# Hugoton Royalty Trust (HGTXU)

*Updated December 28th, 2022 by Aristofanis Papadatos*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $2.10 | **5 Year CAGR Estimate:** | 4.3% | **Market Cap:** | $84 M |
| **Fair Value Price:** | $2.63 | **5 Year Growth Estimate:** | -12.0% | **Ex-Dividend Date:** | 12/29/22 |
| **% Fair Value:** | 80% | **5 Year Valuation Multiple Estimate:** | 4.6% | **Dividend Payment Date:** | 1/17/23 |
| **Dividend Yield:** | 16.7% | **5 Year Price Target** | $1.39 | **Years Of Dividend Growth:** | 1 |
| **Dividend Risk Score:** | F | **Retirement Suitability Score:** | C | **Rating:** | Sell |

## Overview & Current Events

Hugoton Royalty Trust (HGTXU) was created in late 1998, when XTO Energy conveyed 80% net profit interests in some predominantly gas-producing properties in Kansas, Oklahoma and Wyoming to the trust. Net profits in each area are calculated by subtracting production costs, development costs and labor costs from revenues. The trust, which produced 88% natural gas and 12% oil in 2021, has a market capitalization of $84 million.

Due to its pure upstream nature, Hugoton is highly sensitive to the cycles of gas prices. Between April 2018 and October 2020, the costs of the trust exceeded its revenues due to suppressed gas prices. As a result, Hugoton did not offer any distributions during that period. Even worse, when gas prices began to recover in late 2020, the trust had to wait for its revenues to offset past losses. On July 2nd, 2021, Hugoton announced that it had agreed to be sold to XTO Energy for $0.165 per unit in cash. In the special meeting held in December 2021, the deal was rejected by unitholders. Hugoton resumed paying monthly distributions only in August 2022. The suspension of distributions for over 4 years and the failed attempt of Hugoton to dissolve are reminders of the excessive risk of the trust.

In mid-November, Hugoton reported (11/14/22) financial results for the third quarter of fiscal 2022. Its realized prices of oil and gas recovered thanks to the sanctions of Europe and the U.S. on Russia for its invasion in Ukraine. Therefore, even though oil and gas output decreased, distributable income per unit recovered from $0.00 in the prior year's quarter to $0.22. Hugoton has offered total distributions of $0.35 this year, which correspond to a 16.7% annualized yield. The 8-year high annual distribution has resulted primarily from the sanctions of western countries on Russia.

## Growth on a Per-Unit Basis

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2027 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **DCFU** | $0.58 | $0.86 | $1.10 | $0.19 | $0.05 | $0.11 | $0.01 | $0.00 | $0.00 | $0.00 | ***$0.35*** | ***$0.18*** |
| **DPU** | $0.58 | $0.86 | $1.10 | $0.19 | $0.05 | $0.11 | $0.01 | $0.00 | $0.00 | $0.00 | ***$0.35*** | ***$0.18*** |
| **Units[1]** | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 | ***40.0*** | ***40.0*** |

Hugoton has generated an average distributable and distributed cash flow of $0.30/unit per year for the past decade, though with a noticeable decrease in the last eight years. Given the natural decline of the production of producing wells, the long-term downtrend in cash flows should be expected. During the last three years, the total production of Hugoton has declined at an average annual rate of -5%. On the other hand, the trust is on track to post 8-year high distributable cash flow per unit this year thanks to the aforementioned rally of gas prices, which has resulted from the sanctions of western countries on Russia. Given the exceptionally high comparison base formed this year and the natural decline of gas wells, we expect distributable cash flow per unit to decline by -12% per year on average over the next five years.

## Valuation Analysis

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | Now | 2027 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **P/DCFU** | 17.3 | 9.6 | 8.5 | 22.7 | 38.6 | 16.4 | 65.0 | --- | --- | --- | ***6.0*** | ***7.5*** |
| **Avg. Yld.** | 5.8% | 10.4% | 11.8% | 4.4% | 2.6% | 6.1% | 1.5% | 0.0% | 0.0% | 0.0% | ***16.7%*** | ***13.3%*** |

[1] Average Weighted Unit count is in millions.

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The trust's DCFU price multiple has averaged 12.9 in the years in which it has been meaningful over the last decade. Due to the aforementioned excessive risk of Hugoton, we assume a fair DCFU multiple of 7.5. The stock is currently trading at a valuation multiple of 6.0. If it trades at our assumed fair valuation level in five years, it will enjoy a 4.6% annualized gain in its returns.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

