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THE BIG SECRET ON WALL STREET

Cold War 2.0 and the Coming Global Energy Wars

- Profiting From America's Global Gas Dominance
- The Ultimate Shale Patch Cash Cow

FROM THE DESK OF PORTER STANSBERRY

SPECIAL REPORT

Cold War 2.0 and the Coming Global Energy Wars

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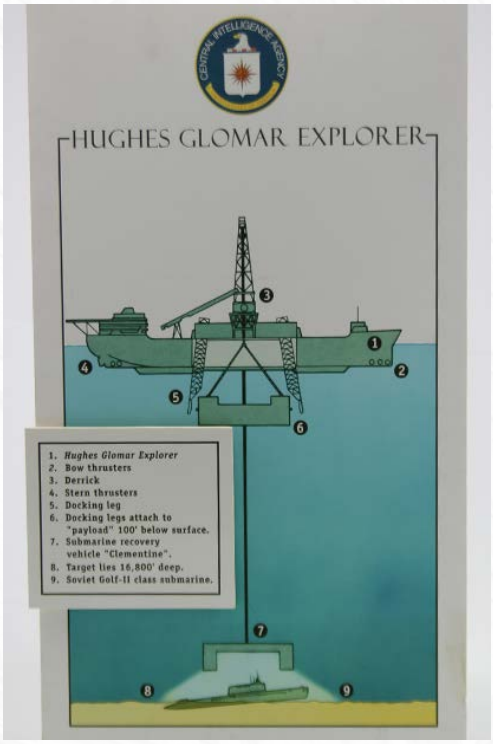

CIA director William Colby sighed as he picked up the telephone.

It was March 1975, and Colby had a tiresome task in front of him: Call every major national news outlet and beg them not to publish a "top secret" story... that they all already knew.

Deep in the throes of the Cold War, America's top intelligence agency had the clever idea to dredge up a sunken Soviet submarine to study its nuclear trappings.

One problem: the sub was three miles underwater off the coast of Hawaii.

How to retrieve it? Easy. Trap it in a huge globe of gas – imagine a really big soap bubble, and think of it underwater, with a submarine inside of it – and *float* it to the surface.

Naturally, that didn't work. So instead, the CIA built a 618-foot ship outfitted with a giant claw underneath – like an arcade prize machine. The claw itself was codenamed "Clementine."

The ungainly ship – launched under the pretense of deep-sea mining – was under construction for months. It was about as secret as Victoria's Secret. And crack investigative journalist Seymour Hersh had a full expose ready to publish in the *New York Times*.

CIA Director Colby dutifully contacted news organizations in the know to tell them to keep quiet. As Time magazine explained,

> *"The Washington Post, NBC, ABC, Newsweek and the Washington Star all got wind of the project. In each case, after a call or visit from Colby there was a decision not to go ahead."*

Eventually, with reporters pointedly excluded from the launch, the "Hughes Glomar Explorer" set to sea, dragging its massive claw like a crippled, one-armed Tyrannosaurus Rex.

And after all that brouhaha… the mission was a New Coke-level flop.

About halfway through the initial recovery operation, one of the grabber arms on the giant claw broke – and much of the just-retrieved Soviet sub sank back to the ocean floor. In the end, the CIA only recovered about 40 feet of the 300-foot vessel… along with the remains of six Soviet soldiers, whom they immediately buried again… at sea.

Hersh later released his story anyway (and went on to become a Pulitzer Prize-winning journalist over a fifty-year career). And the CIA added another entry to its long list of botched cover-ups – compounded by a botched operation in the first place.

The U.S. government has never been good at keeping secrets.

For a more recent example… take the Nord Stream pipeline.

Officially… on September 26, 2022, Russia blew up the pipeline that's the major artery for transporting natural gas from its fields in Siberia and elsewhere, into western Europe. Following the bombing, then-President Biden announced he was working with U.S. allies to *"get to the bottom of exactly – precisely what happened."* The media, however, seemed to have made up its mind from the get-go.

> *"Russia is opening a new front on its energy war against Europe,"*

squawked the Washington Post.

The Washington Post
Democracy Dies in Darkness

ENERGY

Is Putin Fully Weaponizing the Nord Stream Pipelines?

