The Ukraine War and Equities: Surprising Findings on Defense, Commodities, & Tanker Stocks

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As we mark the somber first anniversary of Russia's invasion of Ukraine, I thought it would be interesting to have a look at what equities have been impacted by this brutal and very unnecessary war. My first thought was that defense or drone stocks would be slam-dunk outperformers. I also figured there would be several resource companies that may have done well if they produce key commodities where Russia was a dominant player, assuming the company in question wasn't actually operating in Russia where it likely would have had to forego its assets. What I found surprised me.

Defense and Drone Companies

I first looked at the biggest U.S. defense and drone stocks and did not find what I expected at all. Let's start with Raytheon Technologies Corporation (NYSE: RTX), and Lockheed Martin Corporation (NYSE: LMT) because not only are they two of the largest market cap defense contractors (US$145 billion and US$122 billion, respectively) but they also count as two of the biggest manufacturers of military drones. Excluding dividends, Raytheon is actually down 3.5% over the last year, while Lockheed Martin rose 10.5%. Granted a positive 10.5% return over the last year did materially outperform the S&P 500, which was down 9% over the comparable time period, I was expecting a much better return.

Given the ever-increasing use and impact of drones in Ukraine, I thought I'd look at a company that was almost exclusively focused on this sector alone to see if there was any difference in performance from the multi-faceted defense names. I choose Kratos Defense & Security Solutions Inc. (Nasdaq GS: KTOS). Not only because of the name but the Company has contract ties to the U.S. Department of Defense, and roughly 25% of Kratos' revenue comes from its "Unmanned Systems" division. This all sounds good on paper but the Kratos share price saw a dismal 40% loss over the last 12 months. Even with that pummeling, Capital IQ has the stock trading at 33.2x Forward P/E. I don't think I'll be putting this name on my list as a hedge against the war in Ukraine dragging on for a lot longer.

(Note: An Unmanned System (US) or Unmanned Vehicle (UV) can be grouped into four primary types: (1) in the air, as Unmanned Aerial Vehicle or System (UAV or UAS), commonly known as a "drone"; (2) on the ground, as Unmanned Ground Vehicle (UGV); (3) on the water surface, as Unmanned Surface Vehicles (USV); and, (4) in the water, as Unmanned Underwater Vehicles (UUV).)

Commodity Stocks

Time to change gears and start looking at commodities. Despite oil, natural gas, and refined products accounting for Russia's largest value of exports, I chose platinum as the first place to look given Russia's Norilsk Nickel (MISX: GMKN) accounts for 10-12% of the world supply, which is a higher percentage of global market share than oil or natural gas. For reference, Nornickel, as it is also known, is also the world's largest palladium and refined nickel producer, plus a top-ten producer of copper as well. The best platinum/palladium surrogate I could find was Sibanye-Stillwater (NYSE: SBSW), another of the world's largest primary producers of platinum and palladium. This stock

is down an abysmal 57% over the last 52 weeks. With platinum prices down 10% year-over-year and palladium down 41%, it appears the market isn't reeling from the impact of Russian supply disruptions in these particular metals.

Early in the conflict, natural gas was making a lot of headlines, with European prices spiking to unimaginable heights and all the subterfuge around the two Nord Stream pipelines. The leading European benchmark is Dutch TTF Gas and it is priced in Euro per megawatt hour (€/MWh). Despite this benchmark price peaking in late August 2022 at €339, it is currently trading below €50, even lower than it was trading before this whole mess began. Meanwhile, Henry Hub gas prices in the U.S. also peaked in August at US$9.71/MMbtu (Metric Million British Thermal Unit) but iscurrently transacting around US$2.70, also below year-ago levels. Thus, it will probably come as no surprise that big natural gas producer ARC Resources Ltd. (TSX: ARX) in Canada and EOG Resources, Inc. (NYSE: EOG), a leading gas producer in the U.S., are trading at pretty much the same price they were last year at this time. Or maybe it is a surprise as one might think they'd be down year over year based on the commodity price.

Oil and Refined Products Companies

The question is, did anyone's share price benefit from this unfortunate event? There were a few that I found and they were all oil and refined products related. The most well know name of the bunch is Exxon Mobil Corp (NYSE: XOM) which returned an impressive 41% excluding dividends over the last year. We all know Exxon is a behemoth, and there could be lots of reasons other than Russian supply disruptions that could have influenced the share price but other integrated global giants like Shell PLC (formerly Royal Dutch Shell) (LSE: RDSA | NYSE: SHEL) and BP plc (LSE: BP | NYSE: BP) all had similar one-year performances.

Albeit they all had setbacks of some form in the last year due to the fact that they had to write off or choose to sell (for essentially zero) some Russian assets. Regardless, the large integrated oil companies outperformed the rest of the sector for the most part.

Tanker Stocks

But the big outperformers were the oil and refined product tanker stocks. The returns in this category were what I would have expected from the defense stocks, which as we discussed above, were relatively disappointing. There are many to choose from but I looked at two that I have traded in the past but did not have the foresight to continue holding them. The first company is Scorpio Tankers Inc. (NYSE: STNG), a Monaco-based international transporter of refined petroleum products with a fleet of 113 vessels. This stock returned a whopping 255% over the last 12 months.

