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CAPITAL MARKETS

HEDGING IN 4Q21

A Hedging Hiatus

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FOCUS

What is the latest commodity derivative activity and how does it affect E&P strategies?

KEY POINTS

- Producers added minimal oil and gas hedges since last quarter. We attribute the lack of hedging activity to two key goals from producers. First, they desire to avoid hedging higher proportions of production relative to historical levels. Second, they wish to maintain exposure to elevated market prices for oil and gas. The latter goal is particularly relevant to investors seeking exposure to volatile 12-month futures prices for commodities.
- In aggregate, we estimate hedge books remove $30 billion in value (NPV-10) from the sector in our base price scenario.
- All hedge books, except APA's, are neutral or loss-making in the base price scenario. Hedge books remove over a quarter of enterprise value for [redacted], [redacted], [redacted] and [redacted].
- For oil, producers reduced aggregate hedge volume dated in 2022 since last quarter by 3% to 1.3 MMbbl/d. For 2023 positions, producers increased total oil hedge volume by 15% to 0.3 MMbbl/d.
- [redacted]'s decision during 4Q21 to close out the bulk of its hedge book has proven lucrative thus far. We estimate the decision saved the company $1.2 billion (net of the cost to offset the position). Conversely, [redacted], [redacted] and [redacted] each added at least 20 MMbbl/d of hedge volumes during the quarter, all generating losses in the current price environment.
- [redacted], [redacted], [redacted], [redacted] and [redacted] are the oil-weighted names with market capitalizations over $1 billion that have hedged more than 70% of their next-12-month (NTM) oil production. The price at which each company loses exposure to price upside (which can be different than the "hedge price" for companies with non-swap contracts) ranges from $59 WTI (for [redacted]) to $100 (for [redacted]). Conversely, oil-focused names with less than 20% of NTM oil production hedged include large-caps like [redacted], [redacted] and [redacted].

- For gas, incremental hedging activity was also subdued. The sector increased aggregate 2022-dated gas hedge volume by 11% to 23 Bcf/d. The incremental hedges increased the weighted-average hedge price by 2% to $2.94/Mcf Henry Hub. Similar to the oil side, adding longer-dated (post-2022) gas hedges was more popular than adding near-term hedges.
- [redacted] and [redacted] were the only names to add more than 500 Bcf of gas hedges during the quarter, all appearing to have been struck near a $3 Henry Hub hedge price.
- Going forward, we expect producers will remain reluctant to add hedge volume. They will be discouraged by heavily backwardated futures curves for both oil and gas, a desire for exposure to high commodity prices and a reduced need to protect balance sheets against downside risk due to rapid deleveraging in recent quarters.

