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The Long Pull: A New Report Format …

Brandon here.

We're doing a complete reorg of our publishing schedule and report formats (more on that soon!). To kickstart these changes, we're bringing you a new weekly report called "The Long Pull."

For those unfamiliar, "The Long Pull" is an old trading term describing the BIG moves, trends, and cycles where the BIG money will be made.

This report aims to be a weekly curation of the data, news, and developments in *the long pulls* we're tracking and investing in. All to ensure we're on the ball and well ahead of the herd.

In this week's update, we discuss:

- ➢ **Notes from an OSV Marine Money Conference**
- ➢ **Why major oil producers are bullish on offshore energy**
- ➢ **Low breakevens for offshore versus onshore shale**
- ➢ **Why the newbuild cycle for OSVs is still a ways away**

Let's get after it.

Offshore Service Vehicles (OSV) Updates: Marine Money Conference Notes

TDW is an OSV provider and one of our strongest performers in the fund. We first started buying TDW at around $24/share. Today it trades at $65/share (170% higher).

You can read our write-up on Tidewater (TDW) for a more comprehensive overview of the OSV industry and the value proposition.

Despite the rapid share price increase, TDW remains one of the most undervalued stocks in our portfolio. The company trades at a fraction of new-build replacement costs[1] and is on pace to generate >$600M in EBITDA this year at a $3B market cap[2].

A few weeks ago, OSV CEOs Todd Hornbeck of Hornbeck Offshore Services, Quintin Kneen of TDW, and John Gellert of SEACOR Marine Holdings, did a Panel Discussion on the state of the OSV industry, the 12-24 month outlook, and the growing demand

[1] As of today, new-build economics are ~$60-70M per ship.
[2] 5x multiple at the current market cap despite shares rising 146% over the past year

from the wind turbine industry.

Here are my favorite parts from the discussion (emphasis added).

> **How Oil Price Declines Impacts TDW Business …** *"The interesting thing about the most recent pullback in both the instability and the regional banking Market, as well as the pullback and an oil price, is that* ***it hasn't impacted our activity levels throughout the past seven years.***
>
> *Anytime there was any turbulence in the markets, whether the macro or the oil Market specifically, I would have customers coming to me and renegotiating contracts or delaying tenders pushing out delivery dates.*
>
> ***None of that has happened.*** *In fact, I've seen just the opposite you know* ***there is still a real air of scarcity in vessels out there****, so now day rates are continuing to increase. We moved them up another sixteen hundred dollars in q1.*
>
> *Our Leading Edge day rates are continuing to increase so I certainly appreciate the macro backdrop but from our perspective, especially throughout the international markets,* ***there has been no pullback in activity and certainly no pullback in the acceleration of day rates"***

I mentioned this in a [Market Note two weeks ago](), but it's worth repeating here. OSV demand is <u>not</u> a function of oil prices. At least not as long as oil stays above $60/bbl.

OSV customers (think CVX, PBR, XOM, etc.) operate under long-term investment horizons. They're making decade-long bets on offshore oil in places like Guyana, Suriname, and the Mexican Gulf Coast.

