CASE STUDY

VALUATION MASTER CLASS

by

A. Stotz INVESTMENT RESEARCH

How much can Equinor exploit Europe’s energy crisis?

Valuation Master Class

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This is not investment advice or a recommendation.

Ask
Ajarn
Andrew

How much can Equinor exploit Europe's energy crisis?

Sector: Energy

State-owned multinational petroleum company; ranked among the 15 largest energy companies worldwide

My value estimate:

US$25

(Downside 11%)

SELL

3 things to know about this company

- ★ Soaring energy prices in Europe lead to revenue explosion
- ★ Green shift to stay competitive requires CAPEX ramp-up
- ★ Strong years ahead lead to attractive dividend yields

Key statistics

Analyst consensus (30)	PB ratio	Dividend yield
US$27 (Downside 4%) **HOLD**	**2.7x**	**1.5%**

Sources: A. Stotz Investment Research, Refinitiv

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Revenue breakdown 2020

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Natural gas and crude oil trading 71%

Production per day

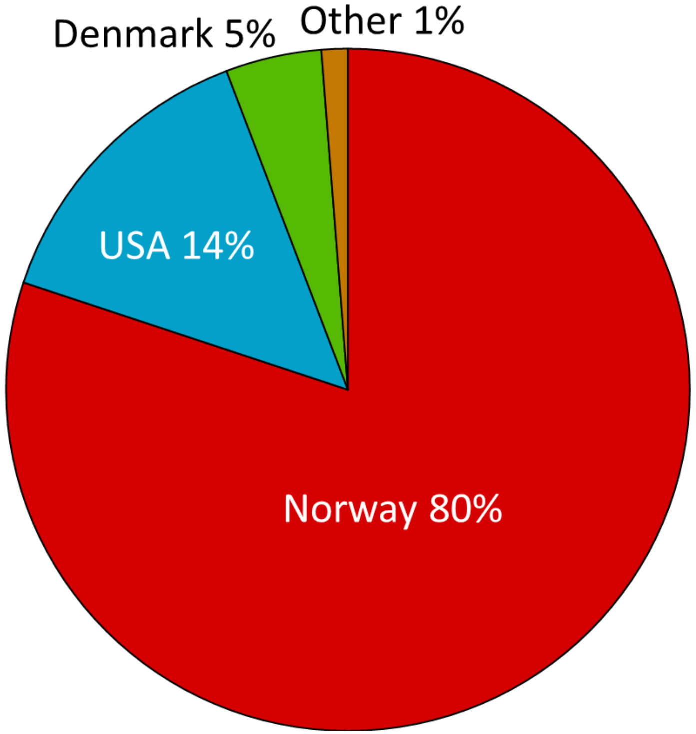
Oil: 1,000 mbbl

Gas: 150 mmcm

Exploration, production and other 29%

Exploration in 10 countries

Breakdown by region



Sources: A. Stotz Investment Research, company data

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Share price and volume remain bullish

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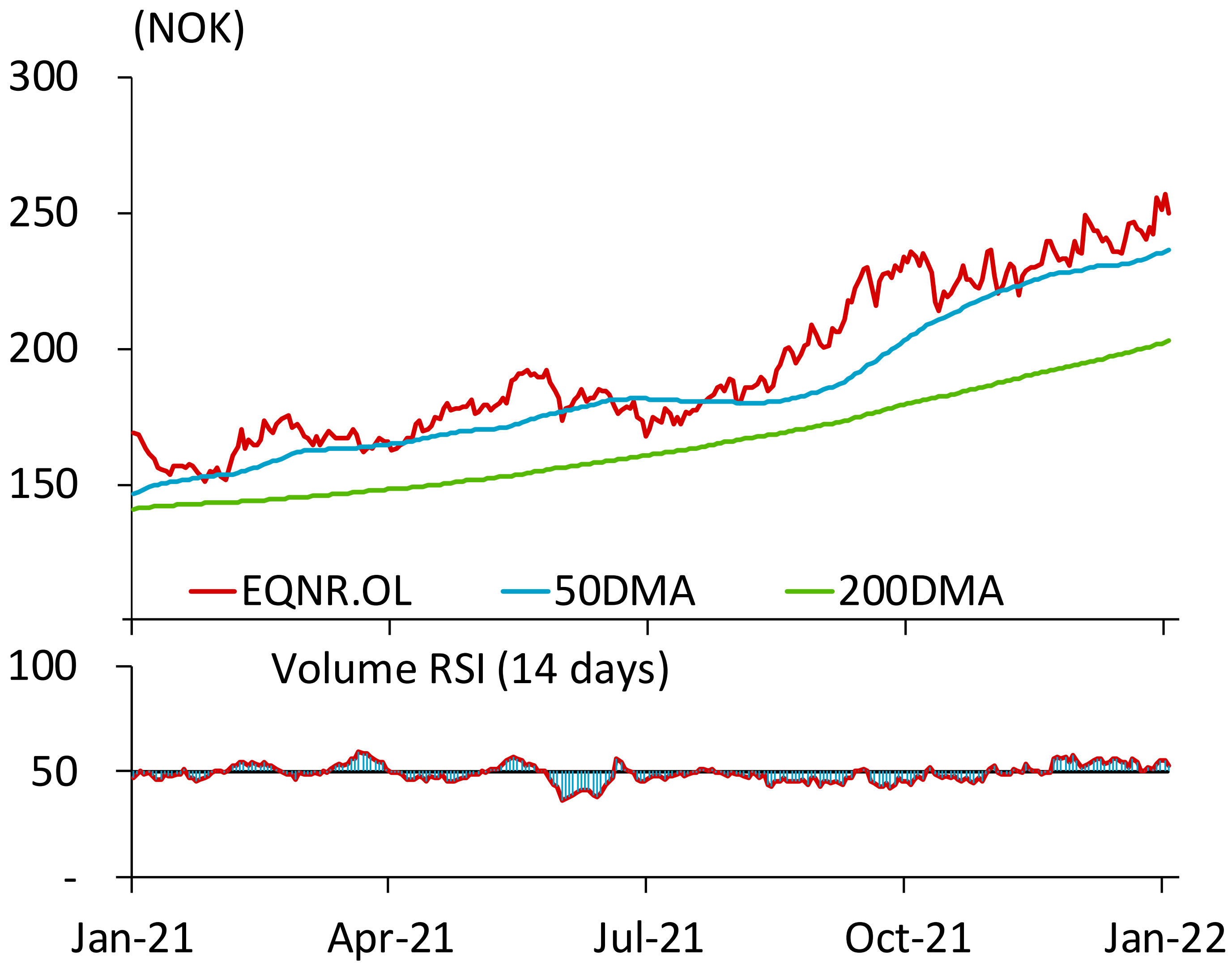

- ★ Over the past year, the stock price saw a strong rally, up 50% YTD
  - **The 50DMA line stayed above the 200DMA throughout the whole period**
  - **Therefore, the price signal remains bullish**
- ★ The Volume RSI has stayed slightly above the 50%-line, which is a positive sign as well

Sources: A. Stotz Investment Research, Refinitiv

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Soaring energy prices in Europe lead to revenue explosion