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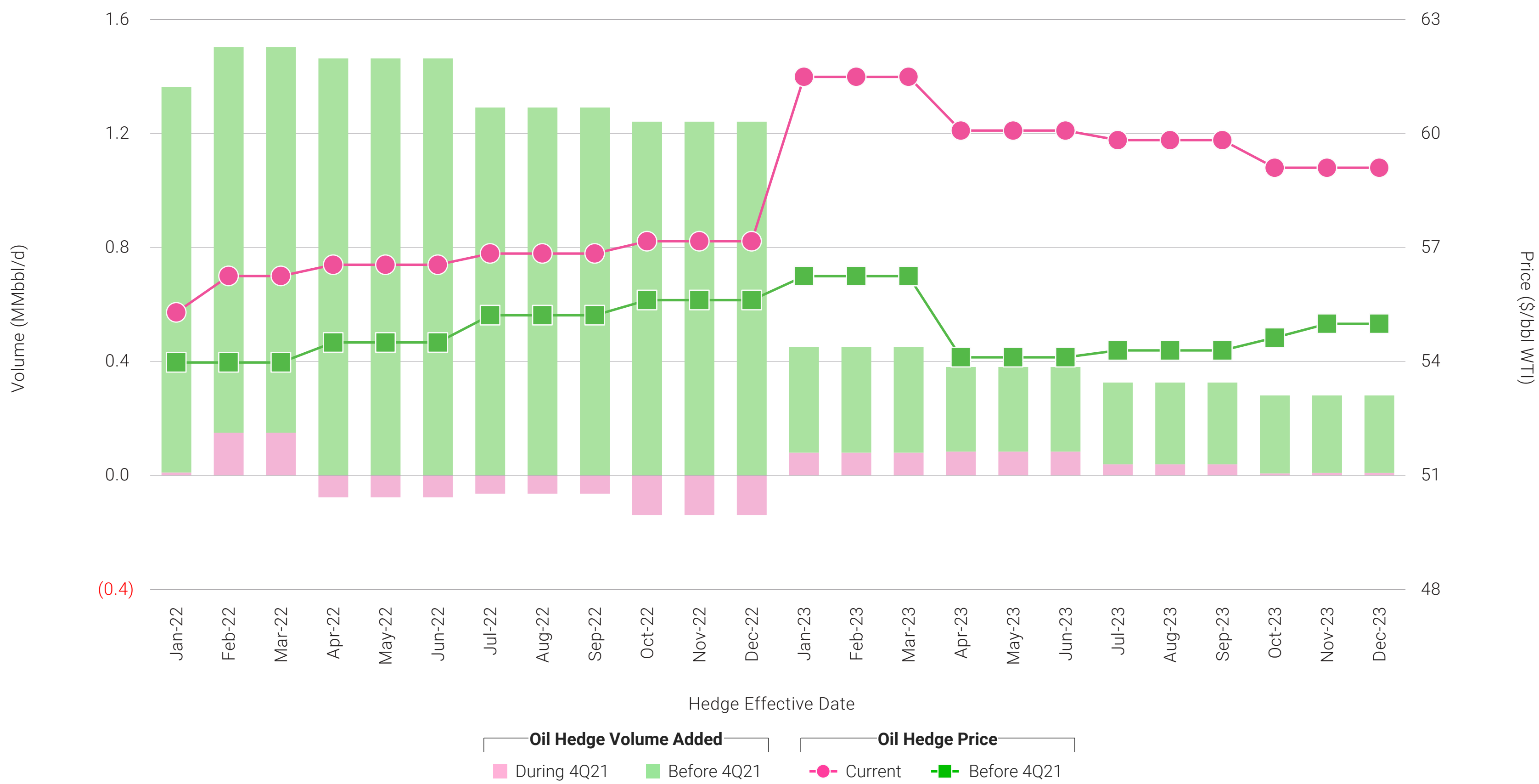
NEED TO KNOW

- We model the hedge positions for 66 public North American E&Ps with material commodity derivative programs. Our analysis focuses on incremental activity, valuations and implications for corporate behavior.
- Only swaps, purchased puts and the purchased-put portion of collar-structure derivatives are considered in “hedge volumes” and “hedge prices” in this report. Other oil, gas and NGL derivatives (e.g., basis swaps, calls, sold options and deferred premium payments) are captured in our model and reflected in our hedge valuations.
- Hedge prices are converted to WTI or Henry Hub terms using basis assumptions.
- Our base price scenario reflects recent strip pricing and flat prices thereafter. Our high and low price scenarios represent +/-$10 WTI and +/-$0.50 HH relative to our base scenario.
- Incremental hedge volumes and prices are deduced by comparing companies’ latest quarterly disclosures.
- We mention two distinct types of hedge dates in our analysis – future dates to mark when contracts are effective and past dates to mark when contracts were added (or entered or traded).
- NTM production is derived by annualizing the latest quarterly production volume.
- Valuations are discounted to the first day of the new quarter. We aim to model companies’ most up-to-date hedge disclosures; see **Appendix** for the as-of date of each company’s hedge position.
- Hedge positions shown here do not reflect any M&A pro forma beyond what was already closed and consolidated within the latest quarterly disclosures.
- Derivative disclosures that lack necessary information and granularity are excluded from our model.

For oil, producers reduced aggregate hedge volume dated in 2022 since last quarter by 3% to 1.3 MMbbl/d. For 2023 positions, producers increased total oil hedge volume by 15% to 0.3 MMbbl/d.

