AozoraStep
Capital LLP

A UK focused Turnaround Value Investment Partnership

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CURRENT MARKET CONDITIONS

1. Inflation everywhere
2. Higher Yields
3. Covid update UK
4. Where to find value

1. INFLATION EVERYWHERE

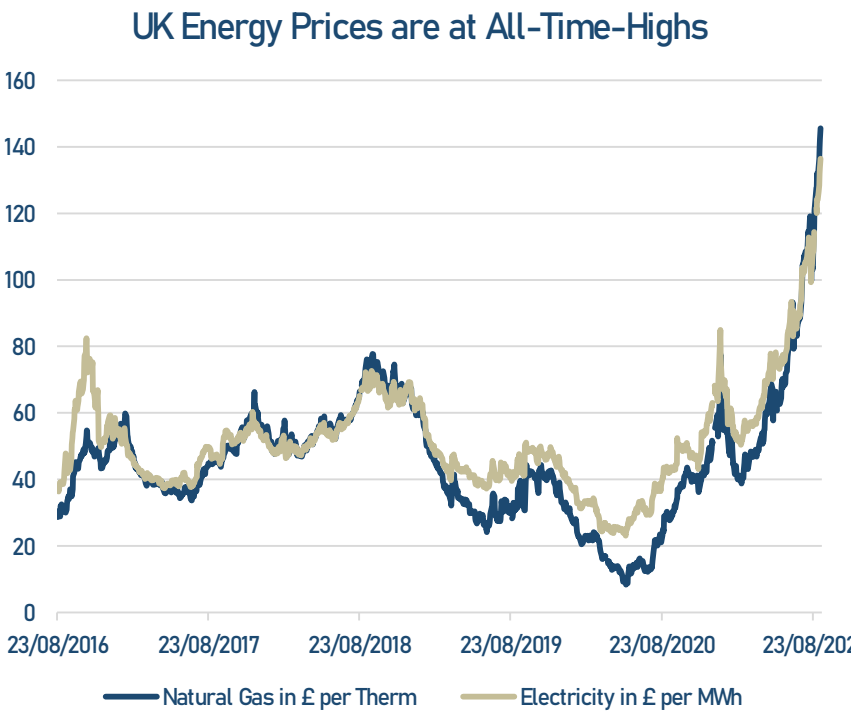
INFLATION – US CPI WILL BE BROADER

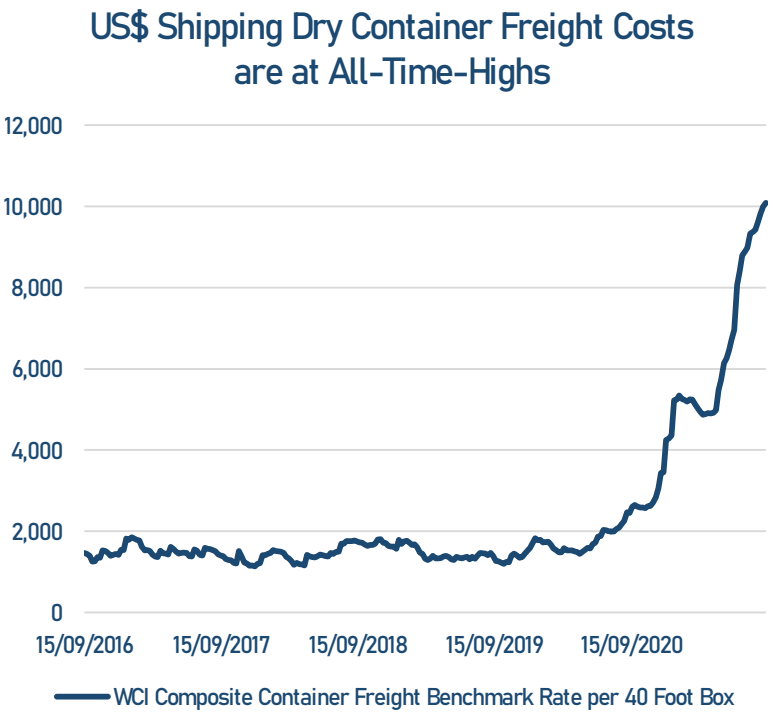
+0.5% July 2021 CPI Print	+0.4% expected August 2021 CPI Print
Biggest drivers: +0.2% used cars (3.47% weight) +1.7% new vehicles (3.74% weight) -4.6% car and truck rental (0.21% weight)	Biggest drivers: Similar prints to July for August
+6.0% lodging away (1.04% weight) +6.8% hotels, motels (0.93% weight) +0.4% rent of shelter (32.7% weight) -1.1% transportation services (5.29% wgt) +0% apparel (2.69% weight) +1.6% energy (7.17% weight)	Energy could be the mover, as prices were more volatile
+0.2% Medical care commodity (1.5% wgt) +0.3% Medical care services (7.07% wgt)	

INFLATION – ENERGY & FREIGHT

- Energy prices are 50% higher than the previous all-time-high

- Expect peak season Aug-Oct to move into Nov-Dec
- Logistics chain under strain, plagued by labour shortage





