

## Exit Centrica: A hidden cash cow, near-term risks justify redeployment of capital

<b>Company:</b>	Centrica	<b>Market Cap:</b>	£4.3bn
<b>Industry:</b>	Utility	<b>Net Debt:</b>	£0 (+ ~£1.5bn pension deficit)
<b>Country:</b>	UK	<b>Revenue:</b>	£16bn
<b>Date:</b>	17 <sup>th</sup> January 2022	<b>Net Income:</b>	£200mio (1.25%)
<b>Dividend:</b>	None	<b>Free Cash Flow:</b>	£1bn (6.25%)
<b>Entry:</b>	£3.1bn	<b>Exit:</b>	£4.3bn

### Exit: Centrica sold

As Centrica has reached my near-term target market capitalization, I have sold the entire position at the end of the first week of January 2022. The reason of reaching the lower bound of my near-term target was not the reason why I sold ahead of a trading update likely to be issued this week though...

### The issues with the Ofgem Price cap

On the one hand, customers like myself who are on a fixed tariff, which is ending at the end of January, are moving automatically into the variable Ofgem tariff. This will mean that Centrica/British Gas has to buy energy in the spot market, i.e. GBp 200 a therm for natural gas, while selling it to me for the average price between February and July 2021, i.e. GBp 60 a therm. Although it is likely that Centrica hedged this exposure in advance, the company will likely still face losses from customers like myself. Whether investors look over these short term losses or not, is difficult to say, as the Ofgem tariff will likely be adjusted to incorporate this “flaw” in the future.

## Low winds

According to a trading update from Good Energy<sup>1</sup>, wind has been blowing 18% below norm in November and 33% below norm in mid-December. Centrica has a few wind offtake agreements in place and hence might not have enough energy to supply to households. SSE's OVO Energy has sent a letter to their customers saying to cuddle with their pets to stay warm, while EON Energy sent their customers a pair of socks suggesting to use less energy to save the planet. Now, why would an energy supplier who generates profits from customer's energy use, ask its customers to use less energy? The low winds are intrinsically linked to this argument, as energy suppliers have more to lose from high energy use of their customers when their energy supplier is lower than estimated.

EON Energy socks sent to customers



## Uniper's massive margin call related credit lines

Uniper, a German energy supplier with revenues around 3.5x that of Centrica, has increased their credit facility with banks by €12bn to pay for margin calls related to energy trading<sup>2</sup>. Although these margin calls shouldn't really matter as it should be seen as temporary working capital outflows, the sheer size of it does surprise. Centrica has around £4.5bn in cash and hence should not need to sign any new credit facilities to pay for margin call.

---

<sup>1</sup> <https://www.londonstockexchange.com/news-article/GOOD/trading-update/15260797>

<sup>2</sup> [https://ir.uniper.energy/websites/uniper/English/5300/ad-hoc-announcements-\\_related-party-transactions.html](https://ir.uniper.energy/websites/uniper/English/5300/ad-hoc-announcements-_related-party-transactions.html)

### **Decommissioning costs for Centrica's Upstream business**

I have always liked the fact that Centrica maintained a strong upstream business, producing natural gas at a time when most other energy downstream suppliers do not, hence being better hedged from the spike in natural gas prices. After selling their Norwegian upstream business, the remaining Spirit Energy UK and Netherlands have an estimated pre-tax decommissioning liability of £1.2bn, and Centrica is looking to keep all cash flows from Spirit Energy at the business until 1.5x of the £1.2bn in cash is achieved. This means that the profits from their upstream business are not available to Centrica anymore. In this sense, I believe Centrica is posting poor results in the upcoming trading update, perhaps to influence more preferential terms on the revised Ofgem tariff and not to be seen in the public by profiting from the energy crisis. This is exactly why I think that current market valuation is fair and more upside could come at a later point. The near-term, however, could surprise to the downside, and for this reason I have sold the position to redeploy the capital to higher near-term opportunities. Long-term, the turnaround of Centrica continues to take shape, as the decline in customers has been reversed.



## Legal Disclaimer

The contents of this publication have been prepared solely for the purpose of providing information about AozoraStep Capital LLP and the services and products it offers, which are targeted for professional investors only. The opinions and views expressed are those of AozoraStep, may change without notice and should not be construed as investment, tax, legal or other advice. AozoraStep does not guarantee the completeness and accuracy of the information provided and all content can become out of date. Products or services mentioned on this site are subject to legal and regulatory requirements in applicable jurisdictions and may not be available in all jurisdictions. Accordingly persons are required to inform themselves and observe any such restrictions. In respect to investments described on this website, past performance is not a guide to future performance. The value of investments and the income of any financial instruments mentioned on this website may fall as well as rise and may have tax consequences. The performance of AozoraStep is based on a personal track record and audited by Sedulo for the time period Q1 2019 - Q1 2021 only with further audits being done on an occasional basis. AozoraStep Capital LLP is currently not authorized by the FCA, but is in the process of authorization. AozoraStep Capital LLP is registered in England and Wales with registered number OC436835. Registered Office: 57 Lansdowne House, Berkeley Square, London W1J 6ER, United Kingdom. Reproduction or distribution of any materials obtained in this presentation or linking to this presentation without written permission is prohibited.