The second company is Frontline Ltd. (NYSE: FRO) a Bermuda-based company providing marine transportation of crude oil and oil products with a fleet of roughly 70 tankers. Frontline returned 97% excluding dividends since the end of February 2022. This quote from Scorpio's Q4, 2022 results pretty much sums up why this sector has performed as well as it has:

> *"…the volatility brought on by the ongoing conflict in Ukraine, which has resulted in the implementation of sanctions on the export of Russian crude oil and refined petroleum products, has continued to disrupt supply chains for crude oil and refined petroleum products, changing volumes and trade routes, and thus increasing ton-mile demand for the seaborne transportation of refined petroleum products."*

Scorpio's Q4/2022 vessel revenue increased 211% as a result and needless to say, the market paid attention even though I did not.

Today I've only scratched the surface of what ramifications the Russian invasion of Ukraine has had on markets and stocks around the world. What I truly hope is that I won't be doing this again a year from now.

Mission Ready Solutions enters 2022 with a new USD$200 million contract from the U.S. Department of Defense

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Defense is a growing business given the amount of upheaval and social unrest in the world today. Government budgets have increased substantially in the face of terrorist threats, the unsettled state of public safety and the COVID-19 pandemic. Today's company is well-positioned to benefit from the above as a contract supplier to the military and law enforcement, both in the USA and abroad.

Mission Ready Solutions Inc. (TSXV: MRS | OTCQX: MSNVF) (Mission Ready) innovates, manufactures, and supplies leading tech-centric defense and next generation personal protective technologies for military personnel, first responders (especially law enforcement, firefighters), and other government

agencies. Mission Ready is committed to being a global leader in personal protective technologies. The Company specializes in providing comprehensive solutions through its privileged access to a host of Federal contracting vehicles (including Multiple Award Schedule (MAS) contracts) administered by the U.S. General Services Administration.

Mission Ready innovates, manufactures, and supplies defense/protective products & solutions for the U.S government, first responders and other government agencies

Source: Mission Ready Solutions website

Mission Ready has several businesses and operates under 3 segments

Mission Ready's segments are Government Contracting Solutions, Manufacturing & Distribution, and Innovations. Mission Ready's businesses include:

- **Unifire Inc.** is the Company's government contracting division. Unifier is an industry-leading manufacturer and distributor of over 1.5 million fire, military, emergency, law enforcement, tools, hardware, and tactical items. Unifire not only sells products but provides specialized training for select first responder groups and law enforcement.
- **Advanced Tech Rescue** provides its own distinctive brand and channel to products manufactured by Unifire, and offers an easily accessible and navigable online platform for first responders and firefighters to find the products they need. Some popular products include rescue saws, rescue chains, positive pressure ventilation fans etc.
- **Protect The Force** specializes in the design and

development of technology, including superior Tactical Gear and Body Armor, providing innovative, modular and scalable solutions for military, law enforcement, fire and rescue personnel.

Mission Ready's businesses

Source: Company presentation

Mission Ready's financial performance has been strong in 2021

For the first nine months ending September 30, 2021, Mission Ready's revenue was $84.74 million, an increase of $22.3 million for the same period in 2020. Net income for the first nine months of 2021 was $1.54 million.

Looking ahead the outlook is strong. Of interest was the announcement on December 3, 2021, where Mission Ready was awarded a U.S. Defense Logistics Agency (a purchasing arm of the U.S. Department of Defense) contract valued at up to US$200 million for "COTS – Shelter Systems." The COTS program's supply chain, at present, offers military tents, parts, and support equipment.

Buck Marshall, President and CEO of Mission Ready, commented: "The team at Unifire has put a tremendous amount of time and energy into this solicitation, having been in active discussions since May 2020, and we are extremely pleased to see their efforts coming to fruition……As we continue to advance, we are confident that our vision and ambitious strategy will successfully position the Company for growth and allow us to further build shareholder value that will reflect in the coming quarters."

Closing remarks

Mission Ready Solutions is an interesting company that does well in good times, but does even better in times of upheaval when governments need to spend more to maintain law and order. We have seen that in the past few years with the U.S Capitol Riot, various terrorist events/shootings, and protests such as the COVID-19 rallies. Now we also have the Russia-Ukraine invasion and war so that governments around the world and regional alliances (including NATO and SEATO) are increasing their defense spending.

After a strong financial performance in 2021, 2022 is looking to be even better for Mission Ready, especially, as evidences by the recent US$200 million contract win.

Mission Ready Solutions trades on a market cap of C$50 million and on a PE of 22.7.

Top picks in defense, aviation, and related ETFs for 2022

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As we start 2022 one area of concern is global geopolitical uncertainty. In particular, Russia continues to threaten Ukraine, and China threatens almost everyone. The biggest Chinese threat, for now, is probably to Taiwan. Then there is always the threat posed by North Korea. Given the increasing global tensions, it is not surprising that many countries are

boosting their defense spending. This leads to an opportunity for investors who want to be ahead of the game just in case a war or conflict breaks out.