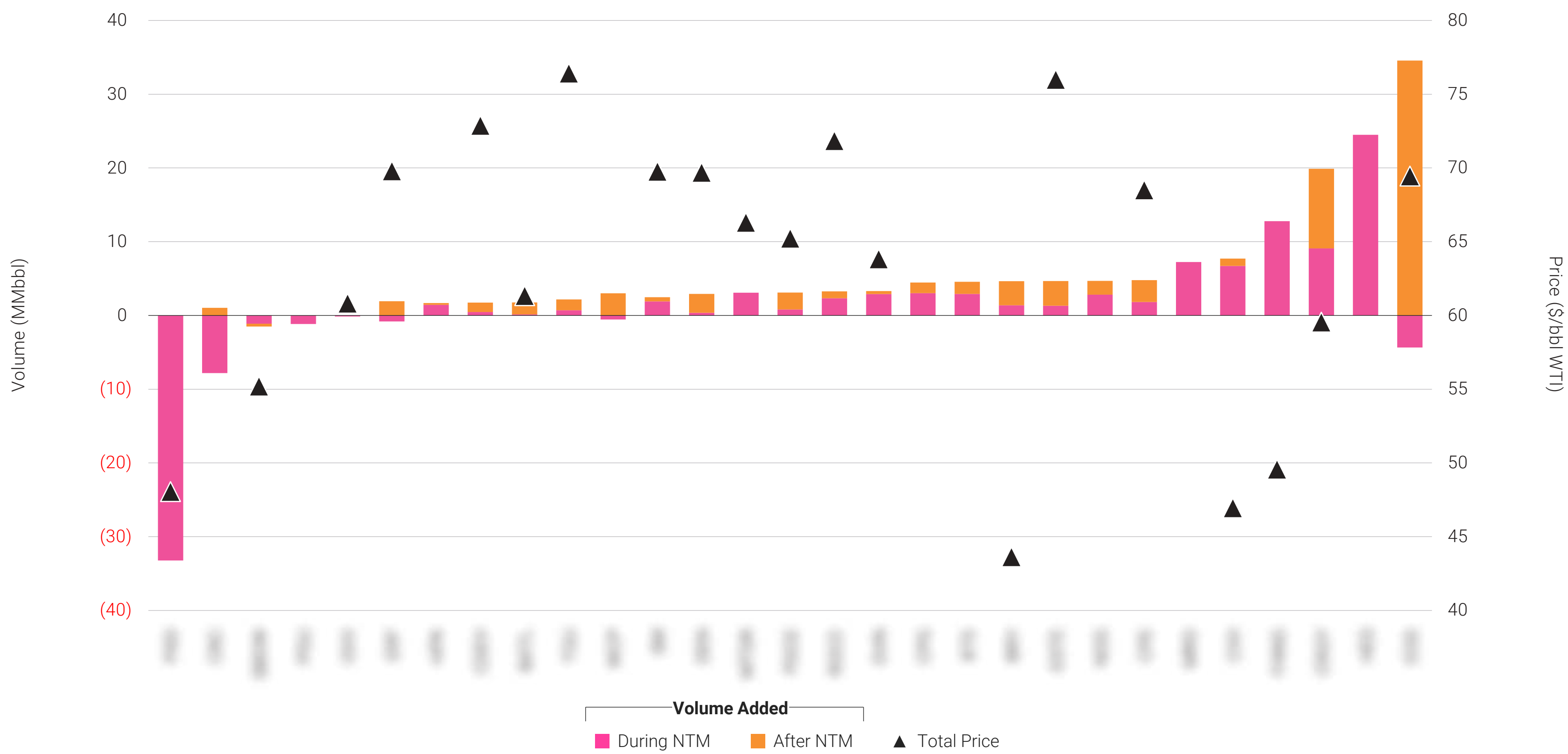
FIGURE 1 | Oil Hedge Volume and Price by Contract Month (Aggregate)



Source | Enverus, company disclosures

[illegible]'s decision during 4Q21 to close out the bulk of its hedge book has proven lucrative thus far. We estimate the decision saved the company $1.2 billion (net of the cost to offset the position). Conversely, [illegible], [illegible] and [illegible] each added at least 20 MMbbl/d of hedge volume during the quarter, all generating losses in the current price environment.

