Summary & Transcript

Matt Polyak

1. Strategic Actions and Decisions

- **Reallocate capital to energy infrastructure to exploit macro structural shifts: The broader global economy is undergoing an unprecedented regime change in free cash flow allocation, positioning the energy sector for significant upside.**
- **Monitor Chinese inventory drawdowns for impending price spikes: China has reduced imports and suppressed refinery utilization to conserve oil, creating an inventory deficit that could trigger an acute product price spike.**
- **Assess long-term supply constraints despite short-term market noise: Physical undersupply remains structural due to global inventory drawdowns and Russian refining disruptions, irrespective of paper market fluctuations.**
- **Invest in behind-the-meter power solutions for hyperscaler data centers: Data centers face multi-year grid delays, driving 40% to 50% of incremental power demand toward modular, on-site generation by 2030.**
- **Evaluate ProPetro (PUMP) for asymmetric upside driven by power expansion: ProPetro is executing a strategy to grow its power segment EBITDA to $850M over five years while utilizing cash flow from its core fracking operations.**

2. Executive Summary

The global energy sector is undergoing an unprecedented regime change in capital allocation, driven by structural undersupply, geopolitical disruptions, and massive power demand from AI and hyperscalers. Despite recent paper market disconnects and transient Chinese demand slowdowns, physical oil markets remain structurally tight with depleted global inventories. Concurrently, grid capacity bottlenecks are forcing data center operators to adopt behind-the-meter power solutions. ProPetro presents a highly compelling investment opportunity to capture this shift; it leverages its core oilfield service cash flows to scale its high-margin, long-term contracted power generation segment with minimal equity dilution risk.

Key Takeaways and Practical Lessons

1. **Energy Sector Valuation Lag: The energy sector represents 3% of the S&P 500 market cap while generating high single to low double-digit percentages of its free cash flow.**
    - **Practical Lesson: Overweight energy equities to capture the repricing driven by free cash flow convergence.**
2. **Refining Capacity Vulnerabilities: Unprecedented supply shocks in Russian refining capacity and physical transport choke points are eroding global operational inventory cushions.**

- **Practical Lesson: Position portfolios for commodity price volatility and upside spikes in refined product crack spreads.**

3. **Data Center Power Infrastructure Bottlenecks: Interconnection delays of five-plus years and skyrocketing grid capacity prices are making traditional grid power unviable for AI expansion.**
   - **Practical Lesson: Target investments in modular, behind-the-meter power generation providers securing 10- to 15-year contracts.**
4. **Paper vs. Physical Market Disconnect: Lower net long positions in commodity paper markets create a false signal relative to underlying physical market deficits.**
   - **Practical Lesson: Base supply/demand modeling on physical inventory drawdowns rather than short-term paper market positioning or chart resistance levels.**
5. **Growth Capitalization Efficiency: ProPetro funded its multi-gigawatt power expansion through convertible debt, lease agreements, and legacy business cash flow without diluting equity holders.**
   - **Practical Lesson: Prioritize capital-intensive growth opportunities where management utilizes non-dilutive financing and secure long-term investment-grade contracts.**

TRANSCRIPT

03:26:54:15 - 03:27:16:16

Matt. Polyak. Hummingbird. Capital. Hello, Matt. George, good to see you. And you. Thanks so much for doing this. We've been together on a couple spaces. We did a podcast incredibly well received. You're probably one of the most successful energy investors in the country that nobody's ever heard about. You're the one of those mysterious hedge fund guys in the background.

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How many? Greg capital is very kind of you to, be willing to do this to help the folks. Even for those of us that follow energy reasonably carefully, it's not so easy. So I don't know how the folks at home do it. So, you're the short answer, man, so to speak. So let's start off with some general talk about what's going on in energy.

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As you and I were talking off camera, you know, I had Mike Rosman on earlier this week urge everyone to go, see that interview. We both have a lot of respect for Mike. You know, the question. I said to myself, what the hell is going on here? I mean, you got the U.S. and Iran rock and a hard place, physical inventories, you know, as a building for, for for the barrels.

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Mike always runs those graphs, has changed the inventories, inversely correlated the changes in price, blah, blah, blah, blah, blah. You know, the speculators, the retail guys are all buried up on oil. The hedges are pretty long ish compared to their historical ranges. It's washed out. Starting to move now. This is a story about China. You know, stop buying oil now we're going to start buying or whatever.