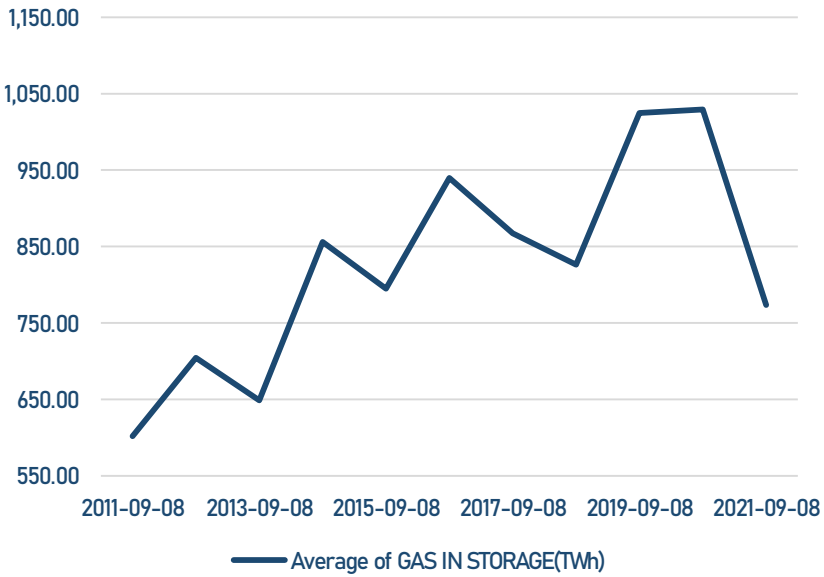
Source: Bloomberg

INFLATION – LOW ENERGY INVENTORIES

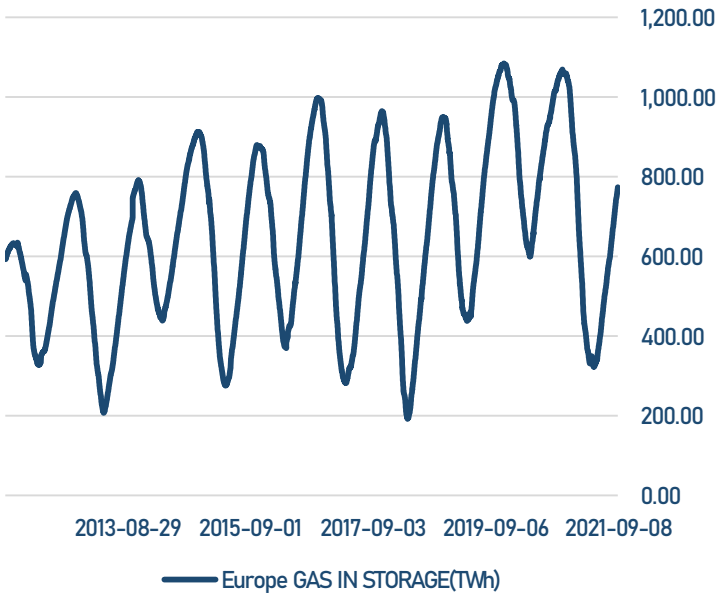
- Gas storage is lowest since 2013 at this time of the year

- A colder than usual winter could slow economy
- Able to estimate a "La Nina" cold winter in October

European Gas in Storage (TWh) is at multi years low, but still higher than 10 years ago



European Gas in Storage is around 100 TWh lower than in 2017 at this time

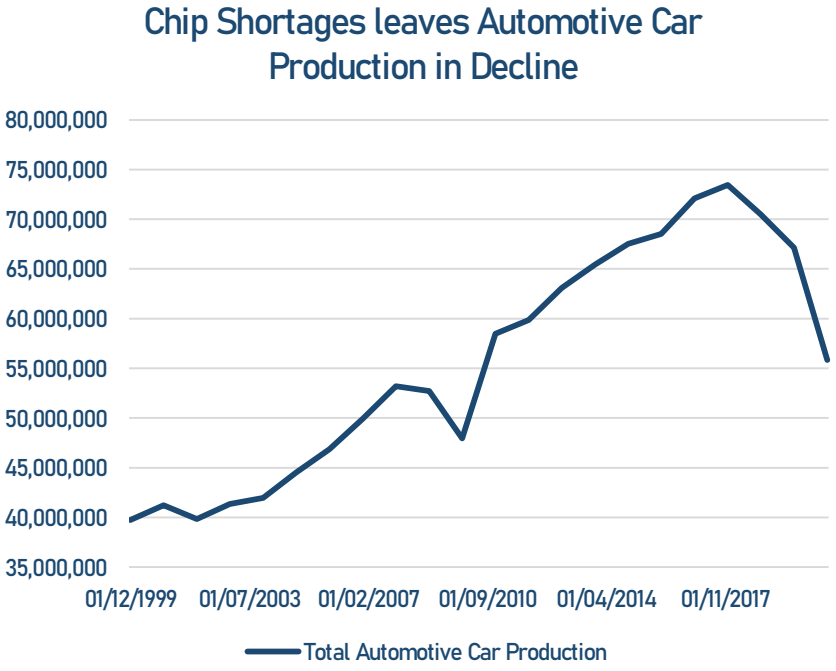


Source: Aggregated Gas Storage Inventory

INFLATION – CHIP & CAR SHORTAGES

- Chip shortages continue to worsen
- Automotive car production is set to slow to a 12-year low

