

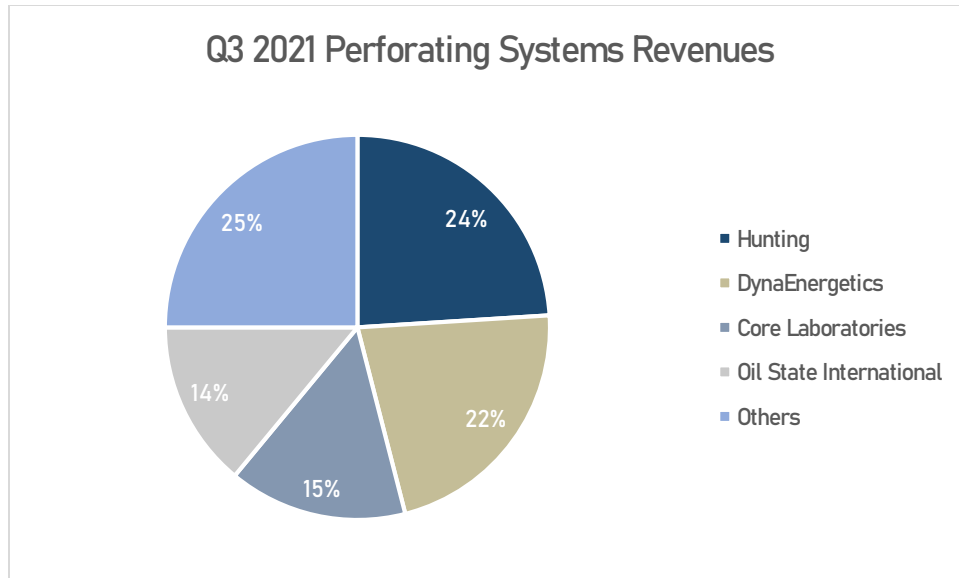
Turnaround: Hunting, positioned for a US shale oil recovery

Company:	Hunting (HTG LN)	Market Cap:	\$350mio
Industry:	Oil & gas equipment	Net cash:	\$78mio (+\$266mio inventory)
Country:	US, worldwide	Revenue:	\$500mio
Date:	17 th November 2021	Net Income:	(\$25mio) (-5%)
Dividend:	3.71%	Free Cash Flow:	\$45mio (9%)
Entry:	\$435mio	Target market cap:	\$600mio to \$800mio

Introduction

Hunting is an oil & gas equipment manufacturer with over 31 operating sites all over the world. The company manufactures oil & gas drilling related equipment for both offshore and onshore markets with a focus on perforating systems and casing & tubes/OCTG (over 70% of profits in 2019). The core of their profits lie in perforating systems under the subsidiary Hunting Titan. Perforating guns house explosives that get fired when the hole is drilled into the ground in order to get the oil moving. While in normal operations, one might need 3-5 perforating guns, in horizontal drilling through shale oil, one need as many as 300 perforating guns. This makes this business so reliant on the US shale oil market, of which Hunting Titan has a perforating system market share of around 25%, ahead of main competitors DynaEnergetics, Core Laboratories and Oil State International. The well-known oil services firms, such as Halliburton, Schlumberger and Baker Hughes, often buy products from Hunting and its competitors to get a job done, often due to special licenses that allow Hunting to transport explosives to various countries. In Hunting's case, around 10-15% of sales are coming through Halliburton¹. Technology is really important in the perforating business and Hunting has over 800 patents granted/pending, more than double that of DynaEnergetics. With the shift towards renewables, Hunting is looking to diversify up to 20% away from oil & gas related revenues and has recently made investments in Well Data Labs and 3D printing firm Cumberland Additive, with another acquisition likely to follow.

