The Weekly Beacon

We will be giving some macro economic market updates on a weekly basis. No equity recommendations will be given in this commentary, and we encourage you to contact us if you have questions regarding any observations.

The two main purposes of a Lighthouse are ***to serve as a navigational aid and to warn ships (Investors) of dangerous areas****. It is like a traffic sign on the sea.*

Fanad Head Lighthouse, Donegal, Ireland

Heceta Head Lighthouse, Oregon

Feel free to send us your photos of Lighthouses to be featured in our weekly market observations.

General Electric Split

After 130 years, General Electric's (GE) reign as one of the world's greatest companies is coming to an end (we say great for the whole period, we will get into recent history later). GE's remaining business units will be split up into 3 separate companies, aviation/aerospace, healthcare, and energy. The company that was founded in 1892 by Thomas Edison is nothing like it used to be, it does not even make lightbulbs anymore.

For shareholders, the last 20 years have been..........bad.

GE's stock is down 85% since its 2000 peak, creating an average annual return of -8.04% over that period.

Pre-2000 is the period when General Electric was a titan in public markets. The stock traded at $5 in 1982 and closed the century above $400/share. The average annualized return for GE investors was greater than 25% over those 18 years. The brick-and-mortar company rapidly expanded in the 80s and 90s and diversified into various sectors. The company took full advantage of rapid economic growth in this period. Since then it has been a struggle… By 2000, GE's debt had ballooned, and its businesses became less efficient. What made their struggles worse was the Credit Crisis when GE Capital was battered by bad debts.

When comparing the world's largest industrial companies in 2000 to today, one number stands out, 394.

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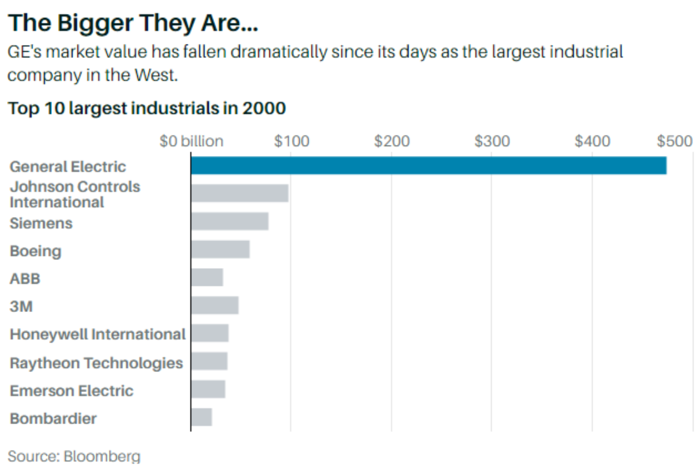

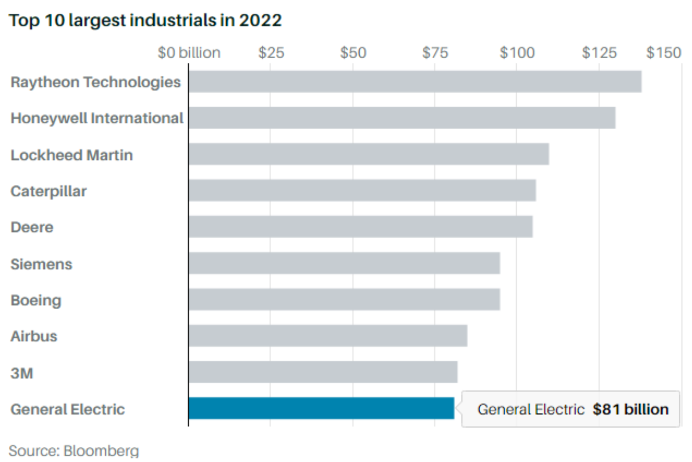

GE's market value has dropped $394 billion over the last 22 years.

So that is all in the past, why do we care?

The company split could come sooner rather than later as GE Healthcare, could be spun off in early 2023 (The original announcement by GE was in November 2021 at the height of financial markets). It's a sad end for a giant humbled by missteps. However, the transition could be a good thing. Once they exchange their GE shares for shares of the three separate companies, investors could start seeing some nice gains.