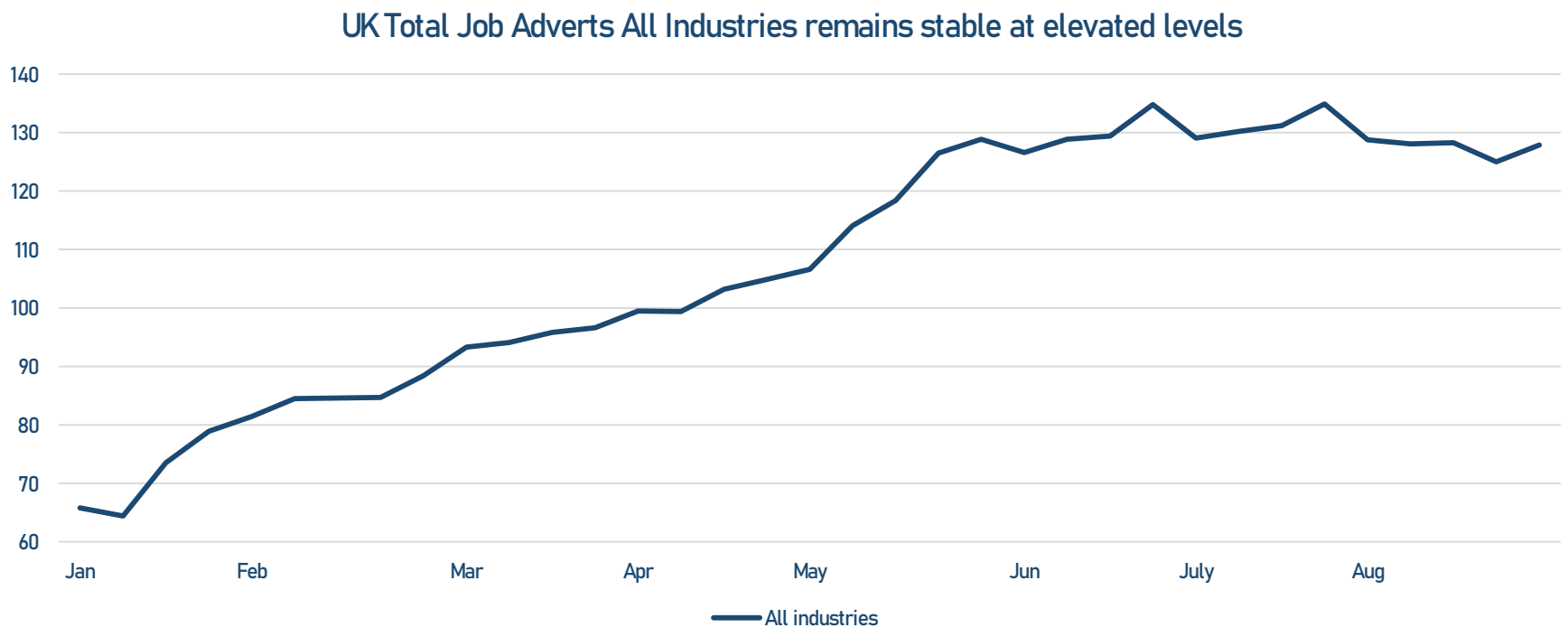
- Car inventories are the lowest in decades
- Low inventories increase retail seller's margins, but soon they have not much to sell



Source: Bloomberg, FRED St. Louis

INFLATION – LABOUR SHORTAGES

- Labour Shortage remains acute
- Signs of easing on the horizon since peak in mid-July
- Construction online employment adverts down -27% since mid-July
- Logistics online employment adverts down -11% since mid-July



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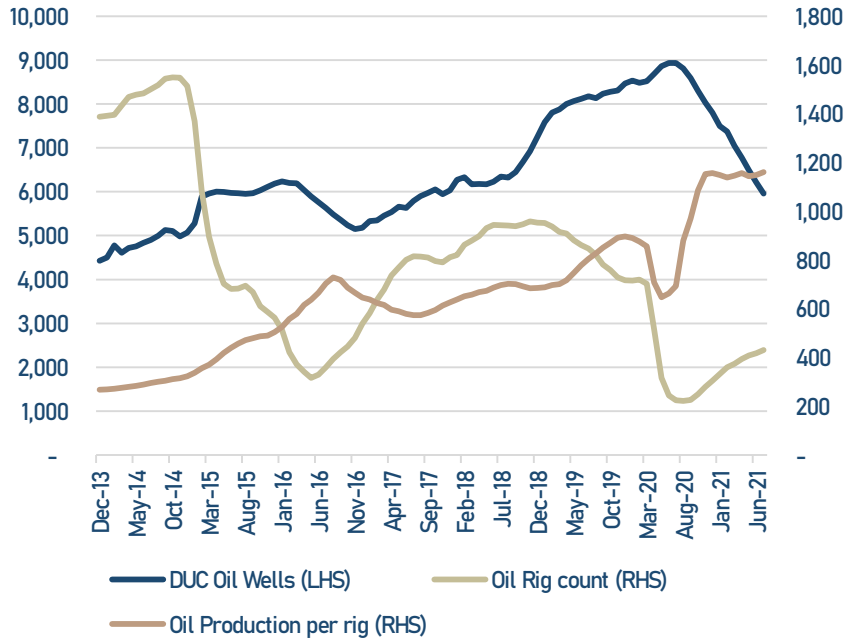
Source: Office for National Statistics

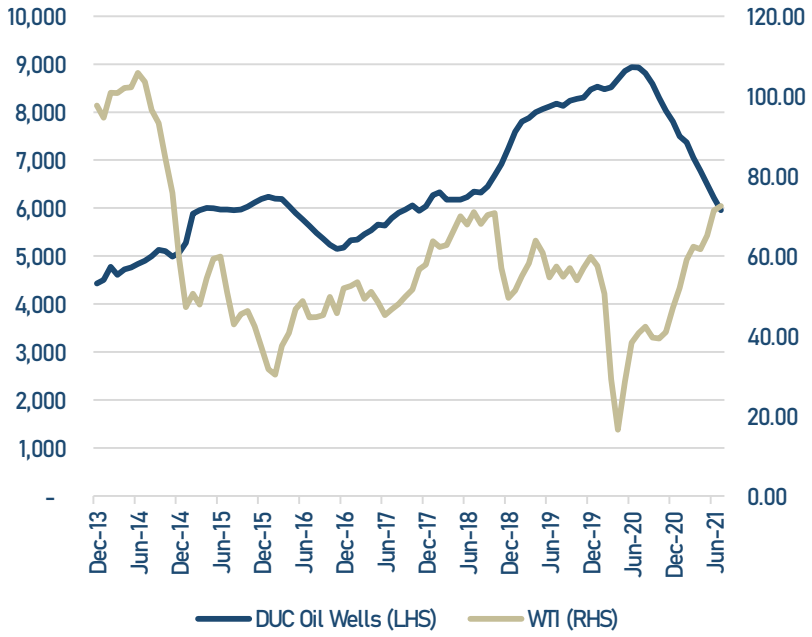
OIL PRICE INFLATION – DRILL, BABY DRILL?!

