

THE BIG SECRET ON WALL STREET

# A Dirty Energy “Fortress” With A 25% FCF Yield

- ✘ Clean Energy is a Scam
- ✘ Coal Rushes Into the “Green Vacuum”

FROM THE DESK OF PORTER STANSBERRY

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#29

## A Dirty Energy “Fortress” With A 25% FCF Yield

### Clean Energy Is A Scam

### Coal Rushes Into The “Green Vacuum”

The truck driver didn't know he was being watched.

But as he swerved his large, unmarked vehicle out of the forest and back onto the main road, a hidden camera flashed once, and then again, under the brooding December sky.

Staying a prudent distance behind, the photographer's smaller vehicle tailed the truck for the next 30 miles. Eventually, the truck driver reached his final destination – a dilapidated plant with rust-marked smokestacks, on the outskirts of Ahoskie, a sleepy railroad town of 5,000 in northeastern North Carolina.

The whistleblower snapped one last photo as the truck, and its cargo, entered the factory gates. The whole journey was officially logged on film.

Enviva had been caught red-handed.

A (supposedly) ESG-friendly “biomass” company, Enviva Inc. **(NYSE: EVA)** trumpeted on its website, “Displace Coal. Grow More Trees. Fight Climate Change”. Meanwhile – and now documented on camera – it was secretly cutting down huge swaths of native forest to generate “zero-emission” fuel.

That wasn't the story Enviva was telling the public in late 2021.

The company claimed it picked up scrap wood, loose limbs, and other “wood waste” that would otherwise rot on the forest floor... and that it then recycled those bits and pieces into eco-friendly wood pellet fuel.

According to a former Enviva employee – quoted anonymously on conservation news site Mongabay –

*“The company says that we use mostly waste like branches, treetops and debris to make pellets. What a joke. We use 100% whole trees in our pellets. We hardly use any waste. Pellet density is critical. You get that from whole trees, not junk.”*

Enviva acknowledged on its own website that “if old forests were to be cut down specifically for biomass ... biomass powered electricity would have higher ... emissions than coal in most cases due to its lower combustion efficiency.”

In other words, the company knew it was doing more harm than good. And – as long as it made money – it didn't care. It was textbook greenwashing.

The term “greenwashing” – fudging sustainability practices in order to turn an extra profit – was coined in the 1980s by environmentalist Jay Westerveld, after he visited a hotel that instructed guests to reuse towels “for the planet” – while at the same time it was building a suite of new bungalows that disrupted the native ecosystem. Greenwashing, in other words, is environmental hypocrisy.

And activist short seller Blue Orca has a keen eye for hypocrisy.

Blue Orca has a history of taking holier-than-thou companies down a peg or two, including hydrogen fuel-powered vehicle maker Hyzon Motors, whose main customers turned out to be fake shell companies... and luggage manufacturer Samsonite, whose CEO resigned after Blue Orca revealed he'd lied about having a doctorate in business administration.

Enviva was the next company in Blue Orca's crosshairs.

As part of its due diligence on Enviva, Blue Orca partnered with an environmental watchdog in North Carolina to obtain damning footage: mature trees cut down, tossed into the woodchipper, and transported to the Ahoskie pellet factory in unmarked trucks. But that was just the beginning.

Blue Orca also uncovered a cache of detailed GPS data showing “before and after” forests that Enviva had completely denuded. And it interviewed a former executive who claimed the company was routinely harvesting 70-90% of the trees from various wooded areas. (The razed forests weren't replanted, either. The land either sat vacant or was sold to housing developers.)

But the biggest lie of all had nothing to do with replanting... or the type of wood Enviva harvested... or even with the company's shady “non-GAAP” accounting practices.

It was that the whole “biomass” industry was a giant scam.

As Blue Orca explained:

*Enviva's business model is an ESG farce built on a carbon accounting loophole. At a high level, Enviva harvests wood and other biomass from forests in the Southeastern United States for conversion into wood pellets at Enviva's manufacturing facilities. These pellets are then shipped mainly to Europe, where European power producers burn the wood to produce electricity.*

*International climate treaties include a grandfathered provision of the Kyoto protocol classifying the burning of forest biomass as a “renewable” energy source under limited circumstances, and this controversial loophole has*

*allowed a burgeoning industry of deforesting biomass to masquerade as a zero-emission energy source. Countries, principally in Europe and Asia, have taken advantage of this loophole, burning wood instead of coal to meet emissions targets.*

*These countries dole out subsidies in the form of carbon credits for switching to wood burning, even though wood pellets emit more CO2 per unit of heat generated than any other widely used fuel source, including coal.*

“Biomass” had nothing to do with clean energy. It was essentially a scheme designed to funnel cash to Europe, while creating what financial commentator Doomberg calls an “orgy of deforestation” in America.

Vox puts it bluntly:

SCIENCE

### **Europe’s renewable energy policy is built on burning American trees**

Biomass energy is inadvertently making the climate crisis worse.

Since Blue Orca published its short report on Enviva in October 2022, the company’s shares have tumbled by over 80% and the UK’s biomass subsidies have come under attack from political leaders, including Tory parliament member Pauline Latham.

In February 2023, Latham criticized her own party for supporting the UK’s biomass subsidies, noting that the UK “pays significant sums in renewable energy subsidies to bioenergy companies making sizeable profits, despite it releasing huge amounts of greenhouse gasses and harming forests’ ability to absorb carbon.”

The UK’s biomass subsidies that put taxpayer money into wide-scale deforestation to produce an energy source more polluting than coal – all under the guise of promoting “clean” and “renewable” energy – is just one of a long list of failures of the climate crusaders.

Despite trillions spent globally on various “renewable” energy investments and tax incentives, alternative energy sources like wind and solar have failed to make a dent on fossil fuel consumption.

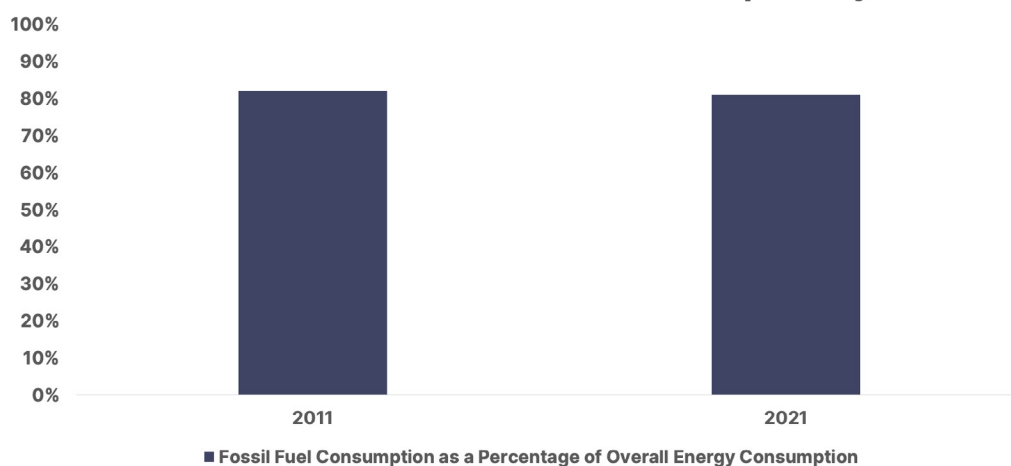
According to Goldman Sachs commodities analyst Jeff Currie, over the last decade, a staggering \$3.8 trillion has been invested into renewable energy sources....

During that same ten years, guess how much the percent of global energy consumption from fossil fuels fell?

*Exactly 1%. From 82%... all the way down to 81%.*



## In 10 Years, \$3.8 Trillion Invested in Renewable Energy Decrease Overall Fossil Fuel Consumption by 1%



Making matters worse, governments around the world – and especially in Europe – are purposely blocking the development of fossil fuel energy sources, despite the failure of alternative energy sources to take up the slack in powering the global economy.

This has set the stage for big distortions in the energy market, including last year’s global gas shortage, which sent prices for natural gas and liquefied natural gas (LNG) to new record highs around the globe.

And it’s creating tremendous opportunities for investors to profit from the repeated failure of modern energy policy... like the one we’re about to explore in today’s issue.

### The Horror of the Void

As Aristotle explained, nature abhors a vacuum. Create a void, and some type of matter will inevitably rush in to fill it. The Latin term is “horror vacui,” or “horror of the void.”

Over the past decade, European countries have limited fossil fuel production and exploration in order to curb carbon dioxide emissions. That’s kneecapped the fossil fuel industry in Europe – and left a gaping “energy vacuum” that needs to be filled.

But renewables – once hailed as a shining green savior – aren’t doing the trick.

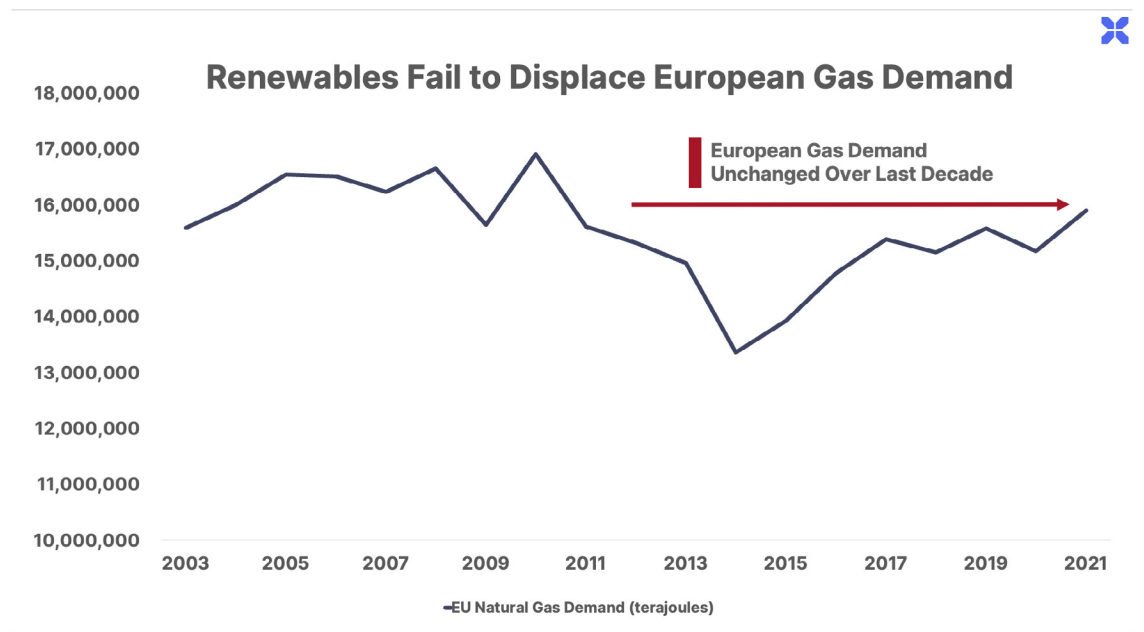
Europe’s “horror of the void” tale began in 2011, when enlightened France imposed a nationwide fracking ban...

Europe’s woke energy czars especially hate hydraulic fracturing (fracking), a controversial oil extraction technique that forcibly breaks up the earth’s crust to obtain fossil fuels. (In the U.S., fracking produces 9 million barrels of oil and 80 billion cubic feet of natural gas each day, generating over \$300 billion annually.)

Other countries soon followed France’s lead, and by 2019, virtually every major economy across Europe had outlawed fracking. These politically-motivated fatwas left the continent’s massive shale gas reserves (an estimated 14 trillion cubic meters of shale gas throughout Europe) completely untapped.

