



IntegrityVikingFunds®

THE NICHE FUND GROUP

# AMERICAN ENERGY

*Integrity*

**Mid-North American Resources Fund**

ICWIX // ICPAX // ICPUX

*Carbon Capture & Storage*

*Portfolio Manager Update: Energy is Leading*

*The Disconnect in Energy Markets*

*Winners Circle: Devon Energy*

Updated as of 9/30/2021

# Is Carbon Capture & Storage Leading the Way to 'Net-Zero'?

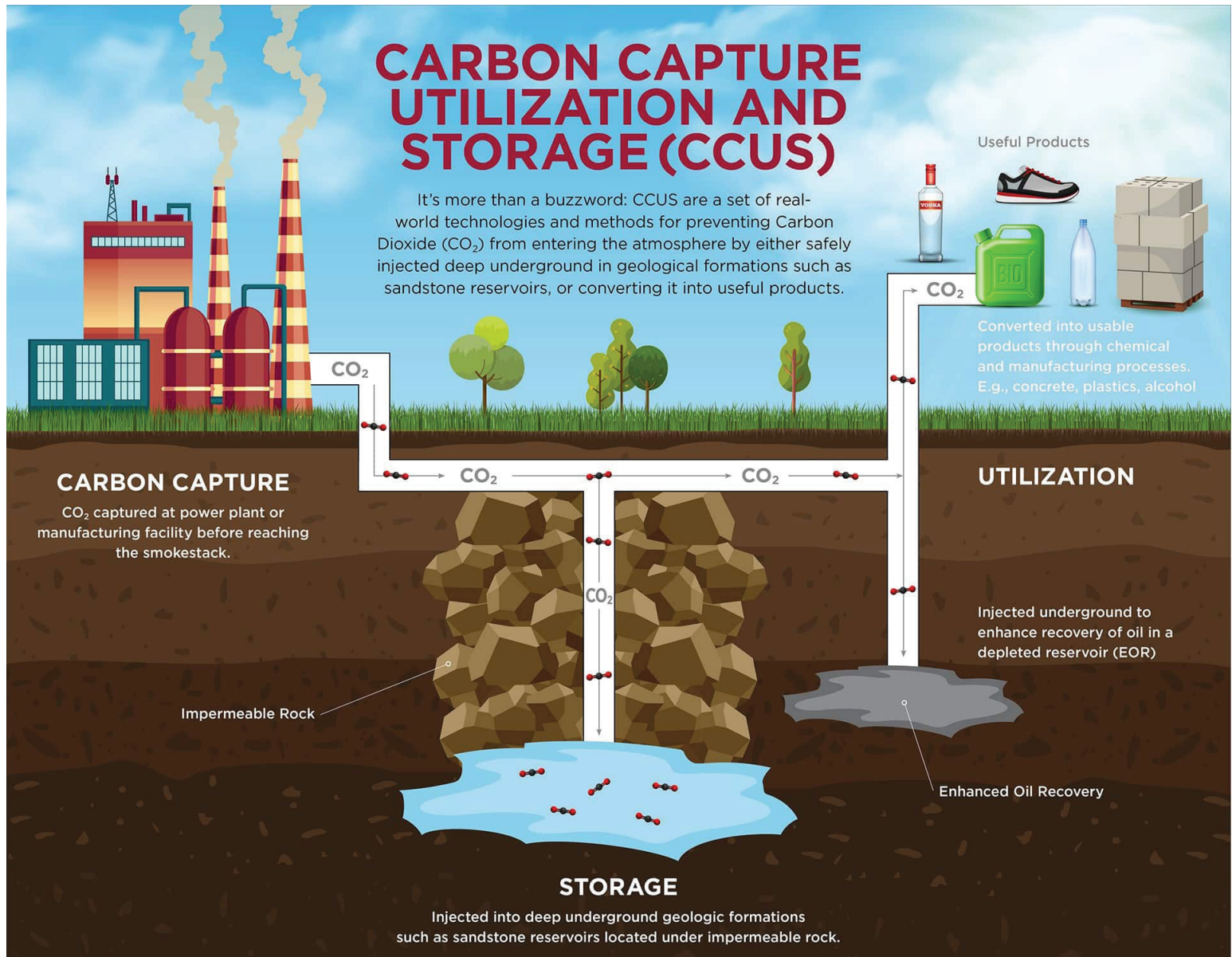
A multitude of Net Zero emissions targets have been announced over the past two years across many sectors, including energy. Institutional investors and energy corporations alike have reflected this shifting mindset, with a heightened focus on addressing the E in Environmental, Social and Governance (ESG) considerations. It is possible that Carbon Capture & Storage could play a leading role in capturing and permanently storing CO<sub>2</sub>.

While technologies like wind and solar will continue to play important roles in reducing emissions, CCS also offers a significant impact, particularly in the power generation and manufacturing sectors. As recently as last fall, the International Energy Agency said "reaching net-zero emissions will be virtually impossible" without it.