- Expect oil prices to rise dramatically, if US shale drillers are not back in full force soon
- Underinvestment is already impacting production
- Production uncertainties in Nigeria, Libya, Iran and Brazil

DUC Oil Wells continue to decline, while Oil Production per Rig is stable, Rig count rises



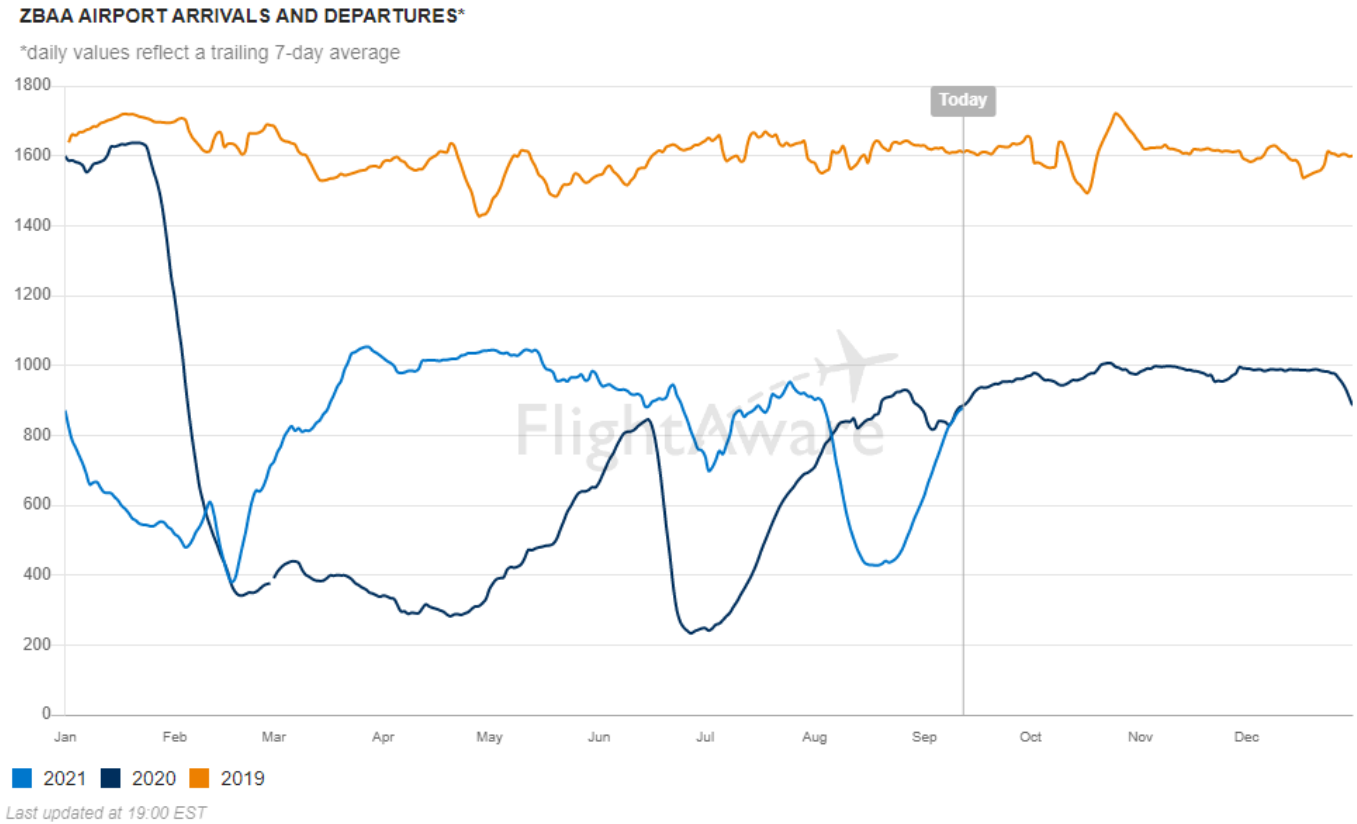
DUC Oil Wells now at 2017/18 level, expecting 2016 lows by Oct/Nov 2021



Source: EIA

OIL PRICE INFLATION – DOWN TO CHINA?

- New outbreak in Fujian Province off coast of Taiwan
- Beijing flights recovered, but with no tolerance Covid policy restrictions can return quickly