> *"First, it (Russia) weaponized gas supply, halting shipments, including via the Nord Stream pipeline. Now, it may be attacking the energy infrastructure it once used to ship its energy,"*

the paper continued.

Never mind that – despite WaPo's insinuations – it didn't make sense for Russia to blow up the vehicle of a major source of revenue.

Less than five months later, the real story came to light. (By comparison, Colby got the mainstream media to sit on the "claw ship" story for more than a year.) And, funnily enough, it was Seymour Hersh who broke the Nord Stream story, too.

Seymour, by then in his 80s, published a bombshell report on the Substack platform on February 8, 2023.

He claimed that the U.S. Navy, under authorization from President Biden, carried out the Nord Stream attack… *not* Russia.

Hersh reported that the attack was planned in December 2021 – three months before Russia launched its invasion into Ukraine. In June 2022, Hersh wrote, during a military training exercise, U.S. Navy divers planted remote-controlled explosives on three of the four Nord Stream pipelines. The bombs were remotely detonated three months later.

If Hersh's reporting is accurate – and a lifetime of prize-winning exposés under his belt, including Watergate, suggest he's rarely incorrect – the reality is that America was purposely weaponizing global energy markets. What's more, it suggests that the U.S. was planning this energy war well before the February 2022 invasion of Ukraine by Russia. And the Nord Stream blowing up was just another example of misdirection (if not downright lying) by Uncle Sam.

What this means is that this was the starting gun on the energy front of Cold War 2.0… – and global energy markets are the battlefield. America wants to replace Russian gas supplies to Europe with American shale gas, through liquefied natural gas (LNG) exports… and won't let anything get in the way. But supplying Europe with made-in-America gas is just the beginning.

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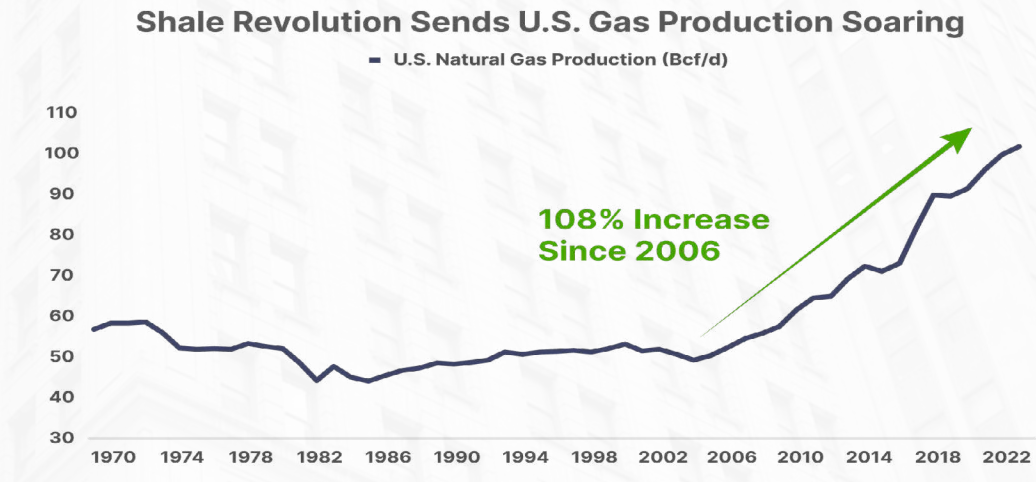
America is well on its way to becoming a global gas exporting powerhouse to countries around the globe, and this is one of the most important investment themes of the next decade.