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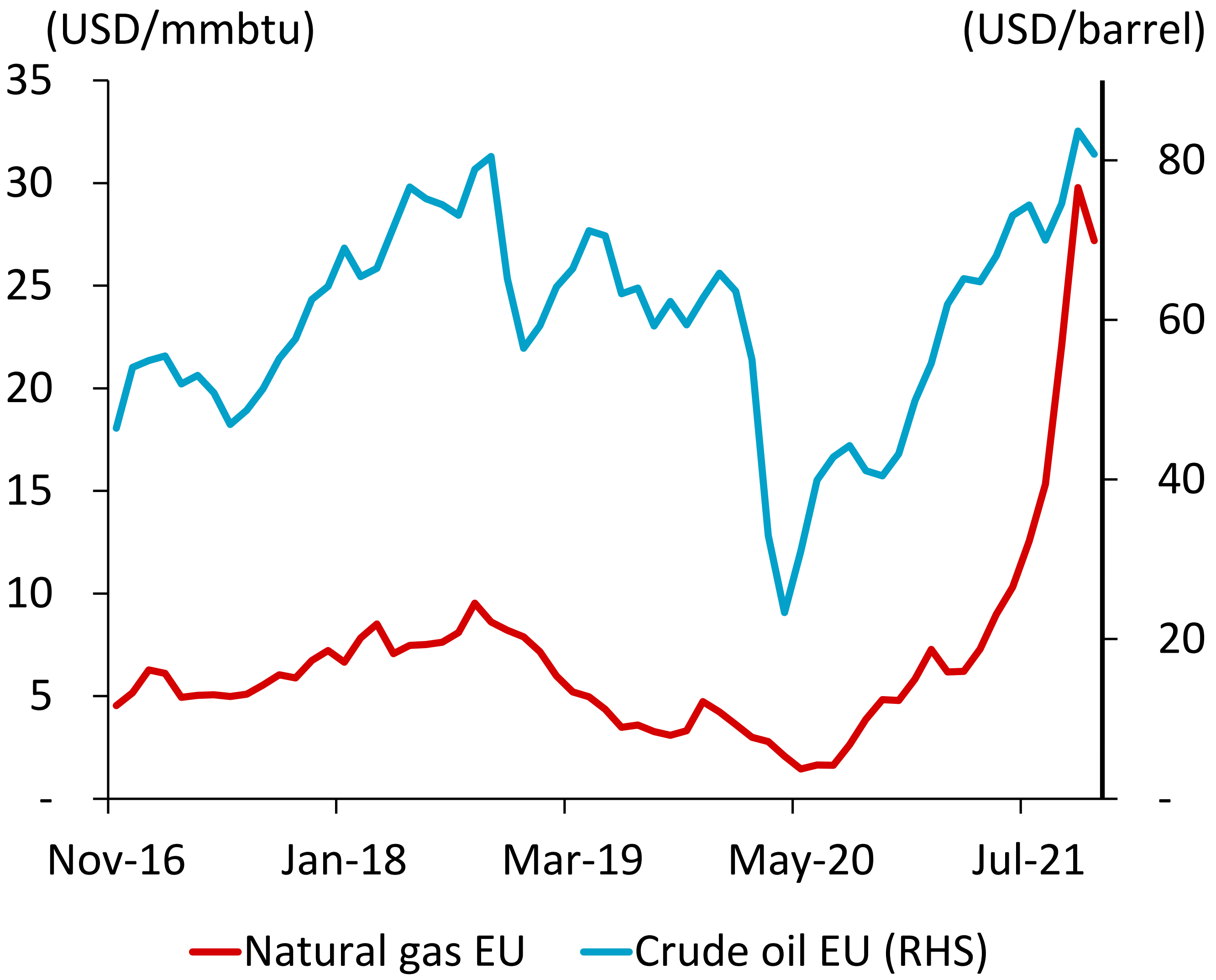

- The economic recovery created strong demand for energy while supply experiences bottlenecks
  - **Gas skyrocketed by almost 500% YoY**
  - **Oil price has risen by more than 85% YoY**
- On top of that, maintenance issues in major gas plants in Norway and unwillingness of Russia to increase supply worsened the situation

Sources: A. Stotz Investment Research, company data

What's actually going on in Europe?

- The EU ambitiously cut back traditional fuels without enough alternatives
- Renewable energy investments are increasing but too slow to compensate for the supply gap in the near-term future
    - **Therefore, you can call the current energy crisis self-inflicted**
    - **The EU must now import oil and gas from other countries, increasing its dependency**

Ask Ajarn Andrew

Europe's unrealistic pace of green transition causing slowdown

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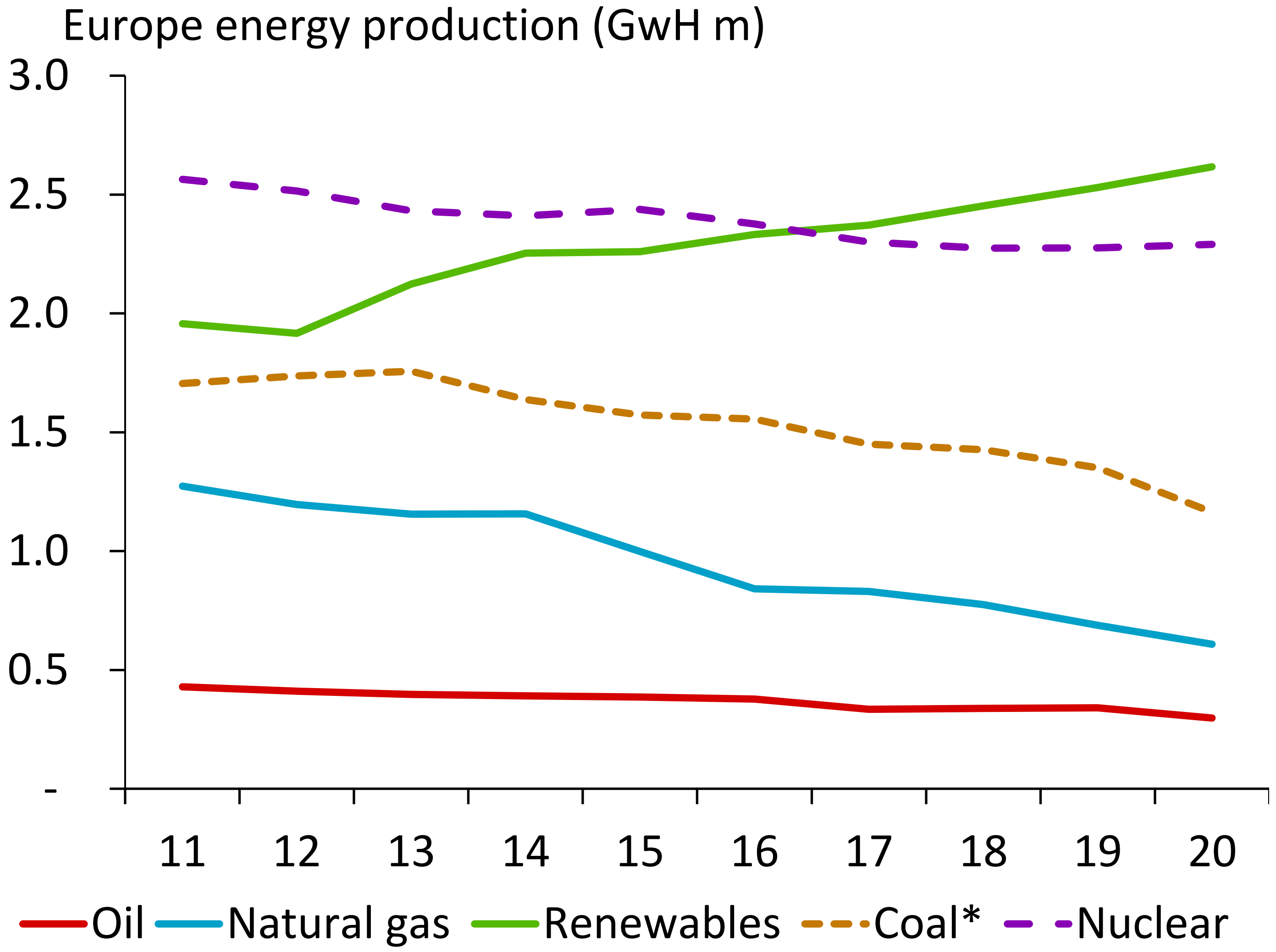
- Risks