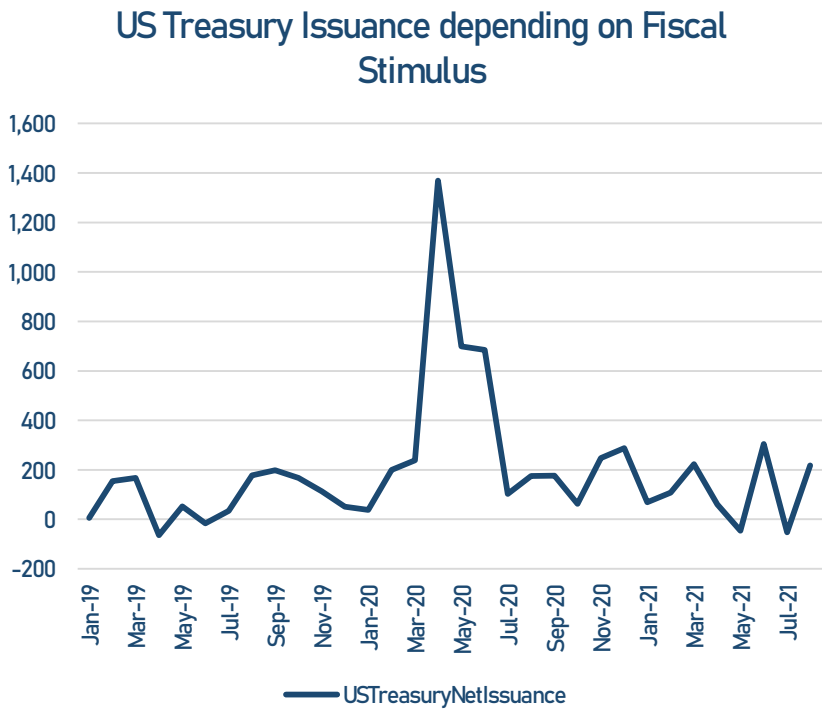


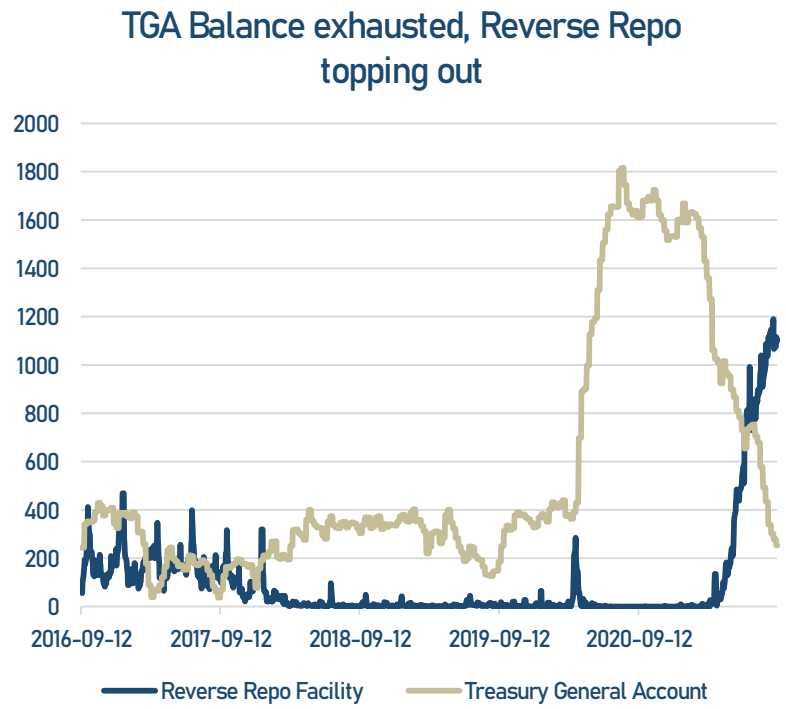
Source: FlightAware

2. HIGHER YIELDS

US YIELD CURVE – HIGHER YIELDS EXPECTED

- 3rd highest corporate bond issuance of this year this week
- Government bond issuance faces hurdles:
  - Debt ceiling in October
  - $3.5trn fiscal stimulus approval





