Investor Insight: Fuel for Thought

Subject experts Arvind Sanger, Stan Majcher and Cale Smith describe how they're navigating the – to put it mildly – evolving global energy-investing landscape, how they think about what's "normal," and why they believe the market is mispricing Vista Energy, BKV Corp., California Resources, Ovinitiv, Devon Energy and Enterprise Products Partners.

Arvind Sanger
Geosphere Capital

"My preference for high-conviction bets is always on bottom-up ideas with unique company-specific characteristics."

Having closed your natural-resources fund in 2018, you started it up again in late 2021 as the Sensible Energy Transition Fund. Explain the rationale behind that.

Arvind Sanger: We need energy for human activity and human progress so there's always an element of growth, but this is a business with very long cycles. You want to invest in energy when an extended cycle of excess investment in supply is over. Business is terrible and CEOs promise capital discipline even if commodity prices were to go up, planning to return surplus cash to shareholders rather than throw money away by sinking it down holes. In 2018 I couldn't see when the sector would stop destroying shareholder value. In late 2021 I could see the beginning of a new cycle and thought it could provide investment opportunity for some time to come.

With constraints on supply, we saw the potential for a demand kick coming out of Covid and believed that fossil fuels as an energy source would have to play a more important role in the energy transition than advocates for alternative energy envisioned or wanted. Since then we've had an added kicker from artificial intelligence and its related data centers' hunger for energy. Over the last 12 years 90% of the increase in global oil demand was met from increased U.S. shale production, but even there the easiest-to-find oil is running low and production is plateauing. Putting aside the hopefully short-term impact of the war in Iran, we believe for the foreseeable future the supply/demand dynamics support higher rather than lower prices for oil, natural gas and some critical minerals. We're still at a point in the cycle for energy, metals and mining where we see opportunity.

What do you typically look for in prospective ideas?

AS: I come at new ideas in two main ways. One is more thematic where I may have a very bullish view on uranium, say, and I'm going to look for the best uranium companies I can find to express that view. The other is looking where there appears to be the most significant misvaluation and then working bottom up to understand what the market might be overlooking. It is important in these cases to identify advantages or aspects of the company's business that can make it work as an investment even if our view on the underlying commodity isn't panning out.

We've spoken about Warrior Met Coal [HCC], for example, where a key part of the thesis was that the company was one of the few players in its industry that was investing in new capacity at its Blue Creek development, which if it came in on time and on budget would significantly expand the company's earnings power [*VII*, April 30, 2024]. So there was a growth angle, not just a bet on the commodity price. In fact, because Blue Creek did successfully come online, the shares have done well since we spoke even though global prices for metallurgical coal have come down.

We always have ideas that fall into both buckets. My preference in terms of high-conviction bets is always on bottom-up ideas with unique company-specific characteristics, overlaid with an assumption that the commodity price either trades in a range or trends higher over time.

Explain how you approach valuation in energy, metals and mining names.

AS: In the last few years – for the first time in my 35 years in the business – we've been focusing on free-cash-flow yields. Because they are not reinvesting every penny back into the ground, many companies are generating a lot of free cash flow and based on our mid-cycle assumptions have 10% or better free-cash-flow yields on current share prices. They're returning most or all of that free cash back to shareholders in dividends and share buybacks, so the free-cash-flow yield can set a floor on what you as a shareholder can earn.

Before we talk about some current ideas, describe your general view on the market-clearing level of oil prices.

AS: Before the war in Iran, Brent crude-oil prices were in the mid to high-$60s per barrel. Our general view was that with U.S. shale production seeming to plateau, global oil supplies were sufficiently tight that global demand growth would meaningfully exceed supply growth over the next couple of years. To us that implied upward pressure on prices and we generally expected a $70-plus oil price to be the level at which demand and supply could be in relative balance.

The war has obviously thrown all that out the window in what we can only hope is the short term. Any lasting supply shocks would force painful demand adjustments, but barring a recession we now believe the floor could be $75-80 per barrel for the rest of the decade because of the political risk premium.

With that overall backdrop, what's your bottom-up investment case today for Vista Energy [VIST]?