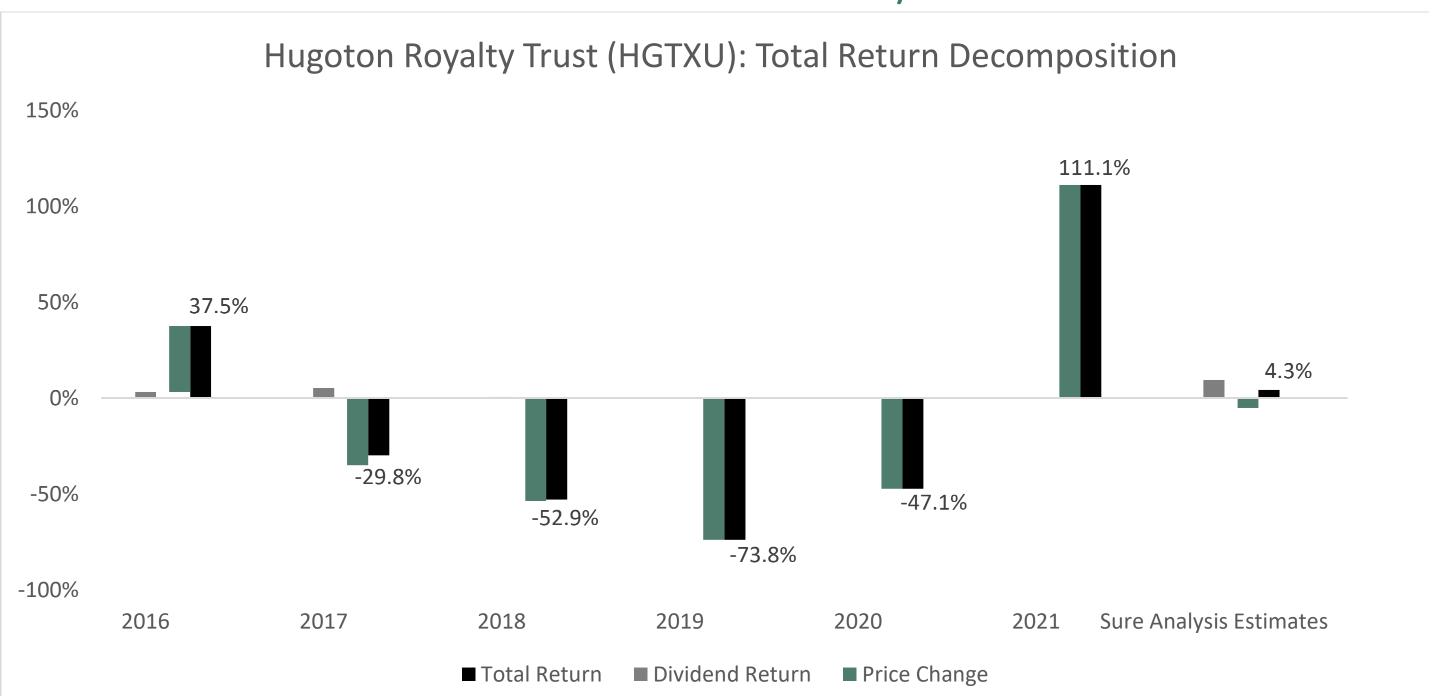
| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2027 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Payout** | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | ***100%*** | ***100%*** |

Due to the suspension of distributions for more than 4 years, Hugoton has offered an average distribution yield of only 4.3% over the last decade, with high volatility. This yield is far lower than the average yield of the other well-known oil and gas trusts. Whenever gas prices are low or development costs are high, the trust may suspend its distributions. Moreover, future distributions are highly unpredictable due to the absence of any guidance and the unknown path of the price of natural gas. The suspension of the distribution for over 4 years, the 95% plunge of the stock between 2018 and 2021 and the failed attempt of Hugoton to dissolve in 2021 are stern reminders of the excessive risk of the trust and its high sensitivity to the downturns of the energy market.

## Final Thoughts & Recommendation

Hugoton is thriving right now thanks to the sanctions of western countries on Russia, which have resulted in record LNG exports from the U.S. to Europe, thus tightening the U.S. gas market. However, we expect the price of natural gas to deflate in the upcoming years due to the record number of renewable energy projects that are in their development phase. We expect Hugoton to offer a 4.3% average annual return over the next five years, as its 16.7% initial distribution and a 4.6% valuation tailwind may be partly offset by a -12% decline of distributable income per unit. Due to its high risk, the stock receives a sell rating. While Hugoton is more cheaply valued than most of the other oil and gas trusts right now, it is not a buy-and-hold stock due to the long-term natural decline of its production.

## Total Return Breakdown by Year

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## Income Statement Metrics

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Revenue** | 25 | 37 | 44 | 8 | 3 | 5 | 2 | 0 | | |
| **SG&A Exp.** | 2 | 3 | 1 | 1 | 1 | | 1 | 1 | 1 | 1 |
| **Operating Profit** | 23 | 35 | 43 | 8 | 2 | | 0 | (0) | (0) | (1) |
| **Operating Margin** | 92.6% | 92.4% | 97.4% | 94.0% | 69.2% | 0.0% | 21.8% | -5.8% | 0.0% | 0.0% |
| **Net Profit** | 23 | 35 | 44 | 8 | 2 | 5 | 0 | - | - | - |
| **Net Margin** | 92.6% | 92.4% | 98.6% | 94.0% | 70.9% | 85.0% | 23.3% | 0.0% | 0.0% | 0.0% |

## Balance Sheet Metrics

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Total Assets** | 113 | 103 | 94 | 88 | 28 | 18 | 17 | 1 | - | 1 |
| **Total Liabilities** | 3 | 4 | 4 | 1 | 1 | 1 | 1 | 1 | 0 | 2 |
| **Long-Term Debt** | - | - | - | - | - | - | - | - | | |
| **Book Value** | 110 | 99 | 90 | 87 | 27 | 16 | 16 | - | (0) | (1) |
| **LTD/E Ratio** | - | - | - | - | - | - | - | | | |

## Profitability & Per Share Metrics

| Year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Shares Out.** | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 |
| **Revenue/Share** | 0.63 | 0.93 | 1.11 | 0.21 | 0.07 | 0.13 | 0.04 | 0.01 | | |

*Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.*