★ Natural gas and coal production are down by 53% and 32% respectively in the past 10 years

- **Most European countries have already closed their coal plants and started to phase out fossil fuels**

★ Renewables have grown by 34% and are now the No.1 energy source in the EU

- **However, the production level is still far from enough to match demand**

Sources: A. Stotz Investment Research, company data

As a result, there is a huge gap between demand and supply

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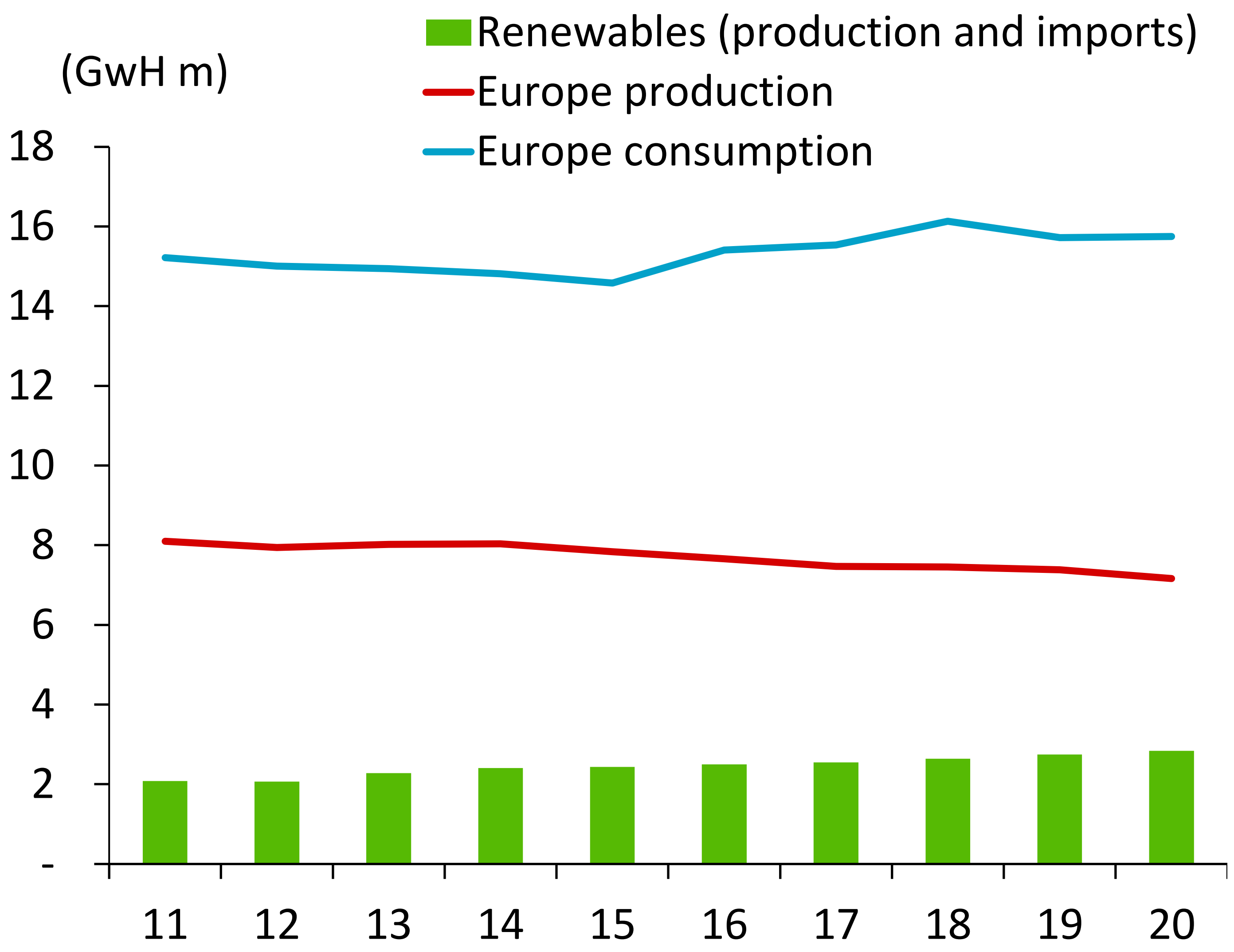

- Lower production while demand for energy has surged increasing the gap further over time
  - **Hence, the EU is now heavily dependent on imports**
- The structural energy problem is unlikely to be resolved soon
  - **Hence, I expect Enquinor to benefit much longer from higher prices**

Sources: A. Stotz Investment Research, company data
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Green shift to stay competitive requires CAPEX ramp-up

