

Exiting Energy - Obsolescence Risk Rising

Re-opening Theme - An Opportunity to Exit Client's Exposure to Oil

Maple Capital used the prevalent re-opening theme in the equity market as an opportunity to eliminate our client's exposure to the oil commodity in most portfolios. In our view, **investors are not being properly compensated for assuming the rising risk of long-term volume declines and obsolescence in the primary consumable end-market.** We anticipated a re-opening rebound in the energy sector and now that share prices have moved near or passed pre-pandemic levels, we executed on that part of our strategy. We will be using those funds to reallocate to **businesses we believe will provide higher return on capital and should benefit from the transition taking shape in the energy sector.**

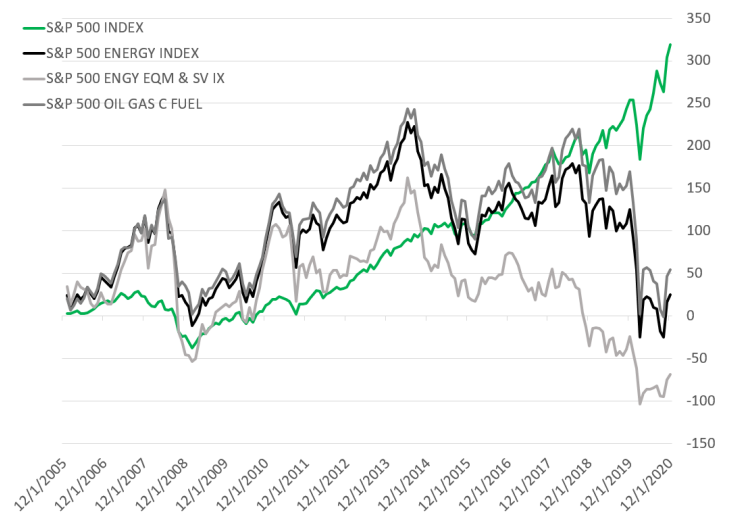
Price-taker Business Along with Cartel Risk

Generating consistent returns in the oil industry has always been fraught with more risk relative to other sectors. The industry is full of very capital-intensive and price-taker businesses that require scale and leverage to operate efficiently. Moreover, instead of a market pricing mechanism driven by supply-demand dynamics, prices are more often determined by OPEC (Organization of the Petroleum Exporting Countries). The power in this cartel consists of National Oil Companies, typically run by autocratic governments, whose main interest is to remain in power for perpetuity – that is what autocracies do. Controlling 80% of the world's low-cost proven oil reserves gives pricing power to this cartel, not the firms available for public investment. In our view, the cartel through various strategies, has kept any major advancement in energy efficiency at bay. We believe that is going to change.

Electrification Creates More Risk of Value Traps, not Value

Electrification is coming to petroleum's major end-market (68% of transportation) via battery (EV) or hydrogen fuel cell (FCEV). Nearly every major auto and/or truck manufacturer has committed to either all EV or FCEV production. We have no idea which will grab

EXHIBIT 1: Energy Sector and Industries Lagging in Returns With Higher Volatility Over Long Time Frames



Source: Bloomberg Financial L.P.

dominant market share, as it could depend on the type of vehicle and its purpose (passenger vehicle, delivery, bulk etc.), just to name one variable. Either way, **natural gas or renewables will replace oil as the consumable due to the economics of much higher equivalent mpg.** In addition, environmental concerns, institutional ownership pressure, and major firms committing (and requiring supply chains) to net-zero carbon dates, also seem to be tipping the scales. Big picture math says petroleum is set up for a steep decline in volumes. We see more risk and uncertainty, rather than value in oil over our long-term investment horizon.

Dividend, Fixed Income Strategies Still Have Exposure

Outside of our core equity allocation, we still have exposure to energy firms. We are comfortable deriving income for clients via firms in traditional energy since lenders to the business are higher in the capital structure for claims on cash flow. However, this view is under constant vigilance and may also evolve, depending on the pace of transition. Traditional energy firms will want natural gas (**oil is on the way out**) to be

used for the electric grid and the electrolyzers that **separate** hydrogen. Renewables are already taking steady market share in the grid. Furthermore, according to recent reports by reputable industry sources, the cost of renewables to also power electrolyzers in the coming years will be cheaper than natural gas by 2030 in many locations. Natural gas could also lose market share to renewables in hydrogen production should it materialize.

As always, time will tell.



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