Despite its potential, we count just 26 CCS/CCUS projects worldwide capturing 36.6 million tonnes of CO<sub>2</sub> per annum (Mtpa) — or just 0.1% of global CO<sub>2</sub> emissions of 38,000 megatonnes in 2019. In our minds, limited adoption of CCS likely reflects an inadequate carrot-stick dynamic. Industrial emitters historically have not had to retrofit facilities with capital-intensive CO<sub>2</sub> processing capability given the option of direct release into the atmosphere and limited carbon levies. In the absence of revenue drivers involving the secondary use of captured CO<sub>2</sub>, CCS is a capital-intensive process with fragile returns that rest almost entirely on carbon prices and government policies. Carbon capture is the most costly component of the CCS equation and one that is benefiting from research & development and the potential for commercial scale. Anchored by its 45Q incentive tax credit structure and enhanced oil recovery structures, the United States leads the way in CCS. Canada, Norway, Australia, Saudi Arabia and the UAE are distant seconds numbers wise, but possess some high profile projects.

Carbon Capture and Storage may offer an immediate and direct path to placing CO<sub>2</sub> emissions back into the earth, albeit one still in the early stages of development.

## How it Works



Source: Context Energy Examined; published 12 May 2021.

# Energy Industry Update

From the Portfolio Management Team of the Integrity Mid-North American Resources Fund



Michael Morey



Shannon Radke



Trey Welstad, CFA

## Further Upside?

Energy is leading all S&P 500 sectors YTD, trading up 45% as of the end of the third quarter. While this move is very encouraging for the sector, we feel there is ample upside left. Next year is shaping up to be a rare cycle for energy with both demand strengthening and supply tightening. This dynamic has not occurred in over a decade and we believe energy is in the early innings of a multi-year, structurally strong cycle. Tailwinds for the energy sector are growing on a monthly basis. Demand is continuing to recover from COVID-19 with gasoline and diesel demand above pre-pandemic levels, while jet fuel demand continues to lag. Global oil inventories are below 5 year averages and we are currently undersupplied by over one million barrels of oil per day (bopd). OPEC's commitment to raise production by 400,000bopd per month remains firm and the group should reach their desired production goals by the end of 2022. Once their desired production level is fulfilled, there should be an increased call on shale to meet the world's growing demand. Global expenditures for exploration and production have decreased dramatically over the past decade and the lag effect of expenditures and realized production is creating an undersupplied environment. Here lies the "Catch-22": to meet global demand, capital expenditures need to rise; investors of oil producers have made it clear they want them to maintain capital discipline and return cash to shareholders versus increasing investments. We see higher oil prices and low inventories pushing oil producers to eventually vocalize the urgency to shareholders and ultimately raise capital budgets. The energy sector appears cheap and under-owned relative to the broader market. We believe the supply and demand imbalance, inflation hedging, and the unintended consequences of energy transition policies should keep energy's run alive for the foreseeable future.

## Importance of Fossil Fuels

The world is in an energy crisis as both natural gas and oil inventories are below 5 year averages. Capital expenditures towards renewable energy have ballooned, however, conventional energy capital expenditures have declined to unsustainable levels. Energy shortages across the world highlight the importance of fossil fuels and the necessity of an "all of the above" approach to secure energy availability. The importance of fossil fuels can be seen in the durability of consumption. While the world continues to progress towards renewable energy, 84% of global energy consumption came from fossil fuels in 2020. That is the same percentage as in 1980. The energy landscape is changing and the growth prospects for renewable energy are undeniable, but fossil fuels are here to stay if the world wants affordable and dependable energy.

*All expressions of opinion are subject to change without notice in reaction to shifting market conditions. Data contained herein is obtained from what are considered reliable sources. However, its accuracy, completeness or reliability cannot be guaranteed.*

## Disconnect in Energy Markets // Underinvestment and Rising Demand

Daniel Yergin, Vice Chairman of IHS Markit spoke with CNBC recently on the realities of the oil market dynamics and the policies being implemented. "There's a disconnect in the energy market, and it could lead to future supply shortages," Yergin said.

**"There's a disconnect in the energy market, and it could lead to future supply shortages."**

*- Daniel Yergin, Vice Chairman of IHS Markit*

He continued saying oil producers are "clearly not investing enough" because investors want them to be more careful and exercise capital discipline. On the other hand, "world demand is going to be back where it was in 2019 in the next few months, and demand will continue to grow, so you will need investment," Yergin said.

While Yergin's comments were focused on the broad global energy market, they hold true to the US Shale market as well. According to the Department of Energy, U.S. oil production remains about 12% below where they were in February 2020 in the early days of the pandemic. That's equivalent to removing the U.S. Gulf of Mexico's entire output from global markets.

