



Hugoton Royalty Trust (HGTXU)

Updated November 16th, 2023 by Aristofanis Papadatos

Key Metrics

| | | | | | |
|-----------------------------|--------|--|--------|----------------------------------|--------|
| Current Price: | \$0.49 | 5 Year CAGR Estimate: | 16.1% | Market Cap: | \$20 M |
| Fair Value Price: | \$1.96 | 5 Year Growth Estimate: | -12.0% | Ex-Dividend Date: | N/A |
| % Fair Value: | 25% | 5 Year Valuation Multiple Estimate: | 32.0% | Dividend Payment Date: | N/A |
| Dividend Yield: | 0.0% | 5 Year Price Target | \$1.03 | Years Of Dividend Growth: | 0 |
| Dividend Risk Score: | N/A | Retirement Suitability Score: | N/A | 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 \$20 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 (11/13/23) financial results for the third quarter of fiscal 2023. Its realized prices of oil and gas plunged -31% and -64%, respectively, while gas output decreased -6%. Given also high operating expenses, Hugoton has not declared a distribution since July. Accordingly, we have used a forward distribution yield of 0% in our calculations. Even worse, Hugoton stated that it doubts whether it can service its obligations in the next 12 months due to its excessive operating costs. The suspension of the distribution and the doubt of the trust about its liquidity are stern reminders of the excessive risk of the trust.

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 | \$0.28 | \$0.15 |
| DPU | \$0.86 | \$1.10 | \$0.19 | \$0.05 | \$0.11 | \$0.01 | \$0.00 | \$0.00 | \$0.00 | \$0.41 | \$0.00 | \$0.00 |
| 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 6%-8% long-term 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 high comparison base formed this year and the excessive operating costs of the trust, we expect DCF per unit to decline by -12% 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 | 1.8 | 7.0 |
| Avg. Yld. | 10.4% | 11.8% | 4.4% | 2.6% | 6.1% | 1.5% | 0.0% | 0.0% | 0.0% | 27.0% | 0.0% | 0.0% |

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 7.0. The stock is currently trading at a 10-year low valuation multiple of 1.8 due to liquidity concerns and the recent suspension of distributions. If the stock trades at our assumed fair valuation level in five years, it will enjoy a 32.0% annualized gain in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

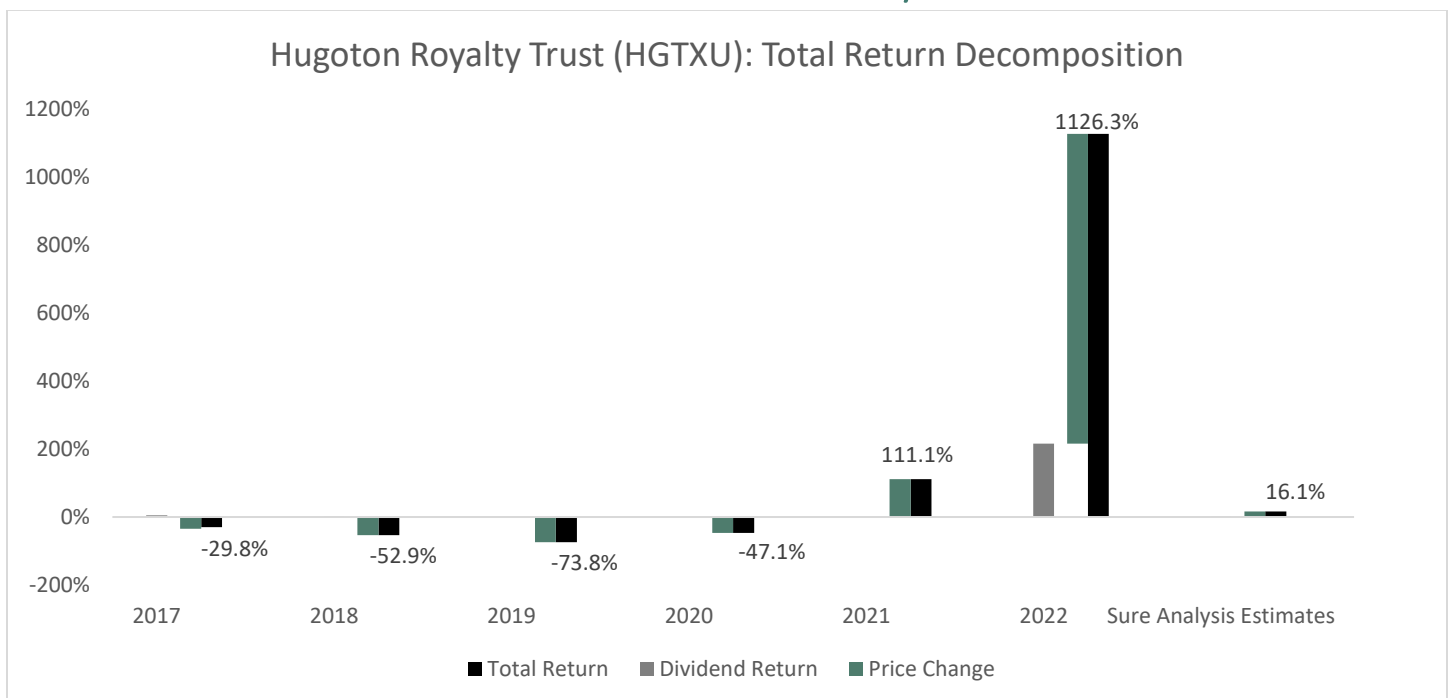
| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 0% | 0% |

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 thrived last year thanks to the sanctions of western countries on Russia, which 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 and is likely to remain low in the upcoming years due to the record number of renewable energy projects that are in their development phase. Moreover, Hugoton is facing liquidity issues due to excessive operating costs. If Hugoton survives, it could offer a 16.1% average annual return over the next five years thanks to a 32.0% valuation tailwind, which may offset a -12% decline of distributable income per unit. Due to its excessive risk, the stock receives a hold rating only for risk-tolerant investors. The stock is clearly unsuitable for income-oriented and/or conservative investors.

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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