Instead, Europe poured three-quarters of a trillion dollars into renewable energy investments, plus untold billions more in tax breaks and government subsidies over the last decade.

Despite this flood of money aimed at replacing natural gas-powered electricity with alternatives like wind and solar, Europeans obstinately continued to use exactly the same amount of gas:



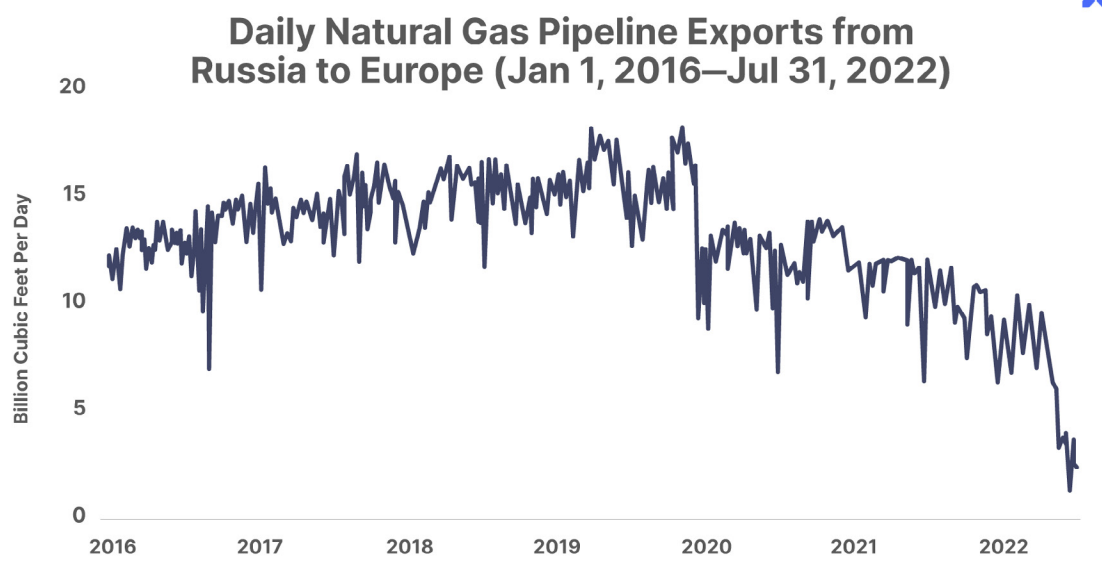
Since Europe had failed to invest in its own gas supply, it turned to foreign imports to keep the lights and heat on. By 2021, 83% of European gas was sourced from foreign suppliers, with Russia accounting for 45% of European gas imports.

Russia filled the energy void until it didn’t.

As has become clear, it’s not a great idea to place the future of your nation in the hands of Vladimir Putin.

On February 24, 2022, Russia invaded Ukraine, and the diplomatic fallout was

immediate. Europe, along with its western allies, including the U.S., imposed a series of financial sanctions against Russia, including restricting imports of Russian oil and gas. The end result: Russian natural gas imports into the EU and the United Kingdom dropped by 50% in 2022 versus the prior five-year average:



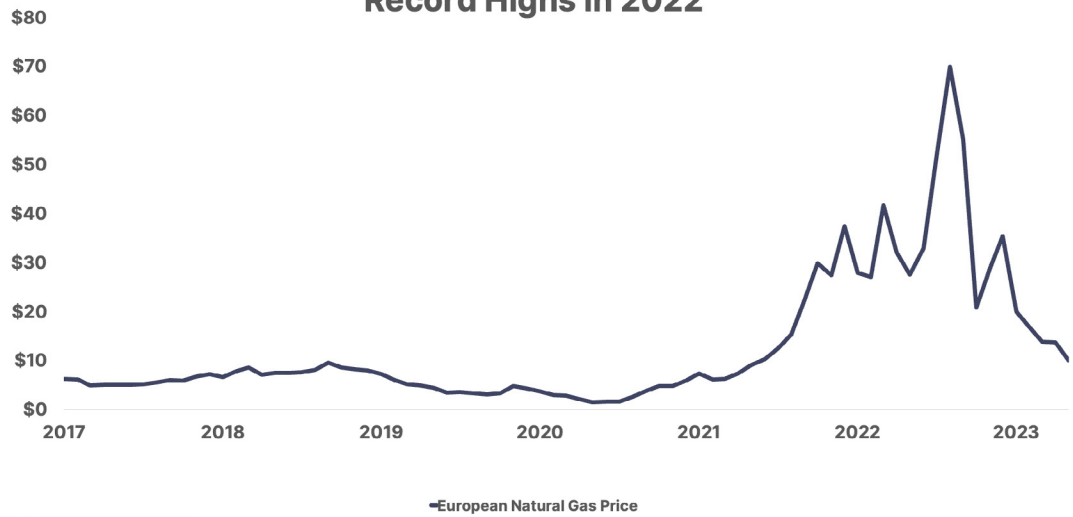
Europe scrambled to replace lost Russian gas supply with imports of liquefied natural gas (LNG), which surged 58% in 2022, including a record volume of LNG imports from the U.S.

Going into 2022, the LNG market was already under strain from booming demand as the global economy emerged from COVID-19 lockdowns. Prices for Asian LNG had already shot up six-fold to new record highs in 2021, with strong global economic activity amplified by a colder-than-expected winter.

So when Russian supplies dried up in 2022, Europe was caught in a bidding war to attract LNG cargoes in the already-tight market... sending European natural gas prices skyrocketing from less than \$10 per million British thermal units (MMBtu) in 2021 to a high of \$70 per MMBtu by late last year.

Fortunately for Europe, LNG prices plummeted last winter as **Mother Nature delivered a “get out of jail free” card**, thanks to one of the warmest winters on record. Gas prices fell back to Earth, creating a temporary sense of calm among European policymakers. But the global gas shortage has merely been postponed, not resolved.

## Global Gas Shortage Sends European Gas Prices to Record Highs in 2022



Even before the 2022 disruption in Russian gas supplies into Europe, a shortage was emerging in the global gas market and prices had already begun moving to new highs. In early 2021, energy research firm S&P Global Platts forecast that LNG demand would exceed supply through at least 2025, as demand for LNG was growing faster than the rate of construction of LNG export terminals.

Now, Europe has to replace a record amount of missing Russian gas, which will only intensify that demand in the years ahead.

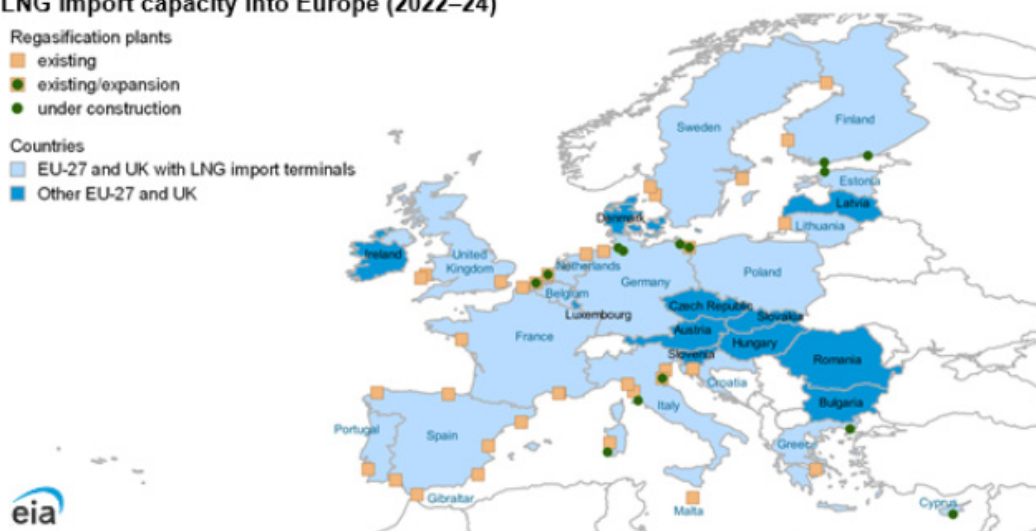


## Europe's LNG import capacity set to expand by one-third by end of 2024

### LNG import capacity into Europe (2022–24)

Regasification plants  
 ■ existing  
 ■ existing/expansion  
 ● under construction

Countries  
 ■ EU-27 and UK with LNG import terminals  
 ■ Other EU-27 and UK



Data source: The International Group of Liquefied Natural Gas Importers (GIIGNL) and trade press  
 Note: Map displays existing and under construction LNG import capacity in the European Union and UK as of November 2022. Capacity under construction is expected to come online in 2023–24. LNG = liquefied natural gas.

Exxon Mobil CEO Darren Woods recently emphasized at a Wall Street Journal CEO Council Summit that the global LNG market will remain undersupplied through at least 2026:

*“You look around the world, and the balance is, the world will be short [of liquefied natural gas] probably through 2026... That’s how we’re seeing that balance play out – it just takes time to bring these very large, capital-intensive projects on stream.”*

Europe replacing Russian gas with LNG represents one of the largest re-shuffling of global energy flows in history, and it will have major implications on energy prices for years to come.

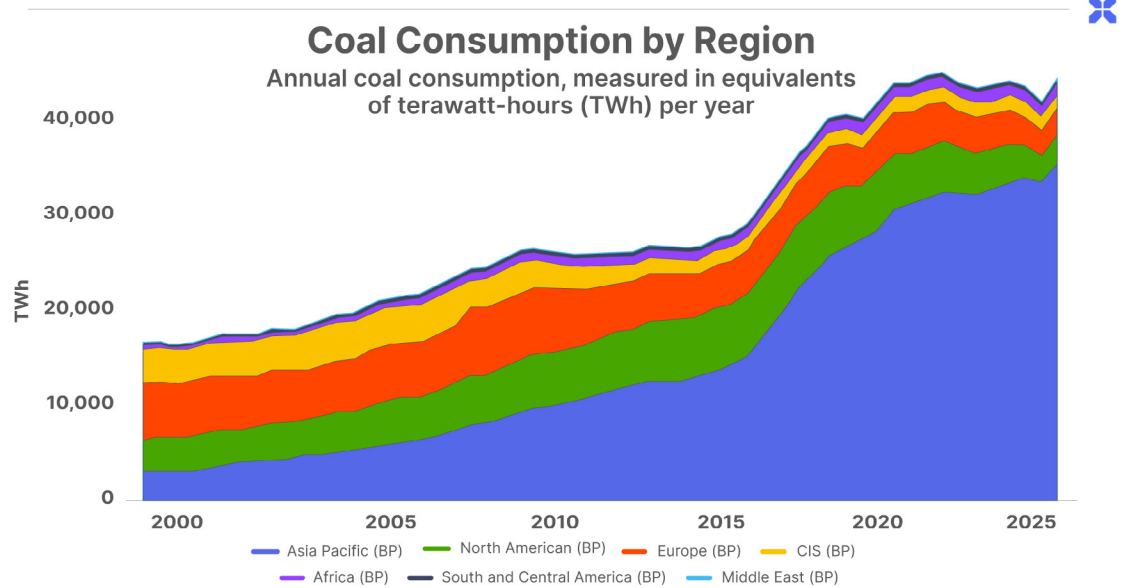
We’ve written about some of the biggest winners from this trend, including one of the largest natural gas producers in the world with an unmatched footprint in the heart of America’s most prolific shale gas basin, managed by the **Gods of Gas**. We’ve also recommended a natural gas **royalty company** as a capital-efficient way to play the coming supercycle in natural gas prices.