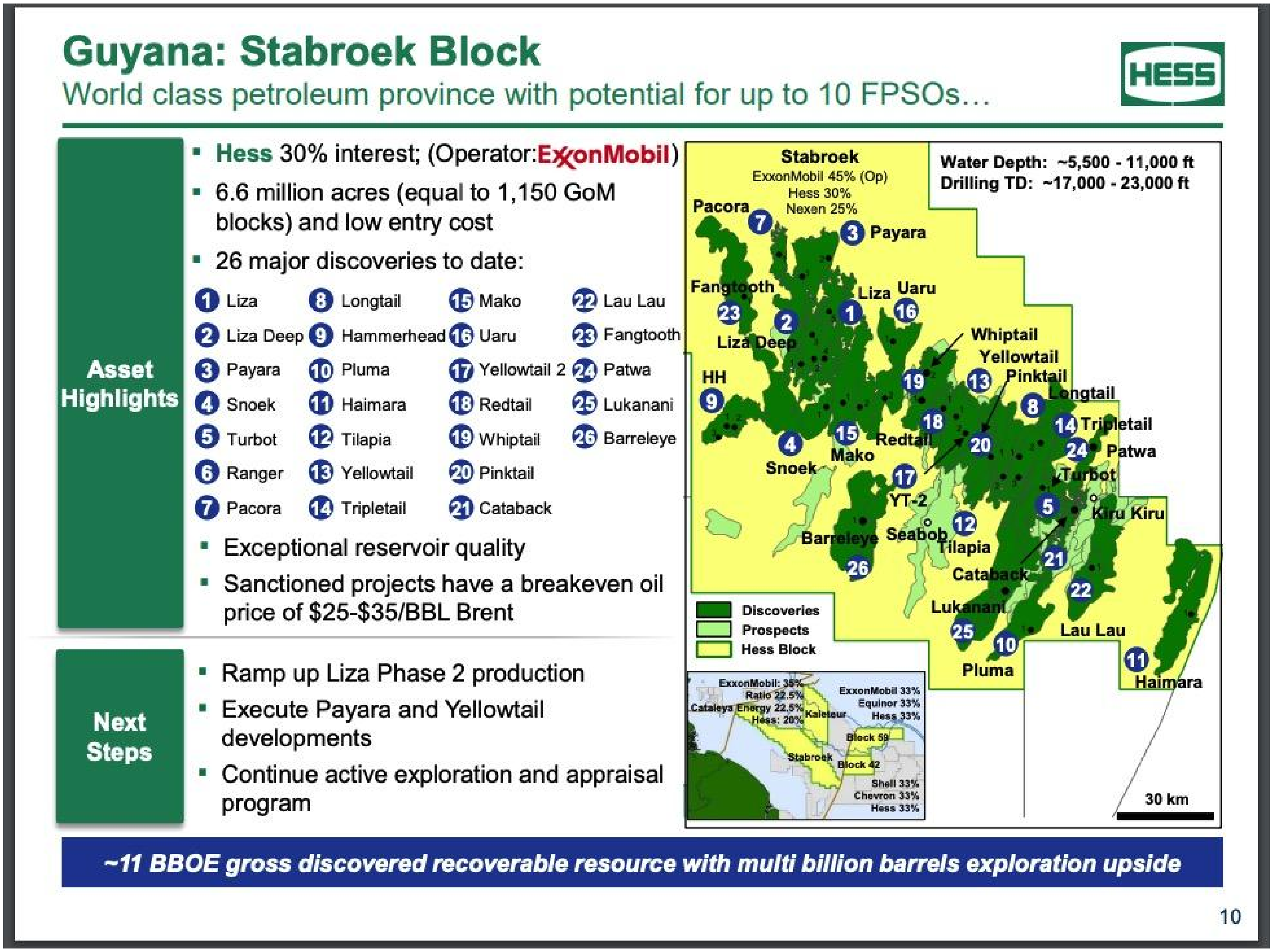
This is why TDW stock has steadily risen *despite* crude's weakness over the past year.

Quintin then explained the levers that could slow OSV investment growth.

> **On What Will Slowdown OSV Investment …** *"One of the areas in which we're seeing the most significant growth, and it was illustrated a little bit in the earlier presentations when you look at the Middle East is that they're doing quite fine at 60 in oil.*
>
> ***Brazil's not stopping at 60, Suriname is not stopping at 60.***
>
> ***The investment decisions that are being made are long-term*** *investment decisions. The general view from my perspective is that people believe oil and gas will be constrained over the next five to ten years,* ***so making investments today in a long-term investment is not a problem."***

The main benefit of offshore drilling versus onshore shale is low breakevens. Whereas [shale breakevens hover around $55-$65/bbl], companies like HESS are finding $25-$35/bbl breakevens offshore in places like Guyana.

Check out the chart below from HES's [May 2022 Investor Presentation] highlighting offshore's leading breakeven economics.



Guyana and Suriname possess low breakevens and massive reserve bases, making them prime long-duration investment resources.

Schlumberger (SLB), the world's largest offshore energy services company, sees no demand/investment slowdown. Listen to these comments from the company's latest earnings call (emphasis added).

