

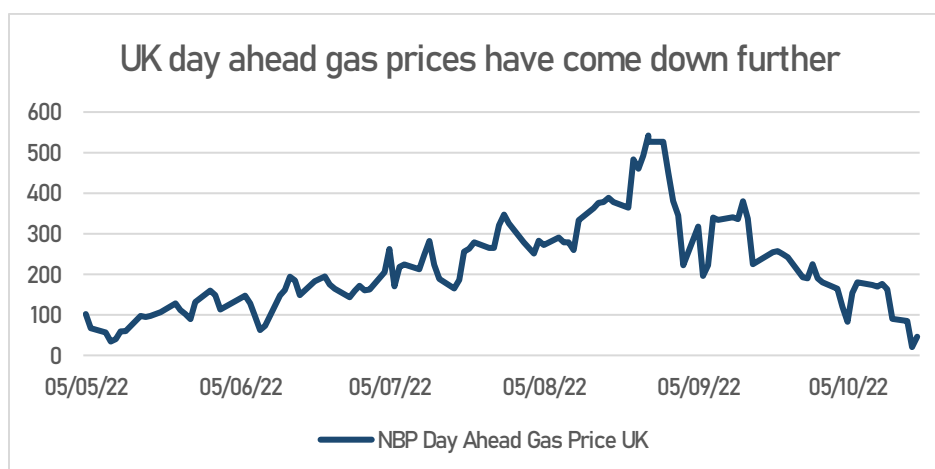
Exit Serica Energy: Unfavourable risk/rewards

Company:	Serica Energy (SQZ LN)	Market Cap:	£870mio
Industry:	Oil & Gas	Net Cash:	£200mio + £300mio pledged for margins
Country:	UK	Revenue:	£1.1bn
Date:	20 th October 2022	Net Income:	£300mio (28%)*
Dividend:	5.3%	Free Cash Flow:	£380mio (35%)
Entry:	£1.045bn	Exit:	£933mio

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

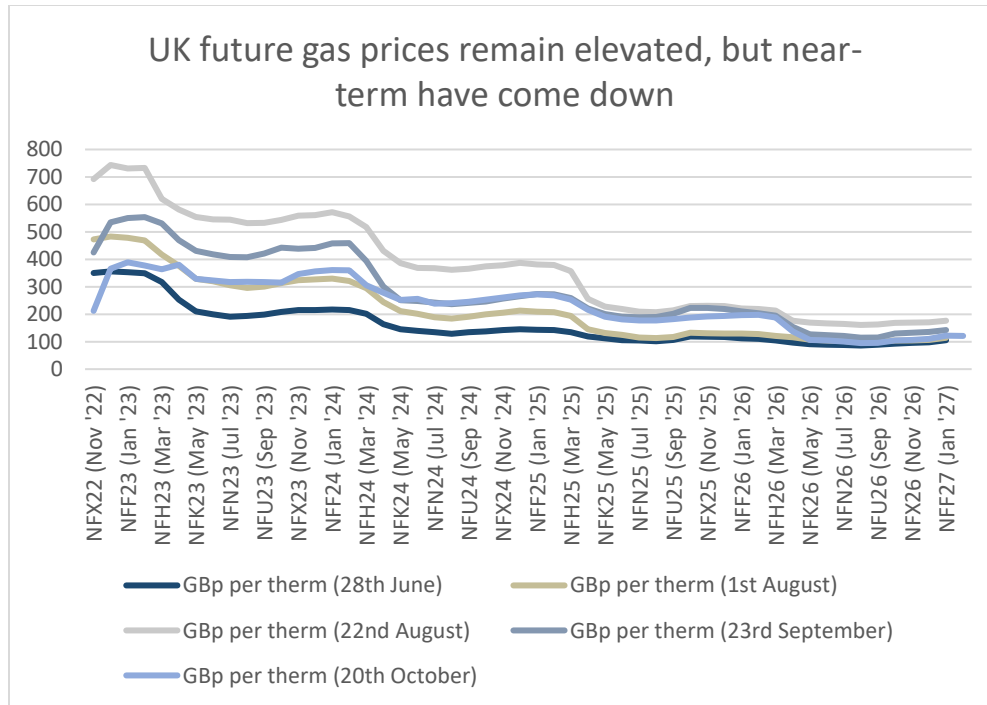
Gas supply: The tide has turned

The energy crisis has now been with us for a good year and with EU gas storage at near record levels, continuing to get filled, near-term gas prices have been coming down, especially the day-ahead price. Germany will keep buying gas to enable storage tank levels 40% full at the end of this winter. However, they are now in a position where they don't need to buy at any price given their storage tanks are full by 96% of capacity. At the same time, LNG tankers appear to be piling up on the Southwest of Spain, counting 10 LNG tankers that are waiting to be discharged¹. This is pushing price down...



