

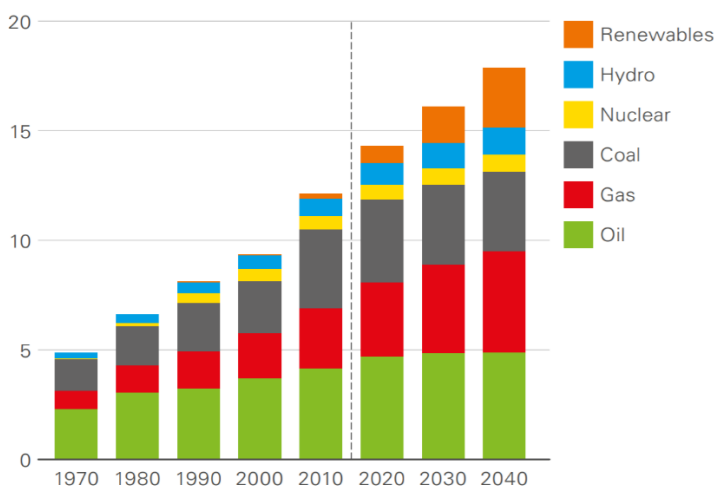
Energy transition – a barbell strategy

As the effects of climate activism and «sustainable investing» reverberates through the energy sector, my own thinking on how to invest centres around a barbell strategy as the cost of capital for clean assets continues to depreciate while the opposite holds true for «bad» (dirty) assets.

One end of the barbell owns clean assets that still offers value. Eolus Vind fits that bill as growth is plentiful, valuation remarkably cheap and its cost of capital looks set to decline, Bonheur much the same and I am keen to learn about others. The other end of the barbell is buying short-dated «bad» assets as the cost of capital soars and payback periods implicitly shorten. Key here is to not own «long-dated» assets that is dependent on discounting earnings too far ahead, say after 2030. E.g, many investors seem to prefer the newest and highest end assets in the oil service industry (Northern Drilling a local favourite), thinking these will achieve premium utilisation and pricing on contracts. While that may prove correct, the problem with this strategy is that the lifetime of these assets stretches well beyond what is a reasonable forecast horizon with any visibility for further investments in oil, which currently arguably is 2030 considering the green policies now being implemented across the globe. Remember, when a movement like to the one we see in climate establishes a firm footing in the population broadly, the speed of change risk is on the upside as rhetorics toughen and policies are set in motion to win/satisfy voters.