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So let me stop. I'm just throwing logs on the fire. I want to hear what you have to say. So Matt thanks. Thanks for doing this. The floor is yours. Yeah. Again, I really appreciate, the chance to come and join you here. Always fun. And what an excellent, discussion you had with Mike. I've known Mike, since the beginning of my career, and, and always valued his insights and his graphs and and, just his his, just any discussion with him, and I know, he's got a lot of great anecdotes, but, as far as the energy markets are concerned, you know, you and I have

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talked about it in the past in terms of, I think the conclusion here is we are in the middle of an unprecedented regime change, change in free cash flow allocation in the broader global economy that is unprecedented. And the entire energy space is set up to benefit from the reallocation of these dollars. Ultimately, energy has sort of shrunk in market cap and relevance over the past 15 years to about 3% of the S&P 500.

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Today it's once again generating high single digit, low double digit percent of the free cash flow of, the S&P 500, as well as, you know, the earnings will certainly follow, as, as you've seen, dollar shift in commodity, prices have obviously been a nice tailwind as well. But, you know, I'd say on the energy side, one big takeaway that I have is I have been extremely surprised by the lack of Chinese buying post Iranian war.

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You've seen a significant pullback, imports into China. You know, you can assume there's very healthy inventory drawdowns happening over the past 4 or 5 months. And you see a reticence to run, refinery utilization in, in China, which just means they're trying to conserve barrels, as well. And so that could also lead to a more acute price spike on the product side.

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And obviously, the other unaccounted for sort of idea here has been the extent to which, the Russia Ukraine dynamic has impaired refining supply, beyond. But what can be predicted as some of these drones have been, very effective in taking off refining capacity. So, generally, you know, still the largest supply disruption of all time. It's been going on for months.

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Doesn't seem like it's getting any better. Seems like it's only potentially getting worse with, now ships getting turned around and the bottom end up straight. It's kind of a scary thing. Once you kind of normalize for the inventory cushion that we've had, what happens when, you know, operational inventory starts to really constrain. And so, crude at 87 bucks today is, is frankly pretty comfortable, especially inflation adjusted.

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And you know, like I said, these these companies in the energy space are making money. They're all benefiting from the change in capital allocation of of AI and hyperscalers spending, CapEx.

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So we're both fans, fully paid up. Fans of the Mike Rothman fan Club, we can buy who's going to be present. User can be vice president. Nobody counts barrels. Better than Mike does. Agree. And you know world Bank our head against the wall trying to figure out why O's and higher. Now I respect the market. You always have to respect the market.

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But you know, there's this line of a couple decades ago that people came up with. Price is truth. No it's not price is not truth. And.

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What do you think you know is it do you think there's some innate relation going on? A lot of conspiracy theories out there. The, you know, Scott person was playing the game and you I'm sure you know this better than I do. These prints come in at 2 a.m. in the middle of the night. Somebody sells like, 5 million barrels.

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Oh, yeah. Someone just woke up in a bad mood. Site saw some crude. I know you don't pretend to have any particular knowledge. I wonder why, but this is so odd. So let's turn on its head. Not understanding it. Let's try to reverse engineer this. Let's try to solve for X. Like what would you have to believe? To to say that these oil prices are not going to go up from here.

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I mean because I can't I can't I can't make I, I'm straining to, to come up with the argument. Is it that the low entries don't matter is that peace is going to break out and it was going to make nice like, what would you have to believe to not think oil prices are going to go up a lot?

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Well, the piece broke out tomorrow. You still have to replenish all the inventory that you lost. 2 billion barrels, a lot of oil. So, you know, we've talked about it in the past too, and I, I know you and Mike were discussing it just on sort of the physical to, paper market disconnect. There's plenty of interesting conspiracy theories going around as to what is actually going on in the paper market.

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You know, CFTC data, has cleaned up in terms of, net length in the commodity over the past few months. You've had people selling and there's actually net less net length, now, but, there was a month ago, pretty meaningfully to a much more normalized level. So if you kind of just look at the position level, the level of data and CFTC stuff, it's I just open interest to sort of come down pretty, pretty, meaningfully.

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So I think that's actually constructive for oil prices. The again, to feed conspiracy theories, if you just kind of look at the chart of oil, it's been, you know, meeting resistance on its 200 day. It's been, you

know, quite a lot of market technicians. I think playing, playing the charts selling but the physical market, I still, you know, call me old fashioned, but believe that the marginal supply and demand of every barrel should drive, price and ultimately, there's not enough supply, and demand has, been slightly impacted as a result of some of the more, acute impacts of of of, supply dislocations where there were places in Southeast Asia that

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had to shut in or, weren't able to get, you know, the fuel to power their infrastructure or restaurants or whatever it was, there was a slight demand impact and, more acute demand impact on of whatever China is doing. However, ultimately, I believe that we are undersupplied, right. And, you know, there there are bright spots in terms of, non-OPEC supply growth.