AS: Vista is a South American oil and gas producer operating primarily in a shale play called Vaca Muerta in Argentina. Unlike most shale basins in the U.S., this is a young basin where production can increase rapidly and where all-in finding and development costs are currently in the $25-per-barrel range, one-third less than what you see now in U.S. shale. The current reserve life is almost 15 years and that will likely grow as they prove out more acreage.

So this is a cost-advantaged producer at an early stage in its lifecycle with significant growth potential. There's still additional pipeline infrastructure that needs to be built, but we think the company can grow production organically by about 10% per year, with another 5% or more likely from M&A. There's plenty of marginal acreage to buy and not many scale players to buy it, so we expect there will be more deals done at attractive prices like Vista's recent acquisition of Equinor's Vaca Muerta portfolio for $1.1 billion. On the cost side, while we aren't counting on it, as they grow they should generate greater cost efficiencies through the application of technology, driving production costs even lower.

INVESTMENT SNAPSHOT

Vista Energy
(NYSE: VIST)

Business: South American oil and gas producer whose primary assets are located in the large but early-in-its-lifecycle Vaca Muerta shale basin in southwest Argentina.

Share Information (@3/30/26):

Price	**76.55**
52-Week Range.	31.63 – 79.20
Dividend Yield	0.0%
Market Cap	$7.08 billion

Financials (TTM):

Revenue	$2.47 billion
Operating Profit Margin	53.3%
Net Profit Margin	29.1%

Valuation Metrics
(@3/30/26):

	VIST	S&P 500
P/E (TTM)	11.5	23.7
Forward P/E (Est.)	8.8	20.4

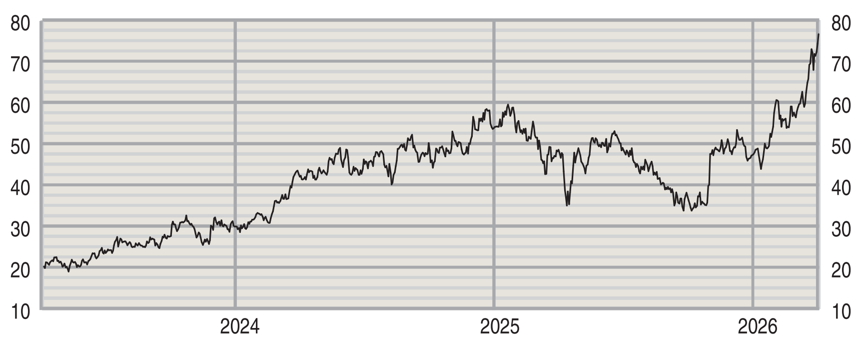
Largest Institutional Owners
(@12/31/25 or latest filing):

Company	% Owned
Capital Research & Mgmt	8.7%
T. Rowe Price	3.8%
J.P. Morgan Asset Mgmt	3.5%
Abu Dhabi Inv Council	2.8%
Ninety One UK Ltd	1.7%

Short Interest (as of 3/15/26):

Shares Short/Float	2.6%

VIST PRICE HISTORY



THE BOTTOM LINE

While he considers the South American firm a cost-advantaged producer at an early stage in its life with significant growth potential, Arvind Sanger believes the market is judging it as "just another mature U.S. shale company." Assuming $75-per-barrel oil, on his 2027 estimates the shares trade at a 14-16% free-cash-flow yield and only 2.5x EV/EBITDA.

Sources: S&P Capital IQ, company reports, other publicly available information

How are you looking at the political risk of investing in Argentina, where political risk has been an issue in the past?

AS: The biggest risk that is not in our control is the Argentinian presidential election expected in late 2027. The current Milei administration is generally pro-business and pro-development – positive for a company like Vista – and the most recent legislative elections indicated that the body politic is for now at least supportive of his political and economic agenda. There doesn't appear to be much appetite to return to the bad days of Peronism, but you can never say never. It's something we have to watch closely.

How is the corporate governance here?

AS: Management is quite solid, with strong capital discipline, a value-creation mindset and significant equity ownership in the company. They've been willing to invest in the business and have generally done it on a countercyclical basis at attractive prices. There is some leverage, which I don't normally like in a cyclical business, but net debt to normalized EBITDA is only 1.2-1.4x so I don't consider it at all excessive.