Primary energy consumption by fuel

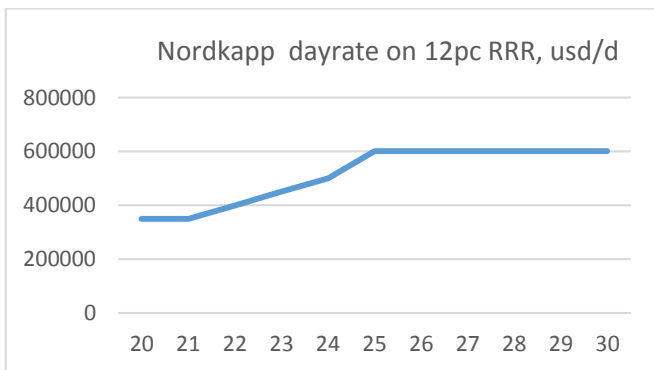
Billion toe



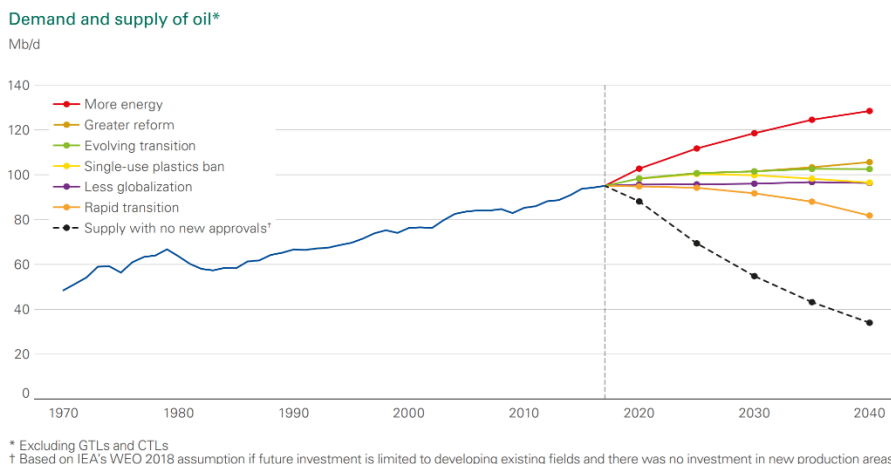
Source: BP Energy Outlook 2019

Sure, as shown in the chart above, the base load effects on demand and the need for hydrocarbons also beyond 2030 as well as the need to increase production also over the next few years is clear and well understood, but that's not the point here. Rather, with the lack of visibility after 2030, I don't think investors will be willing to discount much earnings at all beyond that point, which is crucial to understanding the valuation risk inherent in long-dated assets.

Case in point; Odfjell's acq of Stena MidMax last year at \$600m+ all-in, which, assuming a modest 2pc cost inflation and 12pc RRR, will need a day rate of USD 600k already in 2025 to pay its owners back by 2030 in my rig model. That is up 70pc on its initial USD 350k/d 2-yr contract with Aker BP, and even though the rig may stay fully utilised with Aker BP for the foreseeable future that is too much to ask from investors given the current outlook for oil, ie value destruction continues in the very high end of the market as management teams perception of these companies real cost of capital is outdated. Assuming the cost of capital moves up another 300bps by 2025, which I don't think is unreasonable at all, the MidMax (renamed Nordkapp) will need a virtually impossible USD 750k/d to pay it back by 2030.



A change in the way we consume energy is coming, how abrupt it will be is anybody's guess. My own view is that financial markets are adjusting to the «rapid transition phase» in the chart below at the moment. I wouldn't be surprised to see short to intermediate time periods over the next decade where the «no new approvals» scenario gets discounted. The effects on valuations of long dated assets could be dramatic.



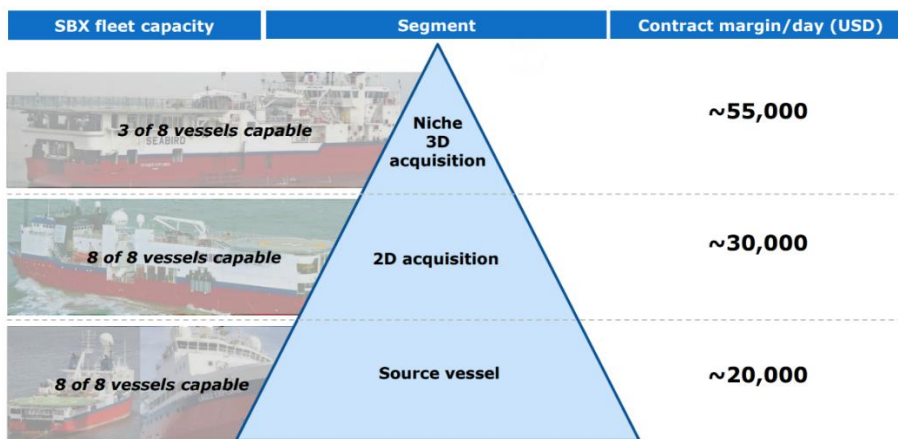
As older assets are hit by the same dynamics – and then some in the financial markets currently – but have very different characteristics in terms of purchase price/current earnings and therefore the implicit hit on valuations as the cost of capital soars, one can envision an emerging asymmetric risk/reward in the capital intensive oil services industry. Seabird is a

