs, Jews, and Muslims. But, for now, that's neither here nor there.

The key point is that green energy is not the dominant source of the world's energy consumption. Oil is. By a large margin.

And, so, here we are, in a world in which ever-increasing demand for oil has elevated Middle East power dynamics to the point that flashpoints in the region become the defining reason that oil prices move.

Indeed, the Israeli/Hamas conflict has nothing to do with oil. It's entirely a fight about both peoples' rights to exist in a homeland of their own by sharing a parcel of Levant that has hosted everyone from Assyrians to Babylonians to Ottomans, Egyptians, and Crusaders.

And yet much of the financial world immediately raced to buy oil on news of the hostilities.

They did so knowing that this conflict has deep roots that divide the region. Moreover, those divisions are as fluid as Arabia's shifting sands. Friends today are enemies tomorrow. Accords put in place years or decades ago can fade like morning mist.

The risk, of course, is that war in the Middle East means serious disruption of global oil supply.

Oil is the region's lifeblood. Aside from tourism and a tiny bit of agriculture and textile manufacturing, local economies depend on exporting oil and petroleum byproducts to survive. Saudi Arabia, for instance, earns 80% of its export income from oil. In Qatar, it's 81%.

As such, oil is a target of war as much as bridges, airports and military compounds.

How best would Iran cripple Saudi Arabia's war effort, or vice versa? Bomb the hell out of oil production and pipeline facilities to kill the cash cow.

Oil demand already exceeds daily production, so if a production platform or a major pipeline were taken offline by a military strike—or a terrorist act—a major source of supply would be shut in, and oil prices would spike globally.

How high?

Who knows? Depends on lots of factors, including the amount of supplies impacted, and for how long.

But that spike would go high. Very high. Something approaching $250 per barrel is not out of the question.

That's why the Israeli/Hamas hostilities are so much more than a fight over land. It's one reason the U.S. immediately sent an aircraft carrier to the region. Ostensibly, doing so is a show of force to protect Israel. But on some level, it's also a commercial transaction—America's military protecting American economic interests in the regional oil patch.

Again, maybe that sounds callous. But the truth never promised to be gentle and kind.

This Pick-and-Shovel Energy Play is Poised for Big Gains

The oil stock I'm leading into here is a company called **Tenaris S.A.**, a Luxembourg-based manufacturer of steel piping and other such products used in the energy industry across the world.

The company is a global leader in the pipes and cables and risers used in drilling for and producing oil onshore and offshore. These materials are also used to transport oil through large pipelines, and for all kinds of other applications necessary for retrieving oil from beneath the Earth and ferrying it to the places it needs to go for refining, storage, and shipping.

As such, **Tenaris** is what's known as an oilfield-services company—a company that provides niche services and products to the oil and gas exploration, production, and transportation industries. In this case, those pipes and tubular casings and whatnot.

Its inclusion in the *Global Intel* portfolio deepens our exposure to an industry in the midst of a commodity super-cycle boom that has several more years—if not a decade—to play out. That super-cycle—of which there have been just three or four over the last century—will push commodity prices vastly higher—everything from gold and silver, to oil, sugar, wheat, and more.

Even as that super-cycle unfolds, the world currently sits on the edge of an energy super shock.

As I've spelled out in other issues of *Global Intel*, as well as in my daily *Field Notes* columns, the over-aggressive race to impose a clean-energy mandate on the world is problematic. As well-meaning as that mandate might be, the inconvenient truth is that the vast quantity of dollars thrown at green-energy technology such as wind and solar farms hasn't really moved the needle dramatically in terms of global energy supply.

Simply put, demand for energy has been growing faster than green-energy supply growth, meaning that green energy's share of the global energy market is largely unchanged over the last decade or so, despite all the money thrown at it.

And the problem here is precisely the money thrown at green energy.

Because of those government mandates, the financial markets and companies have been shoveling oodles of cash at companies developing green tech. Nothing wrong with that... except for the fact that the market has pulled that money from investments that otherwise would have gone to traditional fossil-fuel technology.