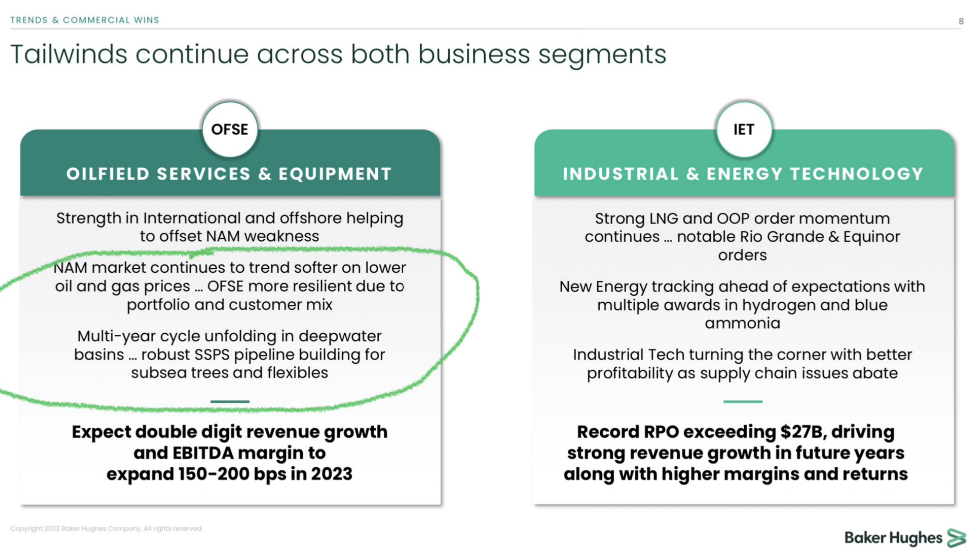
A very good question, James. I think you may have realized that recently we characterized the cycle as breath, resilience, and durability. Let me comment a bit further on durability. There are two or three elements to this.

I think, obviously, we did comment on the return of offshore where the first to flag it and to call for the return of offshore. I think we have seen this international offshore resurgence resurgence materializing in the last 12 months and accelerating, and in the second half actually, the offshore rig count will be higher than the land rig count increase. So this momentum is driven by the economics of offshore assets, where the FID now, the vast majority of the FID are below $50, hence a favorably position for FID Also the geologic and the low carbon nature of most of the assets, accessibility to this resource and is both oil and gas. So offshore is having an assurance that is translating into very significant pipeline of FID and we see it across not only the IOCs and independent that are capturing this opportunity, but also the NOC that have placed a bet on offshore as you can see from the east or the North Sea.

So we see this happening at scale. we see also the emergence of a second leg of FID and future offshore expansion driven by exploration appraisal. Exploration appraisal is happening in many countries. There are many, many rounds of licensing rounds happening.

A lot of exploration and appraisal is happening to find this next reserve and develop. So offshore is there to stay and not only in 24 or 25, but beyond as we can see and with the second leg materializing. Beyond that obviously Middle East has made a significant commitment of capacity expansion both in oil of 4 million barrel or so and in gas for regional consumption displacing oil for energy or for generating some blue ammonia or blue halogen products, as well as further expanding their export in Qatar particularly. So the Middle East capacity expansion is is leading to, as we have been quoting, a record level of investment from this year onward, and is not set to again stop in 2024, as the vast majority of this capital expansion are towards the second half of the decade 2027 or 2030 for some of the targets.

Baker Hughes also commented on the secular drivers building in offshore production investments, noting in their recent quarterly presentation (see below).



The slowdown in North American shale (i.e., Permian Basin) will prompt sustained investment in LatAm's offshore assets.

Like always in a Capital Cycle, we want to see a lag before large amounts of capital come in to boost supply. And as far as we can tell from current data and rig operator comments, the overhang of negative sentiment from the last decade has kept CAPEX in the OSV space muted and conservative. And we see this lasting.

Quintin pitched why supply won't crush demand this time.