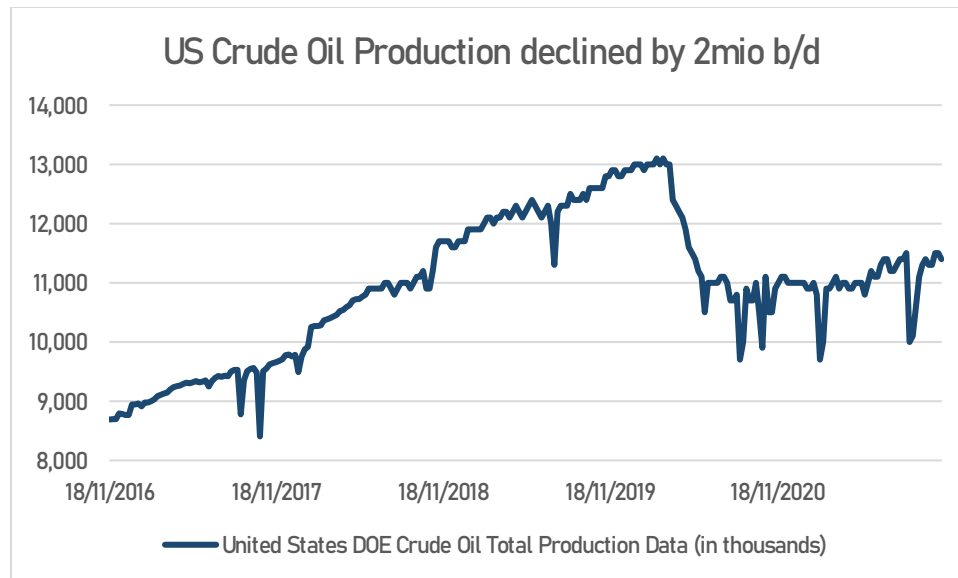
¹ Management estimates



Source: Quarterly reports, Hunting, DynaEnergetics estimates

Why so cheap?

In 2019, Hunting made \$75mio in net income and over \$135mio in operating cash flow. Then Covid came, oil traded at negative \$40 a barrel and capital expenditures of all major oil producers fell off a cliff. While operating cash flow has been maintained at elevated levels of around \$50mio in 2020 and in 2021, this cash flow came from reducing their inventories, which declined from \$350mio to around \$266mio. The lower capital expenditures has led to production declining by around 2mio barrel a day in the US and at its peak in the summer 2020 by around 20mio barrel a day less globally according to the IEA. OPEC+ has since ensured supply is not exceeding demand and the rapid decline in stockpiles led to an oil price recovery to levels last seen in 2014. Despite the rally in oil prices, producers have kept spending lower than expected, which led to a series of downward revisions in Hunting's expected profit for 2021.



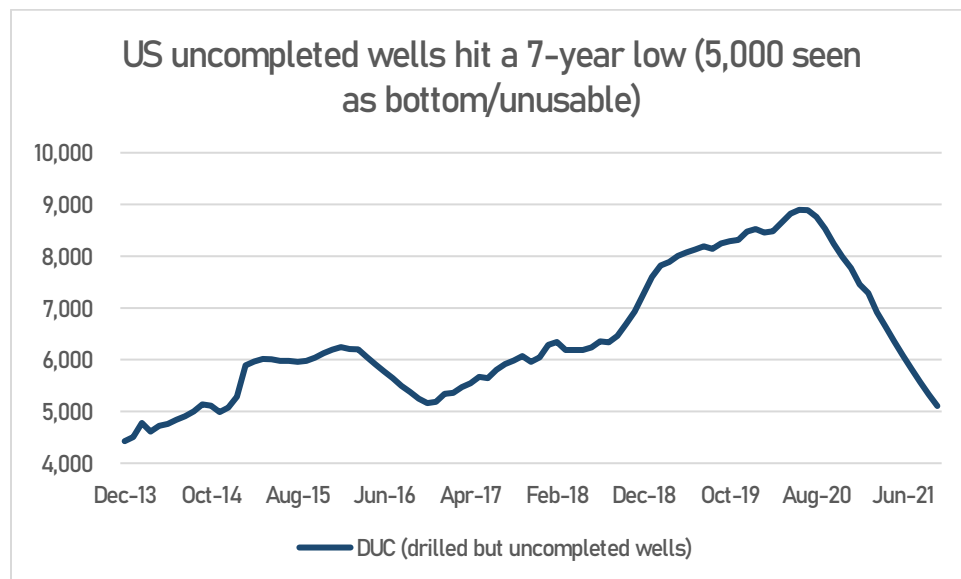
Source: US Department of Energy

What's the turnaround?