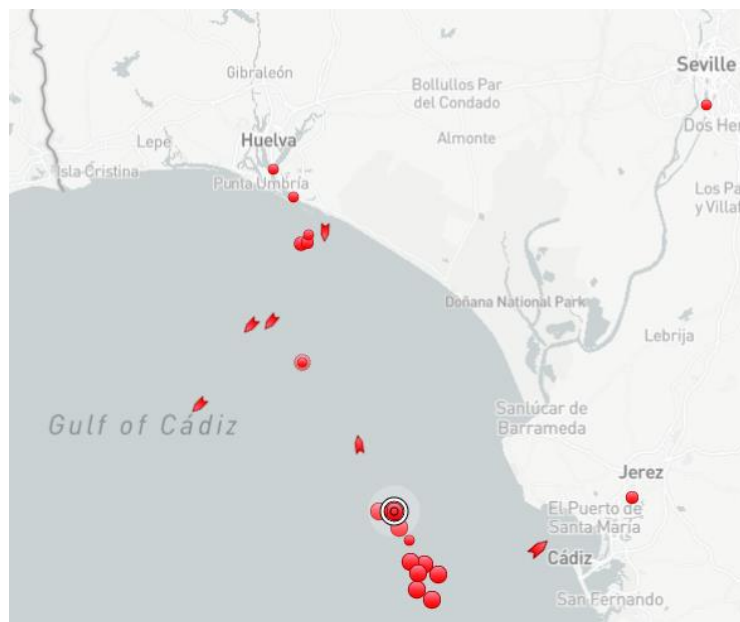
Source: Marex

¹ <https://uk.finance.yahoo.com/news/ships-circling-off-southwestern-spain-050532031.html>



Source: Barchart

10 LNG tankers are currently waiting to be discharged Southwest of Spain



Source: Marinetraffic.com

EU Gas in Storage fulfils nearly 30% of annual consumption

Region	Gas in storage (TWh)	Full (%)	Trend (%)	Consumption (TWh)	Stock/Cons (%)
EU	1,044	94	0.17	3,776	28
Germany	237	96	0.2	905	26
Italy	182	94	0.1	725	25
France	132	99	0.16	430	31
Netherlands	129	93	-0.19	351	37
Non-EU	112	33	0.04	1,031	11
Ukraine	102	31	0.07	261	39
Austria	84	87	0.37	90	93
Hungary	54	80	0.36	108	50
Romania	40	100	0.27	114	35
Czech Republic	39	90	0.19	91	43
Poland	36	99	0.12	232	15
Slovakia	34	91	0.48	53	63
Spain	33	93	0.13	339	10
Latvia	13	55	0.33	12	115
United Kingdom (Post-Brexit)	10	100	-1.03	769	1
Denmark	9	100	0	23	40
Belgium	9	100	0.58	170	5
Bulgaria	5	84	0.5	33	15
Croatia	5	96	0.47	28	16
Portugal	4	100	0	59	7
Sweden	0	93	0	13	1
Ireland	0	0	0	51	0
United Kingdom (Pre-Brexit)	0	0	0	0	0
Serbia	0	0	0	0	0

Source: AGSI

The EU proposals to fight high energy prices

When Germany decided to buy gas in the spot market at any price in June, gas prices began to climb rapidly. It turns out that different countries in the EU sometimes outbid themselves, driving the price even higher. The EU is now looking to solve this problem by centralizing gas buying, which will give them more market power and better coordination². Whether it could drive prices lower is unclear to me. I would see this more like something China is doing in the iron ore space. It could also go the other way, as prices might react in both directions more sensitive when the EU steps into the market... The dynamic price limits for transaction on the TTF gas exchange might work like a circuit breaker and could also dampen the volatility of gas prices going forward.