> **What Prevents Future Overbuilding …** *"There are a few factors that I think will keep it in check, and there'll always be some building, but I don't worry about some building now. I worry about the building we saw from 2012 to 2014.*
>
> *So you know* ***as excited as we are on current day rates, they're still 50% below what they should be in order to justify a new build.***
>
> ***If you're looking at a vessel, you'll have to retrofit the engines for a lower engine and lower carbon technology five years from now there's no economics that makes sense to build a vessel."***

There are two main reasons why day rates are still 50% below where they need to be to incentivize new builds.

First, OSVs screwed shipyards during the most recent boom-bust cycle. They jacked up demand for new boats into a negative day rate shock. That meant they couldn't pay the shipyards for the new boats because they lost so much money on their existing fleet.

So the OSVs declared bankruptcy, leaving the shipyards footing the bill on the new build order book.

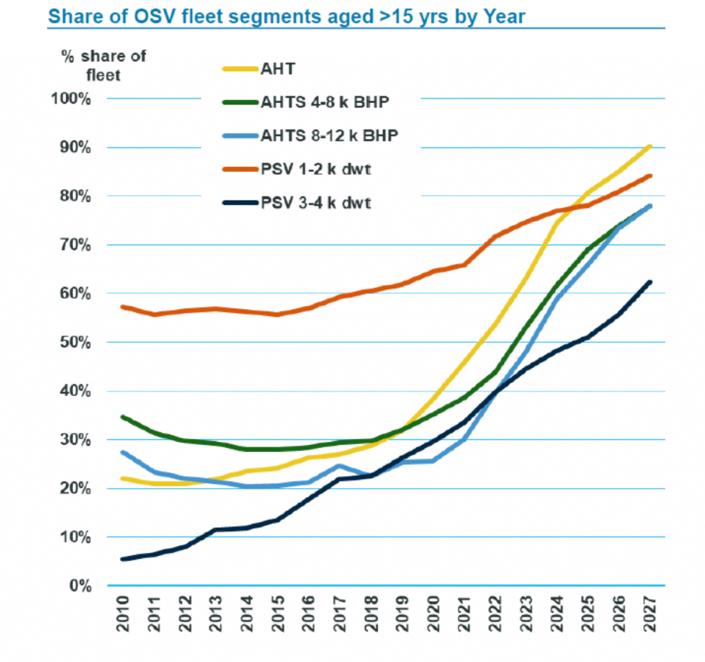
To prevent OSVs from screwing them again, shipyards demanded 60% upfront to build a new boat.

You need 50% higher day rates because shipyards will no longer float the build cost upfront.

These boats still have a ~30-year terminal life; eventually, we'll need new ships. This brings us to the long-term supply/demand imbalance.

> **The Current Supply/Demand Imbalance …** *"You've got the steady increase in demand and steady decrease in Supply and* nothing *in the order book.*
>
> *So we should be able to continue to push price for a fleet of 235 vessels we'll we'll probably push it about three thousand dollars year over year which is a big increase for us. That's about 250 million dollars worth of EBITDA.*
>
> *And I see the same thing in 24 and I don't see anything stopping in 25."*

The obvious question is how long does the industry have before the next new build cycle? Check out the chart below from [MSI Offshore.]



The above chart shows the share of OSV boats >15 years old. Today, we're around 25-30% of the fleet (besides PSV 1-2s). That percentage share will grow to ~70% across the fleet by 2027.

So you've got ~4 years where OSVs like TDW will generate massive profits thanks to higher day rates and minimal capex requirements. And remember, we're still ~50% below the day rates needed to incentivize new builds.

Here's why that matters.

TDW has a current market cap of $3B. The company will generate ~$600M in EBITDA this year at current day rates or its entire market cap in ~5 years. At new build economic day rates ($38,000), **TDW would generate its entire market cap in cash flow within 2-3 years.**

Historically, OSVs trade anywhere between 0.75x-1.25x NAV at the cycle's peak. Assuming $60M in newbuild economics for TDWs ships, we get ~$9.9B in NAV.

So TDW should be worth anywhere from $7.5B to $12.4B at cycle peak or **>3x higher than the current stock price.** It remains one of the highest R/R setups in the book.