AozoraStep

Update Hunting: Positioned for a global oil & gas capital spending recovery

Company:	Hunting (HTG LN)	**Market Cap:**	$560mio
Industry:	Oil & gas extraction/completion	**Net cash:**	$108mio (+$266mio inventory)
Country:	US, worldwide	**Revenue:**	$520mio
Date:	7th March 2022	**Net Income:**	($45mio) (-9%)
Dividend:	2.35%	**Free Cash Flow:**	$54mio (10%)
Entry:	$435mio	**Target market cap:**	$600mio to $800mio

The next chapter

In the last report I put a lot of emphasis on Hunting's perforating systems, as they have historically been the most profitable and is with 36% the largest revenue generator for Hunting. However, as global oil & gas exploration and production is set to recover, other business segments of Hunting come to light. Before the focus turns to Hunting, let's take a look at the industry as a whole…

A return of oil & gas capex

While most oil & gas producers have kept their focus on shareholder returns, capital expenditures are going up across the board, nevertheless. In most cases, capital spending is in line with the annualized Q4 spending. Production is mostly kept stable by the US shale producers, but the large ones, Chevron and ExxonMobil, are looking to increase production in the Permian basin – and that's where the big profits for Hunting lurk. Shale oil & gas producer Diamondback Energy pointed out significant cost inflation in the drilling and completion components with perforating costing +29% more and casing, which includes OCTG up +42% y-o-y. Hunting's order book increased by 41% since 31 December 2020.

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Diamondback Energy drilling and completion cost inflation

Source: Diamondback Energy

Largest Oil & Gas Producer Capital Expenditure Guidance for 2022

Company	Q4 21 Capex in $bn	2021 Capex in $bn	2022 Capex in $bn	Growth	Comment
Shell	6.5	19.7	23-27	in line with Q4	expects to hit lower end of capex guidance
BP	3.6	12.8	14-15	in line with Q4	upped 10yr oil production guidance to flat from -40% prior quarter
Chevron	3.6	11.7	15	in line with Q4	love US shale due to quick ramp-up of production, expects 20% increase
ExxonMobil	5.8	16.6	21-24	in line with Q4	grows Permian production by 25% in 22
ConocoPhilips	1.6	5.3	7.2	12.5% up vs. Q4	fears higher production from other players
EOG	1.057	3.909	4.3-4.7	15% up y-o-y	oil production to return to pre-pandemic levels
Devon energy	0.512	2	1.9-2.2	in line with Q4	depressed Q1, nice uptick end Q1 into Q2
Diamondback energy	0.434	1.487	1.75-1.9	5% up vs. Q4	higher capex, but slightly lower production
Continental resources	0.574	1.541	2.3	in line with Q4	focused on shareholder returns
Marathon oil	0.251	1.032	1.2	20% up vs. 2021	production will remain stable despite uptick in capex
Chesapeake energy	0.265	0.7	1.5-1.8	55% up vs. Q4	higher capex mostly related to acquisitions, sees 12% cost inflation
Occidental Petroleum	0.937	2.87	3.9-4.3	in line with Q4	focus on high return assets
Pioneer natural resources	0.914	3.4	3.3-3.6	in line with 2021	low inventories will constrain production of private players
Hess	0.65	1.83	2.6	in line with Q4	focus on ramping up Bakker by spending 75% more

Source: Earnings calls, Q4 results

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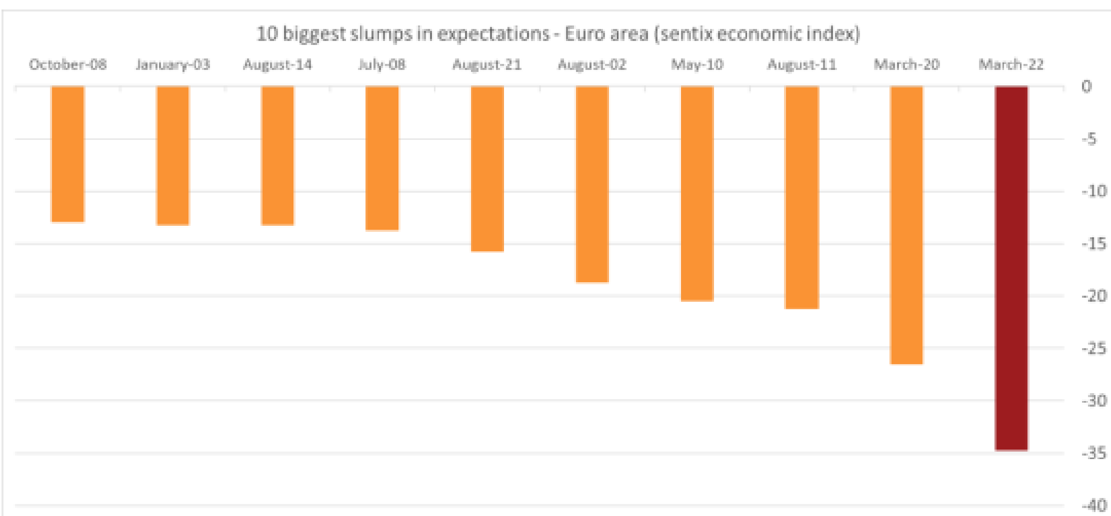
The black swan: Russian sanctions