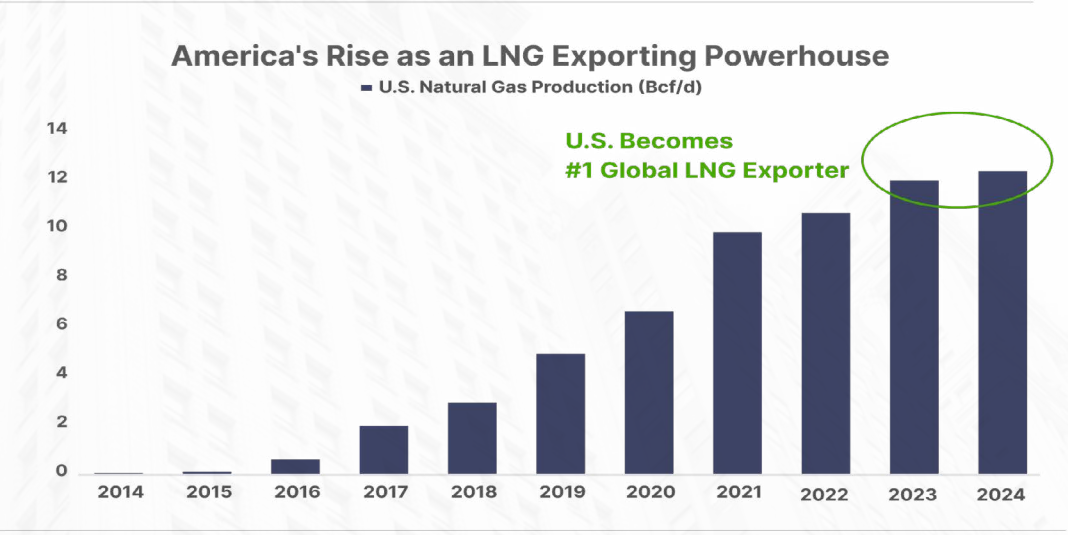
America's Rise as a Natural Gas Superpower

Up until the mid-2000s, U.S. gas production was locked into a three-decade slump of declining output. As a result, America increasingly relied on imported natural gas to keep the lights on and its homes heated in the winter. But the shale revolution changed everything. Starting around 2006, the commercialization of hydraulic fracturing (or "fracking") and horizontal drilling techniques allowed drillers to tap into an ocean of cheap natural gas from previously inaccessible shale rock formations across America.

By 2007, shale drillers had achieved a new record high in U.S. gas production. And that was just the beginning of a nearly two decade shale boom that sent U.S. gas production to 106 billion cubic feet per day (Bcf/d), or more than double pre-shale levels of 51 Bcf/d:



Before long, the flood of cheap shale gas overwhelmed domestic demand, and sent prices crashing from a former high of over $10 per thousand cubic feet (mcf) in 2008 to below $2 by 2012. This made American shale gas some of the cheapest in the world, roughly 80% cheaper than prices in overseas Asian and European markets. This created a lucrative arbitrage opportunity for businesses like Cheniere Energy (NYSE: LNG) to export cheap shale gas into overseas markets through liquefied natural gas export terminals (LNG).



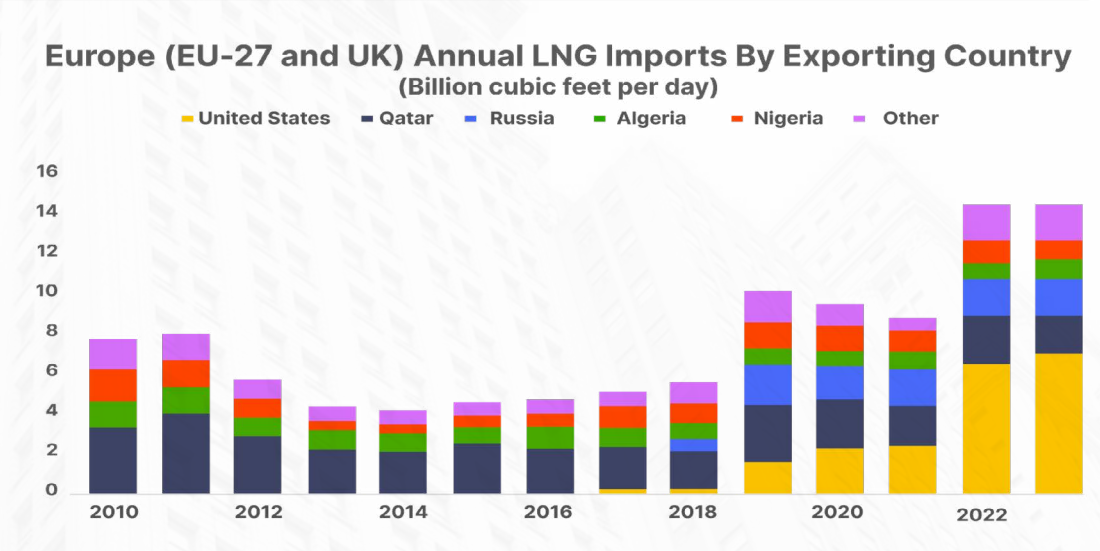
Starting in 2016, a wave of U.S. LNG export terminals came online. By 2017, these growing export volumes had transformed America from a net importer to a net exporter of natural gas. And only six years later, by 2023, the U.S. had become the single largest LNG exporter in the world, sending an average of 12 bcf/d of LNG into overseas markets.

