STOCKS DOWN UNDER

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ASX Top 200 Stocks Down Under

The biggest risk of all is not taking one.

- Mellody Hobson (b.1969), Co-CEO of Ariel Investments

BEACH ENERGY

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Stocks Down Under rating: ★★★★

ASX: BPT
Market cap: A$3.5BN

52-week range: A$1.01 / A$1.83
Share price: A$1.57

It’s been seven months since we last looked at Beach Energy, and it’s grown from $1.21 to $1.53 - a 25% gain. Considering the ASX 200 has lost over 5% in that time, Beach’s performance looks impressive, especially considering it dropped after its FY21 results and had to deal with a class action and the exit of CEO Matt Kay. Beach Energy remains below pre-pandemic levels even though oil prices are at levels rarely seen in the last decade. That sounds like a great opportunity to us, if you’re comfortable with the slightly higher risk.

Share price chart

Source: Tradingview

An energy giant that has kept getting bigger

Like its peer Santos, Beach Energy was born from its discovery of petroleum in South Australia. However, Beach’s discovery well was in a more salubrious location near one of Adelaide’s beaches – specifically the site that now hosts the Grange Golf Club. Today, Beach has producing assets in five basins – the Cooper/Eromanga and Otway Basins in South Australia, the Bass Basin in Victoria, the Perth Basin in WA and the Taranaki Basin in NZ.

Beach Energy also has oil and gas infrastructure assets that include the Moomba processing facility and the Otway gas plant. It also owns a portfolio of onshore and offshore development projects spread across Australia and New Zealand. Beach Energy is Australia’s largest onshore oil producer and a key natural gas supplier to the East Coast market.

The company is facing favourable market conditions at present. One tailwind is elevated oil prices, which are at highs not seen since 2014. The other is the gas shortage facing Australia’s east coast with once reliable fields (such as in the Bass Strait) winding down and gas producers unwilling to sacrifice export volume to make up the shortfall. The ACCC estimated that in August last year, there could be a shortfall of 2 petajoules of gas in 2022. But as we mentioned earlier, Beach Energy is off its all-time lows but still below its pre-COVID peak of $2.77.

Why hasn't Beach fully recovered from the Corona Crash?

The company's FY21 results disappointed investors because they fell short of consensus estimates, even though it recorded EBITDA of $953m and an underlying NPAT of $363m. We think the main reason is Beach's production figures, which have disappointed investors. In the December quarter, production figures were the lowest in four years and in H1 FY22, rates fell 15% compared to the prior corresponding period. For comparison's sake, four years ago, Beach hadn't yet acquired Origin Energy's oil and gas business (Lattice Energy) and that deal was expected to double quarterly production. The company blamed planned and unscheduled maintenance and a drop in supplies. Even though Beach's profit has been boosted due to higher oil prices - jumping by 66% in H1 HY22 - it still fell short of market consensus. The company is targeting 28MMboe (million barrels of oil equivalent) in FY24, which would be less than 10% higher than FY21's total of 25.6MMboe.

Beach Energy has also been dogged by a downgrade of its Western Flank fields in the Cooper Basin last April, and a subsequential earnings downgrade just 8 months after previous guidance. Two legal actions have been launched against the company by shareholders. It also suffered from speculation its largest shareholder, Kerry Stokes' Seven Group, would offload its stake. It also has lacked a permanent CEO since Matt Kay left in November last year (Morné Engelbrecht is acting CEO). And it hasn't been as keen to engage in M&A activity compared to its peers despite having a healthy balance sheet.

But it hasn't been all doom and gloom for Beach Energy. The current highs in oil prices, if sustained, will further boost the bottom line. Last September, it signed its first LNG supply deal with BP Singapore from its Waitsia onshore gas project – while the price was confidential, the deal provided for 3.75m tonnes. And the company is about to kick off the first oil exploration campaign in Cooper Basin's Western Flank since 2017. There are also positive signs on the ESG front. Similar to its peers, Beach Energy is looking to reduce its emissions by 25% by FY25 and 'Net Zero' by 2050. But it has made some progress already, by cutting emissions by 12% between FY18 and FY21. Beach Energy also has a ~33% stake in the Moomba carbon capture and storage project in South Australia with Santos holding the balance.

Santos is a cheap company, but should it be?

It was only a week ago that we looked at Beach's industry peer Santos (ASX: STO) and noted that Beach traded at a low multiple compared to Santos and Woodside Energy (ASX: WPL), with Beach trading at 3.5x and 3.3x EV/EBITDA for FY22 and FY23 respectively, and 7.4x P/E for FY22 and FY23 respectively. We also expressed the view that many oil and gas companies were being disregarded by investors due to ESG concerns. We believe oil and gas companies generally are being wrongly undervalued and have the potential to be re-rated strongly in 2022.

Santos we like because of its higher exposure to natural gas and ESG – less vulnerable than oil to decarbonisation – and because Santos has had stable leadership for some years now. For Beach, the opportunity is to benefit from a stronger re-rating once it finds a permanent replacement CEO, the legal dramas are behind it, and its production figures are trending positively. It's a little riskier than Santos, but this one is also four stars.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia

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