Why is that? The market will more than likely assign true values to these separate companies rather than undervaluing a massive conglomerate with limited comparables and a rough track record. At $73 /share, General Electric appears to be trading for less than the combined values of the 3 separate entities.

Using GE internal projections and market averages for the aviation/aerospace sector. GE Aerospace's enterprise value could be greater than $80 billion if market conditions return to pre-pandemic levels. GE Aerospace produces engines for both Boeing's 737 MAX and the Airbus A321neo. GE Aerospace is estimated to have an EBITDA of $7.7 Billion in 2024. The average EV/EBITDA multiple for Aerospace firms in the U.S. is 13.38x (NYU Stern). Many analysts believe GE Energy could be worth near $10 Billion and GE HealthCare in the $40-50 Billion range. All together on the low end, the companies could be worth (in total) $130-150 Billion.

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GE has an overall Enterprise Value of $95 Billion at the moment. The massive difference in numbers is attributed to future obligations and a large debt pile that GE will split into its various companies. GE's debt sits around $32 billion. Total cash, along with stock in oilfield services and equipment company Baker Hughes and aircraft sales and leasing concern AerCap Holdings, comes to almost $20 billion. Net debt would equal $12 billion. After accounting for all these costs, the company could have some upside going forward (if everything is smooth from here). It is no guarantee and GE does not have the track record we like, we are simply stating that these separate business units could hold the most optimism for GE shareholders in years. Even sell-side analysts have slowly turned around and have green-lighted GE as a buy due to the underlying values of the three separate assets.

*We do not own a position in General Electric.

EV Sales Boom

For long-time readers, critiquing EV producers has become a regular part of this publication. Sell-side analysts, politicians, investment bankers, and the media label these companies as transformative and slap them with massive valuations that make zero sense. We have regularly stated that Tesla is overvalued and that we do not recommend buying it at the moment, however, we would much rather buy it than any of the other pure EV producers that have recently gone public. Many EV producers that hope to compete with Tesla in terms of sales have gone public in the last 2 years, they all went public at the height of the market when bankers slapped massive EV/EBITDA multiples on companies and investors ate it up. Investors labeled all these companies as "transformative" and "essential". However, what has happened since was quite predictable. Every EV producer is down over double the market as they all struggle to produce anything.

We highlighted Tesla's major advantages as its production line and capacity. We also stated traditional automakers as the biggest threat to Tesla in the EV world as they have the production line, manufacturing space, and supply chain. A company growing from the ground up simply cannot produce a million cars in a year, they do not have the capacity, labour, or even capital. A few months later and investors are finally realizing, that production matters and flashy commercials do not (commercials only matter in crypto…..).

However, in the EV world, there are still some numbers that make us shake our heads. We will not mention Tesla here because Tesla looks like gold compared to some of its competitors.

Lucid Motors - labeled the luxury EV titan is down 57% YTD, yet the company is worth $30 Billion and only has $153 million in revenue in 2022. The only issue: net loss is $300 million so far this year and is

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estimated to be $1.9 Billion for 2022. The funny thing is Lucid has the best sales for the companies we will be highlighting.

Nikola, a SPAC favorite that once traded above $60 is down 30% YTD. Nikola is worth over $3 Billion and has created $19 million in revenue in 2022, the only issue, its net loss is expected to be $800 million in 2022. Another high multiple, low revenue, massive terminal growth value company.

And finally, the cream of the crop, Fisker. Fisker is worth $3 Billion and had $10,000 in revenue in the Second Quarter (that is not a typo or a mistake, 2022 revenue is expected to be under $100,000). Their $10,000 in sales can completely be attributed to T-Shirt sales. The company recently announced they were on track to start production this year. Meanwhile, during their public markets debut, the plan was different:

- Proceeds to fully fund the development of the all-electric Fisker Ocean through start of production in 2022

We certainly understand delays, and supply chain issues but to have not begun, almost 2 years after going public, investors should be pissed. They probably are. The stock is down over 40% YTD and even more from its highs. We bet many wealth management clients of investment banks have been caught holding the bag for longer than they thought.

Even if Fisker or the other companies bounce back and start producing vehicles, it will be quite a long time until Tesla is within reach let alone positive free cash flows or even profitability.

