

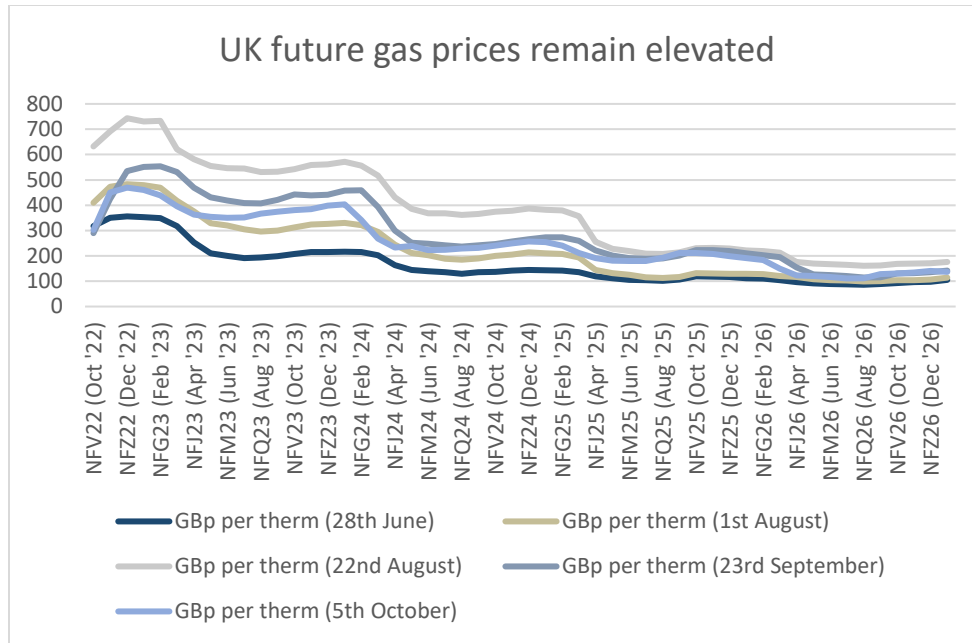
Re-entry Serica Energy: Prolonged time of higher gas prices

Company:	Serica Energy (SQZ LN)	Market Cap:	£1bn
Industry:	Oil & Gas	Net Cash:	£200mio + £300mio pledged for margins
Country:	UK	Revenue:	£1.1bn
Date:	5 th October 2022	Net Income:	£300mio (28%)*
Dividend:	4.6%	Free Cash Flow:	£380mio (35%)
Entry:	£1.045bn	Target:	£1.2bn

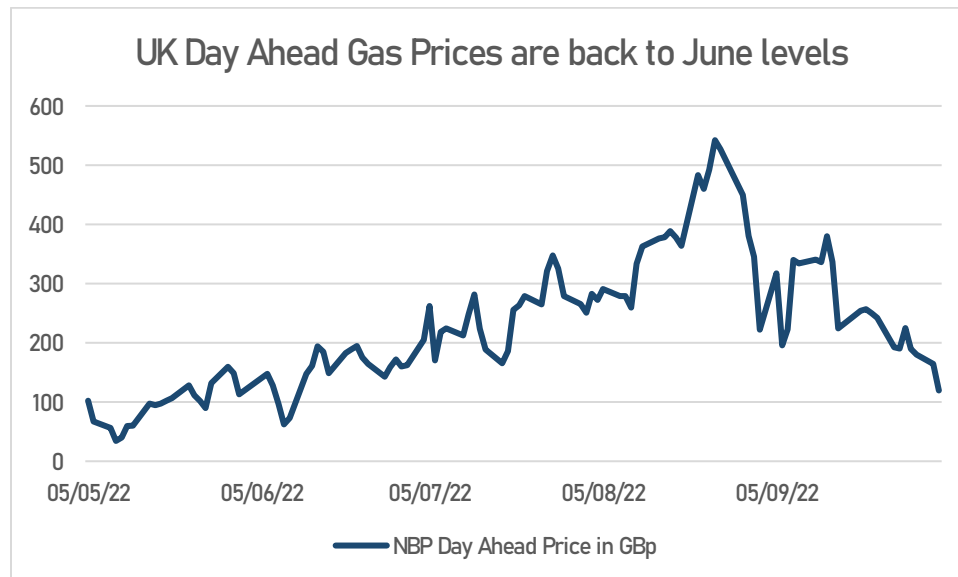
*numbers assume 26.832k boepd production, GBp 206 per therm (gas), \$95 a barrel (oil), 60% tax rate

EU gas in storage at 90%

As gas storage tanks in Europe have been filled rapidly to levels higher than the peak in 2017/18, gas prices have come down slightly, although remain elevated in historical context. In particular, the UK day ahead price has reduced to levels last seen in June before the German government began buying up LNG supplies at any price. The German government has now stopped this type of purchases, as storage tanks are approaching their limits and gas prices have hence come off their peak in late August.