Amidst the devastating invasion of Ukraine by Russia, sanctions have crippled the energy trade with Russia. Russia is the world's 2nd largest natural gas producer (18%), the third largest oil producer (11%), the 6th largest coal producer (5%) and the 7th largest uranium producer (6%). Taking Russia's energy production offline would basically cause the biggest depression the world has ever seen – and that's exactly what the most recent Sentix Economic Index suggests. All oil majors either abandoned their stakes in Russian producers or stopped any additional capital expenditures. Inevitably, this will lead to a decline in production, especially as Russian government default is priced at 80% with the Russian Finance Ministry saying it "will pay its state debt in rubles regardless of the original denomination of the debt. Whether investors get paid will be determined by the sanctions imposed by the West on Russia". The oil majors will now likely look at how to recoup the lost production from Russia and given the geopolitical tensions most probably invest in the US or EU. This will benefit Hunting, as the company has not had any sales to Russia due to its customer base being in the US, Europe, Asia or Africa for the most part.

Sentix Confidence Index Change



10 strongest monthly changes in the expectations component of the sentix Euro Area Economic Index

Source: Sentix

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Natural Gas Production

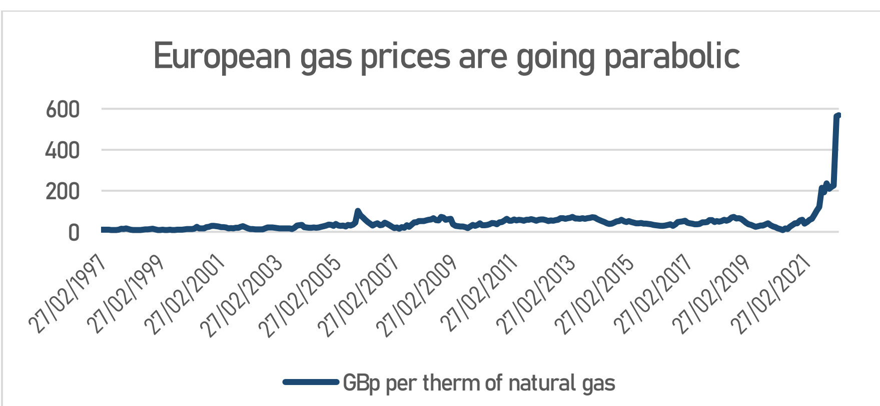
Country	Natural gas production (in exajoule)	In %
USA	33	23%
Russia	25	18%
Iran	8	6%
China	7	5%
Canada	6	5%
Qatar	6	4%
Australia	5	4%
Norway	4	3%
Saudi Arabia	3	2%
Algeria	3	2%
Top 10	101	73%

Source: IEA, 2020

Oil Production

Country	Oil production (in barrels per day)	In %
USA	19	20%
Saudi Arabia	11	12%
Russia	11	11%
Canada	5	6%
China	5	5%
Iraq	4	4%
UAE	4	4%
Brazil	4	4%
Iran	3	3%
Kuwait	3	3%
Top 10	67	72%

Source: EIA, 2020



Source: Barchart

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Oil Country Tubular Goods (OCTG)

OCTG are steel pipes that are needed to transport oil & gas from the inside of the earth to the surface and is a market that is expected to grow 7.4% annually by 2026[1]. Hunting sources its pipes from Benteler and steel from local markets to then go heads up against Vallourec and Tenaris to compete in the OCTG space. Evraz, also an important player in this industry, is now avoided, leaving some room for Hunting and others to make up for it. OCTG makes up 36% of Hunting's revenues and year-to-date, Asia Pacific has already won $26mio of OCTG orders from China. In the US, OCTG pricing is said to reach record levels, which shows that higher steel prices can be passed on easily to customers for OCTG. This segment will likely grow further as Hunting entered a Joint Venture with Jindal SAW Ltd in India, which could see additional $100mio in revenues with strong margins by 2023.

Hunting OCTG

Source: Hunting International

[1] https://www.globenewswire.com/news-release/2022/02/04/2379104/0/en/Oil-Country-Tubular-Goods-OCTG-Market-Size-to-Reach-USD-31-54-Billion-by-2026-Exhibiting-a-CAGR-of-7-4-Fortune-Business-Insights.html