These 3 EV companies were chosen and more could have been used to describe this point. EV companies went public way too early (minus Tesla), and investors did not understand the risk in investing. Many retail investors probably do not understand some of these companies have the possibility of going under due to the capital-intensive requirements and economic backdrop. What happens when IPO and SPAC proceeds run dry and market conditions do not improve?

Just zooming out and looking at Price to Sales ratios of various automobile makers, a pattern is very obvious. (No EV producer is profitable, creates a positive FCF, and most have a negative EBITDA, thus Price to Sales was chosen due to lack of options).

COMPANY	PRICE TO SALES RATIO
TESLA	14.92
TOYOTA	0.7991
VOLKSWAGEN	0.39
MERCEDES BENZ	0.45
FORD	0.42
RIVIAN	219.78
LUCID MOTORS	170.91
FISKER	31720

NIO	5.71
NIKOLA	1,730
LORDSTOWN MOTORS	No Sales

We understand EVs are likely the future but these valuations are flat-out ridiculous.

<u>Inflation "Reduction" Act of 2022</u>

Last week we mentioned that Joe Biden and his party had secured enough votes in the Senate to pass a Bill termed the "Inflation Reduction Act". Moderate Senators in the Democrat party were all on board. One Senator, Sinema from Arizona green-lighted the Bill late last week (she made one major change). Unfortunately, her change was not a reduction in the size of the Bill or removal of tax increases. Her only change to the Bill was something that was targeting Wall Street. Democrats were forced to drop "the provision that would have closed the carried interest tax loophole". Seems interesting, to raise taxes for consumers but not for Wall Street.

CNBC described the loophole as a tax law that allows hedge fund managers, law firm partners, and private equity executives, among others, to pay significantly fewer taxes than ordinary workers. Closing that loophole, which was estimated to raise $14 billion in tax revenue over the next decade, was supposed to help pay for $433 billion in spending on climate and health initiatives. The massive spending-and-tax package squeaked through the evenly divided Senate 51-50 on Sunday with Vice President Kamala Harris' tiebreaking vote. It's expected to pass the House later this week.

Even with economists and industry professionals screaming from the rooftops that this would increase inflation, Democrats did not care and passed the Bill anyway.

BIDEN ADMINISTRATION

Even Biden's Favorite Economist Says Inflation Reduction Act Won't Reduce Inflation

White House touts report that says Americans will see no change in inflation due to the bill until late 2023

INFLATION · Updated on August 5

White House stands by Inflation Reduction Act after CBO warns inflation won't drop as a result

White House press secretary Karine Jean-Pierre insisted that lowering inflation is 'exactly' what the legislation will do

ECONOMIC POLICY

Why the ‘Inflation Reduction Act’ is no such thing

Perspective by Steven Pearlstein
Columnist
August 7, 2022 at 12:10 p.m. EDT

Congressional Budget Office (CBO) - The CBO is a non-partisan federal agency within the legislative branch of government that provides budget and economic information to Congress.)

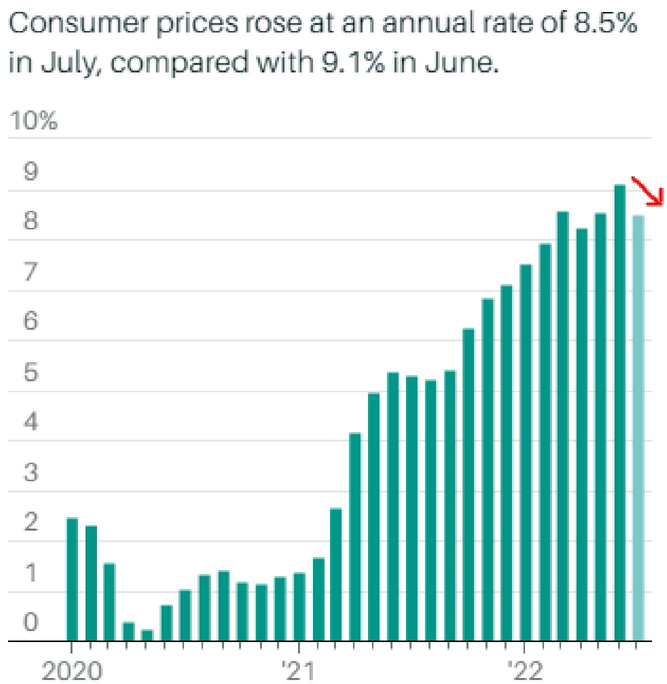
Either way, even if taxes are raised, it will not be until next year (2023), but, spending will begin immediately. The result will be more government spending when inflation is at a 40-year high and people cannot afford necessities. Seems like a horrible move and a desperate move for 2022’s midterm elections.