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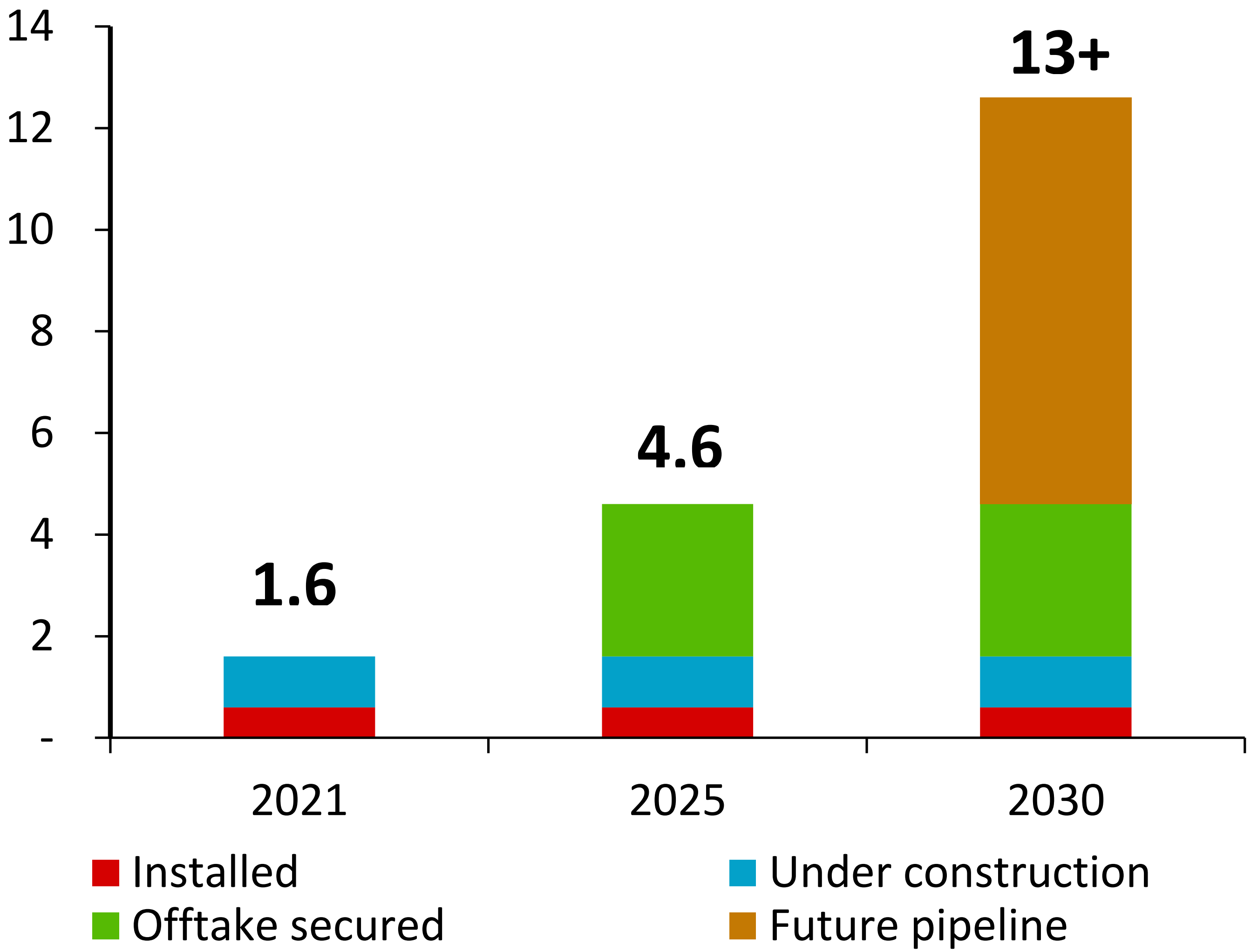
Equinor - Renewable energy capacity (GW)



- Equinor started to diversify its portfolio away from oil & gas
  - **Increasing pressure in Europe to shift green faster requires energy companies to adapt immediately**
  - **Being state-owned should help for a smooth shift**
- As of 2021, it has a renewable energy capacity of 1.6 MW
  - **Until 2030, the capacity is expected to grow more than 8x to 13+ GW**

Sources: A. Stotz Investment Research, company data

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Concentrated production enabled less heavy investments

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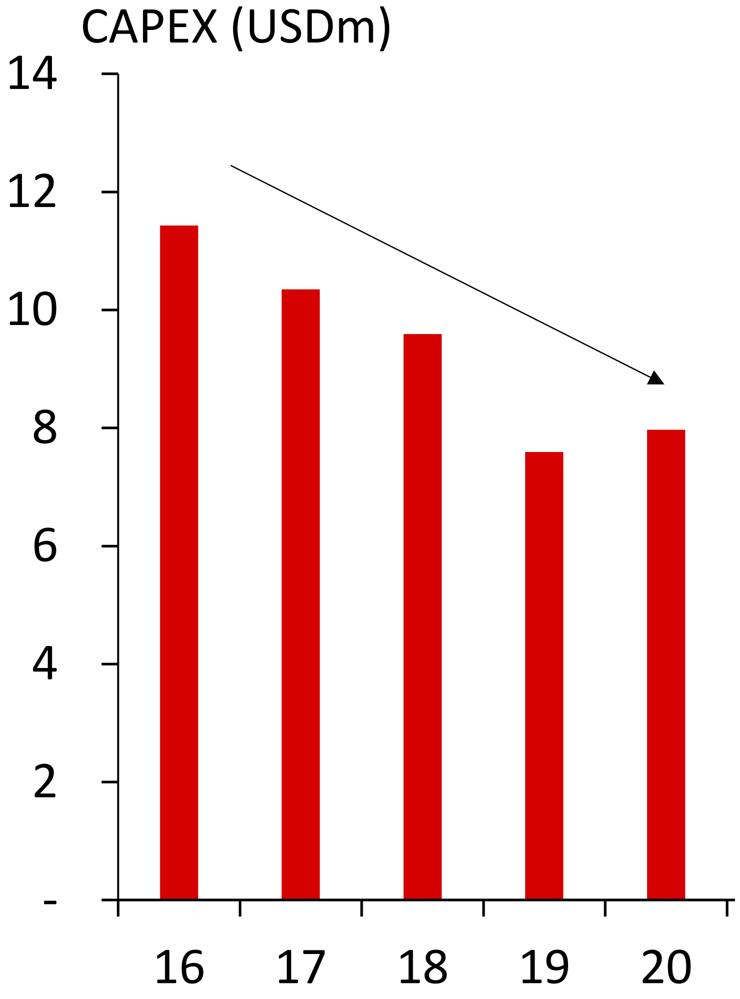

- ★ Equinor was able to reduce CAPEX over time as it concentrated its oil & gas production
  - **In 2021, in produced in 15 countries compared to 30 countries in 2017**
- ★ This number might fall further as the company reduced exploration efforts to 10 out of the 15 countries, where its is currently producing