The Harpoon Report

Hunting for value

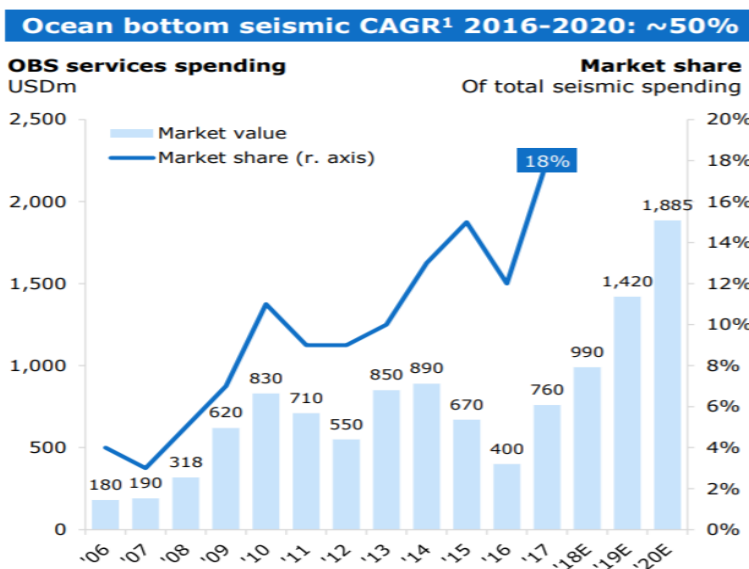
case in point. There is nothing high-end in any way about the company or its assets except for the one thing that really matters; solid execution and earnings with plans to distribute all of its free cash flow to shareholders, as it is already debt free. On top of that comes a proven and experienced management team with a BoD that is there to make sure this mandate is executed upon.

The company is in the «low» end of the seismic market, operating 8 2D/source and niche 3D vessels, which makes it the largest player in a small segment of the market comprising approx 40 vessels. Rates stayed well above cash opex during the downturn, and have recovered >20pc already YTD, providing Seabird with healthy returns already at current levels given the well timed entry costs on its vessels.



Source: Seabird

Also, with the latest vessel acquisitions the company looks particularly well positioned to benefit from the booming OBS market, which may provide a boost to earnings well above what I have factored in here.



Source: Seabird

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Assuming investors will adopt a WYSIWYG approach to the sector, margins are thus given as seen above and the balance to calculate its cash distribution potential is then utilization and mix between segments. Discussing utilization with management leads to a cautious 70pc assumption, even if the Voyager has reported back approx 80pc utilization over the last couple of years, and both Galatea and Eagle as higher end vessels in this category has typically managed the same. I suspect 75pc+ is a more realistic assumption. Furthermore, I have assumed 1 vessel in niche 3D, 1 EM, 2 as source and the balance in 2D, a conservative USD8m SG&A and USD1m annual capex/vessel (implying capex approx 4m lower than its depreciation) giving the following approx metrics as soon as all vessels are operating (2020):

EV/EBITDA	1,65		EV USD	63728824
P/E	2,55		Net debt USD	0
P/B	1,72			
ROE	67 %		FCF USD	29037500
Div yield	46 %		DPS NOK	0,48

So, in contrast to the «higher» end capital-intensive segments of the oil services industry where investors need to cross their fingers and hope for a doubling or thereabouts of rates over the medium term to break even on their assets before 2030, Seabird at NOK 1,05 will be able to pay investors back in 2,2 years already on current rates as soon as all modification work is finished and all it`s vessels are on the water, with lot`s of upside as the cycle gets going. That is the benefit of an amazingly low vessel entry cost. Don`t confuse age/quality of assets with value of earnings. On the latter, Seabird ranks head and shoulders above its peers.

It is simply too cheap to ignore.

BUY target > NOK 2,5, assuming investors will be happy with a 4-5 year payback when cash begins flowing.

Oslo 190719

Ståle