Instead, fossil-fuel producers have markedly scaled back spending on finding new reserves. The result is the situation we have today: Global oil demand topped 103 million barrels per day over the summer, though that has slipped back to about 101.4 million daily barrels as of early October, according to Energy Information Agency data. Supply, however, is running at just over 100 million barrels per day, meaning the world is drawing down above-ground inventories.

Last month, OPEC said it expects daily oil demand to top 104 million barrels next year.

Yet there's no indication that production will add enough barrels to cover the shortfall. So, we can expect inventories to draw down so quick, we reach a tipping point where inventories are effectively depleted, demand continues apace, and there's not enough new supply.

That's the makings of a super shock.

And if a broader war in the Middle East emerges, too?

While I am not predicting a broader war, and while my super shock expectations never took war into account, you can nevertheless see how war would send oil prices hurtling sharply higher.

Green Technology Will Take Decades to Overtake Oil, if Then

I want to be clear here that I'm not recommending **Tenaris** because Hamas attacked Israel, or because war in the Middle East is suddenly a greater risk.

My point with this recommendation is to highlight two realities:

1) Black-swan risks are inherent in the oil market.

2) Oil and its litany of byproducts are critical to modern life and won't be replaced by green technology for another few decades.

Both of those exert upward pressure on oil prices, which in turn exerts upward pressure on energy-stock prices over time.

Reality #2 is in constant play every single day as demand grows, and as production capacity declines and existing reserves deplete.

Reality #1, meanwhile, includes the rare events like war, terrorism, and extreme weather that arise to threaten production.

So, I'm using this moment to deepen our exposure to the industry with an oil stock that's cheap.

In the *Global Intel* portfolio right now, we have several energy stocks, all serving different segments of the market:

- **Transocean (RIG)** is our operator of deep- and ultra-deep-ocean drilling, a highly specialized segment of the drilling market. Deep oceans are where the huge discoveries are still happening, so there's a good deal of money being spent on costly rigs to go in search of, and to produce these deep-water reserves. (We're up 58% as I write this.)
- **Tsakos Preferred F (TNP.PF)** is our owner/operator of super-tankers that ferry oil and natural gas across the seas—a never-ending business. We own the preferred shares for their relative stability and their hefty yield (up more than 25%).
- **Enterprise Product Partners (EPD)** is our owner/operator of pipelines that spiderweb across parts of the country. These petroleum superhighways connect production facilities with refineries, storage facilities, shipping terminals, and end users. It's like owning an oil-and-gas toll road—that pays us a nice dividend every quarter (up 24%).
- **Black Stone Minerals (BSM)** owns a large collection of mineral leases across various and prolific oil and gas regions of the U.S. As demand for finding new reserves ramps up, **Black Stone** will provide exploration-and-production companies with new drilling prospects (up 13.5%).
- **Global Partners Series A Preferred Shares (GLP.PA)** is our owner of oil and gas terminals, gas stations, and such that supplies consumers and business in the Northeast. We own the preferred shares. As a partnership, we also pick up a nice dividend (up more than 5%).

Now, we're adding **Tenaris** to that mix to bring in a complimentary business model.

The company's products are used by firms like **Transocean** that need pipes and casings to drill for and produce oil. They're used by companies like **Tsakos** that rely on pipes and shipping terminals to load and offload oil and natural gas from supertankers. And **Tenaris'** products are used by companies like **Enterprise Product Partners** that build pipelines to move petroleum products around the country.

To me, **Tenaris** is very similar to the sellers of blue jeans and pick axes in California during the Gold Rush. They're not worried about finding the next big oil or gas reserves... they're just selling all the products the exploration and production guys need in their hunt for those reserves. It's a classic pick-and-shovel play.