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Argentina, Brazil, growing five, 600,000 barrels a day, but that's obviously a drop in the bucket. So. So 15 million barrels, right. So you were positive you were positive energy before this conflagration started? In the Mideast, as was I in the Hormuz thing. Kind of like a distraction, like we were doing really well through the end of February to February 28th, when the nonsense started.

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And then, you know, the oil price went up and then it's really come down. And so, you know, everyone's everyone's focusing on the end, on the price and spot price in the screen. And it's all Hormuz all the time. But that's not the reason you were bullish on energy. It's not the reason I'm bullish on energy I almost wish this were Muslim.

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Just go away. So you just very cogently set out the reasons for being positive energy. So as you and I have talked many times before, there may be different ways to express that view, whether it's buying an ETF to buy the crude, you know, just by crude or by deferred crude going to subsector as one of the refiners, which I suspect you don't want refiners, drillers, offshore employees, integrated international.

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So let's talk about how do you what's what's your weapon of choice in terms of expressing your view. So, I've, I've got, a stock pitch for, for today. Obviously with the fall in the energy space that's been, I think even more compelling for the dispersion in some of these names. But, you know, I think about a the largest supply disruption ever.

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And then you compound that with this structural demand bull case for energy, where 25% of every CapEx dollar that any hyperscaler is going to spend is going towards energy, power infrastructure, for those data centers and, these hyperscalers, as of today, are still, you know, very rapidly going free cash flow, negative, spending these CapEx dollars where, they need gigawatts of power and interconnection delays are running five years plus and dealing with the bureaucracy of getting connected to the grid is just not as simple as some of these hyperscalers may have thought.

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And, you know, PJM capacity auctions are up tenfold with a seven gigawatt shortfall. The customer should do the rational thing, which is build their own power plant on their side of the meter, own it, and will control their destiny a little bit more. So I think the advent, behind the meter power, which is a business that did no EBITDA, just two years ago and had no market share or close to no market share, is now going to be 40 to 50% of incremental data center power demand by the end of the decade.

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And so I think that type of shift in dynamic creates quite a lot of opportunity. And one good way that I think listeners, and any investor, can sort of participate in that dynamic is, is perpetual. And so let me share kind of this, slide that I prepared, to get into a little bit more.

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But, we would love to do that. You know.

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Think you see that. Okay. Oh, yeah. Perfect. So pro Petro is, basically there's there's three reasons to own perpetual. One is it's, power business going from zero EBITDA to 850 million in EBITDA in five years, that the market is giving just a fraction of of credit. One stop press, as is my want. I'm going to interrupt you.

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I just want to contextualize what you just said. You just said in five years, 850 million. And my number was immediately drawn to the figures on the upper left. This thing is the Eve of 1,000,000,007 right now. So if I got that right, just for the viewers at home, you're talking about two times EBITDA five years out, and I get that right.

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Well that's that's giving no value to it's massively free cash flow generative business that they have founded and grown on. That's generating, you know, $300 million of EBITDA. Right. So, so I, I need to I need to shut up and let you tell the story going, well, you know, you kind of got ahead of the point to which was the base business is is quietly inflecting, you know, higher crude prices.

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You've seen rig count go up 30 rigs. Pricing power and operational leverage are very meaningful. Balance sheet is clean ahead of a large build cycle for a company that, I think is pretty misunderstood by the broader market. I think, you know, I've known this management team since they IPO and have had a good relationship with these guys, and I think they've, the current management team has done a very good job of, sort of taking a rational, conservative approach.

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And they have executed very well in their legacy business, their legacy frack business, which, basically position them to control very power dense assets to power these frack fleets, these gigantic 60,000 horsepower frac fleets, or, you know, from, an emissions standpoint, they're moving away from burning diesel and burning into a much more efficient electric fleet. And now the same sort of concept is being applied to these modular power units, to power giant data centers.

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And they are winning contracts with investment grade counterparties. Microsoft Z, Oracle, all of these companies have sort of thrown up their hands and underwritten this technology with ten, 15 year contracts, JVs and billions of dollars of investment. So but to the point on, the management team is, this management teams conservatism is going to be the fuel that the 15% short interest in this stock is going to burn up.