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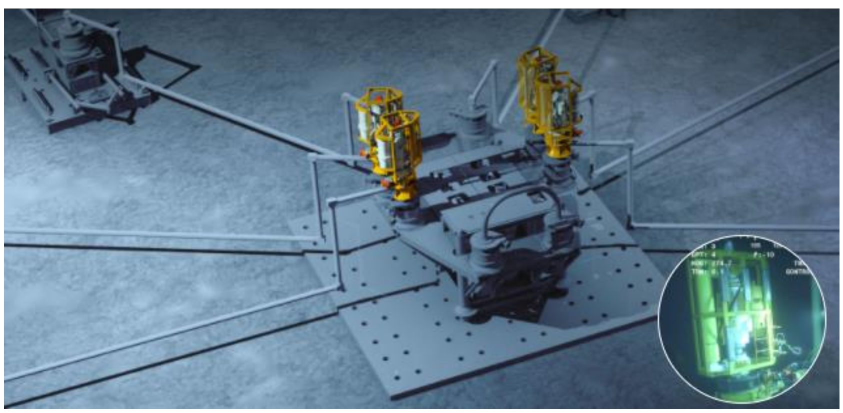
Hunting Subsea

With the UK emphasizing the need for more oil & gas production in the North Sea, Hunting is ideally positioned to benefit from this political shift[2]. Hunting's Subsea Spring has already received $31.8mio of orders in the Gulf of Mexico and South America for its titanium and steel stress joints. Their 2019 acquired subsea businesses with unique technologies RTI and Enpro could now see a recovery from potential projects in the North Sea. Japanese Marubeni-Itochu has held a 40% interest in Hunting's EMEA business, which Hunting now acquired against $31.5mio of inventories. While this agreement has boosted cash flows, it will enable Hunting higher revenue and profits going forward as well as it owns 100% now. Currently Hunting Subsea generates 11% of total revenues.

Enpro Subsea Flow Intervention Technologies



Source: Enpro Subsea

[2] https://twitter.com/KwasiKwarteng/status/1498197281144725505

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Conclusion

With the management actions taken over the last three months, Hunting is ideally positioned to benefit from an increase in oil and gas extraction worldwide. The legal case DynaEnergetics brought about is set to be updated this summer and as it is really identical to the Nike v. Adidas case[3], it would be very surprising to see the Jury ruling against Hunting. With EBITDA turning profitable, I expect to see Hunting achieving net profits and $50mio in operating cash flow in 2022, while keeping working capital and other special items stable, with higher profitability in 2023. Remember, back in 2019 net income was $76.1mio with $137.2mio operating cash flow. Now we have record oil and gas prices and low inventories. Pioneer Resources CEO has said to be able to increase production by 10% instead of 5%, if the US government were to ask for a combined production increase…

Hunting revenues by segment

Product	2021 H2 $mio	2021 H1 $mio	2021 $mio	2020 $mio	2019 $mio
Perforating Systems	95.9	85.8	181.7	154.5	363
OCTG	95.7	76.8	172.5	264.7	357
Advanced Manufacturing	30.5	29.1	59.6	74.3	104.5
Subsea	29.2	29.6	58.8	69.8	44.5
Intervention Tools	13.7	12.1	25.8	30.7	51.7
Drilling Tools	-	-	-	9.9	22.3
Other	12.2	11	23.2	22.1	17
	277.2	244.4	521.6	626	960
Oil and gas			484	586.2	
Non-oil and gas			37.6	39.8	

Source: Hunting results

[3] https://www.iptechblog.com/2020/12/new-aia-rules-implement-hunting-titan-and-preserve-a-dual-role-for-the-ptab/

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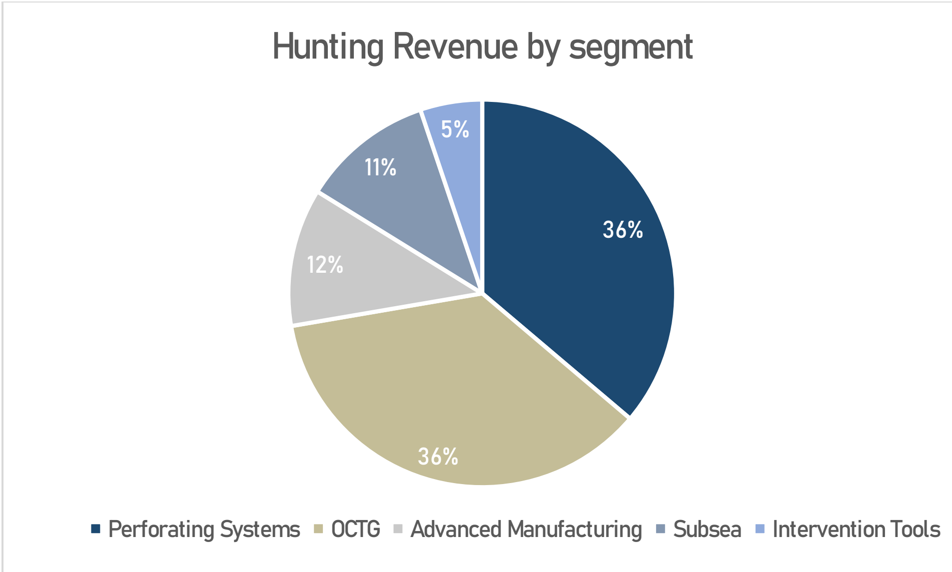

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