As an investor, I love that kind of business. The demand is obvious and widespread. And you don't need to wonder if the company you own will be successful in finding the next big gusher. You only care about the price of oil and gas because high prices means healthy, ongoing demand for your products as exploration and production companies snap up more and more pipe.

And given what I laid out about the oil industry's supply/demand dynamics, I feel confident that **Tenaris** has consistently growing demand for its pipes.

I didn't touch on natural gas, so I will briefly say that nat-gas demand growth in the U.S. is strong because of the war in Ukraine. Europe, as I've written numerous times over the last year or so, has abandoned its reliance on Russia for energy supplies, and that reliance is never to return. Europe learned an invaluable lesson amid the tit-for-tat sanctions that saw Russian oil and gas shipments into Europe dwindle to nothing, causing widespread inflation in electrical and heating costs, and causing Germany's economic engine to sputter.

Instead, Europe is much more reliant on America for liquified natural gas (LNG) shipments. That plays into a piping stock like **Tenaris** because of increased demand for natural gas exploration and production, as well as pipes to ferry the gas from new production platforms to storage and shipping facilities.

My Recommendation: Buy Tenaris S.A. (symbol: TS) at prices up to $35.

Risk Profile: Higher. (What does this mean? Before you act, read a full breakdown of my five-level risk assessment scale **here** .)

Stop/Exit: 55% Trailing Stop Loss

Though **Tenaris** is based in Europe, its shares trade in New York as well as American Depositary Shares, or ADS. As such, you will not have any problem buying them through any broker in the U.S.

As I write this, the shares trade for a smidge under $33. At that price, the stock has a price-to-earnings ratio of about 5.3. Like I said, this is a cheap, cheap stock.

Historically, **Tenaris'** PE has been in the mid-teens.

Frankly, I am not sure why **Tenaris** is so cheap relative to its history.

Annual revenue more than doubled to $11.7 billion from 2020 to 2022, and it's expected to grow again for 2023 to nearly $14.8 billion. Next year could, in theory, see a slight softening if drilling demand in the Western Hemisphere slides, as some people think is possible. But even if that slide were to occur, we're still talking about earnings per share that will be higher in 2024 than they were in 2022... so I really don't understand the market's mispricing of this stock.

That said, I'm not convinced demand will soften very much.

Oil prices have moved up from the low-$70s over the summer, to the mid-$80s—and at one point in September, they were flirting again with the $100 threshold.

Looking ahead, I'm confident we're going to push well-above $100 on the global supply/demand issue now unfolding. And if Israeli/Hamas morphs into something bigger in the region, all bets are off. Oil could see much higher prices than my base case. If we get a big spike in oil, we're very likely to see stocks like **Tenaris** move up quickly. (Note: If that were to happen, I might recommend taking quick profits, but more on that if/when it happens.)

Absent any war-related impacts, my expectation is that **Tenaris** over the next couple of years again trades closer to its historical PE valuation in the mid-teens. Given the market we're in—meaning rising demand—I'm saying **Tenaris** will grow its per-share earnings at a modest 10% annualized rate over the next three years. That would put the company's earnings somewhere near $5.75 per share.

If I apply a 12 PE to that (and that's 25% below the company's historic average), that gives us a share price of about $70 for the 2026 time frame—more than double the current share price.

That's why I say **Tenaris** is cheap.

We have the opportunity to own a major cog in the energy industry—a leading supplier of piping products used from North and South America, to Europe, to Asia, Africa, and the Middle East. In fact, the company recently signed an agreement to provide 46,000 tons of pipe to Brazil, and inked a $25 million deal to supply pipe to Saudi energy giant Aramco as that company expands drilling in Saudi Arabia.

Tenaris management, meanwhile, recently told Wall Street that it senses an increase in drilling activity coming to America soon because of ramping demand for natural gas, as well as the growing realization that oil companies need to step up drilling activity to replace decaying reserves.

All in, **Tenaris** is well-positioned for the energy environment we live in today. All the right winds are blowing in all the right directions and owning **Tenaris** at such a cheap valuation we have today will very likely prove to be a great entry point for this stock.