But this same trend has also created an opportunity in a much less appreciated commodity that virtually no one on Wall Street wants to own...

## Global Gas Shortage Makes Coal Great Again

Coal and natural gas compete for the cheapest sources of baseload power generation around the globe. But coal is less environmentally friendly: It generates about twice the amount of carbon dioxide emissions as natural gas to release the same amount of energy.

That’s why countries around the world have over the past decade been transitioning their electric grids from coal to gas. After growing by 40% from 2004 - 2013, global coal consumption peaked and flatlined from 2013 - 2019. The global shift from coal to gas was made possible by the rise of the global LNG trade, which, in turn, was fueled by cheap U.S. shale gas unleashing low-cost LNG exports around the world.



But last year, as Europe added massive new buying pressure onto an already-tight LNG market, there simply wasn’t enough LNG to go around – particularly for developing countries like Pakistan and Bangladesh.

Bangladesh relies on gas for two-thirds of its power generation. The country couldn’t outbid Europe for the increasingly scarce LNG cargoes last year, causing its LNG imports to drop by 14% in 2022. This caused widespread power outages, including electricity blackouts in nearly every day of the third quarter of 2022, when the global gas shortage reached its peak leading into the winter.

Bangladesh was forced to shutter 22 of its gas-fired power plants, or about 15% of its gas-fired power capacity, in response to surging LNG prices last year. After years of building out its natural gas-based power capacity, the country is now

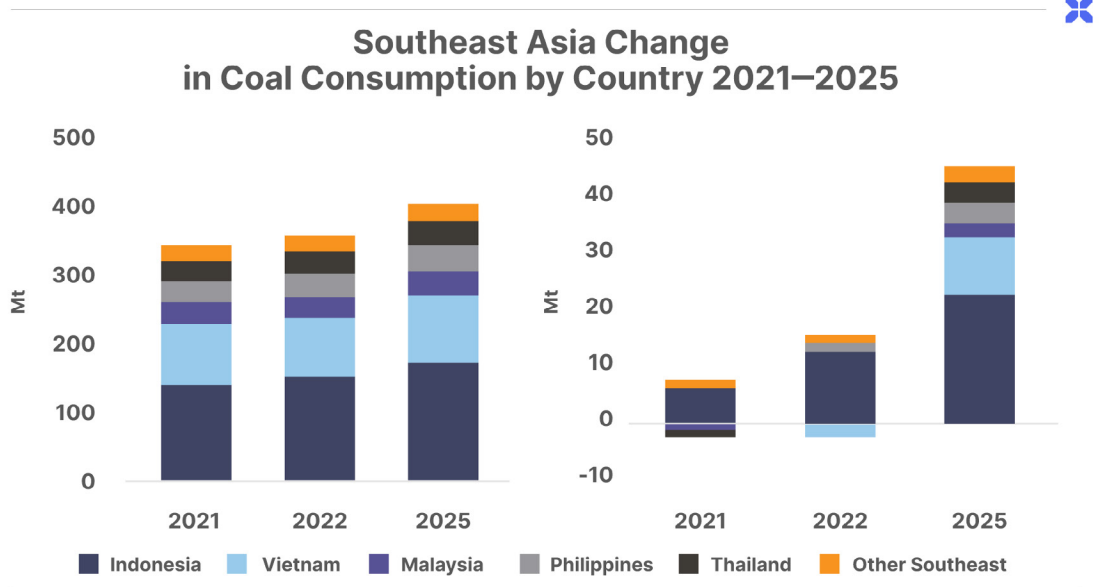
doing a u-turn back to coal. Bangladesh announced plans to add 4.4 MW of coal-fired power plants last year, which will more than double coal's share in its power grid from 8% to 17% of electricity generation.

Pakistan also couldn't compete with Europe's bids on LNG cargoes, forcing the country to slash its LNG imports by 17% in 2022 to a five-year low.

Left without gas, Pakistan went back to coal. In February, Pakistan announced new investments to boost its coal-fired power generation up to 10 gigawatts (GW), nearly 5-fold increase from 2.3 GW currently. The country's energy minister said in a Reuters interview that "LNG is no longer part of the long-term plan."

Developing economies across southeast Asia also boosted their coal consumption last year, led by 9% growth in Indonesia's coal consumption and 6% in the Philippines. Last November, Vietnam updated its long-term energy consumption targets that called for growth in the country's coal consumption through 2030 – reversing a previous plan to cut coal consumption by 2030.

In total, growth in coal consumption across southeast Asia is expected to grow by 4% per year through 2025:



This demand resurgence sent coal prices to new all-time highs above \$400 per metric ton last fall. Prices have reversed lower as record-setting warm winter weather provided temporary relief to both gas and coal prices:



## Coal Hits New All-Time Highs in September 2022



Source: Bloomberg

Ironically, “enlightened” Europe was one of the biggest contributors to coal’s resurgence in 2022. Policymakers were forced to defer their climate-saving ambitions and scramble to prevent millions of households from literally freezing in the 2022 winter.

That’s how coal consumption in Europe – the leading global climate warrior – grew by 9% in 2022 to 377 metric tons (Mt). In total, seven EU countries restarted coal-fired power plants that had been closed, and lifted caps on existing coal-powered electricity in 2022.

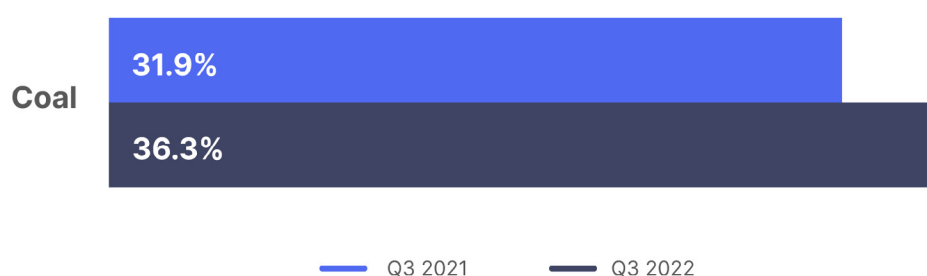
Germany was the largest contributor to Europe’s coal burning bonanza, as it scrambled to replace Russian gas (55% of its total gas consumption). Germany restarted 11.6 gigawatt hours (GW) of previously shuttered coal-fired power plants, and postponed the previously planned shutdown of an additional 3.8 GW of coal-fired power generation.

This increased the share of coal-fired electricity powering Germany's electric grid from 31.9% in Q3 2021 to 36.3% in Q3 2022:



## Germany's Shift Back to Coal

Electricity from coal jumped in the third quarter as the nation resorted to the dirty fuel to cover its needs amid an energy crisis.



Europe still plans to cut coal out of its power mix, but the Russian “energy vacuum” means coal will be a necessary stopgap until at least 2025. The latest coal market outlook from the International Energy Agency (IEA) explains:

*“The current forward markets indicate that the marginal costs of coal-fired power plants will be far below those of gas-fired power plants in the next few years... This would only change in 2025 when forward gas prices are low enough to place efficient gas-fired power plants ahead of inefficient coal-fired ones. However, (coal-fired) power plants are expected to remain very competitive until 2025.”*

Japan and South Korea have also had to burn more coal. Both countries had made progress cutting back on coal consumption to reduce CO2 emissions over the last decade, but turned the coal furnace back up in response to higher LNG prices last year.

In South Korea, the government suspended limits on coal-fired power generation, resulting in a 6.3% increase in coal consumption last year. Japan likewise boosted its coal demand by 1.8% last year to reduce its consumption of high-priced LNG imports.

Given the relative pricing between coal and natural gas, the IEA expects Europe, Japan and South Korea to hold coal consumption flat at today's elevated levels through 2025.

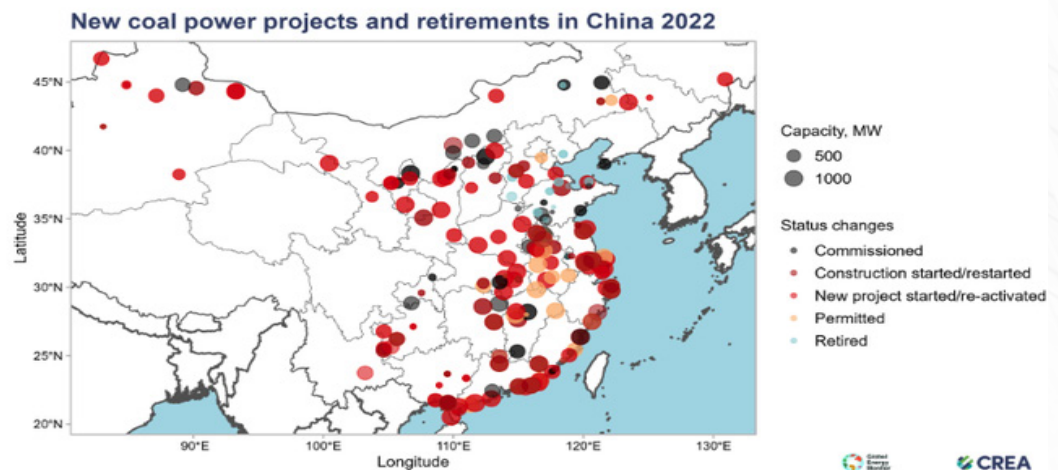
## World's Largest Countries Double Down on Coal

And then, there's China and India – home of the two largest populations on the planet, and the two largest coal consumers globally. These countries are both all-in on the cheapest, most reliable source of baseload power generation.

China, the world's largest coal consumer, accounts for 53% of global demand. Despite China's pledge to supply 25% of its energy grid with alternative energy sources like wind and solar, the country remains committed to coal as a critical source of reliable base power generation.

Coal makes up 60% of China's total energy consumption, and even before the global gas shortage of 2022, the country was doubling down on coal. In 2021, China increased its coal-fired power capacity by roughly 3% with the addition of 26 giga-watts (GW) of coal-fired power generation – adding more coal power plants that year than the rest of the world combined. Last year, China tripled down on its coal fleet with 106 GW of additional capacity, representing an average of two new coal power plants each week. This pushed its total coal consumption up by 4.6% in 2022 to a new all-time high.