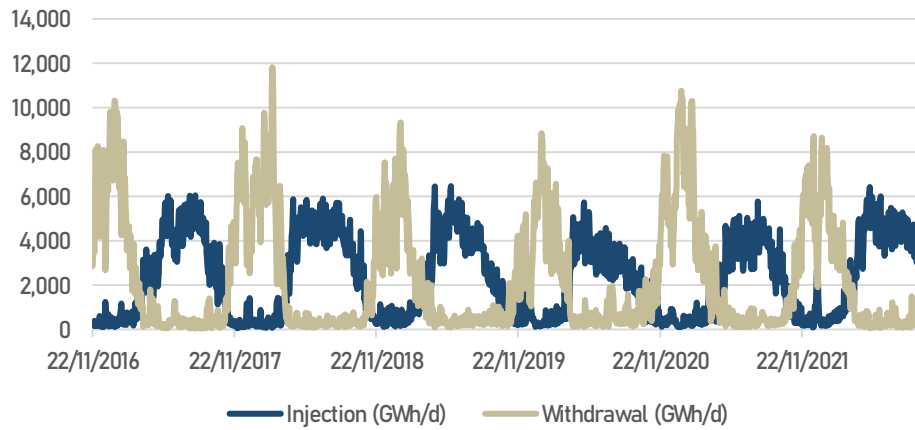


Source: Barchart



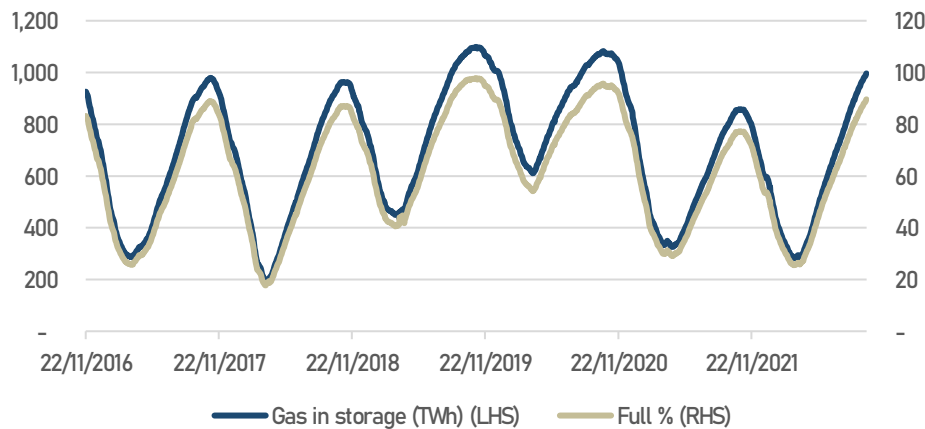
Source: Marex

EU gas injection to storage levels is beginning to level off amidst high storage levels



Source: Barchart

European gas in storage now above peak level of 2017/18



Source: Barchart

Living without Russian gas

A few months ago I have created the below tables to demonstrate what life in Europe without Russian gas could look like. At this point, a worst case scenario of Russian gas imports is likely, while a best case scenario of imports other than Russian seems plausible. Since then, things have obviously evolved and hence the best case scenario of gas supplies from countries other than Russia has likely increased, although by no more than 10% or so from supplies from the UAE or Qatar. Nonetheless, Europe will face gas shortages, which can only be avoided by reducing demand, which is being done. While storage levels are high, the worst case scenario in terms of Russian gas imports will only play out in 2023, as for instance Nordstream I was in operation for around a quarter of this “gas year” (April 2022 – April 2023). This is why the IEA and other organisations warn that “this winter will be difficult, but next winter will be very difficult”. This is the precise reason why Germany has also opted to oppose a price cap on all gas imports, as due to the higher prices, supplies are being reroutes from other areas, such as Pakistan, Bangladesh or Indonesia. Therefore, gas prices will have to stay elevated to enable Europe to scoop up LNG supplies from around the world.

EU gas imports from Russia under different scenarios

Pipeline/LNG carrier	EU imports 2019 (in TWh)	Realistic scenario imports (annualised in TWh)	Worst case Scenario imports (annualised in TWh)	Best case Scenario imports (annualised in TWh)
Russia Yamal Pipeline	358	0	0	0
Russia Nord Stream Pipeline	596	238	0	596
Russia Ukraine Pipeline	433	87	87	173
Russia TurkStream Pipeline	347	347	347	347
Russia Blue Stream Pipeline	173	173	173	173
Russia LNG Carrier	228	228	0	228
Total	2134	1073	607	1517
Difference		-1061	-1528	-618

EU gas imports from countries other than Russia under different scenarios

Pipeline/LNG carrier	EU imports 2019 (in TWh)	Realistic scenario imports (annualized in TWh)	Best case Scenario imports (annualized in TWh)	Worst case Scenario imports (annualized in TWh)
Norway pipelines	1065	1200	1200	1200
Norway LNG Carrier	59	59	59	59
Qatar LNG Carrier	293	293	293	293
Algeria Pipeline	205	300	300	300
Algeria LNG Carrier	98	98	98	98
Libya Pipeline	49	49	49	49
US LNG Carrier	166	661	992	400
Nigeria LNG carrier	127	127	127	127
Trinidad and Tobago LNG carrier	59	59	59	59
Other LNG carrier	49	100	100	100
Total	2170	2946	3277	2685
Difference		776	1107	515

Source: AozoraStep Capital Market Views Episode 15

Serica's Enterprise Value

While a £1bn market cap of Serica Energy sounds fair, an enterprise value of just £500mio does not. Serica has boosted its net cash from £100mio to £420mio within just one year and to £500mio by end of September 2022. At the same time, the UK Energy Profits Levy is actually somewhat helpful for the company, since as much as 80% of its capital spending on exploration and drilling can be offset from taxes, enabling the company to increase production without impacting cash flows much. Despite the recent decline in day ahead prices, I estimate the average gas price sold by Serica for the year 2022 to be around GBp 206 as of 4th October 2022, which would result in a net profit of around £300mio.

Why enter for a 20% return?

Usually, I target 40% returns for an investment to enable enough room for mistakes and unforeseen surprises. In the case of Serica Energy I view the position as a hedge against other positions, as a rise in gas prices affects most other parts of the economy at this point. In addition, the large cash amount provides downside protection, since Serica would buy back shares or return cash as dividends to shareholders once their hedges have come off. Last but not least, the geopolitical environment is getting grimmer by the day and commodities have proven to be a good hedge against this risk.



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