When both the CBO and the Washington Post both agree that inflation will not be reduced by this Bill, people should listen.

Either way, expect higher prices, more carbon taxes, and no solutions. All this Bill promises to do is cause more energy shortages going forward.

Speaking of Inflation

July’s inflation data was released on Wednesday. For the first time in a while, inflation dropped month to month. However, it still is at a 40-year high and prices are still being reported to increase year over year at almost 9% (we think it's higher). The major decreases seen in the last month were seen in energy where oil, retail gasoline, and electricity prices all dropped. Energy prices dropped for several reasons but in the medium term, they look like they have almost bottomed. The only solution for high energy prices has been to release oil from the Strategic Petroleum Reserve (SPR) and beg OPEC nations for more production. Two issues, the SPR is drying up and is at a 40-year low (in terms of capacity filled), and OPEC countries are struggling to fill current quotas (how do we expect them to increase when they cannot fill current quotas).



We will not dive further into energy but, we do think inflation can rise again and quite quickly as energy prices increase.

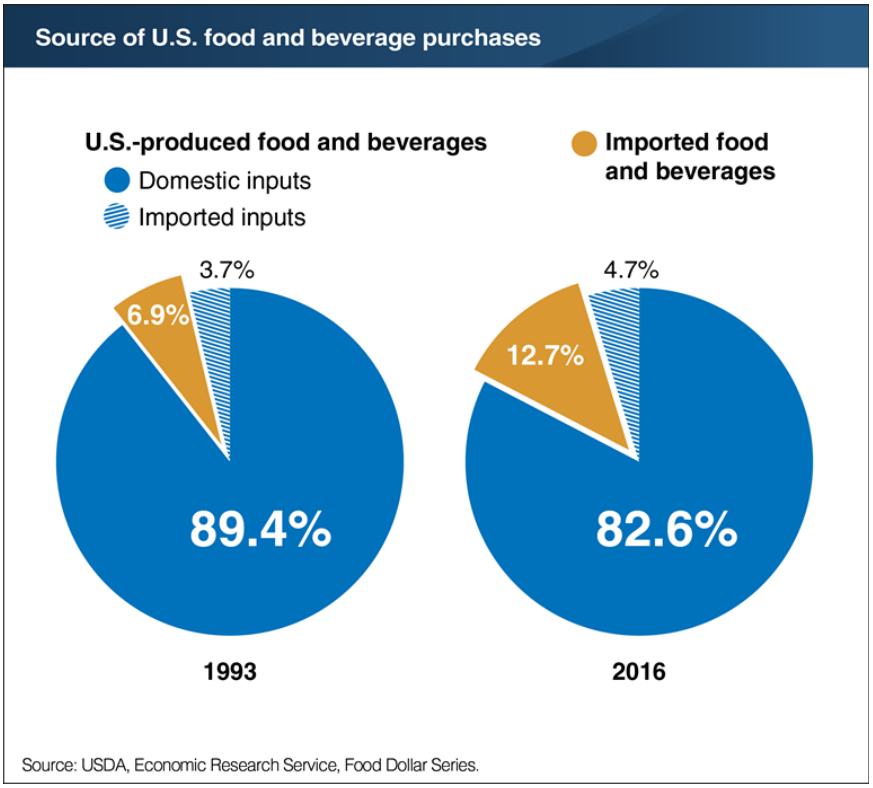
The consumer-price index stayed flat in July from a month earlier and decelerated to an 8.5% annual pace. The Labor Department reported Wednesday, marking a sharper fall than had been expected from the previous month's 9.1% pace. Economists had forecast a 0.2% rise in July over the month and 8.7% over the year.