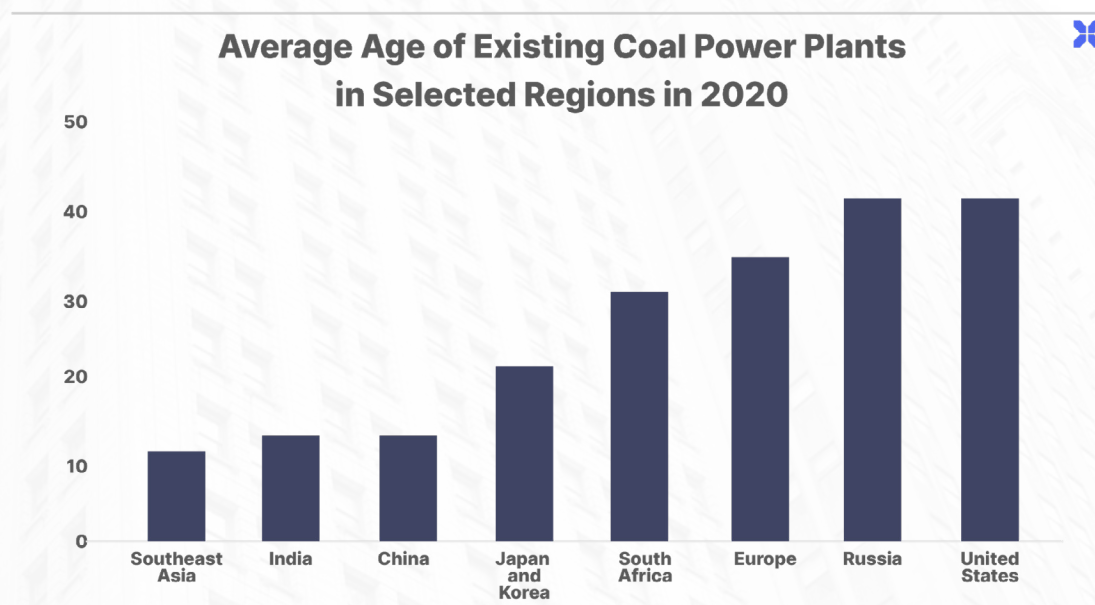
## China permits two new coal power plants per week in 2022



India, home of the second-largest population in the world at 1.4 billion people, is also one of the fastest-growing economies on the planet, with expected GDP growth of 7.3% in 2023. Much of that growth is powered by coal, which fuels 73% of the country's electricity generation. India currently has 25 GW of coal-fired power plants under construction, and the IEA estimates coal demand for India will

grow through at least 2025.

In the U.S. and Europe, policymakers are prohibiting investment in new coal-fired power plants, and pushing the industry to begin phasing out these plants as they reach the end of their useful lifespans. In contrast, India, China and a large cohort of developing economies in southeast Asia, like Indonesia and Vietnam, will be running their relatively young fleet of coal-fired power plants for decades to come:



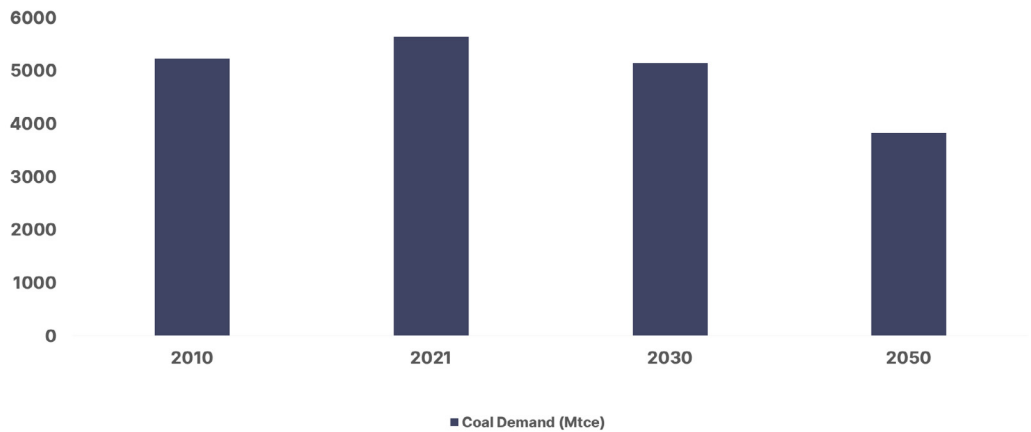
With the global gas shortage pushing both rich and poor countries around the world towards burning coal, the hated commodity will experience a multi-year demand boost that will hold global consumption flat through at least 2025, according to the latest estimates from the IEA.

Looking ahead, the IEA notes that if policymakers around the globe eventually follow through on their long-term plans to close coal plants, consumption will fall by around 10% from 2022 levels by 2030.

From there, the IEA's projections assume that further progress in closing down coal plants will bring global consumption down another 25% through 2050:



### World Coal Demand



Source: International Monetary Fund

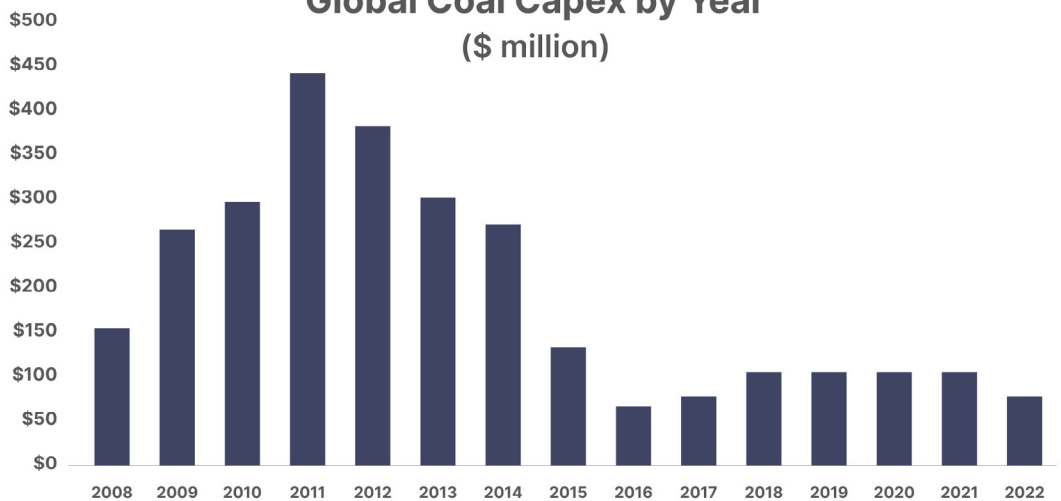
For the next several years, though, it's clear that coal demand is headed straight up.

### A Capital Vacuum

The problem for global energy markets, and the opportunity for us, is that institutional investors don't want coal dust on their fingers. Even after 2022's cash flow windfall resulting from record high coal prices, capital expenditures for growing coal output (i.e., growth capex) fell to new lows last year, as shown below:



### Global Coal Capex by Year (\$ million)

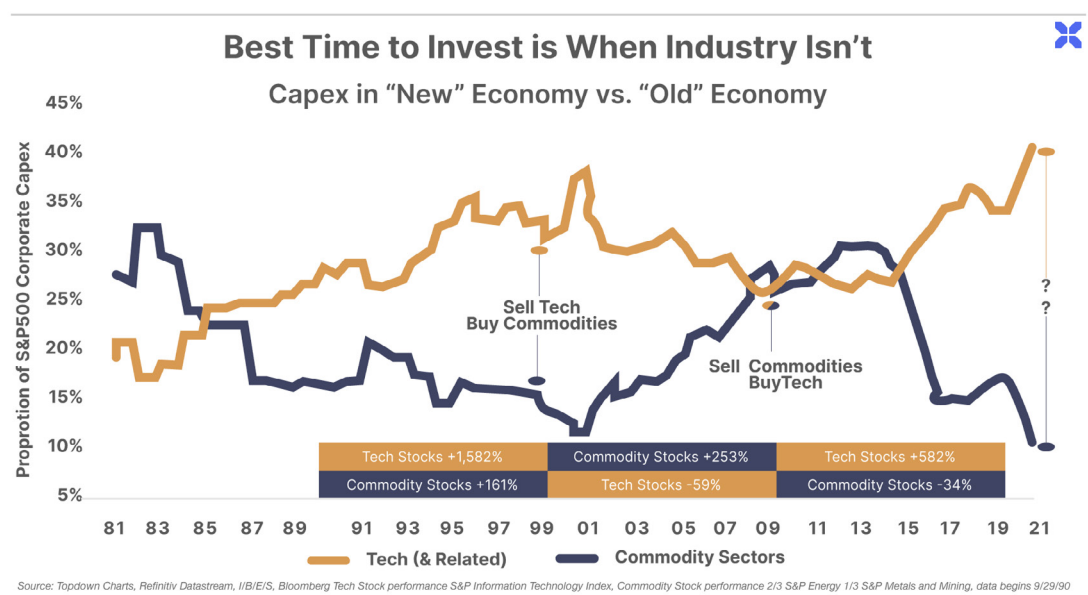




So even though coal demand may fall by 25% through 2050, ongoing, significantly lower levels of investment into coal production means supply could fall even faster – regardless of how high prices go.

In other words, even assuming that policymakers follow through with their stated intentions to shut down coal plants (i.e., the global energy shortage is solved), there’s still a multi-decade runway for low-cost coal producers to rake in the cash.

History shows that the best time to invest in any sector is precisely when capital is fleeing:



Right now, the big money is out chasing AI (as we [discussed here](#)). Institutional investors have left the boring “old economy” sectors like energy in the dust in favor of new darlings like Nvidia. Today, energy is by far the cheapest sector in the S&P 500... and the coal sector is the cheapest, and most hated, among the energy cohort.

Now, these are not the kind of world-class, capital efficient businesses that Porter & Co. typically focuses on. (We’ll delve into the financials of the sector in a moment.) But top-tier coal producers today are priced as if they’re facing imminent bankruptcy, despite all of the factors lining up to unleash a cash flow windfall for years to come.

In short, coal stocks have simply become too cheap to ignore.

How cheap? Below, we’ll introduce a business that generated \$1.6 billion in free cash flow over the last 12 months. And after netting out the \$500 million in net cash on its balance sheet, the company trades at just 1.5x free cash flow.

It’s committed to returning the majority of its cash flows back to shareholders,

including a recently announced \$1 billion buyback, representing 40% of the company's current trading value, net of cash.

## Dirty Energy, Clean Balance Sheet

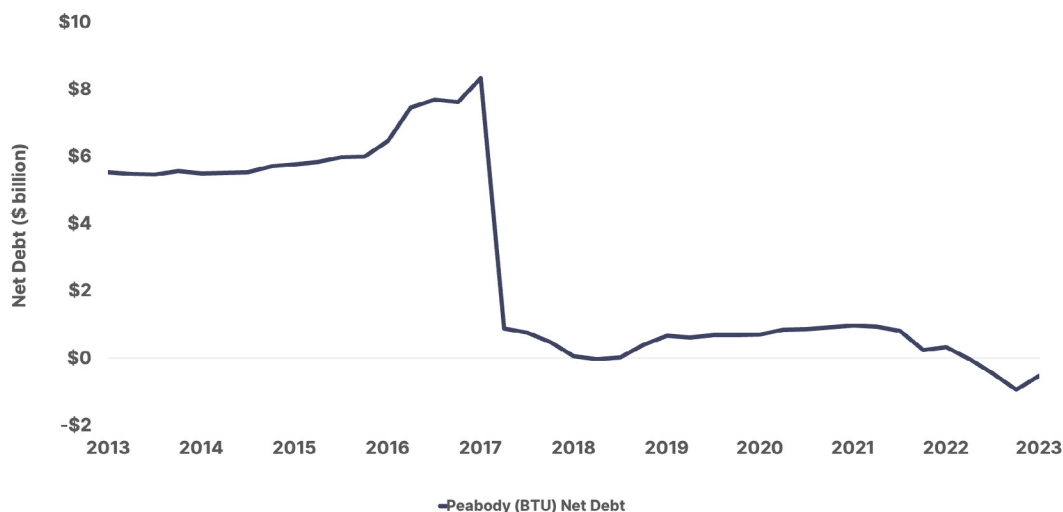
Peabody Energy (**NYSE: BTU**) is the largest independent (i.e., non-government owned) coal miner in the world. Last year, the company produced 124 million metric tons (Mt) of coal, generating \$5 billion in revenue and \$1.7 billion in operating income (earnings before interest, tax, depreciation and amortization).