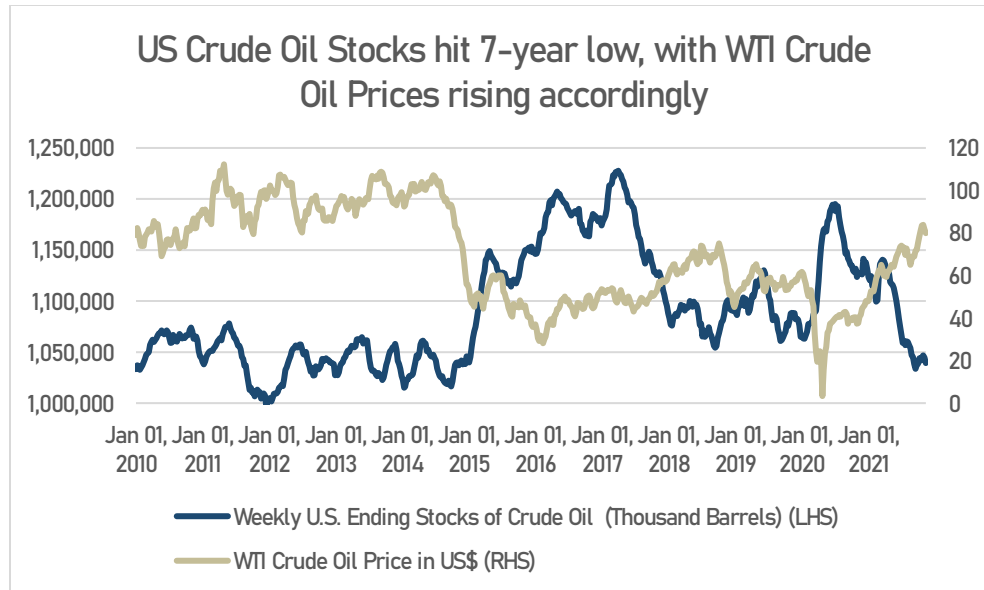
Currently, Hunting just about breaks even, but their Titan division is starting to show profits again. As drilled but uncompleted (DUC) wells and US Crude Oil stocks have reached a 7-year low, I anticipated oil prices to move back to 2010-2014 levels, which has only happened to some degree. At the same time, I believed that US shale oil production is ramping up, benefitting Hunting Titan, with international oil production following suit in 2022. So far, US shale oil production has increased somewhat, but not to a degree as expected. Capital expenditures of oil producers have kept a lot more stable than anticipated. Amid low crude oil stocks that resemble 2010-2014 levels, I would have expected to see \$100 a barrel oil prices by now. This did not occur partly due to a stronger US\$. Now, the Biden administration seems to be considering releasing more of their Strategic Petroleum Reserves potentially together with China, India, Japan and South Korea². I would see this as a mistake, as OPEC+ could then decide not to increase output by 400k b/d next month (equivalent to 12mio barrel a month) and shale oil producers might be even more cautious in raising production. While this could be a headwind for Hunting at first, I continue to believe that without an increase in US shale oil production, oil prices are set to move back to 2010-2014 levels, ultimately leading to higher capital spending and production. At the same time, Hunting and all its

² <https://www.reuters.com/business/energy/asia-looks-spr-shock-treatment-high-oil-prices-after-us-request-2021-11-18/>