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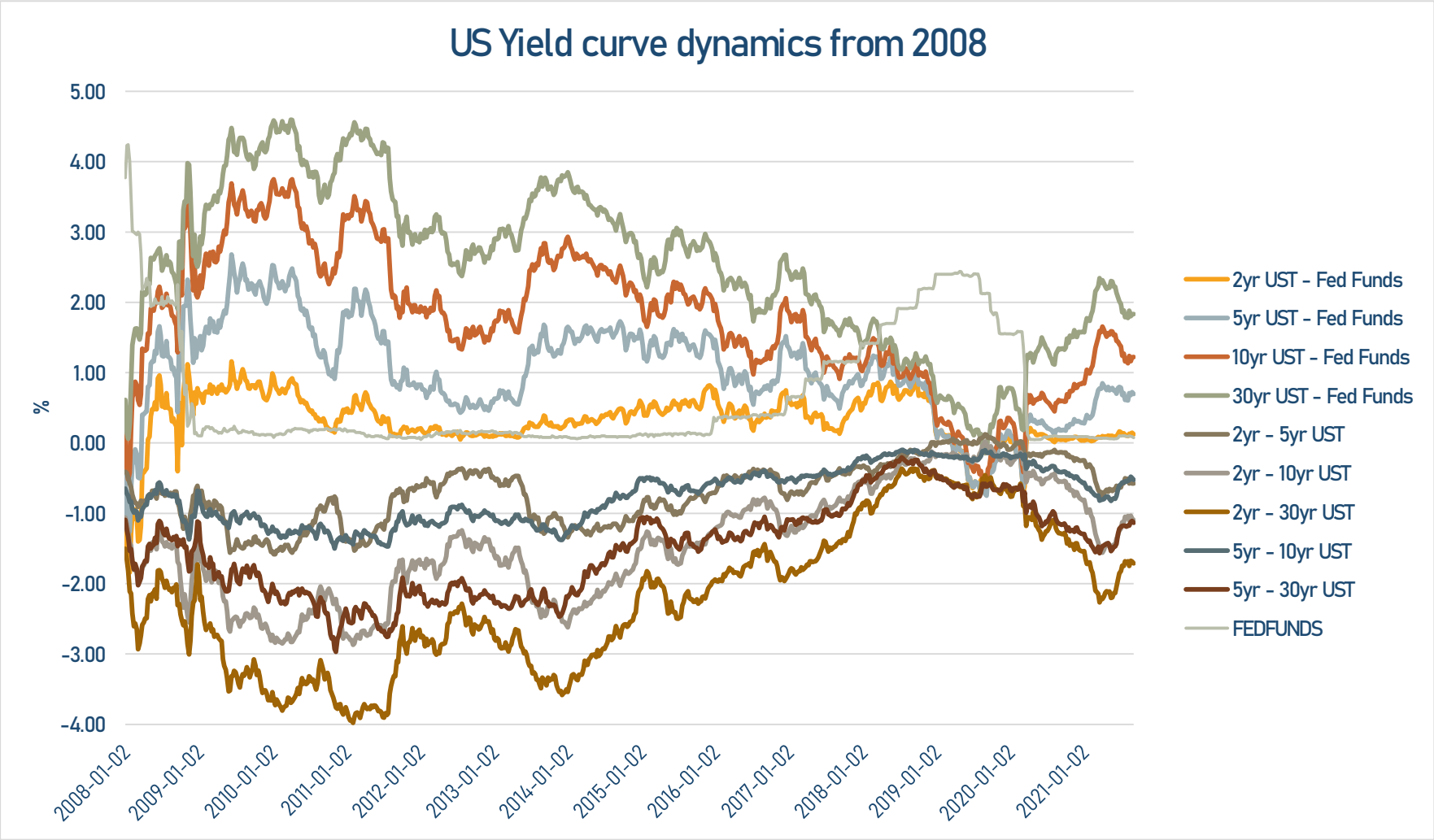
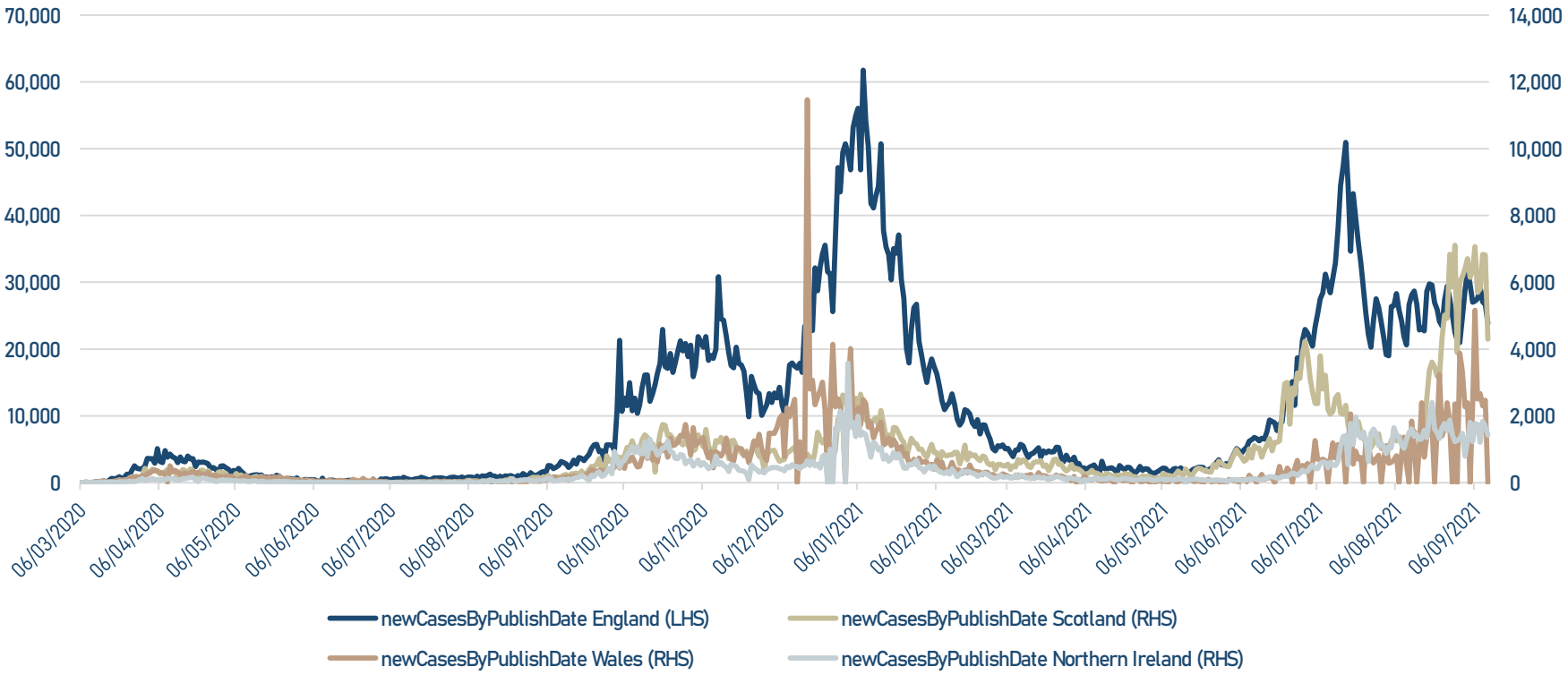


3. COVID UPDATE UK

COVID – IS UK REACHING HERD IMMUNITY?