Across its 17 mines in the U.S. and Australia, Peabody owns 2.1 billion tons of proven coal reserves (i.e., coal deposits that can be economically mined in the future at current prices). This is enough coal in the ground to keep the current rate of production going for the next 17 years. These mines also hold another 2.4 billion tons of probable reserves (i.e., reserves that could become economically recoverable after further mine development).

Like most coal companies, Peabody hasn't had the easiest decade. It filed for bankruptcy in April 2016 following a five-year bear market in coal, during which prices fell from \$130 per ton in 2011 to \$50 by 2016. Bankruptcy allowed the company to slash its debt load by nearly 90%, from \$8.3 billion to \$900 million when it emerged from bankruptcy in April 2017.

Since then, management has further strengthened the company's balance sheet. Over the last 12 months, Peabody earned windfall profits as coal prices soared to record highs of \$450 per ton, generating a record \$1.6 billion in free cash flow. The company used this cash to pay down all of its net debt, and established a net cash position of \$550 million as of March 31, 2022 – giving Peabody one of the cleanest balance sheets in the industry.

## Peabody's Fortress Balance Sheet



Peabody's "fortress" balance sheet means it's strong enough to weather the vagaries of the commodity cycle – unlike some of its more leveraged peers. As famed fund manager Peter Lynch once explained:

*"The most important question to ask about a cyclical is whether the company's balance sheet is strong enough to survive the next downturn."*

Another benefit of Peabody's pristine balance sheet is that the company can now give excess cash to shareholders. On April 17, Peabody's management said it would return 65% of cash flow to investors via three mechanisms: a regular quarterly dividend, future special dividends, and a \$1 billion share repurchase program.

The \$1 billion buyback represents 40% of Peabody's \$2.5 billion enterprise value (i.e., the sum of its equity and net debt), and will be supported by Peabody's expected cash flows over the next two years.

Despite the 70% drop in coal prices from \$450 to \$130, Peabody locked in elevated prices for a portion of its 2023 production through future supply contracts and hedging positions, including \$243 per ton for 40% of its export volumes into the seaborne thermal market and \$244 per ton for 30% of its seaborne metallurgical volumes (more on these segments below).

As a result, the company is expected to generate roughly \$1 billion in free cash flow this year.

In 2024, when these hedges roll off, Peabody is expected to generate about \$500

million in free cash flow. Based on its current enterprise value of \$2.5 billion, this represents a 25% free cash flow yield.

And that's a conservative estimate, assuming coal prices stay at current levels and the global gas shortage has been resolved by 2024. The current \$1 billion share repurchase authorization, which will be supported by cash on the balance sheet and the next two years of estimated cash flows, could reduce the company's share count by one-third through year-end 2024.

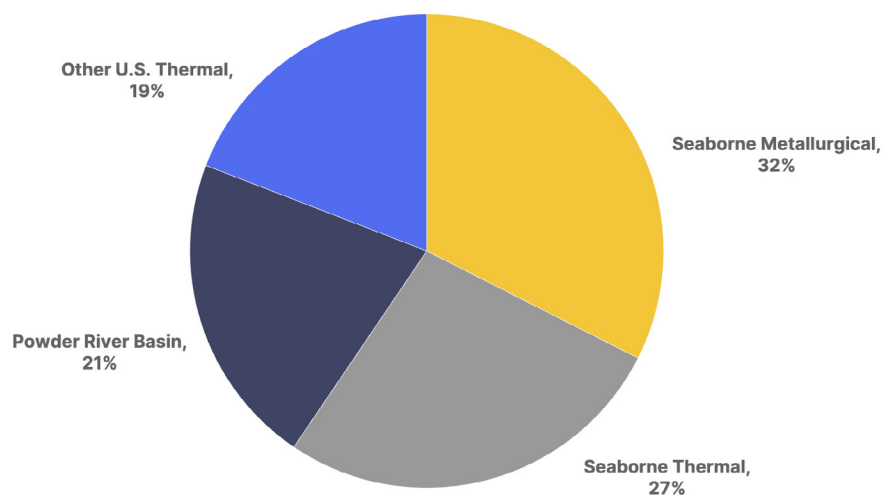
Next, let's dive deeper into Peabody's operating segments to understand the relative importance of the different types of coal it mines and the markets that it serves.

### Peabody's Key Business Segments

Peabody's fate is not tied entirely to the coal used in coal-fired power plants, known as thermal coal. The company also sells another type of coal used for making steel, known as metallurgical coal, which has no viable substitutes.

Peabody's coal mining business is separated into four segments, based on the type of coal (thermal vs. metallurgical) and the markets it sells to (U.S. sales versus overseas sales, known as the "seaborne" market).

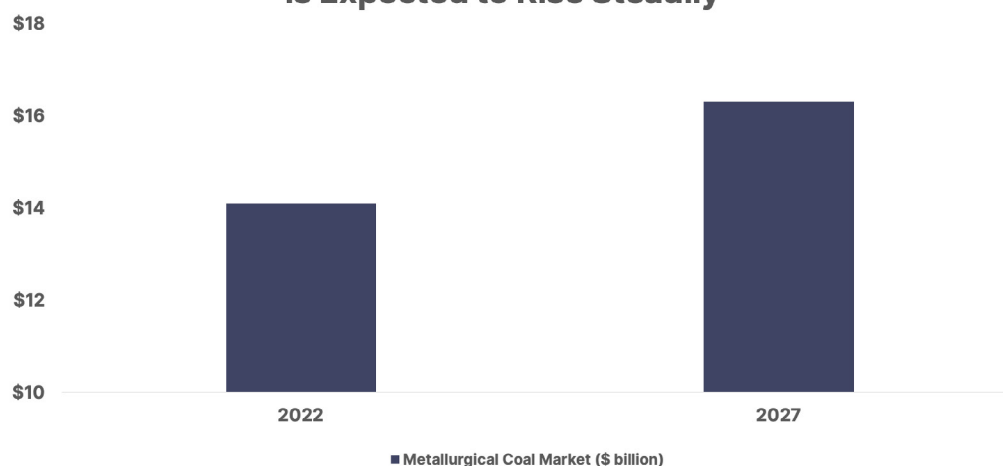
Peabody's Revenue by Segment



Metallurgical coal consumption is expected to rise in line with global GDP growth for the foreseeable future. Estimates by energy research firm Wood MacKenzie indicate that the metallurgical coal market will grow at 2.7% annually, from \$14.1 billion in 2022 to \$16.3 billion by 2027.



### Metallurgical Coal Consumption is Expected to Rise Steadily



Peabody's seaborne businesses, which make up 59% of its total sales, export thermal and metallurgical coal from its mines in Australia and Alabama. This coal is sold into a variety of end markets around the world, like China – the world's largest steel producer – which uses imported metallurgical coal in its steel manufacturing.

Seaborne metallurgical coal is Peabody's largest business unit, making up 32% of sales. The producing mines in this segment include the Metropolitan mine in New South Wales, Australia, the Coppabella and Moorevale mines in Queensland Australia, as well as the Shoal Creek mine in Alabama.

Like thermal coal, metallurgical coal prices rallied last year as supply shortages emerged. Peabody's average selling prices in this segment surged to \$244 per ton in 2022, up 85% from \$132 per ton in 2021.

Peabody is also increasing capacity at several of its mines in the seaborne metallurgical segment, through mine expansions at the Moorvale mine in Queensland and at the Shoal Creek mine in Alabama.

Last year, the company sold 6.6 million metric tons (Mt) of seaborne metallurgical coal, an 18% increase from 5.5 Mt sold in 2021. The combination of more volumes and higher prices drove a 122% increase in Peabody's revenue in this segment, from \$728 million in 2021 to \$1.6 billion in 2022.

Peabody's management expects to sell between 7 million - 8 million tons of seaborne metallurgical coal in 2023, up nearly 1 million tons from 2022 at the midpoint of this guidance range. The growth will come from the ongoing mine expansions at Moorvale and Shoal Creek. Longer term, additional growth will come

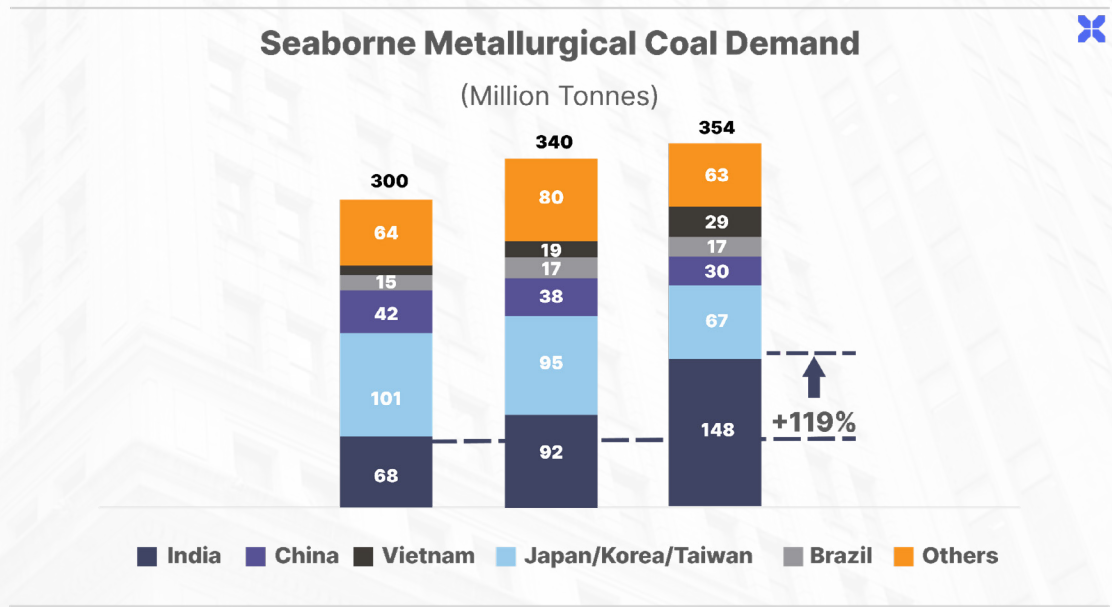
from the redevelopment of the company’s North Goonyella mine in Queensland, Australia.

In the third quarter of 2022, Peabody initiated a \$240 million investment for the redevelopment of North Goonyella. The Goonyella mine contains over 70 Mt of reserves, and Peabody expects production to start in 2026, which will provide the next leg of growth for the seaborne metallurgical segment in the second half of this decade.

Although demand for metallurgical coal will remain steady, supply is limited. The ESG/environmental movement lumps all coal – thermal and metallurgical – into the “dirty commodity” basket, so the same pressures on capital expenditures that limit thermal coal mining also limit metallurgical coal mining.

The difference is that, while governments can, and eventually may, phase out thermal coal, there’s no alternative for metallurgical coal. That side of the business will continue to drive growth for Peabody... whether the ESG chieftains like it or not.

The key demand drivers for the metallurgical segment will be fast-growing economies like China, India and a wide swath of emerging economies in Asia and around the world – with current projections indicating 119% demand growth through 2050:



These same regions will supply demand for Peabody’s seaborne thermal coal segment, the company’s second largest business unit, making up 27% of sales in 2022.

Peabody's seaborne thermal coal is supplied by three mines in Queensland, Australia. These include the Wambo surface mine and the Wambo underground mine, as well as Wilpinjong - one of the lowest-cost thermal coal mines in Australia.

The company's seaborne thermal segment has taken a hit over the past couple of years due to an embargo from China (Australian lawmakers suggested that China might have started Covid on purpose, and the Chinese government retaliated with trade sanctions).