Sources: A. Stotz Investment Research, company data

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Expect rising CAPEX

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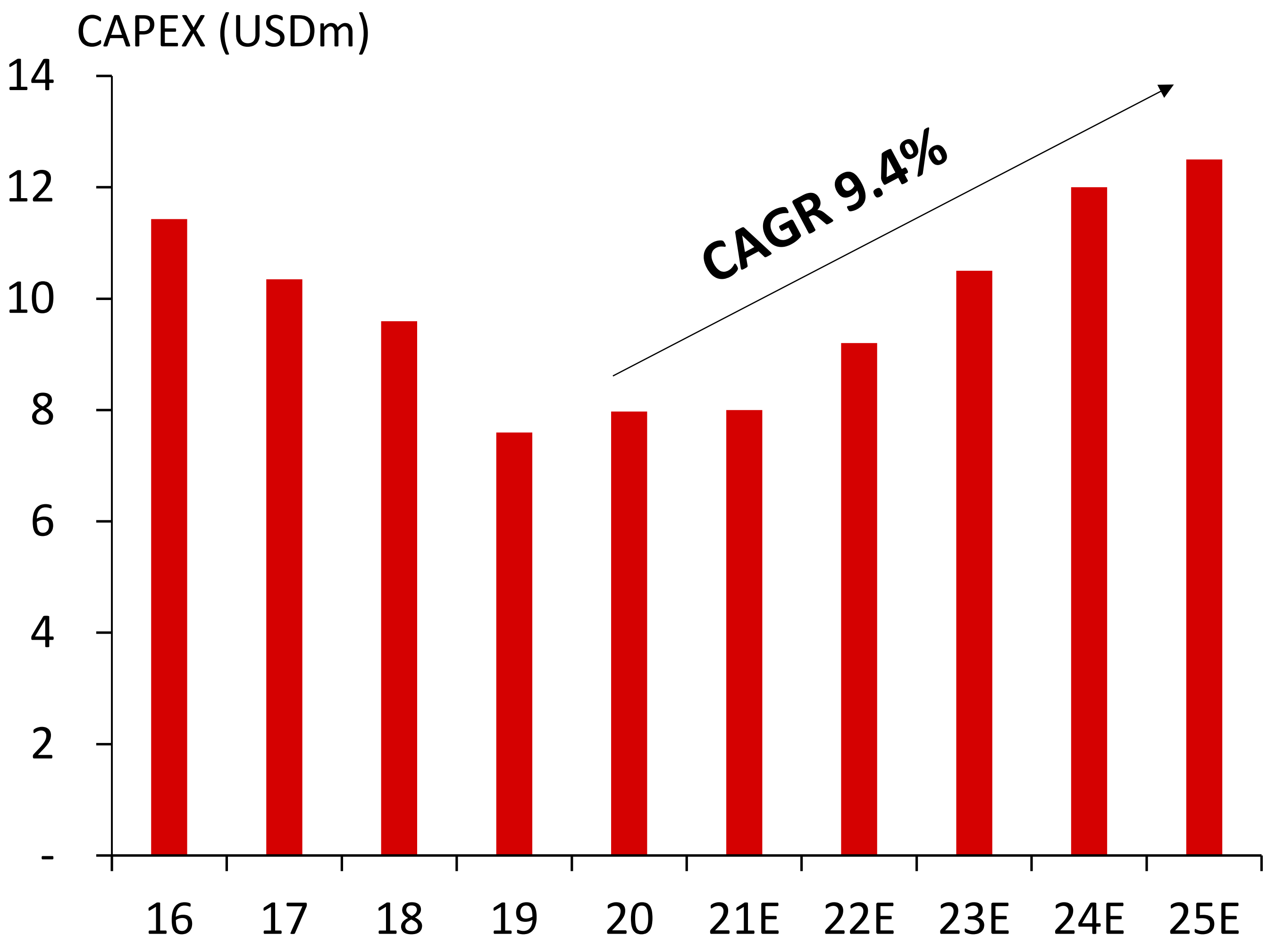

- ★ In 2021, renewable CAPEX made up 12% of its total CAPEX, compared to 4% in 2020
- ★ With a US$23bn allocation to realize its renewable energy growth plan, CAPEX should rise much faster
  - **Getting the CAPEX forecast right is crucial for determining the value of a company in a capital-intensive industry**

Sources: A. Stotz Investment Research, company data

3 Strong years ahead lead to attractive dividend yields

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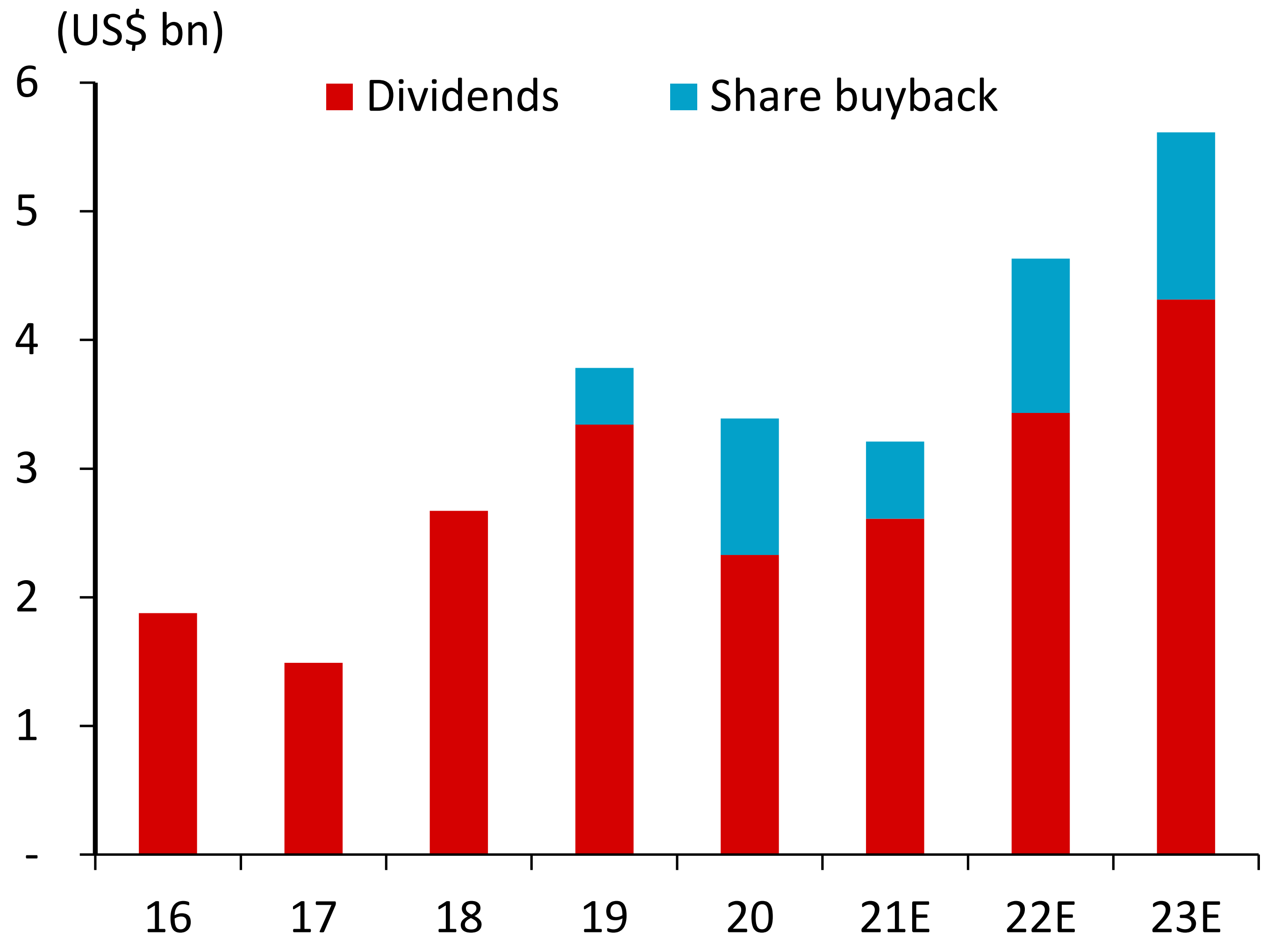

- ★ In 2019, Equinor introduced its share buyback program
- ★ With the enhanced outlook, the management aims to increase the program to an annual $1.2bn in buybacks, enhancing returns
- ★ I also expect a strong increase in dividends over next 3 years
  - **The dividend yield could grow to a remarkable 4%+ in 23E**