And this trend is just getting started. The near-term driver of growing U.S. LNG export demand will come from European countries seeking to diversify away from Russian supplies.

When Russia invaded Ukraine in February 2022, the European Union relied on Russia for about 45% of its natural gas. After the geopolitical flareup between Russia and the West, the EU announced plans to stop using Russian gas by 2030.

As we've **written before**, this means Europe will need to source its energy somewhere else... and that's where American LNG (liquefied natural gas) comes in.

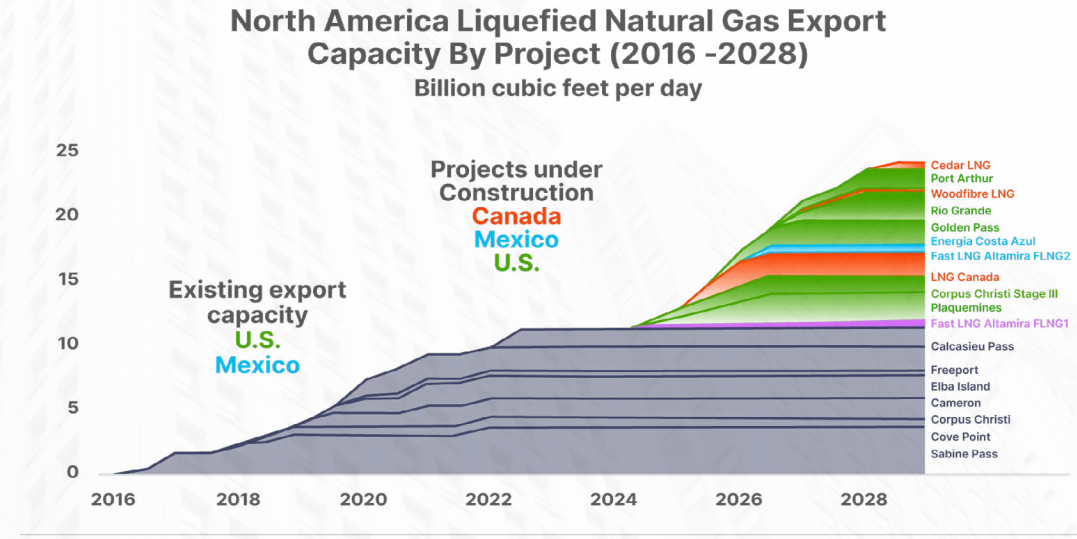
In the wake of the disruption in Russia's invasion of Ukraine in early 2022, Europe turned away from Russian gas and towards U.S. LNG. The volume of U.S. LNG imports into Europe nearly tripled from 2.4 Bcf/d in 2021 to 6.5 Bcf/d in 2022, making up 44% of total European gas imports. The number increased again to 7.2 Bcf/d in 2023, and the only constraint for higher volumes is a lack of LNG import terminals. But with a wave of new import terminals planned or already under construction throughout Europe, American LNG should continue displacing Russian gas imports into Europe for the foreseeable future.



America has the export facilities – and the plentiful shale gas reserves – to feed those import terminals over the next decade. Longer term, growing global demand for gas as a cheap, cleaner burning energy source over coal (currently the world's largest energy source for baseload power) will fuel decades of demand into Asian economies like India, home to the world's largest population of 1.5 billion people, or 4x the size of the US.