### Crude Deficit

**U.S. oil supply is still well below pre-pandemic levels**



Source: Department of Energy

Bloomberg

# Winner's Circle // Devon Energy



# devon

## About

Devon Energy is a leading oil and gas producer in the U.S. with a premier multi-basin portfolio headlined by a world-class acreage position in the Delaware Basin. Devon's disciplined business model is designed to achieve strong returns, generate free cash flow and return capital to shareholders while focusing on safe and sustainable operations.

## History

Devon was founded in 1971 by John Nichols and his son Larry. Nichols got his start as a Certified Public Accountant auditing books of oil companies in the Oklahoma City area. In 1950 he registered the world's first public oil and gas drilling fund with the Securities and Exchange Commission. In 1988 he took Devon public by listing DVN on the American Stock Exchange. In the 90's and early 2000's Devon made numerous acquisitions of Oil and Gas companies spanning from the Gulf of Mexico to Canada. More recently the company has shifted its focus to become a premier North American Shale company. To attain this, Devon divested its offshore and international assets, and made strategic purchases in North American shale plays.

Perhaps the most influential transaction would be the merger of equals with WPX Energy that was completed in January this year. "This transformational merger enhances the scale of our operations, builds a dominant position in the Delaware Basin and accelerates our cash-return business model that prioritizes free cash flow generation and the return of capital to shareholders," said Dave Hager, executive chairman. "We are excited to combine our teams and we look forward to executing on our disciplined strategy to create value for all of our stakeholders."

## Devon Energy Corporation

Ticker: DVN

Headquarters: Oklahoma City, OK

Founded: 1971

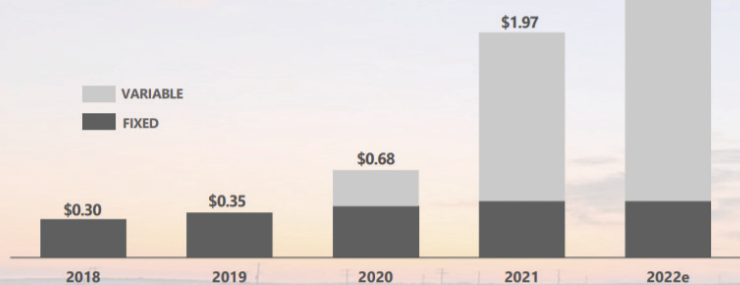
Employees: 1,400

Market Cap: 27.4B (10/25/2021)

## A history of returning cash to shareholders

(Dividends per share)

 **29** CONSECUTIVE YEARS OF DIVIDEND PAYMENTS



(1) Assumes \$80 WTI, \$4.00 Henry Hub & NGL realizations at 45% of WTI and that 50% of excess cash flow (adjusted free cash flow less fixed dividends) is paid through a variable dividend. Any future dividends, whether variable or fixed, are authorized and determined by the board in its sole discretion.

Source: Devon Energy Corporation; Q3 2021 Earnings Presentation

**Discipline and Dividends.** To prove this, Devon announced an industry-first variable dividend earlier this year. The company's fixed-plus-variable dividend framework is designed to pay a sustainable fixed dividend through the cycle and evaluate a variable dividend on a quarterly basis. After the fixed dividend is funded, up to 50 percent of the remaining excess free cash flow in each quarter may be distributed to shareholders through a variable dividend. "We are excited to reward shareholders and differentiate ourselves from peers by declaring an industry-first variable dividend," said Rick Muncrief, president and CEO. "With our business scaled to consistently generate free cash flow, this innovative 'fixed plus variable' dividend framework is uniquely designed to enhance our ability to return meaningful and appropriate amounts of cash to shareholders across a variety of market conditions."

Devon touts being committed to leading the industry with

**Investments may lose value. The Fund is sold by prospectus only. An investor should consider the investment objectives, risks, and charges and expenses of the Fund carefully before investing. The prospectus contains this and other information about the Fund. You may obtain a prospectus at no cost from your financial adviser or at [www.integrityvikingfunds.com](http://www.integrityvikingfunds.com). Please read the prospectus carefully before investing.**

The Fund's top ten holdings are: Devon Energy 8.21%, Pioneer Natural Resources 7.47%, Cactus Inc 7.03%, Cheniere Energy 4.64%, Baker Hughes 4.33%, Diamondback Energy 4.16%, Enbridge Inc 3.81%, ChampionX Corp 3.73%, Phillips 66 3.69%, Exxon Mobil 3.36% and represented 50.43% of the Fund's portfolio as of 9/30/2021. The portfolio may or may not hold and is not restricted to the companies listed.

Because the Fund normally invests in common stocks of companies engaged in natural resources-related activities in a limited geographical area, the Fund's performance largely depends on the overall economic condition of the related sectors and geographical area. Additionally, diplomatic, political or economic developments in foreign countries could adversely impact the Fund's investment in securities of foreign companies.



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