The weather forecast

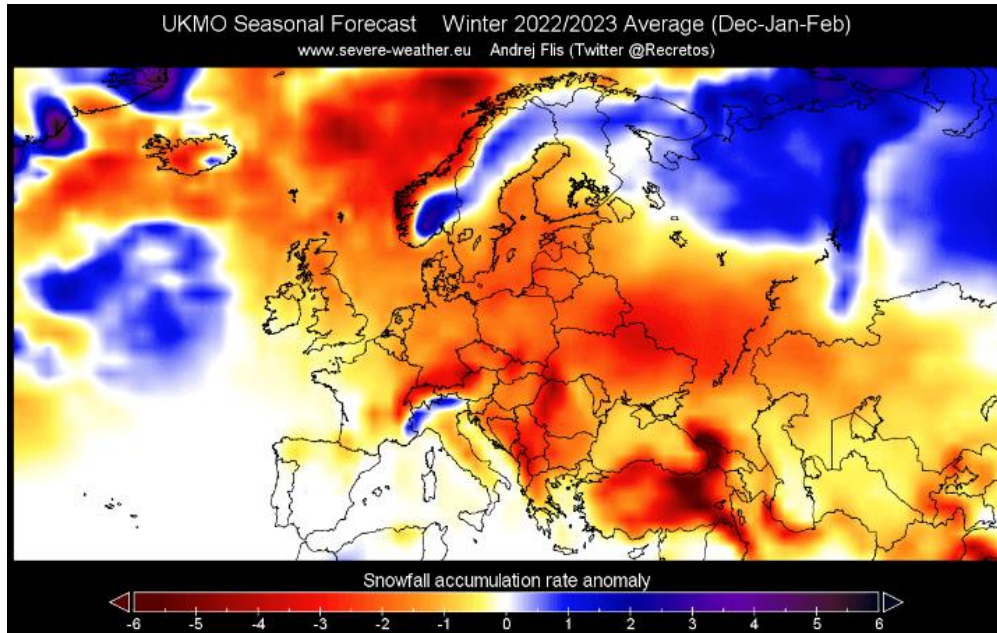
Finally, the all-important question will be: What's the weather like this winter? Long-term weather forecasts are not always very reliable. The current forecasts indicate that we will have another year of the La Nina weather phenomenon, which would point to a colder than normal winter³. At the same time, less snow than usual is being forecasted. On the other hand, the dynamics of the Polar Vortex will influence how much cold air from the Arctic reaches Europe. If the Polar Vortex is weak, it means that cold air can escape the polar regions and reach Europe or North America during the winter, making it colder on the continents. The Polar Vortex usually weakens when there is more snowfall during October. Current data as of 8th October show that the extent of Eurasian snow is 10% larger than usual, indicating a possibility of a weaker Polar Vortex and hence a colder winter for Europe and North America⁴.

² https://ec.europa.eu/commission/presscorner/detail/en/ip_22_6225

³ <https://www.severe-weather.eu/long-range-2/winter-2022-2023-seasonal-snowfall-predictions-update-united-states-canada-europe-fa/>

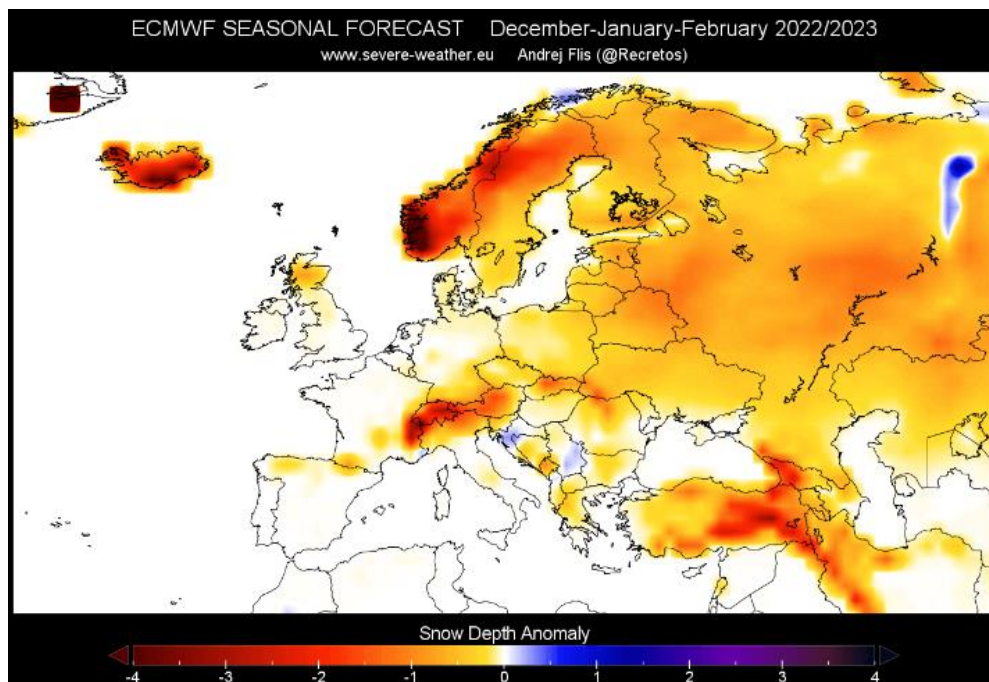
⁴ <https://www.severe-weather.eu/global-weather/polar-vortex-winter-weather-snow-cover-influence-forecast-united-states-canada-europe-fa/>