Indian Prime Minister Narendra Modi has announced plans to increase the country's share of natural gas for power generation from 6% today to 15% by 2030, by increasing its LNG imports. In addition to India, other significant countries like Japan and Korea have already made natural gas their primary source of baseload power, and dozens of emerging economies throughout Southeast Asia are following suit.

And with the world's largest source of cheap gas, thanks to the shale revolution, the U.S. is the best positioned country in the world to fulfill this demand. That's why tens of billions of dollars have been committed to building nine new export facilities in the next several years. When completed, these projects are expected to double U.S. LNG export capacity from 12 bcf/d currently to 24 bcf/d by 2028:



Source: U.S. Energy Information Administration

The bottom line: the stage is set for a boom in U.S. gas production to feed America's growing LNG export infrastructure.

The conventional wisdom says to buy shares of the exploration and production companies (E&Ps) that will produce all of this gas. But one of the big challenges in the E&P business is the high capital requirements. Drilling thousands of feet into the earth to tap into gas deposits is an expensive proposition. That's because each well begins depleting shortly after it's tapped, and thus E&Ps are constantly on the capex treadmill – meaning they must constantly funnel their earnings back into capex to drill new holes in the ground.

We prefer to invest in the far more lucrative businesses that get the upside from America's rising gas production, but without the heavy capital requirements associated with drilling holes thousands of feet into the earth. Specifically, the companies that own the mineral rights to the land upon which other E&Ps drill their oil and gas wells. These mineral rights owners, known as royalty companies, receive a percentage of the oil and gas produced from the wells drilled on their acreage (i.e., royalties), but without spending a dime on drilling rigs or other costs of production.

These low capital requirements make energy royalties one of the most capital efficient businesses you'll find anywhere. We previously recommended an energy royalty company focused primarily on oil in the Permian basin, and it's become one of our top performing stocks, up triple digits in less than three years. This reports analyzes a similar company focused primarily on natural gas.

This company has a dominant acreage position in the heart of America's two fastest-growing gas basins. While other regions like the Eagle Ford have exhausted their core acreage and hit a peak in production, these basins are firing on all cylinders. In each case, these basins barely suffered a hiccup during the COVID-19 meltdown in energy prices, and have since set new all-time production highs.

Best of all, the management of the company we're analyzing today has a lot of skin in the game (insiders collectively own more than 25% of the business). They have proven to be world-class capital allocators, by establishing a leading acreage position in some of the most prolific gas basins in America. They manage the business like it's their own, using very little debt and pursuing a conservative hedging program that protects the downside.

This combination of top tier acreage holdings and an excellent management team with skin in the game makes it our favorite gas-focused energy company.

The Perfect Way to Play America's Gas Boom

Black Stone Minerals (NYSE: BSM) is one of America's largest oil and gas mineral owners, with an asset base spanning 20 million gross acres across 41 U.S. states. The company has an estimated reserve base of 64 million BOE (barrels of oil equivalent), made up of 70% natural gas and 30% oil reserves.

Importantly, Black Stone is structured differently from standard equities. It's a master limited partnership ("MLP"), which means that an investor purchases "units" instead of shares, and receives "distributions" instead of dividends.

Also, investors who buy MLPs are considered limited partners in the business. This unique business structure brings tax benefits, but also potential complications come tax time.

MLPs are considered "pass-through" entities, which means they pass through cash flows and tax liabilities to their limited partner investors. This is different from a regular corporation, which pays corporate taxes, and acts like a separate entity from the investor. The pass-through structure means MLPs avoid corporate taxes. Instead, the investors (as limited partners in the business), are responsible for their portion of the company's taxes.

So at tax time, investors receive a K-1 form instead of the more common 1099 form for stock dividends. While K-1s are more complicated than 1099s, most tax software programs are set up to process these forms in a matter of minutes these days.