The stock has done quite well over the past year. How inexpensive do you consider it at a recent price of $76.50?

AS: We consider this a growth business, but the shares have been trading more like it's just another mature U.S. shale company. Assuming $75 oil, on our 2027 estimates the stock trades at a 14-16% free-cash-flow yield and 2.5x EV/EBITDA. That for a company that we think from increased production can grow free cash flow over the medium term at 15% annually. And the risk to me on oil prices is to the upside. For a company so directly tied to oil, higher prices would have an important incremental impact.

For another off-the-radar idea, describe your interest in BKV Corp. [BKV]?

AS: This is our largest position. BKV was founded ten years ago by Chris Kalnin, the CEO, in partnership with an Asian company called Banpu that mines coal and operates thermal and renewable power plants in Thailand. B stands for Banpu, K stands for Kalnin, and V is for Ventures. The idea was to buy natural-gas assets in the U.S., starting in the Barnett Shale, and then mirror the model in Thailand by buying an independent power producer in Texas in 2021. They've also set up de novo carbon capture and sequestration operations in the Barnett Shale and in Louisiana.

Last year they made an accretive acquisition of a private competitor in the Barnett and now 75% of EBITDA comes from the natural-gas exploration and production business. The reserve life is currently 10 years and with a break-even cost for natural gas of under $1.75 per Mcf they make good money with prices currently in what we consider at least a medium-term trading range of between $3 and $4 per Mcf. I should probably say a bit more about that: While demand is growing strongly for U.S. natural gas, supported by rising export demand for liquefied natural gas [LNG] and baseload-power demand for data centers, our view is that over the next few years the U.S. market is going to be well supplied by natural-gas production growth. As a result we're not making a big directional bet on gas prices.

The real excitement here is in the power business. They're actively discussing with hyperscalers to dedicate a portion of their current 1.5-gigawatt capacity for a new data center, while adding up to 750 megawatts of added capacity to meet new grid and data-center demands. They've also acquired several thousand acres of land near their Barnett properties for a greenfield power project using natural gas from their fields, and have placed orders for turbines and other power-generation equipment for 1.2 gigawatts in capacity.

INVESTMENT SNAPSHOT

BKV Corp.
(NYSE: BKV)

Business: Natural-gas exploration and production, with reserves mostly located in the U.S.'s Barnett Shale; also owns independent power production facilities in Texas..

Share Information (@3/30/26):

Price	**29.27**
52-Week Range	15.00 – 32.81
Dividend Yield	0.0%
Market Cap	$3.20 billion

Financials (TTM):

Revenue	$893.8 million
Operating Profit Margin	22.8%
Net Profit Margin	19.4%

Valuation Metrics
(@3/30/26):

	BKV	S&P 500
P/E (TTM)	14.8	23.7
Forward P/E (Est.)	14.9	20.4

Largest Institutional Owners
(@12/31/25 or latest filing):

Company	% Owned
Banpu Public Co	63.4%
Bedrock Energy Partners	4.8%
Boston Partners	1.9%
BlackRock	1.6%
Goldman Sachs Asset Mgmt	1.6%

Short Interest (as of 3/15/26):

Shares Short/Float	25.9%

BKV PRICE HISTORY

THE BOTTOM LINE

The real excitement in this business comes from the company's existing and future power-generation capacity in Texas that is likely to be in high demand from energy-intensive data-center projects tied to AI, says Arvind Sanger. Assuming an 8x EV/EBITDA multiple on his 2029 estimates, the share price would more than double from its current level.

Sources: S&P Capital IQ, company reports, other publicly available information

Texas is the #1 destination for new data centers in the U.S. and state regulators there are focused on making sure those centers don't unduly take power away from the grid on very hot or cold days when retail customers need it. As a result the state is encouraging data centers to set up their own power projects to avoid straining the grid. BKV is well-positioned to offer power with attractive economics that could be further bolstered by tying in carbon sequestration in ways that make the electricity generation "greener." That could have added appeal to hyperscaler customers.

What upside do you see in the shares from today's price of around $29.25?

