STOCKS DOWN UNDER

4 JULY 2022

ASX Top 200 Stocks Down Under

Natural gas is the future. It is here.

- Bill Richardson III (b. 1947), 30th governor of New Mexico (2003-2011)

BEACH ENERGY

Benefiting from gas shortages on the east coast

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Stocks Down Under rating: ★★★★

ASX: BPT
Market cap: A$3.9BN

52-week range: A$1.01 / A$1.90
Share price: A$1.705

This edition marks the third time we have covered Beach Energy (ASX: BPT), the first two occasions being 16 August 2021 and 14 March 2022. Since 14 March, Beach is up 2%, a figure that may not appear impressive being even lower than inflation. However, it is ahead of the ASX 200's 6% decline during the same timeframe and roughly in line with the ASX 200 Energy Index. This alone might be enough to consider it a safe haven in a difficult year for markets. But we think the real catalyst for Beach's growth is the gas shortage on Australia's East Coast, and that it is well-placed to capitalise.

Share price chart

Source: Tradingview

The East Coast's pain is Beach's potential gain

Beach Energy is one of the ASX's largest energy stocks with five producing assets. These include the Cooper/Eromanga and Otway Basins in South Australia, the Bass Basin in Victoria, the Perth Basin in WA and the Taranaki Basin in New Zealand. Beach also owns oil and gas infrastructure assets and offshore and onshore development projects. Anyone interested in the story of how Beach began and handled the first year of the pandemic, including the crash in oil prices, should check out our 16 August 2021 edition.

Ultimately, the biggest catalyst for the company is Australia's gas shortage in the East Coast. Last year, the ACCC estimated it is 2 petajoules of gas, which is 2 million billion or 556 gigawatt hours. This was because once reliable fields (particularly in the Bass Strait) were winding down and gas producers were unwilling to sacrifice export volume to make up the shortfall. But in 2022, the problem has gone from bad to worse thanks to adverse weather and the sanctions on the world's largest gas exporter, Russia, as retaliation for its invasion of Ukraine. Inflation and supply chain bottlenecks are hurting too.

The shortage of coal, also a major Russian export, has added insult to injury, because gas plants make up much of the shortfall, but the ageing infrastructure is struggling to cope with demand. And the supply shortage is not meant to get better any time soon with no end to the Russia-Ukrainian war in sight. Even if the government was to mandate gas suppliers to withhold exports for the domestic market, it would take a while to become effective.

Beach set to benefit in the short and longer term

All of these are beneficial for ASX-listed energy companies generally. But we are singling out Beach Energy because it is capitalised to address both in the short and longer term. In the shorter term, it completed the acquisition of Senex Energy's (ASX: SXY) Cooper Basin assets and is set to benefit from higher prices. We observe that benchmark natural gas prices at the Wallumbilla gas hub in Queensland have gone from A$9/GJ last February to ~A$36/GJ last week. Beach's annual realised sales gas price was only $8.4/GJ in the last quarter, but it will likely be higher in the quarter to come. Although not all of its volumes are oil linked, its contracts are longer term which provides tability of revenue.

In the longer term, Beach Energy has set itself up well, anticipating the 2024 start of Stage 2 production at Waitsia, which it has a 50% stake in. This is one of the largest gas fields every discovered onshore in Australia and the combined field and production facility will deliver 250TJ per day, over its 15-year life cycle. Overall, Beach is targeting production of 28mmboe in FY24 and we think this could increase through further M&A activity.

And more than its peers

We also like Beach's reasonable multiples relative to its peers. It is trading at an EV/EBITDA ratio of only 3x on consensus FY23 earnings. This is well below Santos (ASX: STO) at 4.6x and Woodside (ASX: WPL) at 4.3x. At first glance, you might explain it by both companies' larger capitalisations. But we observe that Woodside's valuation is based on the assumption that the Scarborough LNG project, the biggest in Australia for at least a decade, will start on schedule. But even so, this will not be until 2026, will cost over $16bn and there is no certainty it will not experience cost blowouts and delays. Also remember that Scarborough LNG will go to international markets only.

Santos is in a better position, already possessing gas producing assets. But unlike Beach Energy, it sells its gas on long-term contract prices linked to crude oil. The company is benefiting from prices seen for much of 2021, but to reap current oil price levels, these will need to stay elevated for some time to come.

This said, Beach has not been without controversy and is still below its pre-Corona Crash levels. The company has failed to live up to investor expectations, suffered from disappointing production figures for much of FY21 and in 1HY22 – in the latter period, production rates fell 15% compared to the prior corresponding period and were the lowest in four years. Bear in mind that five years ago Beach had not yet acquired Origin Energy's oil and gas business, and that deal was expected to double quarterly production. And worst of all, it downgraded its Western Flank fields in the Cooper Basin in April 2021. This led to legal actions against the company and speculation that Kerry Stokes' Seven Group, BPT's largest shareholder, would exit.

One other problem we observed in our 14 March 2022 report was that it lacked a permanent CEO since Matt Kay's departure, but this has been resolved with the permanent appointment of Morné Engelbrecht.

We accept that the legal cases hanging over the company's head are a risk. But we think the company is in a better position than it was 6 months ago with a new permanent boss as well as the East Coast gas shortage. As we have shown, it is capitalised in the short term (given the nature of its gas sales contracts) and the longer term (with new projects set to come online). Although this company is not without risk, we think it is four stars.

Beach Energy is also a Stocks Down Under Concierge stock.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia

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