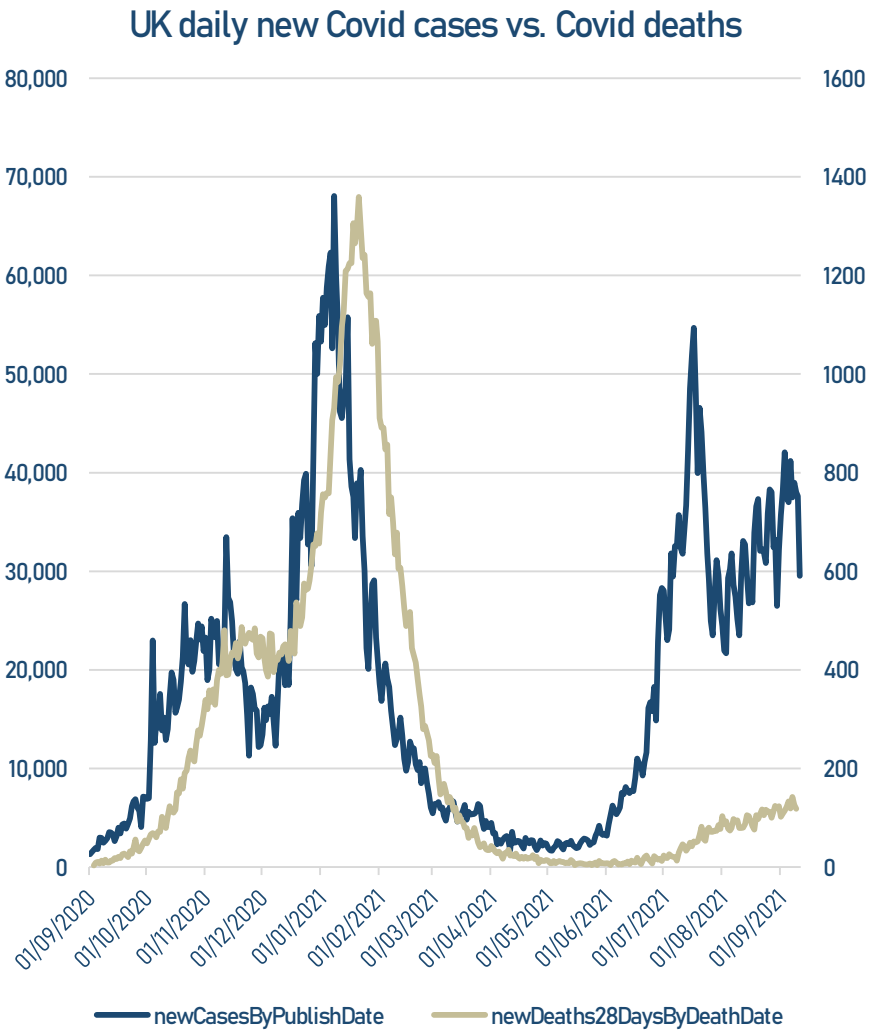
- Scotland's cases trebled after schools reopened mid-August
- No such change in cases reported in England since reopening in September
- Expected 75,000 daily Covid cases in UK not valid → signs of herd immunity

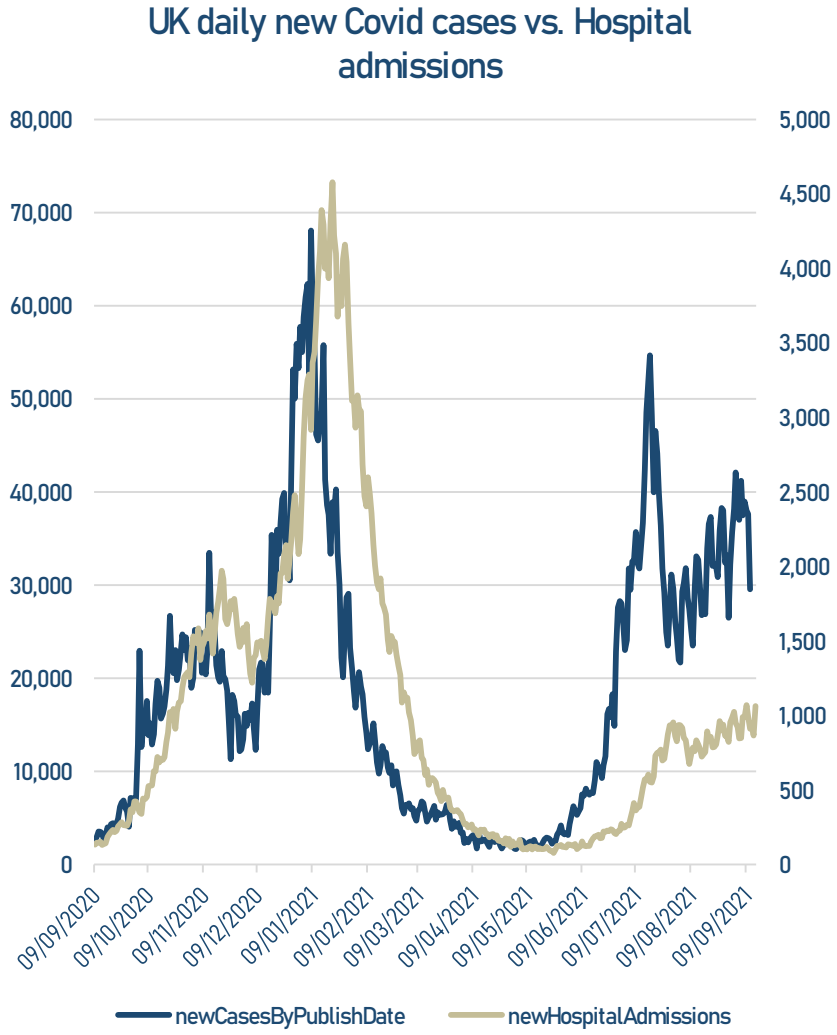
UK Covid Cases climb after schools reopen in Scotland, but stay stable in other regions