However, in January 2023, China announced it would allow coal importers to begin taking shipments from Australia again. Progress in resuming-full scale trade has been slow, but demand should gradually rebound.

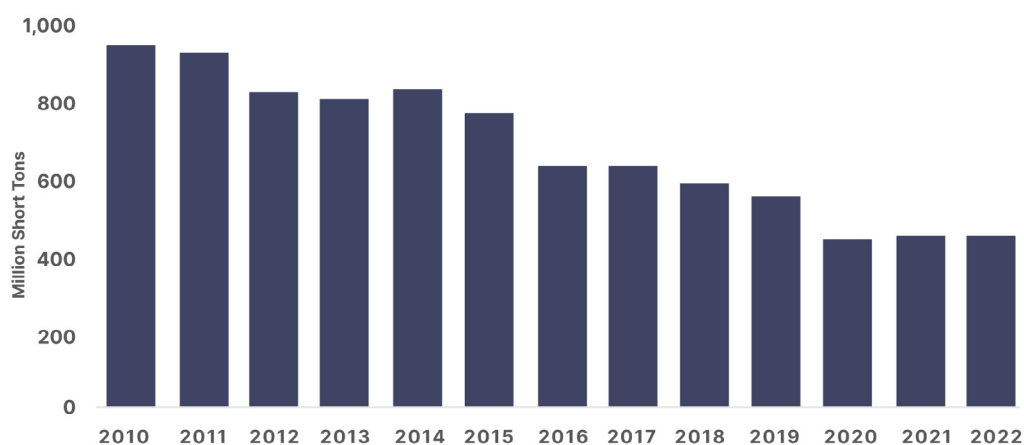
## Peabody's U.S. Operations

Peabody's U.S. thermal coal business supplies coal to U.S. power plants, and made up 41% of sales last year.

In the bigger picture, Peabody's U.S. business faces the same headwinds as other U.S. thermal coal suppliers: the steady decline in U.S. coal-fired power generation, due to the rise of cheap shale gas as a cleaner burning alternative. Since the dawn of the shale revolution in 2010, U.S. coal deliveries to the U.S. power sector have fallen by roughly 50%.

However, the growing global gas shortage since 2021 – which pulled U.S. gas prices higher in tandem – contributed to a rise in U.S. coal consumption, because coal is cheaper.

### Coal Shipments to the U.S. Electric Power Sector



Source: U.S. Energy Information Administration, Coal Data Browser

The central component of Peabody's U.S. business is the Powder River Basin (PRB) segment. Located in central Wyoming, the PRB is the largest source of coal

reserves and production in the U.S., with 2.3 billion tons of reserves.

The three mines in this segment include the North Antelope Rochele, the world’s largest coal mine, as well as the Caballo and Rawhide mines.

Last year, Peabody’s PRB operations produced 83 Mt of thermal coal, down 7% from 88 Mt in 2021 due to temporary supply chain and weather disruptions among U.S. rail carriers.

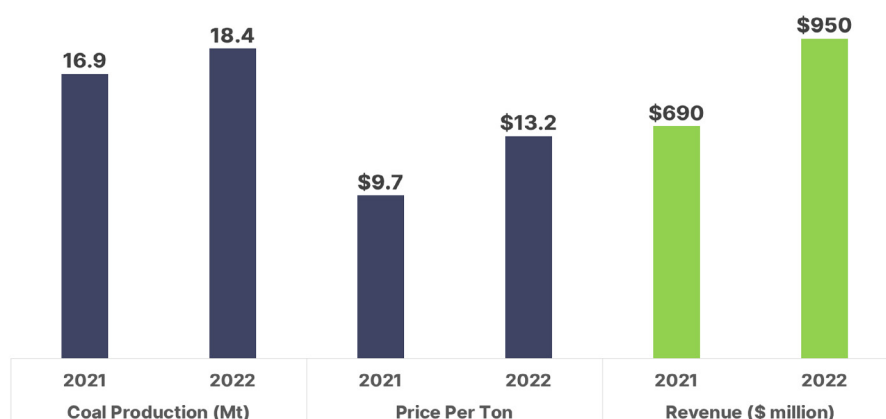
The good news is that these disruptions are now largely resolved, and the customers who buy Peabody’s PBR coal are running low on inventories after burning more coal than expected during the period of high gas prices in 2021 and 2022. During the Q4 earnings call on February 14, management noted:

*“We are essentially sold out at all of our U.S. domestic operations for 2023 and the railroads are focusing on improving service levels from last year’s challenges, including weather and staffing levels.”*

With utilities rushing to refill depleted stockpiles, Peabody expects its PBR volumes to rebound by 10% to 91 million tons in 2023.

Many other coal-fired power plants are facing inventory depletion across the U.S., which has allowed Peabody to sell out all of its 2023 coal capacity for its fourth business unit – which contains six mines and is classified as the “Other U.S. Thermal” segment. These mines didn’t face the same railway disruptions as the ones in the PRB, and generated significant revenue last year.

### Higher Coal Volumes and Increased Prices Drive Revenue Growth in 2022



Management noted on the Q4 call that depleted coal inventories across U.S. power plants are supporting a continued strong outlook for both volumes and pricing in



the U.S. thermal coal market for 2023 and 2024. It expects its other U.S. thermal volumes to come in around 18 - 19 Mt in 2023, which would reflect similar levels as last year's 18.4 Mt at the midpoint.

Peabody is well positioned as one of the lowest-cost coal producers in the U.S., given its leading position in the PRB. And while U.S. coal consumption will likely continue declining over time, higher prices could offset lower volumes.

Recall that, since coal competes with natural gas in the U.S. power sector, coal prices tend to trade up and down with gas prices. As we've written about previously, U.S. gas prices will increasingly converge with much higher overseas prices as the growth in LNG exports increasingly links the American market with overseas markets for natural gas. From 2024 - 2026, a series of new LNG export terminals will drive a roughly 50% surge in U.S. LNG export capacity.

That's why we expect U.S. gas prices will trade closer to the much-higher overseas gas prices in Europe and Asia starting in 2024 and beyond, which will also provide a boost for U.S. coal prices.

Meanwhile, Peabody's largest segments – seaborne metallurgical and thermal coal – will grow for years to come. Metallurgical coal consumption will grow in line with global GDP growth for the foreseeable future. And with China, India and a wide swath of developing economies doubling down on coal in light of the global gas shortage, Peabody's seaborne thermal coal volumes will likely rise through at least the mid-2020's, and possibly beyond.

Let's revisit the macro outlook for the current state of the global gas shortage.

## Energy Czars Keep Making Bad Decisions

We've [previously written](#) about the record-setting warm weather that helped Europe, and the world, avoid an energy crunch last winter. The gas market was also spared by China's Covid-zero policies, which kept demand capped from the world's largest LNG importer last year.

But with China dropping its Covid-zero economic restrictions earlier this year, the country is poised to soak up an estimated 80% of the new LNG export capacity coming online in 2023, according to IEA chief Fatih Birol. In February, Birol warned that Europe is far from out of the woods, and policymakers should make sure they secure additional energy sources before winter.

Unfortunately for Europeans, their leaders are choosing renewables as their backup power system yet again...

Despite ample evidence that renewable energy doesn't work, Europe continues doubling and tripling down on the same flawed policies, setting the stage for a continuation of the crisis.

For instance, on April 15, Germany announced the official closure of its last three remaining nuclear power plants, which supplied power to more than 10 million households, or roughly one-quarter of Germany's population. The pre-planned shutdowns are part of a pledge Germany made back in 2011 to phase out all nuclear power; and the crippling energy crisis of 2022 did not derail those plans.

From a climate perspective, Germany's decision to shutter its nuclear power capacity – **the ultimate form of reliable power generation that's 100% free of carbon emissions** – is baffling. Even the country's climate activists were puzzled by the decision. Hans von Storth, an analyst for German climate research firm Coastal Research, made the following comments to CNBC in the wake of the news:

*"This is hugely disappointing, when a secure low carbon 24/7 source of energy such as nuclear was available and could have continued operation for another 40 years... Germany's nuclear industry has been world class. All three of those reactors shut down at the weekend performed extremely well... For me, as a climate scientist, the whole thing is incomprehensible."*

German policymakers appear to believe that curtailing nuclear energy will force wind and solar energy to take up the slack. By 2030, German policymakers plan to generate 80% of its electricity from renewable sources like wind and solar. That's like switching off your main breaker in order to light your home with birthday candles.

Meanwhile, the UK's Labor Party announced last month that it plans to proceed with a push to block all new projects for oil and gas development in the North Sea, responsible for 98% of the UK's domestic oil and gas production.

Speaking to the British Broadcasting Company (BBC), a Labor party source explained:

*"We are against the granting of new licenses for oil and gas in the North Sea. They will do nothing to cut bills as the Tories have acknowledged; they undermine our energy security and would drive a coach and horse through our climate targets."*

This comes at a time when 90% of North Sea energy firms are already cutting back on investment, according to research firm Offshore Energies UK. The firm estimates that, at the current rate of investment, North Sea oil production could fall by 80% by 2030.

Finally, the Dutch government announced on June 15 that it would shut down Europe's largest gas field – the Groningen field – in October, just before the critical winter heating season, when European gas supplies will be most precarious. European natural gas prices rallied by 24% on the news, as the market began

pricing in the growing risk of a gas shortage this winter.

In summary, the overwhelming evidence suggests European policymakers will continue making the same mistakes that created today's global energy shortage. As these policies continue backfiring, coal will become the pressure relief valve.

## Coal: A Call Option on Poor Energy Policy

The record-high coal demand and prices of 2022 trace directly back to the total failure of European energy policy over the last decade. Had Europe embraced a sense of energy realism over climatism (i.e., the religion of climate activism), the continent could have achieved energy security through a combination of shale gas and nuclear energy.

Instead, European policymakers ditched nuclear and natural gas and went all-in on solar and wind, which have repeatedly failed to live up to their promise. That's why, even before the disruption of Russian gas flows into Europe, global coal demand was on the rebound in 2021 – growing by 6% to just shy of new all-time highs. That's after more than a decade of a concerted global effort to curtail coal consumption.

And that's why an acute European energy crisis is not needed for coal prices to enjoy a multi-year tailwind of higher prices.

Mr. Market doesn't offer many opportunities like this – a business generating \$500 million in annual free cash flows, trading at a \$2.5 billion enterprise value, with a pristine balance sheet, and the ability to return 40% of the current trading value to investors within the next two years.

In the scenario where coal demand enters into secular decline at some point later this decade, Peabody will still enjoy a multi-year runway of booming demand and higher prices. And with a management team committed to returning excess cash flow to investors, the company is positioned to buy back shares faster than the rate of coal market declines.

Peabody is a high-yielding annuity that will return a steady stream of cash to investors in a normal environment. And it offers a call option on the repeated poor policy decisions in Europe and around the world that could unleash another windfall of cash flows if the global energy crisis worsens from here.

If the worst of the energy crisis is over, and coal prices simply remain around current levels, Peabody's 25% free cash flow yield will likely generate market-beating returns regardless. And if global gas supplies run low again, Peabody is due for another 2022-like windfall, when it generated \$1.6 billion in free cash flow.

**Action to Take: Buy Peabody Energy (NYSE: BTU) below \$25 per share.**

## New to the Porter & Co. Portfolio? Start With Our Top 3 “Best Buys” Today

Our goal at Porter & Co. is to bring you world-class investment research, focused on “inevitable” businesses that you can buy and hold forever. This is the surest and safest path to building permanent wealth.