AS: If we assume 3-5% annual growth in natural-gas production and that the company by 2029 has at least 1 gigawatt in power generation dedicated to one or more AI hyperscalers, we estimate that EBITDA can almost double from today's $550 million level. Putting an 8x EV/EBITDA multiple on that higher level of EBITDA – up from less than 6x today – would translate into a share price of around $65. With the potential of a second power location coming on line by end of the decade, there is likely to be even more upside as that project progresses.

One last thing I'd add is that the company is only covered by E&P analysts. As the power-generation part of the business becomes more important, we would eventually expect that to drive the valuation higher because power companies produce steadier, more predictable cash flow.

Is your competition as an energy-stock investor more limited than it once was?

AS: I was not the only investor to walk away from the sector seven or eight years ago. While I came back, a lot of sector-dedicated investors have moved away and generalists probably found more exciting things to invest in. That means there are probably fewer investors with long experience doing what I'm doing. Smart young people in the sector are mostly at the multi-strat hedge funds running market-neutral strategies. That to me is a very restrictive way to invest in such a long-cycle business. They're trying to pick up alpha by marrying one E&P or oil-field-services company against another and it doesn't matter what part of the cycle you're in.

I think the real opportunity in a cyclical industry is when the wind is in your sails but nobody's paying for that. I believe that's the case today and it's what makes the value investor in me very excited.

If you turn out to be wrong investing in the sector, why is that most likely to be?

AS: I'm less concerned about supply shocking me in the various commodities. The surprises would likely be on the demand side from a serious economic slowdown, for example, tied to the war or otherwise. The biggest concern I'd have is if the situation in the Middle East drags on and the world concludes we need to reduce our reliance on oil and gas flowing through the Strait of Hormuz. This could cause renewables to get a second burst of momentum, which they have lost in the last couple of years. Would it make a meaningful dent in demand in the next two or three years, no, but in four or five years it could.

Stan Majcher
Hotchkis & Wiley

"The situation in the Mideast may cause a significant and extended deviation from our estimate of normalized oil prices."

Why have you over time found energy to be fertile investing ground?

Stan Majcher: As an active manager you try to outperform by taking advantage of some type of market inefficiency. As a value investor that translates into buying something for a lower price than it's worth, meaning we get a higher return than the discount rate the market is using. Energy is fertile ground because it's complicated and it's a small portion of the index so people don't focus on it. That's particularly true in small and midcap names. I was at a conference earlier this month and most of the active managers there were talking about whether they were overweight or underweight Exxon or Chevron and there was little discussion of what they were intrinsically worth.

One unique characteristic of the oil market is its ability to revert back to balance. A year and a half ago people were predicting a heavily oversupplied oil market and that oil prices were going to fall. Oversupply happens in every cyclical market and our argument from seeing cycles over and over is that the market responds by delaying or shutting down uneconomic projects. Given that global oil production decline rates are higher than they have ever been and that reducing capital spending has a more immediate impact than it ever has, we felt oversupply would be short lived. People underestimate the ability of the market to revert, which can create opportunity from time to time.

We haven't yet changed our view that $75 per West Texas Intermediate [WTI] barrel is a normalized price for oil where the market balances. Above that you see production come on to take advantage and below you see higher-cost production pull back. The situation in the Mideast may cause a material deviation from those levels for an extended period. The longer the Strait of Hormuz is disrupted, the problem in energy markets goes from a logistical issue to one where production is shut down in a material way because there's nowhere for the oil to go. That would put a lot of upward pressure on oil prices and increase the risk of a significant economic contraction that would be needed to balance the market. Both the oil and equity markets seem to believe we're going to go back to balance or even oversupply quickly. Given the scale of what is happening I'm skeptical that will be the case.

Describe your general approach to research and analysis with a potential energy investment.

SM: Typically opportunities to buy something for less than it's worth occur because there is one or more controversies about a company that is being mispriced or the valuation metrics the market uses are distorted. It could be investors are worried about the company's resource life – the number of years to keep production flat at the current drilling and completion pace – and whether there's any terminal value. It could be around the extent to which production costs are changing. It could be uncertainty or concern around a particular political regime. One recurring theme of late has been finding companies that are spending a lot of capex on a project that doesn't come on for two or three years. Putting a multiple on free cash flow without adjusting for the current overspend means the market actually ascribes a negative value to the project when it shouldn't.

We generally know the controversies going in. Our focus then is on how impor-