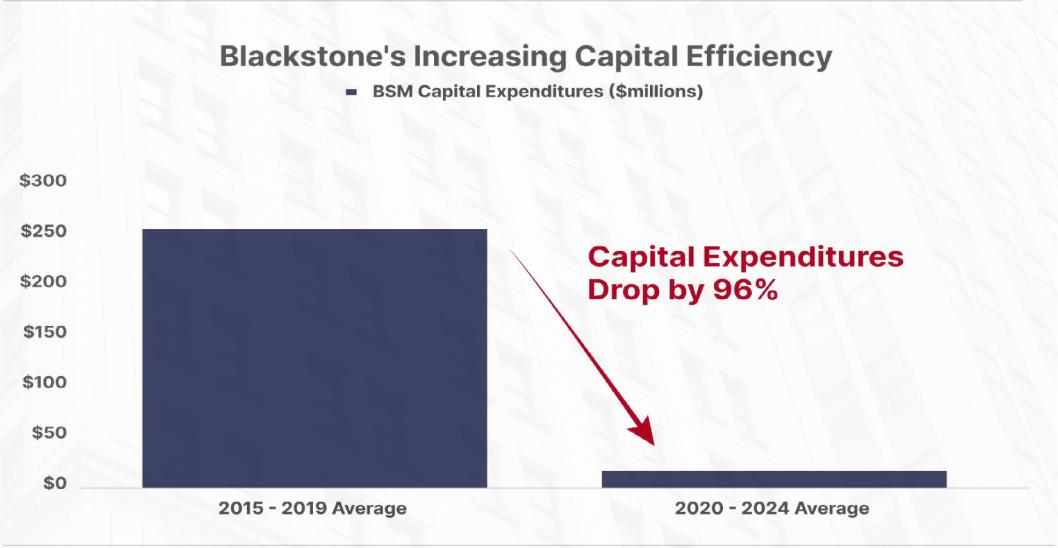
Historically, Black Stone focused on making two types of acreage acquisition deals: purchasing both royalty interests, and working interests.

The capital efficient royalty business model is compelling. As the owner of mineral royalties, Black Stone doesn't spend a dime of the capital expenditures associated with producing oil and gas. Instead, Black Stone receives a portion of the production from E&P companies that drill the oil and gas wells on the land it owns.

Working interests, on the other hand, are investments into wells that require payment for a proportion of the costs associated with drilling and operating those wells.

In recent years, Black Stone has shifted its exposure to working interest acreage, transitioning towards a royalty pure play. Today, over 95% of Black Stone's production volumes come from its royalty interests.

This move away from working interests has dramatically improved Black Stone's capital efficiency. Consider that, in the five years from 2015 - 2019, the company averaged nearly $250 million in annual capital expenditures. But over the last five years from 2020 - 2024, Black Stone's capital expenditures have fallen by 96% to $11 million per year on average.



This shifting business model has boosted Black Stone's free cash flow margins from 14% to 74% while return on equity has more than doubled from 21% to 44%. These metrics make Black Stone one of the most capital efficient business models you'll find anywhere.

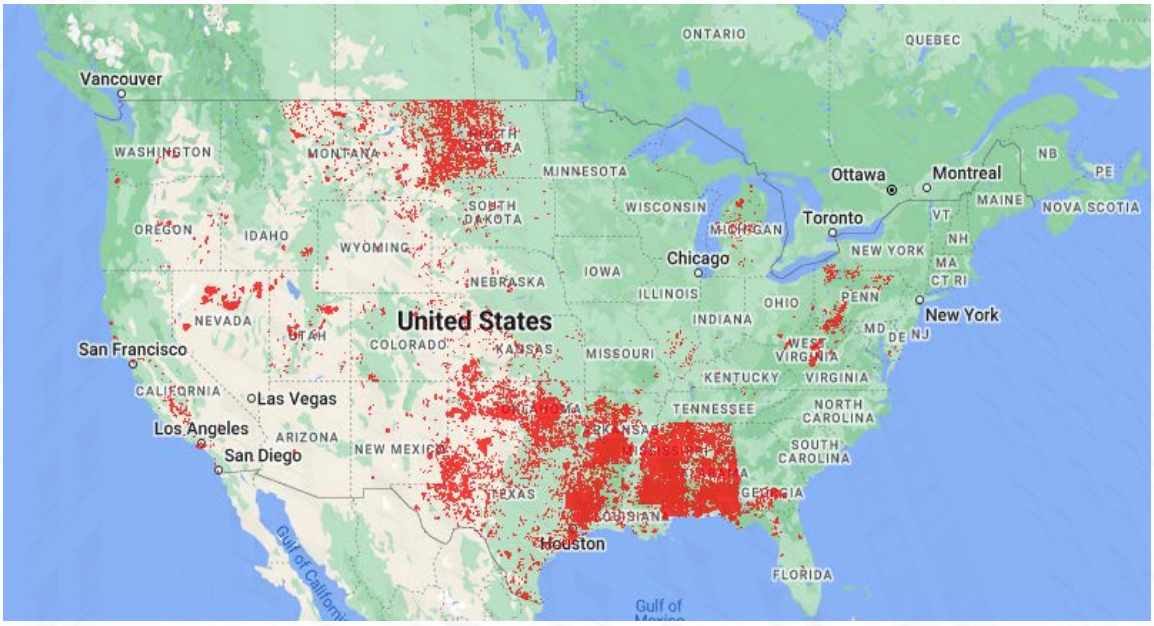
Finally, another key measure of capital efficiency we analyze is the profitability per employee. A good company might earn a few hundred thousand dollars per employee, whereas world-class businesses might earn a million or more.

