



Hugoton Royalty Trust (HGTXU)

Updated April 11th, 2023 by Aristofanis Papadatos

Key Metrics

Current Price:	\$2.00	5 Year CAGR Estimate:	9.1%	Market Cap:	\$81 M
Fair Value Price:	\$4.50	5 Year Growth Estimate:	-20.0%	Ex-Dividend Date:	3/30/23
% Fair Value:	44%	5 Year Valuation Multiple Estimate:	17.6%	Dividend Payment Date:	4/14/23
Dividend Yield:	30.0%	5 Year Price Target	\$1.47	Years Of Dividend Growth:	1
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Hold

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 87% natural gas and 13% oil in 2022, has a market capitalization of \$81 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 late March, Hugoton reported (3/30/22) financial results for the full fiscal 2022. Its realized prices of oil and gas jumped 42% and 75%, respectively, thanks to the sanctions of Europe and the U.S. on Russia for its invasion in Ukraine. Therefore, even though gas output dipped -4% due to natural decline, distributable income per unit jumped from \$0.00 in 2021 to \$0.41 in 2022. Hugoton has offered total distributions of \$0.60 over the last 12 months, which correspond to a 30.0% annualized yield. However, gas prices have plunged this year due to a warm winter. We thus expect lower distributions in the upcoming months.

Growth on a Per-Unit Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
DCFU	\$0.86	\$1.10	\$0.19	\$0.05	\$0.11	\$0.01	\$0.00	\$0.00	\$0.00	\$0.41	\$0.60	\$0.20
DPU	\$0.86	\$1.10	\$0.19	\$0.05	\$0.11	\$0.01	\$0.00	\$0.00	\$0.00	\$0.41	\$0.60	\$0.20
Units¹	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 cash flow (DCF) of \$0.27/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 four years, the total production of Hugoton has declined at an average annual rate of -5%. On the other hand, the trust posted 8-year high DCF per unit in 2022 thanks to 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 DCF per unit to decline by -20% per year on average until 2028.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
P/DCFU	9.6	8.5	22.7	38.6	16.4	65.0	---	---	---	3.7	3.3	7.5
Avg. Yld.	10.4%	11.8%	4.4%	2.6%	6.1%	1.5%	0.0%	0.0%	0.0%	27.0%	30.0%	13.3%

¹ Average Weighted Unit count is in millions.

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The trust's DCFU price multiple has averaged 12.2 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 10-year low valuation multiple of 3.3 due to abnormally high distributions in recent months. If the stock trades at our assumed fair valuation level in five years, it will enjoy a 17.6% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

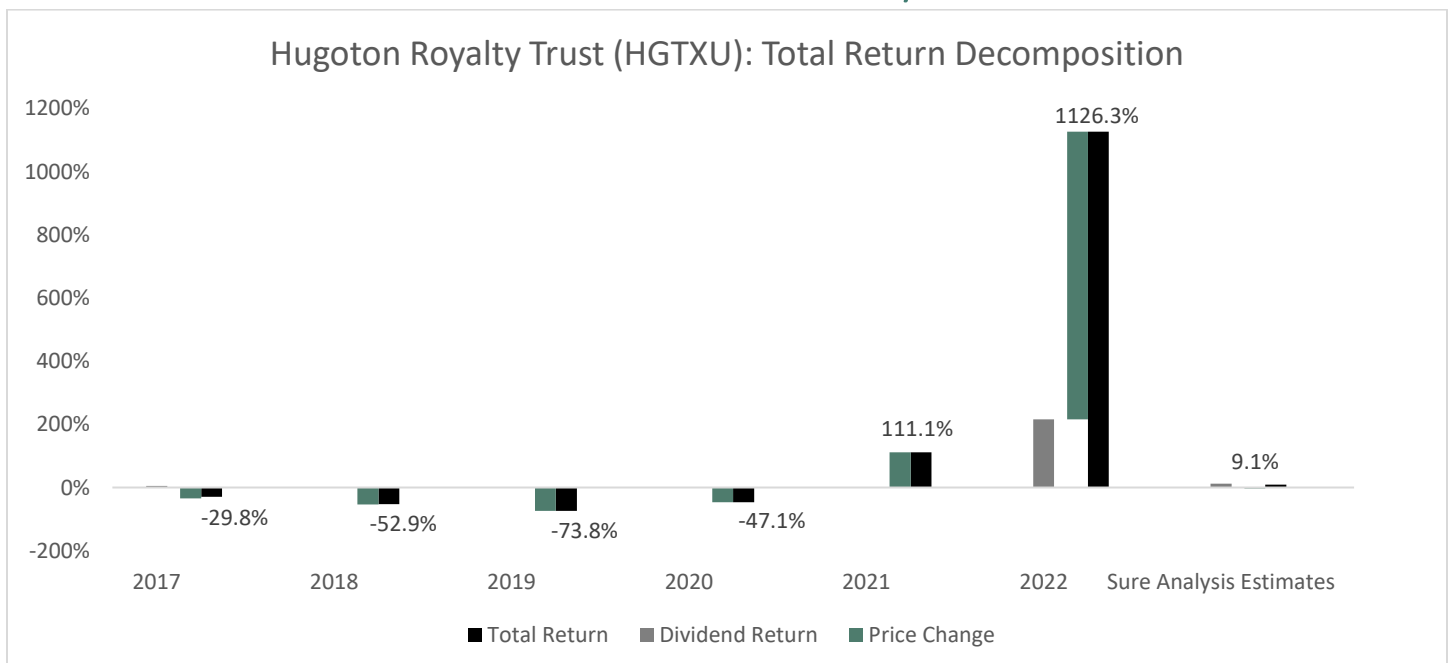
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Due to the suspension of distributions for more than 4 years, Hugoton has offered an average distribution yield of only 6.4% 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 has been thriving in recent months 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, the price of natural gas has plunged this year due to an abnormally warm winter. We expect gas prices to remain low in the upcoming years due to the record number of renewable energy projects that are in their development phase. Hugoton could offer a 9.1% average annual return over the next five years, as its 30.0% initial distribution and a 17.6% valuation tailwind may be partly offset by a -20% decline of distributable income per unit. Due to its high risk, the stock receives a hold rating only for risk-tolerant investors. 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	37	44	8	3	5	2	0			20
SG&A Exp.	3	1	1	1		1	1	1	1	---
Operating Profit	35	43	8	2		0	(0)	(0)	(1)	---
Operating Margin	92.4%	97.4%	94.0%	69.2%	0.0%	21.8%	-5.8%	0.0%	0.0%	---
Net Profit	35	44	8	2	5	0	-	-	-	17
Net Margin	92.4%	98.6%	94.0%	70.9%	85.0%	23.3%	0.0%	0.0%	0.0%	84.9%

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	103	94	88	28	18	17	1	-	1	3
Total Liabilities	4	4	1	1	1	1	1	0	2	3
Long-Term Debt	-	-	-	-	-	-	-			0
Book Value	99	90	87	27	16	16	-	(0)	(1)	0
LTD/E Ratio	-	-	-	-	-	-				---

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Shares Out.	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40
Revenue/Share	0.93	1.11	0.21	0.07	0.13	0.04	0.01			0.49

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

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