Source: Public Health England

COVID – UK LEARNT TO LIVE WITH COVID





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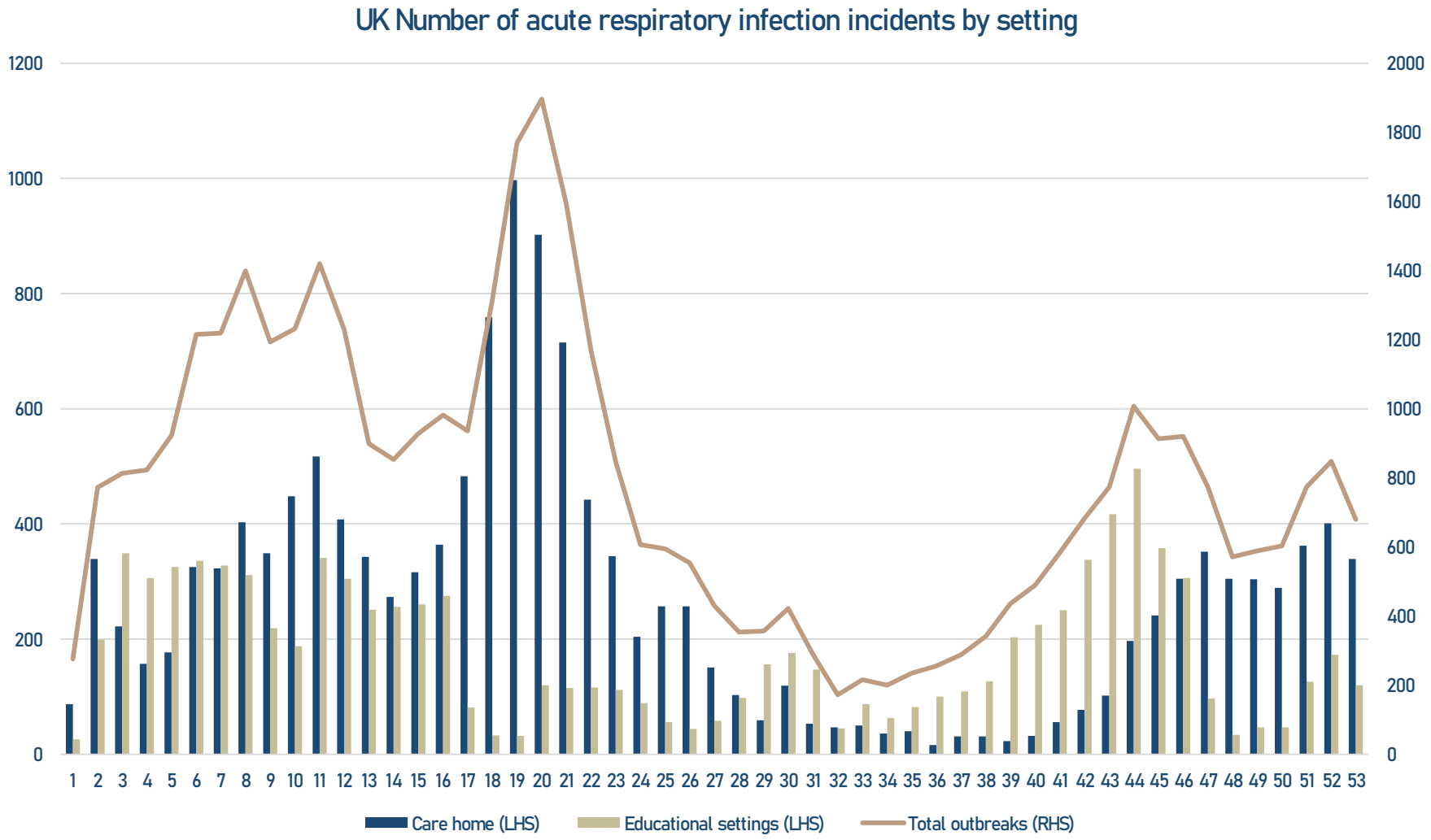
Source: Public Health England

RESPIRATORY DISEASES – STABLE



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Source: Public Health England

4. WHERE TO FIND VALUE

TURNAROUND – UK ENERGY SUPPLIER

- Centrica
  - British Gas owner with +9mio UK customers
  - 2/3 on Ofgem tariffs, 1/3 on fixed rates
  - Upstream gas production hedging begins 24 months in advance
  - Signed 15yr Power Purchasing Agreements with offshore wind farms at £57.5 per MWh (current prices are £133 per MWh) starting in 2022
  - Is signing on new customers from failing smaller utilities
  - Biggest competitors: EDF, EON, SSE, Scottish Power
  - Legacy contract a drag (£50-100mio)
  - FCF of £1bn+
  - £185mio interest expense, £400mio oil&gas capex, £175mio pension deficit

British Gas — Energy Plus Protection Mar2024v20
Fixed rate contract: 30 Months
Early exit fee: £100.00
Comparison site exclusive · Bronze Standard - Green Tariff · Includes boiler cover · Most popular
Additional annual cost: + £146.96 (£76.81 pm) — What will I pay?
Choose plan · Plan info

ESB energy — Brighter Future 24 v21
Fixed rate contract: 24 Months
Early exit fee: £60.00
Bronze Standard - Green Tariff
Additional annual cost: + £173.24 (£79.00 pm) — What will I pay?
Choose plan · Plan info

Cheapest fixed, no exit fee

good energy — Good to Fix August 2023
Fixed rate contract: 23 Months
Early exit fee: None
Gold Standard - Green Tariff
Additional annual cost: + £202.71 (£81.46 pm) — What will I pay?
Choose plan · Plan info

octopus energy — Octopus Exclusive 24M Fixed September 2021 v2
Fixed rate contract: 24 Months
Early exit fee: None
Comparison site exclusive · Bronze Standard - Green Tariff · Supplier of the Year
Additional annual cost: + £210.12 (£82.07 pm) — What will I pay?
Choose plan · Plan info

SO ENERGY — So Cinnamon Two Year - Green
Fixed rate contract: 24 Months
Early exit fee: £60.00
Bronze Standard - Green Tariff
Additional annual cost: + £212.80 (£82.30 pm) — What will I pay?
Choose plan · Plan info

Source: U Switch