Furthermore, it is starting to look like 2022 will see some recovery in the civilian aviation sector, assuming we are near the end of the COVID-19 pandemic, or at least getting back to more normal living.

Research groups also see a recovery ahead for U.S aerospace and defense. Fitch stated in December 2021: "Fitch Ratings views the 2022 Aerospace & Defense (A&D) sector outlook as improving following a bottoming out in early 2021 and a moderate improvement in 2H21." Deloitte also forecasts a recovery in 2022.

Below are three defense or aviation stocks/ETFs to consider in 2022.

Defense stocks can offer some safety to a portfolio especially if we get any conflicts in 2022

iShares U.S. Aerospace & Defense ETF

The iShares U.S. Aerospace & Defense ETF (ITA) seeks to track the investment results of an index composed of U.S. equities in the aerospace and defense sector. The advantage of using the ITA ETF is the broad exposure to the U.S aerospace & defense sectors, which are sure to gain if there are any global breakouts of hostilities.

The current top 5 holdings are:

- Raytheon Technologies Corporation. (NYSE: RTX) (20.83%)
- The Boeing Company (NYSE: BA) (18.38%)

- Lockheed Martin Corporation (NYSE: LMT) (5.27%)
- Northrop Grumman Corporation (NYSE: NOC) (4.71%)
- TransDigm Group Inc. (NYSE: TDG) (4.66%)

The ITA ETF trades on a PE ratio of 26.59, with a dividend yield of 0.9%pa.

An alternative to the ITA ETF is the SPDR S&P Aerospace & Defense ETF (XAR) with a key differentiator being that XAR takes an equal weighted approach. XAR describes its approach as an "equal weighted index which provides the potential for unconcentrated industry exposure across large, mid and small cap stocks". XAR trades on a weighted average PE of 24.75.

Northrop Grumman Corporation (NYSE: NOC)

Northrop is one of the world's largest weapons and military technology providers. It is also a large U.S military aircraft manufacturer. What I like about Northrop is that it is well diversified and provides products and services across the air, land, sea, space, and cybersecurity sectors. Over the years Northrop has grown organically but also via takeovers, including that of Orbital ATK Inc., a global aerospace and defense systems company. This has enhanced Northrop's capabilities especially in the area of Ground-Based Interceptor ('missile') products.

In March 2021 it was reported that Northrop had won a US defense contract for up to $3.9 billion to design the next-generation interceptor for the U.S. missile defense network. The report stated: The new interceptors would be a part of the Ground-based Midcourse Defense (GMD) system here, a network of radars, anti-ballistic missiles and other equipment designed to protect the United States from intercontinental ballistic missiles (ICBMs). Northrop's stock rallied on the news, but there is still the possibility of a contract extension or expansion as Reuters stated: "The next-generation interceptor program could be worth

as much as $10-$12 billion over its lifetime as the contractor works to make the technology capable of defeating current threats and future technological advances from countries like North Korea and Iran." There is also the next possibility of a space based defense system (read "a space-based sensor layer for ballistic missile defense").

Northrop trades on a market cap of US$62 billion and has a current PE ratio of 16.1. Not bad when you consider the U.S S&P 500 PE is currently 33.8.

The Boeing Company (NYSE: BA)

When it comes to U.S companies with massive exposure to defense, aerospace and civilian aviation there is none bigger than Boeing. I like Boeing in 2022 as it stands to benefit both as the aviation industry recovers post-COVID-19, and if we get any rise in the defense stocks due to global conflicts.

Boeing is an aerospace company that manufactures commercial jetliners and defense, space and security systems. Its products, and tailored services, include commercial and military aircraft, satellites, weapons, electronic, and defense systems, launch systems, advanced information and communication systems, and performance-based logistics and training.

Boeing trades on a market cap of US$125 billion and has a 2022 PE ratio of 32.8. Not cheap but remember Boeing is potentially at the early stage of an earnings recovery as global airlines look again to open their airline order books. One example of this is today's news of U.S. carrier Allegiant Air rumored to be buying 50 Boeing 737 MAX jets valued at US$5 billion.

Closing remarks

We never know when the next terrorist attack or a global

conflict will breakout. Given the tensions building after a tough two years enduring the COVID-19 global pandemic, it would not be surprising to see a geopolitical event spark in 2022. Will it be Ukraine, Taiwan, North Korea, the South China Sea, the Middle East, a terrorist attack on Western soil, or an unforeseen black swan event? It is hard to predict, but one thing is certain, and that is that buying up some ‘defense’ stocks as insurance, early at very reasonable market valuations, makes a lot of sense as we enter 2022.

Finally, the aviation sector looks poised to come out from its worst-ever downturn caused by COVID-19 in 2020 and 2021.

It now looks like it is time to book a seat and invest back into the defense, aerospace and aviation sectors in 2022. Fasten your seat belt and enjoy the ride, hopefully with much less turbulence in 2022.