Black Stone has 93 full-time employees, plus 15 contractors, for a total of 108 workers. Over the last year, the company earned $404 million in net income, or nearly $4 million in profit per employee. This makes Black Stone one of the most capital efficient businesses anywhere in the public markets.

The secret to Black Stone's strong financial performance is that its key acreage lies in the heart of America's two most prolific – and profitable – gas basins.

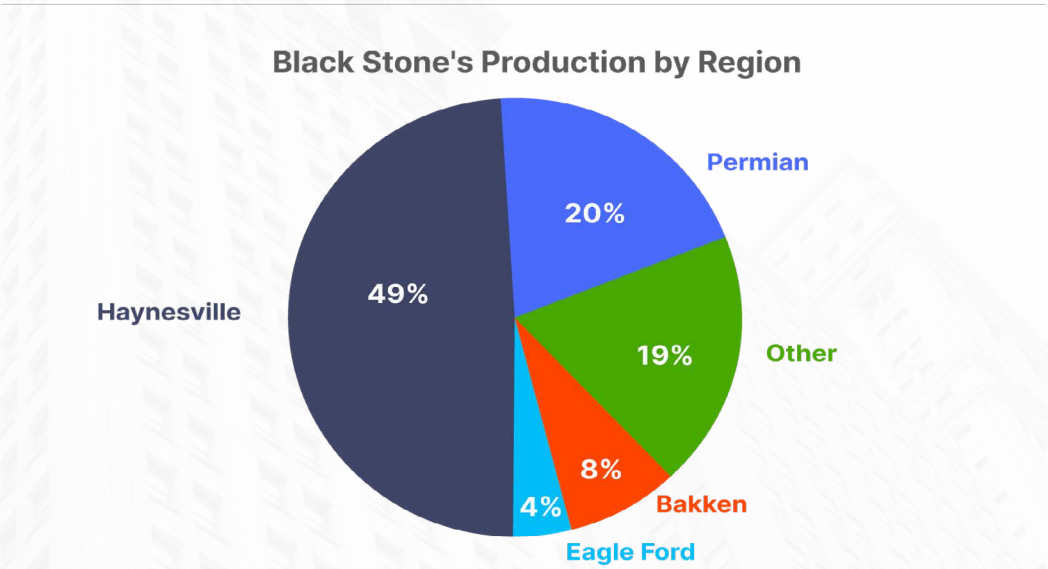
Black Stone's Acreage Holdings

Black Stone's acreage spans across every major onshore U.S. oil and gas basin, but most of the land it controls is concentrated along the Gulf Coast region:



This puts Black Stone's key acreage in close proximity to America's booming LNG export infrastructure along the Texas and Louisiana Gulf Coast.

Approximately half of the company's royalty volumes come from Haynesville shale formations, which form a continuous stretch of land from east Texas and into Louisiana. The company's next biggest basin exposure is in the Permian basin in West Texas and New Mexico, followed by a minority of exposure in the Bakken, Eagle Ford and smaller basins along the Gulf Coast.



Together, the Haynesville and Permian make up nearly three-quarters Black Stone's production volumes. This positions Black Stone squarely in the heart of America's two key natural gas production powerhouses.