Sources: A. Stotz Investment Research, company data
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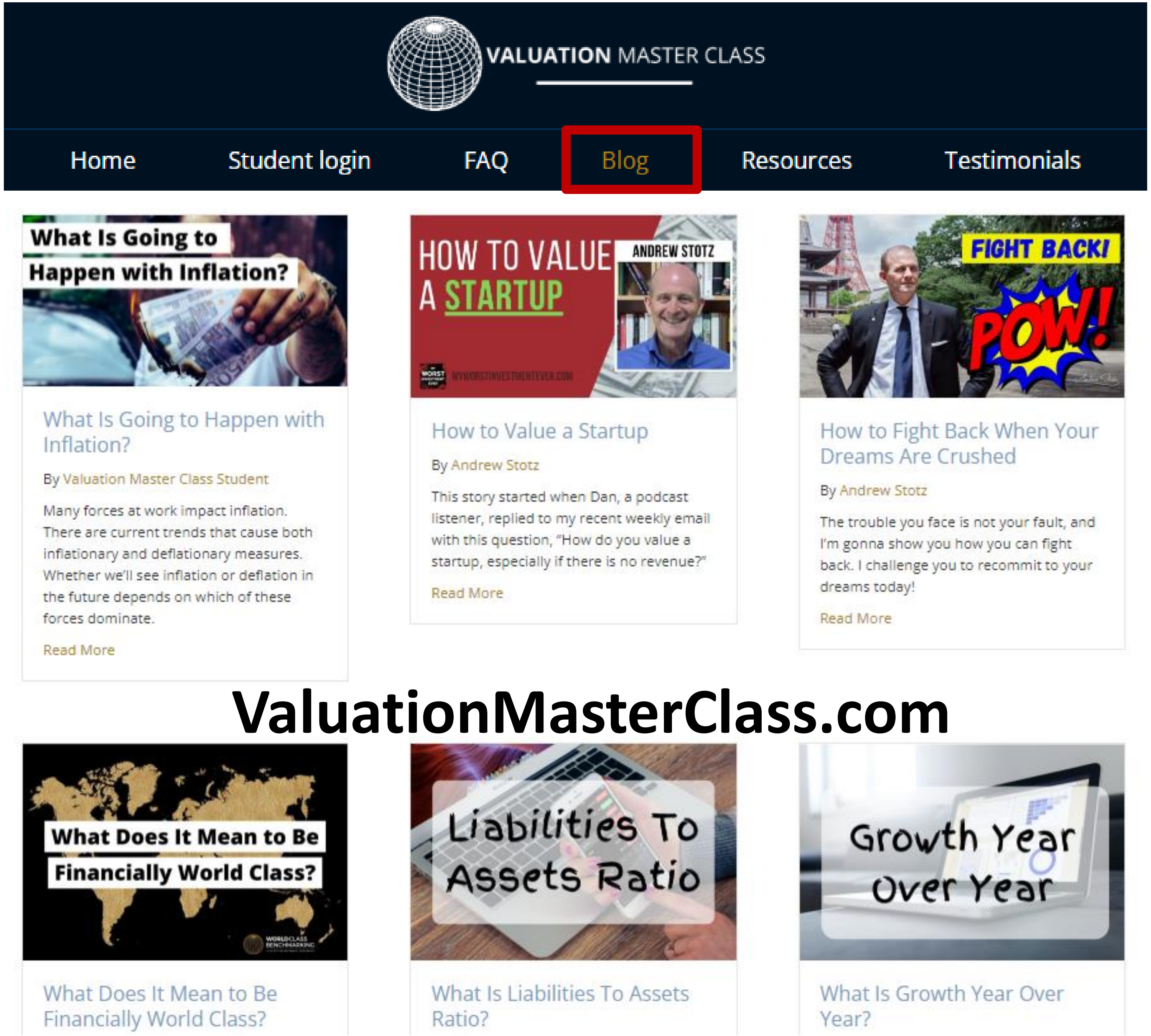

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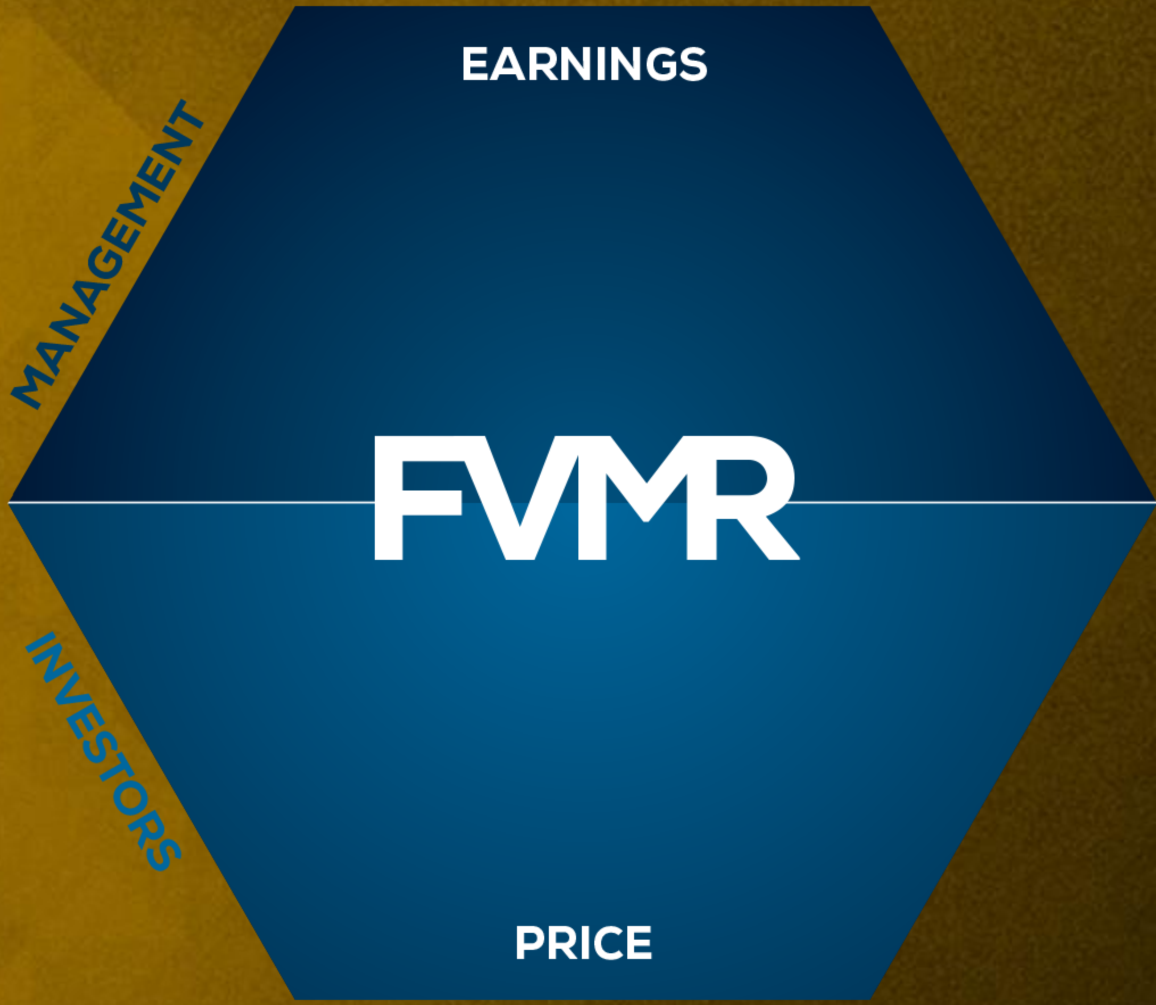
It's usually up within 24h.