FIGURE 2 | Latest Oil Hedge Activity: Volume and Price of Oil Hedges Added During 2Q21



Source | Enverus, company disclosures

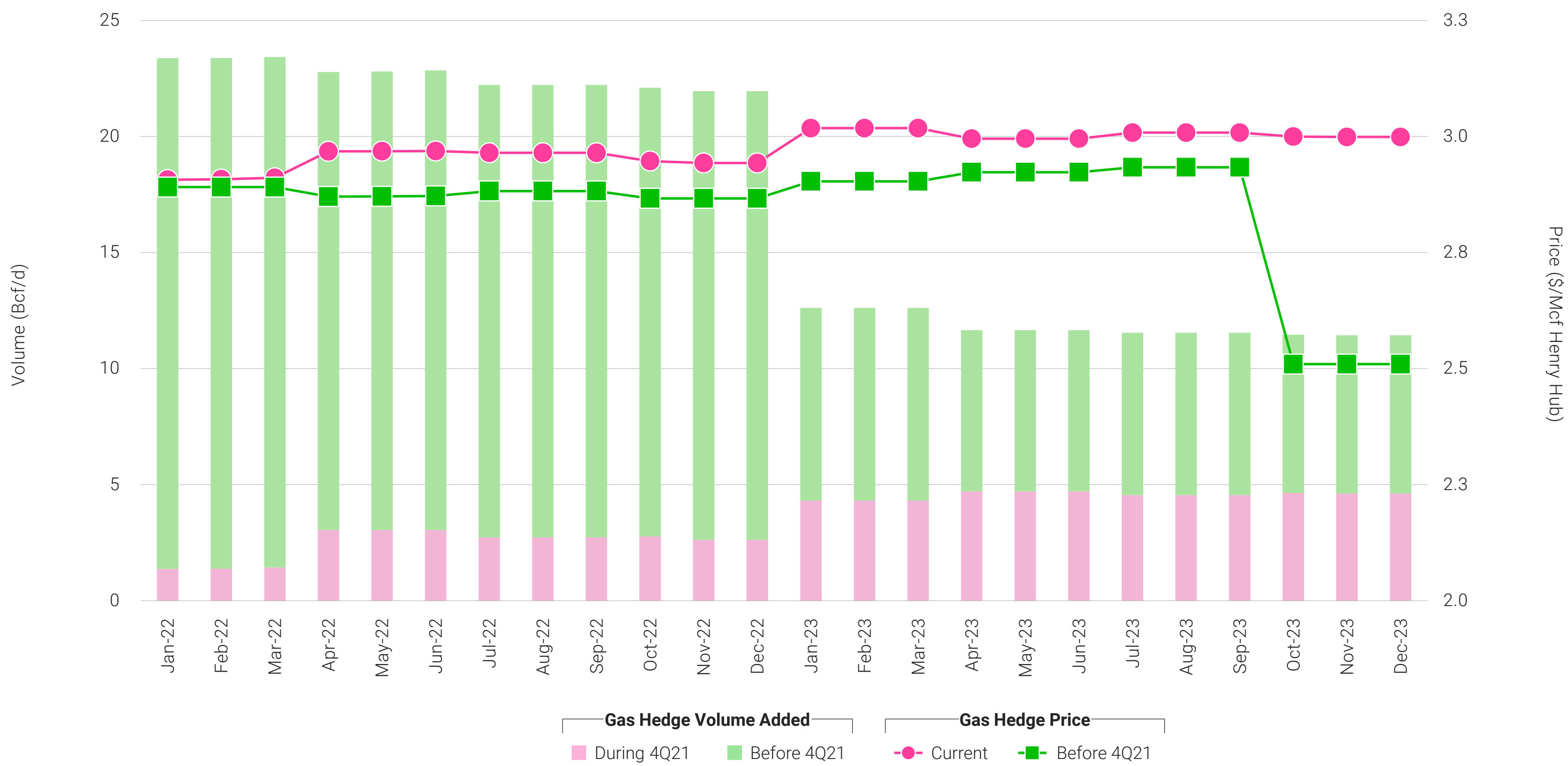
[illegible], [illegible], [illegible], [illegible] and [illegible] are the oil-weighted names with market capitalizations over $1 billion that have hedged more than 70% of their next-12-month (NTM) oil production. The price at which each company loses exposure to price upside (which can be different than the "hedge price" for companies with non-swap contracts) ranges from $59 WTI ([illegible]) to $100 ([illegible]). Conversely, oil-focused names with less than 20% of NTM oil production hedged include large-caps like [illegible], [illegible] and [illegible].

FIGURE 3 | Updated Oil Hedge Position: % of Production Hedged (by Timing of Contract Entry) and Price

Source | Enverus, company disclosures

For gas, incremental hedging activity was also subdued. The sector increased aggregate 2022-dated gas-hedge volume by 11% to 23 Bcf/d. The incremental hedges increased the weighted average hedge price by 2% to $2.94/Mcf Henry Hub. Similar to the oil side, adding longer-dated (post-2022) gas hedges was more popular than adding near-term hedges.