Much of the fall in the pace of inflation in July was due to the drop in gasoline prices, which fell 7.7% over the month. Other categories saw significant declines as well, including airfares, used cars and trucks, and apparel. Most of the large "fallers" are tied to oil prices so it's no surprise.

While consumers got relief at the pump and on their energy expenses, another necessity food increased at a record rate in July.

Grocery prices in July had their largest price increase since 1979. The price of food at home rose 1.3% from June to July, marking a 13.1% increase compared to last year. Among groceries, egg prices had the largest increase. Their cost rose by 4.3% in July, and 38% in the year. Potatoes also rose 4.6% on the month and 13.3% year-to-year. Butter was up over 26% on the year in July, and coffee rose by over 20% over the same period. Either way some frightening news for consumers. The unfortunate news, this could get worse. Looking past short to medium-term supply chain issues, and a conflict in Ukraine, major policy errors are being made by governments that will cause massive food shortages. Fertilizers being banned, farmland being seized in the name of pollution reduction, and heavy regulation by governments across the world will lead to higher food prices. These errors are happening across the world and are most evident by looking at Sri Lanka but are also happening all across Europe. Canadian farmers are currently in gridlock with the Justin Trudeau Administration over pending policy and the U.S. has even mentioned decreasing emissions through green farming. Green farming decreases production.

A glaring trend has also started to occur in the West. It is importing more food on a percentage basis. They have not increased production domestically at the same rate consumption has:



We talk about energy security being a national security issue. Will food security become the next major national security issue?

We will not go further into this topic but will be hosting a webinar on Wednesday, August 24th where we will talk about Food Security with Jason Aitken, President of Qu'Appelle Beef, a Canadian Beef producer based in Saskatchewan. Click here to register for the webinar.

MacNicol & Associates Asset Management has exposure to this ongoing issue in both public and private markets.

This is the Future

The future will be an interesting place. Predictions on what will happen in the future are wide-ranging. Either way, some of tomorrow's economists or columnists that write about the economy might write with a different lens than old-school economists……

This is a real headline from the New York Times.

The New York Times

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OPINION
GUEST ESSAY

The Vibes in the Economy Are … Weird. Really Weird.

Aug. 4, 2022

We know it's tough to read today's economy but it's in a recession due to government-caused inflation. Either way, the headline made us laugh, and we hope it does the same for you.

Planned Blackouts

When we proclaimed rolling power outages as a thing that will come true, we were doubted by many. Many pointed to western governments and said they simply would not let it happen. The unfortunate issue, it already has. California has used rolling blackouts to save power during energy shortages. The good thing for California residents, the climate is extremely nice, and one can live without air conditioning and a furnace (most of the time). The issue would be when these rolling blackouts trickled into areas of the world that rely on furnaces in the winter due to the cold.

Well the UK is the first of many that will be employing blackouts this Winter. They are running numbers and understand it's what has to be done. Remember what happens in the UK will be much worse in Germany whose energy grid is Russian and green-reliant and is already in complete shambles.

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UK Braces for Blackouts, Gas Cuts in January in Emergency Plan

Tuesday, August 9, 2022 09:50 AM
By Alex Wickham and Rachel Morison

- Reasonable worst-case scenario envisages 4-day power shortfall
- Industry, households could face planned power outages

(Bloomberg) -- The UK is planning for several days over the winter when cold weather may combine with gas shortages, leading to organized blackouts for industry and even households.

Under the government's latest "reasonable worst-case scenario," Britain could face an electricity capacity shortfall totaling about a sixth of peak demand, even after emergency coal plants have been fired up, according to people familiar with the government's planning.

Under that outlook, below-average temperatures and reduced electricity imports from Norway and France could expose four days in January when the UK may need to trigger emergency measures to conserve gas, they said. The government Department for Business, Energy and Industrial Strategy didn't immediately respond to a request for comment.

Either way, we hope anyone affected by these blackouts is not seriously hurt and do hope the energy situation improves around the world. We doubt governments will implement what is needed to be done to expand the energy supply. We think they will continue bowing down to the green energy team and the ESG crowd which will in turn hurt society.

MacNicol & Associates Asset Management Inc.
August 12, 2022

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