Investors' Chronicle

SMALL COMPANIES

Profiting from the European gas crisis

Our award winning small-cap stock picking expert has been keeping an eye on the forward energy price curve for good reason.

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By **Simon Thompson**

I have been keeping a keen eye on UK forward energy prices with a view to hedging out our household consumption over the next 12 months, and well before Ofgem drops the bombshell of the autumn price cap on Friday, 26 August 2022. I made the switch this week, locking into a gas price of 11.27p per kwh and 41.5p per kwh electricity price with my supplier Octopus Energy, both of which are above Ofgem's summer 2022 price cap of 7.32p and 29.5p per kwh, respectively

However, the fixed gas price I signed up to is likely to be at least 11 per cent below the new price cap for the final quarter of 2022 when I switch my heating back on, and safeguards my bills against the real possibility of wholesale gas prices spiralling in the event of Russia significantly cutting supplies to Europe. If that happens then Ofgem's gas price cap for the first quarter of 2023 (to be announced on 24 November 2022) will easily exceed 13p per kwh, and would impact the electricity price cap, too, given that gas generation accounts for more than a third of the National Grid's output. There is another reason for my interest, too.

Parkmead in an earnings upgrade cycle

- Record gas revenue of €14.5mn in the 12 months to 30 June 2022
- Dutch TTF prices are trading at €165 per MWh, or double the prices embedded into analysts' earnings forecasts
- Netherland gas production fully unhedged

Parkmead (PMG:49.5p), a UK and Netherlands focused energy group, is a major beneficiary of the European energy crisis.

The group's unhedged low-cost onshore gas portfolio in the Netherlands delivered 21.8mn cubic feet per day of output in the

12 months to 30 June 2022, the equivalent of 3,750 barrels of oil equivalent (boe) per day, at a field operating cost of $8.60 per boe with an average netback of $120 per boe.

This was driven by an average Dutch Title Transfer Facility (TTF) gas price of €86 per MWh, well ahead of finnCap's €70 per MWh assumption, hence why the group's record gas revenue of €14.5mn was 13 per cent above analyst Jonathan Wright's forecast. The windfall revenue gains feed straight through to profits, prompting FinnCap to upgrade its pre-tax profit estimate by more than a quarter to £8.2mn on revenue of £13.1mn, up from a pre-tax loss of £2.6mn on revenue of £3.6mn in the 2020/21 financial year. On this basis, expect earnings per share (EPS) of 3.7p.

Moreover, although Wright raised his 2023 pre-tax profit estimate by 18 per cent to £9.1mn on revenue of £14.1mn, this forecast only factors in a cautious looking €80 per MWh gas price, up from €65 per MWh previously. However, Dutch TTF prices are currently trading at €165 per MWh and the forward curve is averaging almost €150 per MWh for Parkmead's 2022/23 financial year. In other words, at current spot prices, there is 100 per cent upside to FinnCap's revenue estimate and even larger upside to its earnings forecasts.

Furthermore, Parkmead and its Dutch partners are planning a low-cost two-well drilling campaign in the final quarter of 2022 (£1.5mn net combined cost) across their Dutch licenses. The drilling programme is targeting 37.2bn cubic feet of gross gas reserves and has a high geological chance of success (40 to 49 per cent). If successful, the prospects offer a fast-track tie-in opportunity, thus offering even greater potential upside to elevated gas prices this winter. This is also not embedded in analysts' forecasts.

The drilling prospects have an unrisked value of 19p a share, or six times more than the 3p a share risked valuation embedded in Wright's group risked net asset value (NAV) per share estimate of 164p.

It's also worth noting that estimated group net cash of £19.6mn (18p a share), Kempstone Windfarm (£4.3mn) and Pitreadie Farm in Aberdeenshire (£6.2mn) account for £30mn of Parkmead's market capitalisation of £54mn. This means that the group's operational businesses are in the price for £24mn, or less than three times FinnCap's operating profit forecasts of £8.8mn (2021/22 financial year) and £9.7mn (2022/23 financial year).

Given the heightened risk to European gas supplies being further materially reduced through Russia's Nord Stream pipeline, a consequence of which will send gas prices even higher, and the very conservative assumptions embedded in analysts' earnings estimates, then the risk to Parkmead's earnings is skewed heavily to the upside.

So, although the share price is trading around the level of my last buy call when I covered the interim results ('**A trio of Ben Graham value plays', 28 March 2022**), the obvious potential for further material earnings upgrades should act as a strong share price catalyst. Buy.