While we don’t believe in timing the market, we do keep a constant eye out for bargains. In each edition of The Big Secret, we highlight three current portfolio picks that are at an attractive buy point. In addition to today’s recommendations, we suggest you focus on these:

- 1. Dirty energy is never going away... Instead, it will just take safer, cleaner forms, like nuclear energy. **BWX Technologies (BWXT)** is [A Matter of National Security](#), and a bargain at 16x enterprise value (i.e., the combined value of equity and debt) to operating income. BWXT has been a leading manufacturer of nuclear reactors and components since the birth of the nuclear power industry over 100 years ago. BWXT is responsible for powering the Navy’s submarines and aircraft carriers as well as all the mechanical equipment in the engine room. The company’s recession-proof business with the U.S. government is based on long-term contracts that provide a high degree of cash flow stability and predictability. It’s also pioneering a revolutionary “bring-your-own-energy” concept for the commercial sector: small modular nuclear reactors (SMRs). These portable reactors could rip up the playbook of energy as we know it today, making nuclear energy a safe, cheap and sustainable global energy source.**
- 2. **Credit Acceptance Corp (CACC)** is a leading subprime auto lender, which we call the [Goldman Sachs of White Trash](#). The business of making subprime loans isn’t glamorous, but it’s tremendously profitable and highly capital efficient. CACC has generated 63% free cash flow margins over the last five years, and today trades at just 15x earnings. (It’s at a buy point of \$500 per share, or less than 16x earnings.) Shares have recently sold off on fears of a subprime auto lending meltdown, but as we explained in a recent [portfolio update](#), CACC is uniquely positioned to benefit from spiking default rates – and that’s already showing up in its latest quarterly earnings report. With lending standards tightening and auto delinquencies on the rise, more consumers are entering the subprime category. This was confirmed last quarter as CACC’s loan growth surged by 26%.**
- 3. **Viper Energy Partners (VNOM)** is an oil and gas royalty company – the best business in the energy sector, and the [Secret Behind T. Boone’s Fortune](#). Unlike oil and gas producers, VNOM never spends a dime searching for oil or**

drilling holes deep into the earth. It simply owns the land upon which other companies drill, and collects a percentage of the cash flow. That makes it one of most capital efficient businesses you'll find anywhere, with 80% free cash flow margins. VNOM funnels its profits directly to shareholders, instead of back into the ground. VNOM currently trades at a 16% free cash flow yield – the best valuation since the depths of the COVID-19 pandemic. The company is returning capital to shareholders through a 5.2% dividend yield and a repurchase program that has reduced outstanding units by 10% over the last 18 months.

| The Big Secret on Wall Street PORTFOLIO  |                  |                               |               |             |               |        |                 |              |                       |                     |
|--|------------------|-------------------------------|---------------|-------------|---------------|--------|-----------------|--------------|-----------------------|---------------------|
| ENERGY & COMMODITIES                     | Ticker           | Description                   | Purchase Date | Cost Basis  | Closing Price | Yield  | Income Received | Total Return | Status                | Risk Rating (1 - 5) |
| EQT CORPORATION                          | EQT              | U.S. Gas-Focused E&P          | 06-03-2022    | \$47.99     | \$39.45       | 1.25%  | \$0.60          | -16.55%      | Buy Under \$50        | 4                   |
| TELLURIAN INC.                           | TELL             | U.S. LNG Exporter             | 06-17-2022    | \$3.53      | \$1.38        | 0.00%  | \$0.00          | -60.91%      | Buy Under \$5         | 5                   |
| VIPER ENERGY                             | VNOM             | Oil and Gas Royalty           | 09-02-2022    | \$30.58     | \$25.23       | 5.23%  | \$1.31          | -13.21%      | Buy Under \$34        | 3                   |
| BWX TECHNOLOGIES, INC.                   | BWXT             | Nuclear Power Equipment       | 12-23-2022    | \$58.24     | \$68.62       | 1.28%  | \$0.46          | 18.61%       | Buy Under \$65        | 3                   |
| BLACK STONE MINERALS                     | BSM              | Oil and Gas Royalty           | 02-17-2023    | \$15.90     | \$15.91       | 12.07% | \$0.48          | 3.05%        | Buy Under \$18        | 2                   |
| AMERIGO RESOURCES                        | ARREF            | Base Metals                   | 03-31-2023    | \$1.21      | \$1.20        | 6.67%  | \$0.00          | -0.83%       | Buy Under \$1.35      | 4                   |
| BITCOIN                                  | BTCUSD           | Cryptocurrency                | 05-12-2023    | \$27,179.90 | \$30,200.70   | 0.00%  | \$0.00          | 11.11%       | Buy Under \$35,000    | 4                   |
| PEABODY ENERGY                           | BTU              | Coal Mining                   | 06-23-2023    |             | \$21.29       | 1.41%  | \$0.00          |              | Buy Under \$25        | 4                   |
| <b>BATTLESHIP STOCKS</b>                 |                  |                               |               |             |               |        |                 |              |                       |                     |
| ALTRIA                                   | MO               | Tobacco Maker                 | 07-15-2022    | \$42.24     | \$43.76       | 8.59%  | \$2.82          | 10.27%       | Buy Under \$50        | 1                   |
| PHILIP MORRIS                            | PM               | Tobacco Maker                 | 07-15-2022    | \$90.18     | \$95.69       | 5.31%  | \$5.08          | 11.74%       | Buy Under \$100       | 1                   |
| CREDIT ACCEPTANCE CORP                   | CACC             | Consumer Finance              | 07-29-2022    | \$575.91    | \$494.13      | 0.00%  | \$0.00          | -14.20%      | Buy Under \$600       | 3                   |
| NOVO NORDISK                             | NVO              | Pharmaceuticals               | 10-28-2022    | \$106.67    | \$160.02      | 2.19%  | \$1.19          | 51.13%       | Hold                  | 2                   |
| WINMARK CORPORATION                      | WINA             | Specialty Apparel Stores      | 09-16-2022    | \$218.96    | \$356.26      | 0.90%  | \$5.30          | 65.13%       | Hold                  | 1                   |
| ACTIVISION BLIZZARD                      | ATVI             | Video Games                   | 03-03-2023    | \$77.71     | \$82.30       | 0.00%  | \$0.00          | 5.91%        | Buy Under \$82        | 2                   |
| DOMINO'S PIZZAS INC                      | DPZ              | Restaurants                   | 02-27-2023    | \$300.00    | \$320.82      | 1.37%  | \$1.21          | 7.34%        | Buy Under \$300       | 3                   |
| DREAM FINDERS HOMES, INC.                | DFH              | Homebuilder                   | 04-28-2023    | \$14.83     | \$23.18       | 0.00%  | \$0.00          | 56.30%       | Buy Under \$16        | 4                   |
| FRANCO-NEVADA CORP                       | FNV              | Precious Metals Streamer      | 05-12-2023    | \$154.74    | \$138.49      | 0.98%  | \$0.00          | -10.50%      | Buy Under \$170       | 2                   |
| <b>INCOME &amp; DISTRESSED DEBT</b>      |                  |                               |               |             |               |        |                 |              |                       |                     |
| MICROSTRATEGY INC                        | CUSIP: 594972AC5 | 2025 Convertible Bond         | 10-14-2022    | \$758.00    | \$1,043.51    | 0.72%  | \$7.50          | 38.66%       | Hold                  | 4                   |
| QURATE RETAIL, INC.                      | QRTEP            | 8% Cumulative Preferred Stock | 01-20-2023    | \$40.64     | \$35.96       | 22.25% | \$4.00          | -1.67%       | Buy Under \$50        | 3                   |
| ANNALY CAPITAL MANAGEMENT                | NLY              | Real Estate Investment Trust  | 02-03-2023    | \$23.75     | \$20.44       | 17.22% | \$0.65          | -11.20%      | Buy Under \$24        | 2                   |
| SABA CAPITAL & INCOME OPPORTUNITIES FUND | BRW              | High Yield Bond Fund          | 03-17-2023    | \$8.07      | \$7.77        | 13.75% | \$0.18          | -1.55%       | Buy Under \$9         | 3                   |
| OAKTREE SPECIALTY LENDING CORP           | OCSL             | Specialty Investments         | 03-31-2023    | \$18.57     | \$18.96       | 11.60% | \$0.00          | 2.10%        | Buy Under \$22        | 2                   |
| <b>Property &amp; Casualty Insurance</b> |                  |                               |               |             |               |        |                 |              |                       |                     |
| W.R. BERKLEY                             | WRB              | P&C Insurance                 | 05-26-2023    | \$56.10     | \$58.50       | 0.68%  | \$0.00          | 4.28%        | Buy Under \$62        | 2                   |
| PROGRESSIVE CORPORATION                  | PGR              | P&C Insurance                 | 06-09-2023    | \$131.08    | \$131.76      | 0.30%  | \$0.00          | 0.52%        | Buy Under \$160       | 2                   |
| CHUBB LIMITED                            | CB               | P&C Insurance                 | 06-09-2023    | \$191.63    | \$195.14      | 0.20%  | \$0.00          | 1.83%        | Buy Under \$220       | 2                   |
| SKYWARD SPECIALTY                        | SKWD             | P&C Insurance                 | 06-10-2023    | \$24.66     | \$25.87       | 0.00%  | \$0.00          | 4.91%        | Buy Under \$221       | 2                   |
| <b>BETTER THAN THE MARKET</b>            |                  |                               |               |             |               |        |                 |              |                       |                     |
| CAMBRIA SHAREHOLDER YIELD                | SYLD             | Yield Focused ETF             | 01-06-2023    | \$61.22     | \$58.73       | 2.64%  | \$0.57          | -3.13%       | Buy Under \$65        | 2                   |
| <b>WATCHLIST</b>                         |                  |                               |               |             |               |        |                 |              |                       |                     |
| NVR, INC.                                | NVR              | Homebuilder                   | NA            | -           | \$6,062.57    | 0.00%  | -               |              | Buy Under \$3,500     |                     |
| FREEPORT-MCMORAN                         | FCX              | Base Metals                   | NA            | -           | \$39.72       | 1.51%  | -               |              | Waiting For Recession |                     |
| SOUTHERN COPPER CORP                     | SCCO             | Base Metals                   | NA            | -           | \$73.80       | 4.07%  | -               |              | Waiting For Recession |                     |
| SHERWIN-WILLIAMS                         | SHW              | Specialty Chemicals           | NA            | -           | \$246.28      | 3.93%  | -               |              | Buy Under \$150       |                     |
| <b>HALL OF SHAME</b>                     |                  |                               |               |             |               |        |                 |              |                       |                     |
| ICAHN ENTERPRISES                        | IEP              | Specialty Investments         | 12-09-2022    | \$50.39     | \$20.25       | 39.51% | \$4.00          | -51.88%      | Sell                  |                     |

Disclaimer: this hypothetical portfolio should not be considered investment advice or a recommendation to buy/sell any financial instrument. For informational purposes only. Investors should perform their own due diligence before buying or selling any financial instrument. No express or implied guarantee of accuracy or applicability to real-world trading. Risk Ratings are based on a security's fundamentals and business model rather than its current valuation.

Last Saturday, members of *The Big Secret on Wall Street* received “Four Vital Reports” including [The Insurer That Treads Where Others Fear](#) – Porter & Co.’s Skyward Specialty report. We’ve added Skyward Specialty to the Property & Casualty Insurance section of the portfolio.