PORTFOLIO REVIEW

Generac Holdings is Primed for Major Growth

Not everything is strawberries and cream.

Sometimes it's strawberries... and the cream went bad months ago.

Which is to say, I want to talk about the one stock-market position in our portfolio suffering the most: **Generac Holdings (GNRC)**, the maker of industrial and residential generators.

I've always promised that I would be forthright in my commentary on my recommendations, be they good or bad. **Generac**, alas, has been bad for us—a strawberry slathered in spoiled cream. The shares are down 35% since adding it to our portfolio mid-summer.

Generac's weakness began with a second-quarter earnings report in August that the Street did not like. Sales for the quarter were down 23%, and net income came in at $0.70 per share vs. $2.21 in last year's second quarter. Sounds bad.

But this was always going to be the case. The company even said as much, warning investors that there was no way **Generac** was going to live up to the post-COVID euphoria of new homeowners spending like drunken sailors, existing owners remodeling homes to fit a stay-at-home lifestyle, or homeowners upgrading their defenses with generators to survive hurricanes, power outages, and whatnot.

But Wall Street being Wall Street, investors still tanked the stock.

Yet, nothing has fundamentally changed about **Generac** and the trends it benefits from.

Pandemic spending was always going to be a sugar high. Now we're back in the real world. And the real world is chockablock with problems that play to **Generac's** product line.

First, as a headline in The Telegraph so accurately captures, "The U.S. is facing a blackout 'crisis'—thanks to green energy." Green energy, while necessary for the future, has sucked up too much investment capital that would have been better spent upgrading America's aging power-production infrastructure. As a result, the U.S. is a case study in the ways in which energy transition can be—and is being—mismanaged.

Back in August, to give just two recent examples, a power-grid operator in Texas and one that serves customers from Minnesota down through Louisiana both announced that they likely didn't have enough resources to meet demand during a heatwave. In Texas, the cost of a megawatt hour of power at one point in the Dallas region soared to $925 from its more typical price in the mid-$60s to high-$70s.

Also back in August, Hurricane Idalia ripped through the Florida panhandle and into Georgia and a corner of South Carolina. More than 500,000 homes and businesses were without power, some for days.

These are not one-off events.

Storms are increasingly powerful because of a warming climate that is leading to increasingly hotter ocean temperatures that fuel hurricanes. Between 2020 and this year, 10 hurricanes hit the U.S., four of which were Category 3 and 4, which are considered major hurricanes. Between 2000 and 2003, three hurricanes landed in the U.S.—all Category 1 or 2. Between 2010 and 2013, the number was also three, and all were Category 1.

Clearly, there is increasing demand for generators simply because storms are more powerful and more frequent.

Meanwhile, the U.S. power grid seems increasingly held together with duct tape and kite string. At a U.S. Senate committee hearing a few months back, politicians heard about a "reliability crisis" coming to America because the country's aging power infrastructure is so vulnerable.

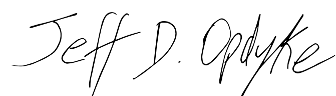
Again, this plays to **Generac's** product line.

The company expects cash flow will double by the end of 2026, and it's targeting significant growth opportunities in the housing market, particularly among new home buyers who, at the outset of construction, are installing whole-house generators. These are powered by a dedicated natural-gas pipeline, and kick on the second the local power grid kicks off.

Management has clearly been upbeat about the business in talks with investors. The C-Suite projects revenue to grow as much 14% annually through 2024. And it's expecting gross profit margins to expand.

Fatter profit margins across larger sales means bigger earnings per share are in our future... and that will have Wall Street returning to **Generac** shares.

Yes, we have to be patient. But patience is one the best character traits to have as an investor. We have some catching up to do to return to the black with this particular stock, but based on what the company is seeing and saying, and based on what's going on with the bigger trends that drive generator demand, I am confident **Generac** will turn positive for us.



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