UKMO snowfall forecast winter 2022/23



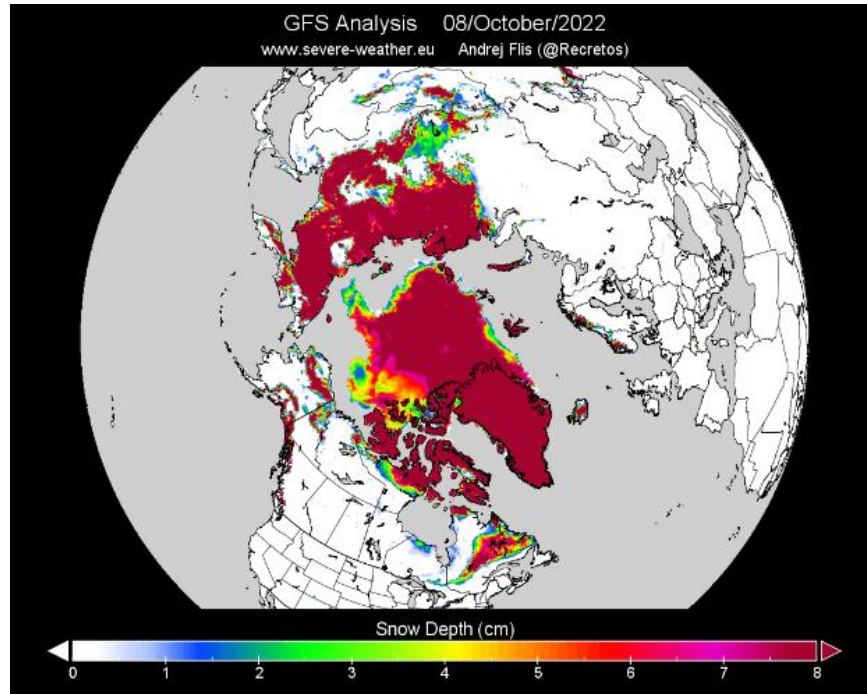
Source: Severe-weather.eu

ECMWF snowfall forecast winter 2022/23



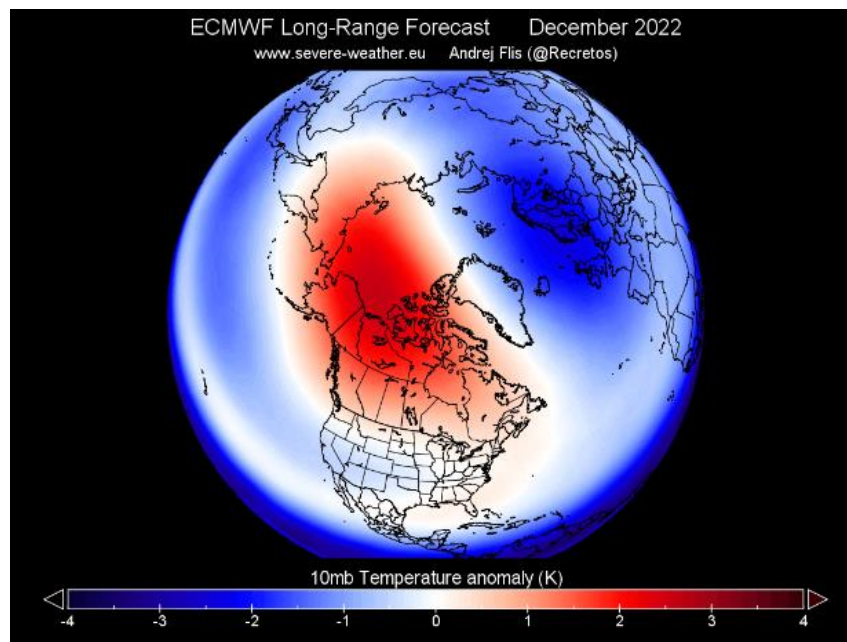
Source: Severe-weather.eu

GFS snowfall anomaly October 2022



Source: Severe-weather.eu

ECMWF temperature anomaly winter 2022/23



Source: Severe-weather.eu

Conclusion

I have sold the position in Serica Energy due to the high gas storage levels, warm weather, and a general sense that more positive news, such as French nuclear power and the US gas export terminals coming online, will lower European gas prices. While Serica Energy notes that they have £500mio net cash, it is important to understand that there will be more taxes payable, likely in the region of £100mio. Therefore, the net cash amount might be somewhat misleading, especially as their net current assets are only around £225mio. It was difficult to see this, as the trading updates were often focused on net cash, but it wasn't possible to see the current liabilities. The interim results and the developments in the gas markets have made me realise that the fair value is therefore lower than the £1.2bn market cap I estimated.



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