AozoraStep

Update Harbour Energy: Mistakes made, then corrected

Company:	Harbour Energy (HBR LN)	**Market Cap:**	$3.25bn
Industry:	Oil & gas producer	**Net Debt:**	$0.8bn
Country:	UK, worldwide	**Revenue:**	$4.5bn*
Date:	2nd February 2023	**Net Income:**	$1.1bn (24%)
Dividend:	$400mio share buyback (12.2%) $200mio dividend (6.1%)	**Free Cash Flow:**	$1.1bn (24%)**
Entry:	$3.33bn	**Target:**	$4.5bn

*post-hedging oil price $80/bbl and gas price 71p/therm **post tax, post capex

Upwards revision in my valuations

I initially entered Harbour Energy end of November last year as valuations appeared not to be able to fall further and cold weather was set to hit the UK that could start to reprice Harbour Energy. However, despite the cold weather and high gas prices, oil prices tanked during those weeks, leaving Harbour Energy's valuation unchanged. With the latest trading update, including an outlook for 2023, my numbers were way too pessimistic and therefore required an upward revision.

Harbour Energy 2023 earnings outlook estimates

Parameters	in $bn
Post-hedge revenues*	4.5
Opex	(1.1)
Capex	(0.9)
Decommissioning	(0.2)
Tax charge	(1.2)
Net income**	1.1
Dividend	(0.2)

*$80/bbl, 70p/therm **Capex + decom = Depreciation

Source: Own estimates, Harbour Energy

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Harbour Energy 2023 tax payment estimates

Harbour Energy

2023	CT	SCT	EPL
$m	30%	10%	35%
Revenue	4,500	4,500	4,500
Hedging			
Opex	(1,100)	(1,100)	(1,100)
Capex	(900)	(900)	(900)
Decom	(200)	(200)	
Interest	(100)	(100)	
Tax losses	(1,000)	(1,000)	
Investment allowance		(562.5)	(261.0)
Taxable profits	1,200	637.5	2,239.0
2023 Tax charge	**360**	**63.8**	**783.7**

CT = Corporate Tax
SCT = Supplementary Charge Tax
EPL = Energy Profits Levy

Harbour Energy

2023	
$m	
Post-hedge revenue	4,500
Opex	(1,100)
EBITDAX	3,400
Gross operating cash flow	3,400
Capex	(900)
Decom	(200)
Lease	(200)
Interest	(100)
Cash tax	(955)
FCF (post-tax, pre-distributions)	1,045

Source: Own estimates, Harbour Energy

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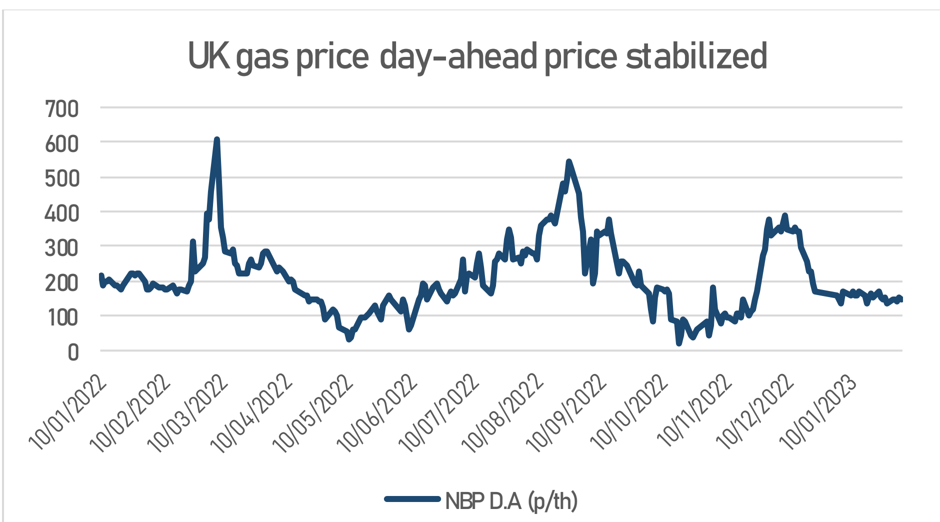
Why sell & re-enter?