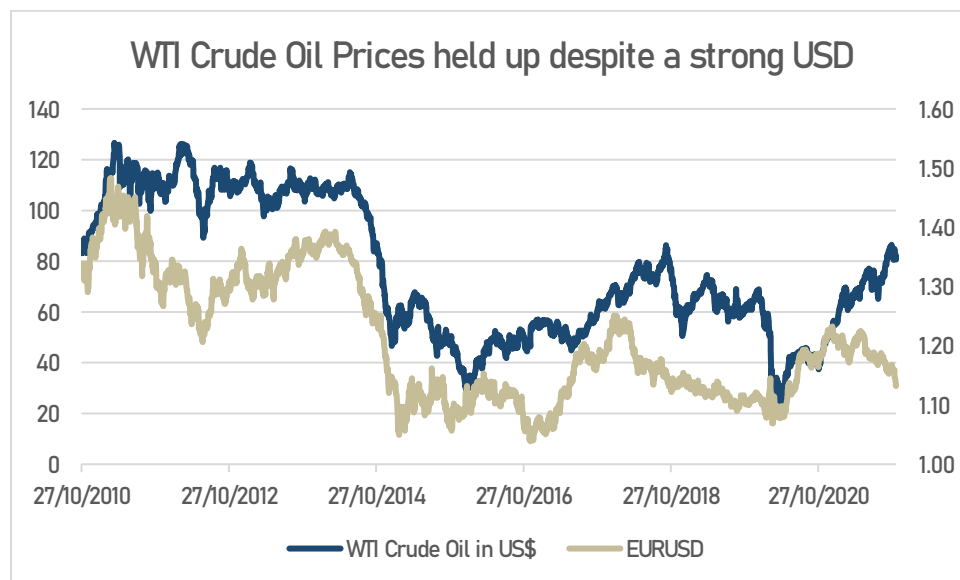
competitors are raising prices to improve profitability and are looking to increase prices further as we head into 2022. When they have done that in the past, it was extremely successful and they were able to increase prices by as much as four times in a single year. Furthermore, Hunting trades to a significant discount to DynaEnergetics (DMC Global), Core Laboratories and Oil State Petroleum. For example, DMC Global has a market cap of \$760mio compared to Hunting's \$350mio. Part of this reason is the listing in London and a poor understanding of the company by investors. This is expected to change with a US ADR Level II listing expected by H2 2022. Finally, Hunting has made intelligent investments to diversify and with cash holdings of around 20% their market capitalization, the company might look at share buybacks amid the low valuation.



Source: EIA



Source: EIA, FRED St. Louis



Source: Bloomberg

DynaEnergetics Patent Litigations

In times of crises there will always be fights and quarrels. DynaEnergetics is Hunting's main competitor in perforating systems, but charges around 15% more for their products. Over the last year, there have been small machine shops replicating products of DynaEnergetics, Hunting and other manufacturers, in some parts infringing on patents. In the case of DynaEnergetics, smaller manufacturers have sold products that were previously infringed by Oil State International, which Oil State International has taken off markets in the past, but possibly supplied to those smaller players this year. DynaEnergetics has been trying to protect their IP in the past, but was only partially successful. Currently, DynaEnergetics has sued as many as 15 companies for infringing their patents³. The company also has three active cases running against Hunting Titan for infringing certain parts of their perforating systems. One case, which is likely to receive a decision by January 2022, has been particularly interesting, as the Board has ruled this specific patent to be unpatentable, but needed to revisit their rulings, as Hunting has argued for obviousness only⁴. However, the patent claims some obvious features of a detonating assembly, which Hunting has had on the market prior to DynaEnergetics and their patent filing. The Board hence also ruled the case as anticipated and I do not expect the prior ruling to reverse. The other two cases are of similar nature and DynaEnergetics might need to drop them to save legal fees to focus on the other cases against the smaller shops that could potentially be ruled in their favour.

Conclusion

While oil is out of favour in a push towards electric vehicles, oil demand is currently expected to peak only by 2025⁵. These predictions, however, have continuously been wrong in the past with 36 predictions made since 1972, only seven are still valid, i.e. not in the past⁶. There will also be higher natural gas demand, as nations are looking to phase out coal. In light of the lowest oil stockpiles since 2010-2014, continuously increasing demand, price increases in the industry and the comparatively low valuation, Hunting is a turnaround candidate with the potential of doubling its market capitalization in 2022.



³ <https://insight.rpxcorp.com/entity/4037602-dynaenergetics-europe-gmbh>

⁴ [Hunting Titan, Inc. v. DynaEnergetics Europe GmbH, IPR2018-00600 \(uspto.gov\)](https://www.uspto.gov/ip/record/Hunting_Titan%2C_Inc._v._DynaEnergetics_Europe_GmbH%2C_IPR2018-00600)

⁵ <https://www.spglobal.com/platts/en/market-insights/latest-news/oil/082321-global-oil-demand-to-peak-by-2025-under-un-pathway-platts-analytics>

⁶ https://en.wikipedia.org/wiki/Peak_oil#Predictions

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