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So, you know, it's it's a it's a shorted, misunderstood name with a wonderful catalyst staff and, you know, getting a tiny fraction of what this business is worth, in my opinion. You know, I kind of talk about it on the slide itself, like the you just need the company to do what they said they're going to do.

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Yeah. So the short interest based on. Right, right. Let me ask you this. As far as the power generation side of things concerned, you have some of the, if some companies are to talk about a lot of growth. I know this is not an the cloud, but, you know, so a big number is prospective future growth, blah, blah, blah.

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Everyone focuses on the top line, but they don't pay attention to the capital.

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And city, you know, the dilution, which is often going to be masked in a lot of cases or what the margins might be. Is this company, going to have to raise a lot of money and have any sense, good sense of what the pro forma economics would look like, or is this a better experience? By contradistinction, you can take the neo clouds, you know, iron, all CFR or whatever.

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It's like garbage, total garbage. So explain to me why I shouldn't be skeptical. It's for the same reason. That's a great question. First of all, they have raised a meaningful amount of capital. They just completed a $675 million convert offering. So some of that is also playing into the short interest dynamics that I mentioned. Just having, you know, Arby's set, folks kind of inflating that short interest number.

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And they also did a 100. And so almost $170 million equity deal at the very beginning of the year. Now that convert that they did for $675 million was set. You know, it was a cap cost structure with a

conversion premium at 37.5% higher than where the stock was a few months ago, which was 30% higher than what that bit where it is today.

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So it was underwriting sort of a, you know, $20 conversion, if memory serves correctly. So ultimately and then they have this, this free cash flow engine from the base business, the legacy business that is funding this growth. And they also have a agreement with Stone Brier as well as caterpillar, who was their historically their largest supplier, for sort of lease agreements.

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So they can end these leases actually, depending on how they're structured can be NPV positive versus large upfront payment. For some of this equipment. So, this analysis that I put together on this valuation that I put together, I want to stress, is assuming that these guys are spending 1.6 $1.7 million per megawatt upfront and getting the equipment five years later.

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So you're kind of getting that NPV accretion along the way. Relative to when these megawatts are actually going to be deployed. So yeah, I want to make sure that that's coming across like, the cash is there. They have the cash that they need. The ongoing cash needs are funded by the base business. They have a lease agreement that they can fall back on, where there's no large capital outlays.

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And they have 240MW underwritten today versus, supply chain commitment of 2.6GW. So the job is still on them to contract another two plus gigawatts. That's a tremendous amount of power that's to Savannah, Georgia's worth of power, that they need to contract still. So, I understand the skepticism. I think, you know, the company has spoken very publicly about being in discussions and, you know, a couple hundred megawatt deals.

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They, just signed their first data center, a few months ago. They also are creating microgrids for traditional oil and gas exploration and production companies that are also ten year contracts. And from my perspective, as long as the return is there and it's a ten year contract and a high quality counterparty, I don't really care if it's a data center or a microgrid, but, because the return is the same and, and, you know, you just kind of lose the buzzword.

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But, ultimately, the management team is properly incentivized. They are comped on two things, right? Or, well, three safety. Free cash flow generation of the legacy business and their ability to sign megawatts. Well, the incentive is certainly there. So and okay, we're going to wrap this up. It sounds like a really interesting situation. Very attractive risk reward again.

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So an best advice I recommend everyone do their own research but certainly has a lot of talk to the upside and I got to ask the question. I always ask who was the good who's straight or so you got a

big short interest, right? So what are the signposts along the way, say, between now and the end of the year?

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Like how do you see this playing out? There any, deliverables or that they'll trigger which could, you know, make the stock go go up. Yeah. You know, obviously, Halliburton, one of their big, sort of competitors, just came out and done. Well, you know, them being a smaller pressure pumping player, there are 20% of the Permian themselves versus Halliburton and a half.

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Halliburton is sort of burdened by maintenance expenses and getting fleets back to work. But activity is improving. So I think there's there's a inflection in, in the base business fundamentals that is and pricing power that's better than people appreciate. And then I think they just need to do what they have said that they're going to do, which is get contracts.

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And and then you're unlocking billions of dollars of value. It sounds like exactly how it works. Again, not a short term idea, but it sounds like this could work for a

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lot. Matt, I can't thank you enough for doing this. And you're very private person. Your own private money. Very kind of you to try to help folks.

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Should really doing a public service here, trying to educate investors what I'm trying to do as well. So thanks again for doing this. We'll see each other I'm sure, and have the space podcast whatever. And again thanks so much. Really appreciate it. George, thanks so much. Take care. Take care.