Despite a near doubling in the net income estimate, why did I sell the position and then re-entered? First of all, that's my personal estimate, which is never 100% accurate, although it usually leaves room to the upside rather than the downside, as was the case here (though this was an extreme case, as I estimated higher capex, did not include the $2bn tax asset and included the 3rd tax payment in year 2023 rather than 2024). Secondly, the main reason I bought Harbour Energy was because I believed we were at a turning point. Back in November 2022, gas prices spiked again, oil prices were in the mid-$80s and there was a real risk of the UK facing power outages amidst much lower than usual temperatures. However, while gas prices surges, oil prices plummeted. The cold snap also didn't last very long and was followed by much warmer temperatures than usual with strong wind power generation, which then led to unusually long-lasting European gas storage build ups during the holiday season. On 4th February, the EU gas in storage was at levels similar to record levels recorded in 2020 at this time of the year (70%). Back in 2020, we ended the winter with over 54% gas in storage (vs. 26% in 2022)[1]. While this hasn't led me to sell the position, the mixture of latest central bank meetings, shift of the market towards pricing in more rate cuts and lower inflation outlook, on top of uncertainty regarding the Russian oil and products price caps and how it could lead to hoarding and also Russia maximizing their output[2] gave me the ultimate trigger to sell. When Russia then announced to cut their production by 500k bpd, I have re-entered the position.



Source: Zenergi.co.uk

[1] https://agsi.gie.eu/#/

[2] https://gcaptain.com/the-eus-ban-on-russian-diesel-wont-really-stop-fuel-flows/?subscriber=true&goal=0_f50174ef03-7d1a229c43-170437283&mc_cid=7d1a229c43&mc_eid=61a021805a

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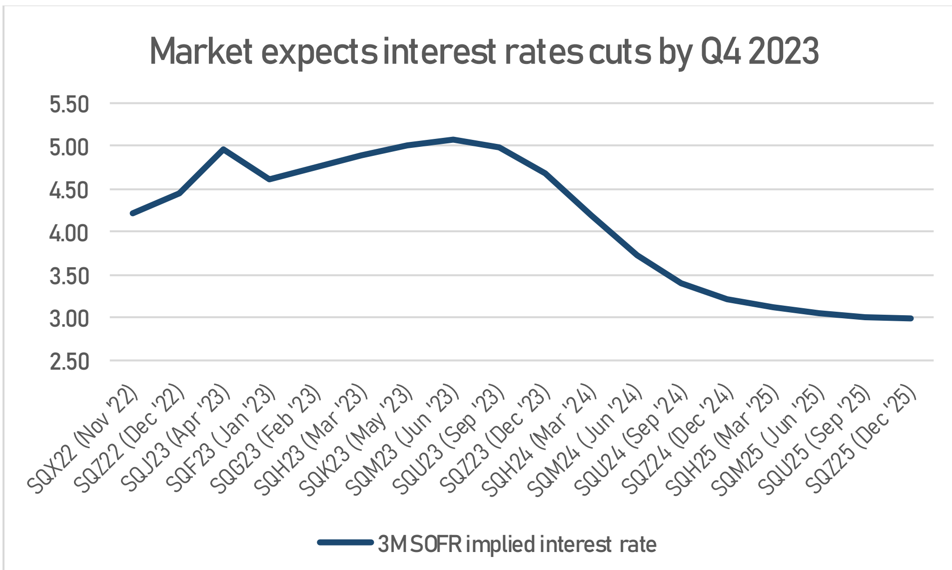
European gas in storage on 4th February

4th February	Full %
04/02/2017	39.25
04/02/2018	46.64
04/02/2019	50.46
04/02/2020	70.17
04/02/2021	49.28
04/02/2022	36.01
04/02/2023	70.42

Source: AGSI



Source: Barchart

Opportunity costs & positive engagement

Harbour Energy has hedged a significant amount of their oil (32%) and gas (66%) for 2023, however, different to my expectations they stopped hedging at current forward prices for 2024. In my opinion, oil prices at $80/bbl and gas at 150p/therm should be hedged, as it would provide significant better hedges than for 2023 ($74/bbl & 42p/therm) and hence justify a higher valuation. In any case, the valuation of Harbour Energy remains too low, but would not expect any repricing unless oil prices rally above $90/bbl or until the results are being announced on 9 March 2023. The IR department of Harbour Energy has been extremely helpful in making me understand the tax liabilities and free cash flow calculations, as per screenshots above. The reason why net income is equals free cash flow is due to the way oil and gas taxes are being paid in the UK, which is done through 3 separate payments: 1st in July, 2nd in October and the 3rd in January the following year, which is therefore excluded. Harbour Energy could therefore reprice with the announcement of the full year results.

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