FVMR Scorecard

- Measures a stock's attractiveness relative to all other companies
- Attractiveness is based on four elements
  - **Fundamentals, Valuation, Momentum, and Risk**
- Scale from 1 (Best) to 10 (Worst)



Strong momentum at a cheap price, but high beta

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Fundamentals

W ☐ ☐ ☐ ☐ ■ ☐ ☐ ☐ B

(%)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**
Operating profit margin	20.6	25.8	20.3	7.9	29.8
Recurring net margin	6.7	9.8	6.6	3.7	5.2
Asset turnover	56.6	70.3	54.6	38.1	54.5
Return on assets	3.8	6.9	3.6	1.4	2.8
Recurring return on equity	10.8	18.7	9.9	4.6	10.0

Valuation

W ☐ ☐ ☐ ☐ ☐ ☐ ☐ ■ B

(x)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**
Price-to-sales	1.1	0.9	0.8	1.3	1.2
Price-to-earnings	16.3	8.9	11.4	34.8	23.0
Price-to-book	1.7	1.6	1.2	1.7	2.2
PE-to-EPS growth (PEG)	0.0	0.1	nm	nm	nm
EV/EBIT	6.5	3.9	5.0	21.8	4.2

Momentum

W ☐ ☐ ☐ ☐ ☐ ☐ ☐ ■ B

(%)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**
Revenue growth	33.5	28.8	(19.9)	(27.3)	40.4
Recurring EPS growth	5,167.3	88.0	(46.1)	(58.0)	(17.4)
Operating profit margin chg. (bps)	2,101	518	(550)	(1,240)	1,604
	6mth	3mth	1mth	3wk	1wk
Price change	20.9	18.9	3.6	4.0	5.0

Risk

■ W ☐ ☐ ☐ ☐ ☐ ☐ ☐ ☐ B

(x)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**
Current ratio	1.4	1.6	1.3	1.6	1.7
Net debt-to-equity (%)	39.9	27.1	41.3	60.6	8.3
Times-interest-earned	13.3	17.9	8.7	2.8	16.3
	5yr	3yr	1yr	6mth	3mth
Beta	1.4	1.4	1.6	1.6	1.6

Note: Benchmarking against 90 non-financial companies in Norway.

Sources: A. Stotz Investment Research, Refinitiv. Notes: *Bars are decile rankings of the most recent period. **Past 12 months of published data. na = not available, nm = not meaningful. Valuation is based on historical prices.

Recently, I created a short online course explaining my FVMR investing approach

I usually sell it for $97 but for a limited time I am offering it for FREE

Analysts are sceptic how longevity of heightened profits

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Analyst consensus valuation

Recommendation	Oct-21	Nov-21	Dec-21	Current
Strong buy	5	5	5	4
Buy	6	5	5	4
Hold	11	12	12	13
Sell	4	5	4	5
Strong sell	2	3	4	4
Average score	**2.7**	**2.9**	**2.9**	**3.0**

Price target	Oct-21	Nov-21	Dec-21	Current
Median	23	26	26	27
Mean	24	25	26	27

30 analysts

Downside: 4%

Analyst consensus 3-year forecast

(%)	18	19	20	21E	22E	23E
Revenue growth	2.5	(19.9)	(27.3)	92.0	5.7	(8.8)
Gross margin	38.4	37.3	33.3	42.5	40.9	41.8
EBIT margin	24.9	21.0	7.8	35.6	34.6	28.3
Net margin	9.6	2.9	(12.0)	10.8	10.7	9.1

- ★ Most analysts stays at HOLD recommendation for now
  - **4 analysts even issued a STRONG SELL (which they rarely do)**
- ★ Consensus expects two strong years in terms of revenue but then a drop in 23E due to normalization of commodity prices
  - **Equinor is engaged in a highly volatile industry**

Sources: A. Stotz Investment Research, Refinitiv

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Profit & loss statement

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(YE Dec, US$ m)	2019A	2020A	2021E	2022E
Revenue	62,911	45,753	84,186	91,762
Cost of goods & services	(39,446)	(30,515)	(45,039)	(52,304)
Gross profit	**23,465**	**15,238**	**39,146**	**39,458**
SG&A	(2,663)	(4,189)	(2,105)	(2,294)
Other operating (exp)/inc	(7,574)	(7,468)	(5,974)	(5,915)
EBIT	**13,228**	**3,581**	**31,067**	**31,249**
Interest expense (net)	(568)	(743)	(1,040)	(874)
Other non-operating inc/(exp)	(136)	105	(252)	(249)
Earnings before taxes (EBT)	**12,524**	**2,943**	**29,776**	**30,125**
Income tax	(7,441)	(1,237)	(19,281)	(20,485)
Earnings after taxes (EAT)	**5,083**	**1,706**	**10,494**	**9,640**
Equity income/Minority interest	156	39	140	166
Earnings from cont. operations	**5,239**	**1,745**	**10,634**	**9,806**
Forex/Exceptionals before tax	(3,396)	(7,255)	(1,421)	-
Net profit	**1,843**	**(5,510)**	**9,213**	**9,806**

- Elevated profit level of the next two years is solely driven by higher oil and gas prices
  - **Equinor did not aggressively expand its production**

Sources: A. Stotz Investment Research, Refinitiv

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Balance sheet - assets

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(YE Dec, US$ m)	2019A	2020A	2021E	2022E
Cash & short-term investments	12,051	17,623	19,555	23,900
Accounts receivable	8,233	8,232	14,499	15,803
Inventories	3,363	3,084	3,378	4,213
Other current assets	1,131	1,885	1,684	1,835
Total current assets	**24,778**	**30,824**	**39,115**	**45,752**
Long-term investments	1,442	2,262	2,647	3,096
Net fixed assets	69,953	65,672	64,389	63,815
Intangible assets	9,280	6,667	6,965	7,278
Goodwill	1,458	1,481	1,503	1,526
Other long-term assets	11,152	15,066	20,339	20,949
Total assets	**118,063**	**121,972**	**134,958**	**142,417**

★ Net fixed assets continue to decline as the company further narrows its production to a few locations
- **It’s part of its strategy to concentrate production to highly profitable areas**
- **Still, I expect rising NFA in 23E onward due to renewable energy expansion**

Sources: A. Stotz Investment Research, Refinitiv

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Balance sheet - liabilities

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(YE Dec, US$ m)	2019A	2020A	2021E	2022E
Overdrafts & short-term loans	4,087	5,777	4,175	3,966
Accounts payable	9,027	7,736	10,259	11,914
Other current liabilities	6,443	5,989	10,102	11,011
Total current liabilities	**19,557**	**19,502**	**24,536**	**26,891**
Long-term debt	24,945	32,338	30,613	29,083
Other long-term liabilities	32,402	36,240	39,502	40,292
Total liabilities	**76,904**	**88,080**	**94,651**	**96,266**
Minority interest	**20**	**19**	**37**	**57**
Paid-up capital - Common shares	8,917	8,016	8,016	8,016
Paid-up capital - Preferred shares	-	-	-	-
Retained earnings	37,481	30,050	36,653	43,027
Revaluation/Forex/Others	(5,259)	(4,193)	(4,399)	(4,948)
Total equity	**41,139**	**33,873**	**40,270**	**46,094**
Total liab & shareholders' equity	**118,063**	**121,972**	**134,958**	**142,417**