FIGURE 4 | Gas Hedge Volume and Price by Contract Month (Aggregate)



Source | Enverus, company disclosures

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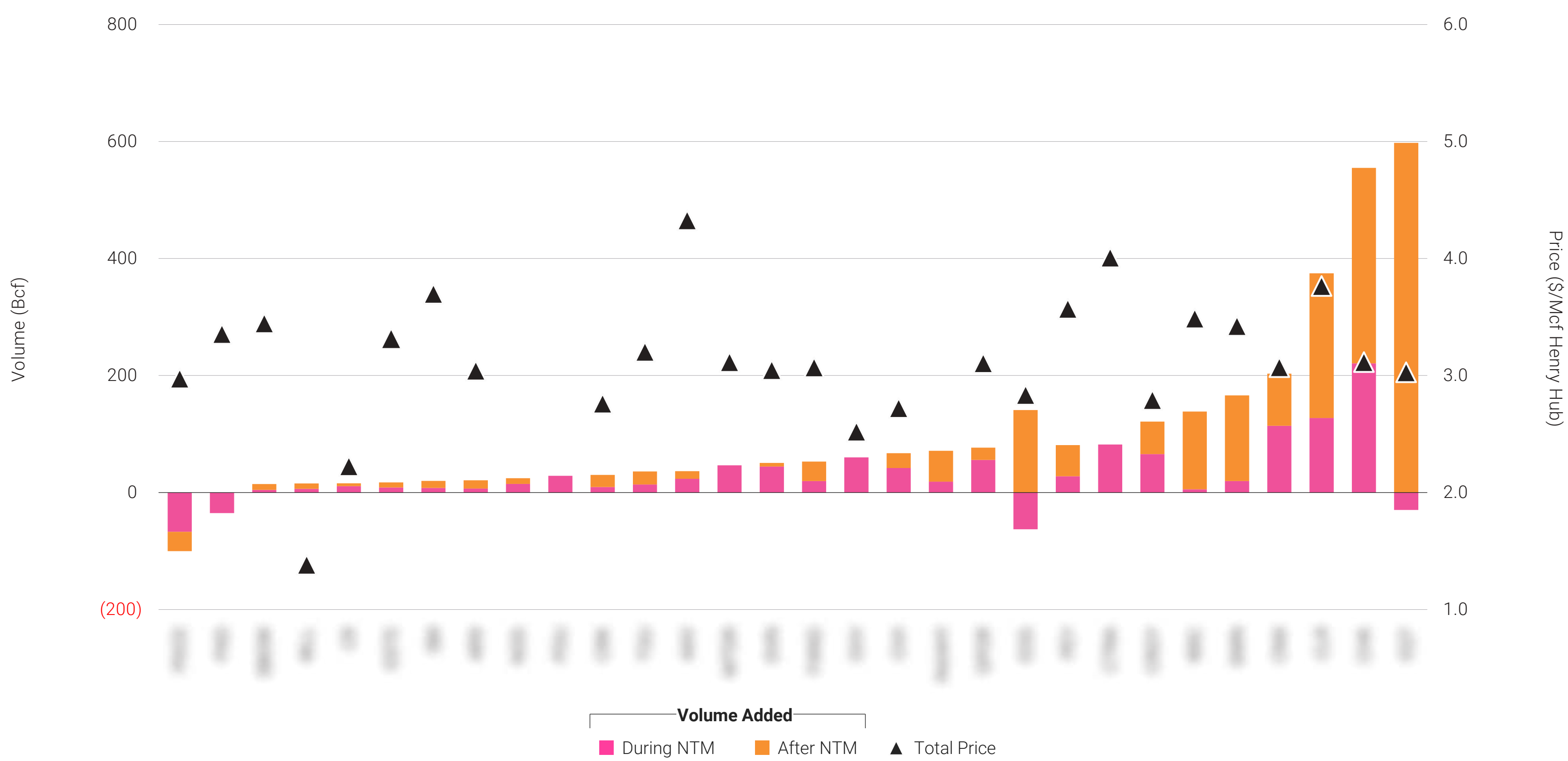
FIGURE 5 | Gas Hedge Volume and Price by Contract Month (Aggregate)



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