## Altria Keeps Smoking

Last July, we added both Altria Group Inc. (MO) and Philip Morris (PM) to *The Big Secret on Wall Street* portfolio. Since then, these two investments have generated steady performance with a reliable flow of income, including an 8.6% dividend yield for Altria and a 5.3% yield for Philip Morris.

In the original recommendation, we made the case for Altria as a prototypical Buffett-style “Inevitable” business – one whose competitive advantage is so clear and deeply entrenched that it will dominate its industry for the next several decades.

Altria is the leading U.S. cigarette brand, with nearly 50% market share. Its competitive advantage is thanks to the strong loyalty cigarette consumers have for their favorite brands, and the cartel-like industry structure arranged in the wake of the 1995 Master Settlement Agreement (MSA) between Big Tobacco and the Attorney Generals of virtually every state in America.

U.S. cigarette sales peaked in the late 1990s, and have since entered into a persistent decline. However, Altria (and other U.S. tobacco makers) have managed to outpace volume declines with higher prices over the past two decades.

In 2022, despite a 9.7% decline in cigarette volumes, Altria grew its net income by 3% from \$8.76 billion to \$8.81 billion, thanks to further price increases. This was Altria’s 13th consecutive year of growth in net income since 2009.

Altria has a long history of rising prices to offset volume declines, and this trend shows no signs of ending anytime soon. It’s a simple, highly capital-efficient business model. The company’s core products haven’t changed in decades. Plus, U.S. tobacco companies like Altria are prohibited from spending (wasting!) money on advertising. This combination of pricing power, low operating expenses and few capital requirements, allows Altria to post world-class 42% net income margins and 38% free cash flow margins.

This means Altria can send a substantial portion of capital back to shareholders, through a nearly 9% dividend yield and share repurchases. In 2022, Altria completed a \$3.5 billion share repurchase program and authorized a new \$1 billion share repurchase program it expects to complete in 2023.

The combination of consistent growth in net income and ongoing share repurchases has translated into steady growth in earnings per share over the last decade, from \$2.37 in 2013 to \$4.85 last year:



### Altria Earnings Growth Since 2010



Altria remains attractively valued today, at below nine times earnings. The company's resilient business model is perfectly positioned to withstand a potential economic downturn.

It enjoys the combination of low operating expenses and capital requirements, plus incredible pricing power. We expect Altria will continue growing its net income and shrinking its share count, boosting earnings-per-share like clockwork for many years to come. With a nearly 9% dividend yield, investors get paid to wait for the shares to move higher as earnings continue growing over time.

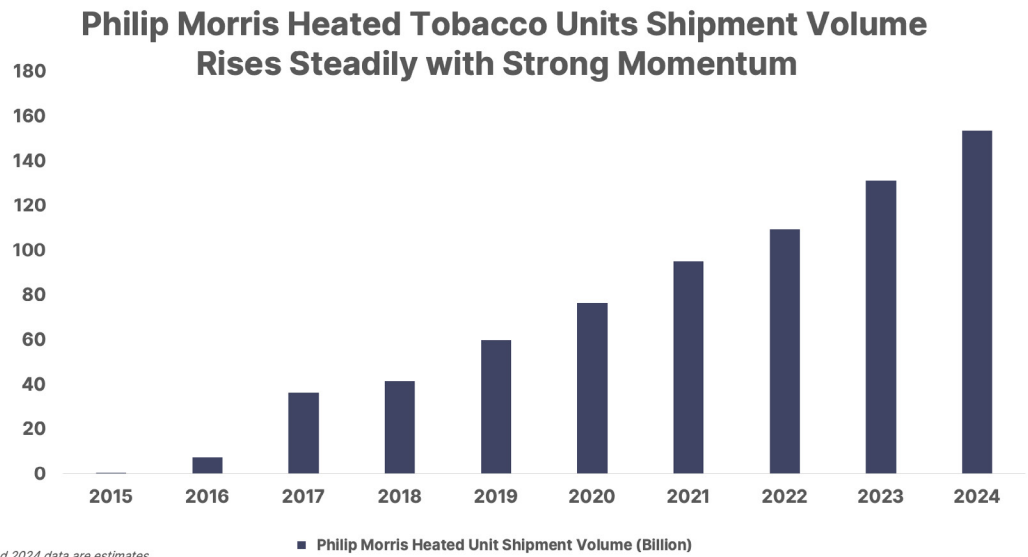
### A Hedge for the Tobacco Leaf

Meanwhile, our other tobacco recommendation, Philip Morris, offers a hedge against the ongoing volume declines in the traditional cigarette business. Philip Morris – owner of the international rights to the Marlboro brand – is investing heavily in smoke-free products, which are gradually taking over the global nicotine market.

The global market for nicotine products is estimated at \$931 billion, with traditional combustible tobacco (i.e., cigarettes) making up 82% of the total, at \$765 billion in sales last year. Smoke-free nicotine makes up the remaining 18% of the market, but this segment is growing at a much faster 20% annual rate over the last five years, compared to just 2% growth in the combustible segment.

Phillip Morris's IQOS device is one of the most popular smoke-free products internationally. IQOS has grown tremendously outside of the U.S. as its unit

volumes continue to rise steadily with strong momentum.

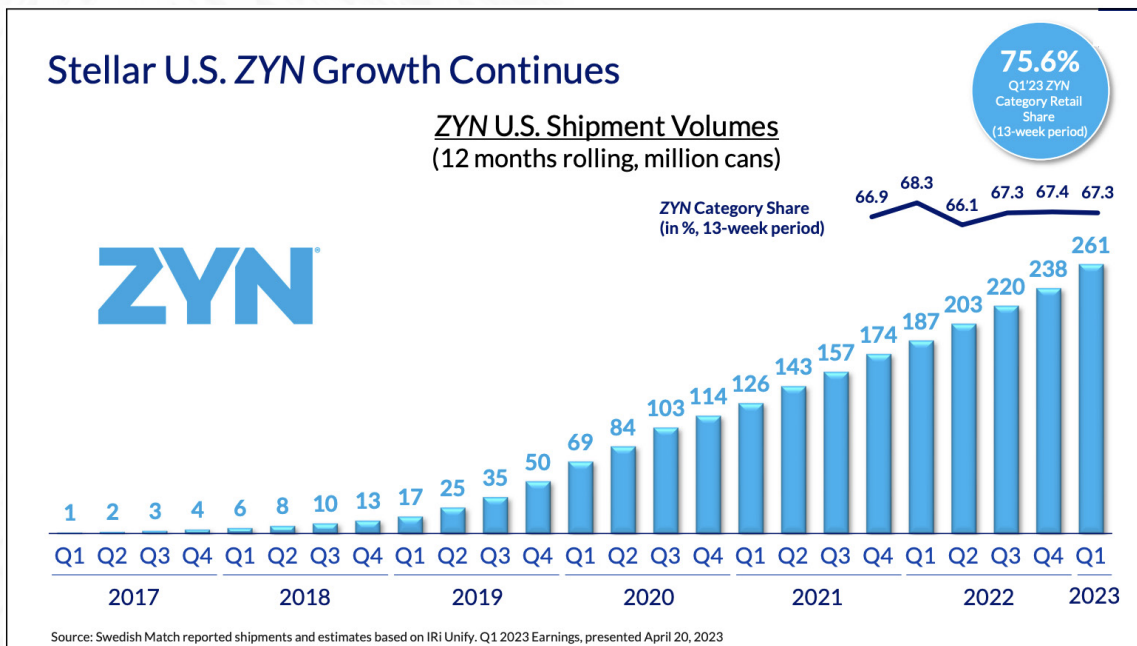


Altria also owns the rights to distribute IQOS devices in the U.S., but due to a patent dispute with British American Tobacco, Altria won't be able to sell the IQOS device in the U.S. until April 2024.

However, Philip Morris's ZYN nicotine pouches – a smoke-free way for nicotine users to get a quick fix on the go – appear to be the biggest winner in the U.S. smoke-free market.

In November 2022, Philip Morris acquired Swedish Match, the maker of ZYN, for \$16 billion. ZYN's growth in the U.S. is parabolic, with shipment volume increasing by 47% in the first quarter compared to a year ago.





With over 75% market share in the U.S., ZYN has become the most popular nicotine pouch of its kind. In a recent call with analysts, management acknowledged that ZYN is growing much faster than it anticipated when Philip Morris made the acquisition:

*“There are two key engines driving the U.S. growth of ZYN, as covered at CAGNY. First is the progressive increase in distribution, with the number of stores 13% higher than Q1, 2022 at around 140,000. There remains ample opportunity to further increase this over time. Second are velocities, or the number of cans sold per store per week. ZYN velocities continue to grow sequentially and by an impressive 21% compared to prior year as the brand continues to resonate with adult nicotine users.”*

ZYN still has plenty of room for growth domestically and internationally, especially as Philip Morris already has distribution to continue to roll out ZYN. Phillip Morris is currently adding production capacity to decrease the costs to produce ZYN pouches at scale, and will also launch ZYN in five to ten new international markets in the coming months as well.

The rise of less harmful smoke-free nicotine delivery methods, like ZYN and IQOS, is transforming global nicotine consumption from an industry in decline to one towards growth. And Phillip Morris is leading charge in this new growth market, with roughly 32% of its revenues now coming from its smoke-free nicotine portfolio. This makes Phillip Morris the ideal hedge against shares of Altria.

## Mailbag

In *The Big Secret on Wall Street* mailbag, Porter answers letters from readers. He cannot offer individual investment advice, but can respond to general questions.

Please email us at [mailbag@porterandcompanyresearch.com](mailto:mailbag@porterandcompanyresearch.com) if you'd like to be featured in this segment. We'd love to hear from you!

### Today's letter comes from L.V., who writes:

*"I have never purchased any kind of bond, having always focused on equities. I'm sure I'm not alone in this position so my question might help others also.*

*With equities I own, I decide when/if I want to sell it and at what price. I understand with bonds they have an expiry date, and that the price to buy varies along the way. So my question is, if the bond goes right through to maturity, do I have to do anything or will the organization simply contact me and ask for my bank details to pay the maturing dollar amount to me?"*

### Porter's comment:

*Buying and selling corporate bonds is not much different from buying and selling stocks. You can buy and sell freely-traded bonds at any time up until the maturity date (albeit, often with less liquidity than is available in the stock market). When the bond reaches its maturity date, the company is obligated to repay the full face value of the bond, or else the company will be in default.*

The trick, as always, is to only buy corporate bonds from companies that have low odds of defaulting on their obligations. If no default occurs, the company will repay the full face value of the bond. In this case, no action is required on your part. Your broker should automatically replace the bond in your brokerage account with the cash payment from the company that issued the bond.

In the scenarios where a default occurs, the situation becomes much more complex. A number of different outcomes are possible from here; including repayment of the bond at a discount to face value, or a swap of the debt for an equity position (i.e., shares) in a restructured, newly formed entity.

That's why due diligence is so important in debt investing. Fortunately, we have Martin Fridson, one of the best debt minds in the business, to help subscribers navigate this complex, but highly-rewarding investment landscape. Martin's advisory, *Porter & Co. Distressed Investing*, is only available to our Partners – [click here](#) to learn more.



*Porter Stansberry*

Porter & Co.

Stevenson, MD

P.S. If you'd like to learn more about the Porter & Co. team – all of whom are real humans, and many of whom have Twitter accounts – you can get acquainted with us [here](#). You can reach me (Porter) personally via:



porterstansberrydirect@gmail.com



@porterstansb