Oil production generates a lucrative byproduct: natural gas. And the Permian, America's leading oil producing formation, leads the pack in gas, with output increasing by 6 Bcf/d over the past three years.

The Haynesville is a close second behind the Permian, which has grown gas production by 3 Bcf/d over the past three years. The Haynesville shale hosts the second-largest source of gas reserves in America, behind the Appalachian shale. But unlike Appalachia, where growth is constrained by lack of pipelines and export infrastructure, the Haynesville basin feeds directly into America's largest suite of LNG export terminals along the Gulf Coast. Likewise, the Permian basin hosts a large (and growing) number of pipelines that flow into this LNG export infrastructure.

Many of America's gas basins are past their peak production. In contrast, the robust growth in the Haynesville and Permian shales offsets declines elsewhere across the U.S.

In fact, the combined growth in these two basins has exceeded total U.S. production growth over the last three years. This means that total output from the rest of America's gas basins, in aggregate, is shrinking even as the Permian and the Haynseville continue growing and taking market share.

Black Stone's concentrated exposure in these two leading U.S. gas basins makes it the perfect company to cash in on the continued rise of American gas production and LNG export dominance.

The Cash Cow of the Shale Patch

Despite Black Stone's stellar economics, the company today trades at a deeply discounted valuation of just 9x free cash flow. That's a roughly 70% discount versus the S&P 500, despite the fact that BSM earns substantially higher margins and returns on capital than the average S&P 500 company.

Since Black Stone went public in April 2015, the company has not had a single year of negative earnings. And because of Black Stone's low capital requirements, it routinely sends the majority of its earnings back to investors instead of sinking it back into the ground.

While the amount the company pays out to investors fluctuates with gas prices, one thing remains constant: Black Stone has consistently paid a distribution in every quarter since it first began paying out distributions in August of 2015. Since then, the company has paid out a total of $12.20 per share of income to investors.

And the real power of owning Black Stone comes from the compounding effect of continuously reinvesting these dividends over time. Consider that an original $100,000 investment in Black Stone at its IPO in April 2015 would have paid out $5,000 in annual income in the first year after the company began paying out distributions in August of 2015. An investor who reinvested the distributions since then would have increased their ownership from 5,263 units initially to 12,083 today, or an increase of 130%.

And those shares now pay out an annual income of $1.50 per unit, translating into over $18,000 each year on the original $100,000 investment. So even though the share price has fallen by 22% since its IPO, the total return earned by investors over that time is a positive 78%.

Meanwhile, the decline in its unit price has not been caused by any decline in its business fundamentals. In fact, BSM is generating 40% more royalty volumes today versus when it went public in 2015. The only thing that's changed is the valuation has gotten cheaper, falling from 16x free cash flow in 2015 to 9x free cash flow today. Looking ahead, we believe Black Stone will benefit from both a higher valuation and the continued growth in earnings and free cash flow from the business.

Meanwhile, investors can have confidence in the management team. They run the business like owners, because they are – insiders own 25% of the business. This leads to a conservative culture that aims to protect and safeguard the business through the inevitable ups and downs in the commodity price cycle. This includes things like implementing a prudent hedging strategy that locks in high prices during bull markets, surrendering some short-term upside in order to protect the business against the inevitable bear markets. They also manage the company's balance sheet with prudence, with zero debt.

That's how Black Stone has survived and thrived through two deep bear markets in the last decade since going public, including the 2014 - 2016 energy price collapse, as well as the 2020 COVID-19 outbreak that sent natural gas prices to multi-decade lows.

Since Black Stone is run and managed by owners with skin in the game, they're not interested in putting the business at risk in order to chase every last penny of short-term upside. With millions of dollars of their own personal wealth at stake, they're focused on protecting the business above all else.

With a solid management team, capital efficient business, and concentrated acreage in the heart of America's fastest-growing gas basins, Black Stone is positioned to thrive from America's ongoing rise as a low-cost leader in natural gas exports.

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Stevenson, MD

P.S. If you'd like to learn more about the Porter & Co. team, you can get acquainted with us **here**. You can follow me (Porter) on **X** here: **@porterstansb**