★ The company slightly increased its LT-debt over the pandemic
  - **However, I expect that part of its elevated profits can be used to repay debt over time**

Sources: A. Stotz Investment Research, Refinitiv

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(YE Dec)	2019A	2020A	2021E	2022E
General growth (YoY, %)				
Revenue	(19.9)	(27.3)	84.0	9.0
Assets	4.9	3.3	10.6	5.5
Gross profit	(22.3)	(35.1)	156.9	0.8
Operating profit	(32.3)	(72.9)	767.6	0.6
Attributable profit	(75.5)	(399.0)	267.2	6.4
EPS	(75.6)	(402.7)	269.5	6.8
Recurring EPS	(49.3)	(54.1)	458.5	1.8
Du Pont analysis (%)				
Net profit margin	2.9	(12.0)	10.9	10.7
Revenue per kr100 of assets	54.6	38.1	65.5	66.2
Assets/equity (x)	2.7	3.2	3.5	3.2
Return on equity	4.4	(14.7)	24.9	22.7
Others (%)				
Effective tax rate	81.5	-	68.0	68.0
Dividend payout ratio	90.5	77.4	26.8	34.9

- After making a loss in 2020, the company is likely to see a record net margin in 21E
  - **Still, don't expect the company to be able to maintain such a margin over the long run**
  - **Oil and gas prices can change directions easily**

Sources: A. Stotz Investment Research, Refinitiv

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Ratios (cont.)

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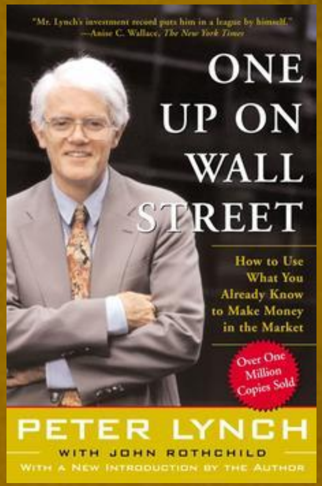
(YE Dec)	2019A	2020A	2021E	2022E
Internal liquidity (x)				
Current ratio	1.3	1.6	1.6	1.7
Quick, or acid test ratio	1.1	1.4	1.5	1.5
Working cap. mgmt (Days)				
Inventory conversion period	25	38	26	26
Receivables collection period	49	65	49	59
Days from raw mat to coll	74	103	74	86
Payables deferral period	78	99	72	76
Cash conversion cycle	(4)	4	3	9
Profitability ratios (%)				
Gross profit margin	37.3	33.3	46.5	43.0
EBIT margin	21.0	7.8	36.9	34.1
EBIT return on avg assets	11.5	3.0	24.2	22.5
Return on average assets	1.6	(4.6)	7.2	7.1
Financial risk (x)				
Liabilities-to-assets (%)	65.1	72.2	70.1	67.6
Debt-to-equity	0.7	1.1	0.9	0.7
Net debt-to-equity	0.4	0.6	0.4	0.2
Times-interest-earned	23.3	13.4	31.3	35.3
Effective interest rate (%)	3.6	2.9	3.6	3.5

★ Its low cash conversion cycle helps the company to manage its working capital efficiently

Sources: A. Stotz Investment Research, Refinitiv

A. Stotz Investment Research Stock Picking Checklist



- Inspired by Peter Lynch's ten baggers (A stock that has gone up 10x)
- Based on our extensive research
- 9 factors that drive long-term share price performance

Long-term share price performance potential

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Good / Moderate / Weak

A. Stotz Investment Research Stock Picking Checklist	Potential	Comment
1. Management – Management has a proven commitment to growth	Weak	Focus has been more on production concentration rather than aggressive expansion
2. Growth – Product and industry can support a decade of 10%+ annual growth	Moderate	Highly volatile industry with rising demand; company is subject to rapidly changing oil and gas prices
3. Sustainable – Competitive strategy creates sustainably high gross margin	Good	Being among the largest energy players in the market helped to maintain a stable gross margin
4. Quality – Good earnings quality, non-core items are small or non-existent	Weak	High exposure to gains and losses from hedging oil and gas prices
5. Efficiency – In the long run sales grow faster than assets	Weak	A quantity-driven increases in revenue requires heavy capital investments
6. Tight – Relatively low cash conversion cycle, negative is best	Good	Cash conversion cycle stood at 4 days in 2020
7. Cash flow – Operating cash flow is consistently positive	Weak	Fluctuating operating cash flows were sometimes not able to cover investing cash flows in the past
8. Capacity – Company has access to capital to fund growth	Good	Being state-owned facilitates access to further capital
9. Inexpensive – Valuation is reasonable, avoid very expensive stocks	Moderate	Cheap on 21E PE , but in line with PB compared to Norwegian Energy companies

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Free cash flow

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(YE Dec, US$ m)	2019A	2020A	2021E	2022E
EBIT	13,228.0	3,581.0	31,067.2	31,249.0
Est tax rate (%)	*81.5*	-	*68.0*	*68.0*
NOPAT	**2,444.7**	**3,581.0**	**9,941.5**	**9,999.7**
Add: Depre & amort	9,914.0	9,529.0	10,237.5	10,673.5
Less: CAPEX	(7,596.0)	(7,971.0)	(8,901.6)	(10,044.2)
Chg in A/R	765.0	1.0	(6,266.6)	(1,304.9)
Chg in inventory	(1,219.0)	279.0	(293.9)	(835.5)
Chg in oth curr assets	(313.0)	(754.0)	201.3	(151.5)
Chg in A/P	913.0	(1,291.0)	2,522.9	1,654.9
Chg in oth curr liabs	415.0	(454.0)	4,113.3	909.2
Less: Chg in working cap	**561.0**	**(2,219.0)**	**276.9**	**272.2**
Less: Chg in invest cap				
Free cash flow to firm	**5,323.7**	**2,920.0**	**11,554.3**	**10,901.2**
FCF per share (US$)	*1.6*	*0.9*	*3.6*	*3.4*
NOPAT growth (%)	*(67.9)*	*46.5*	*177.6*	*0.6*
FCF growth (%)	*(37.6)*	*(45.2)*	*295.7*	*(5.7)*

- Equinor faces higher CAPEX over the next few years in line with its plans to slightly increase oil & gas production and to realize its renewable energy targets

Sources: A. Stotz Investment Research, Refinitiv

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Value estimate

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Forecast assumptions

3-year average	Consensus	My assumptions
Revenue growth (CAGR)	22.8	23.1
Gross margin	41.7	42.8
EBIT margin	32.8	33.4
Net margin	10.2	10.3

My valuation method

Market: Norway	
Market risk-free rate	1.7
Market equity risk premium	8.5
Market return	10.2
Company beta (x)	1.3
COE	12.3
WACC	8.4
Terminal growth rate	2.0

Valuation Method: FCFF

★ The ongoing energy crisis in Europe should support a higher price level than usual

- **I expect the company to record high revenue over the next 3 years**
- **However, afterward, I forecast a decline in revenue than should also normalize profits**

Sources: A. Stotz Investment Research, Refinitiv

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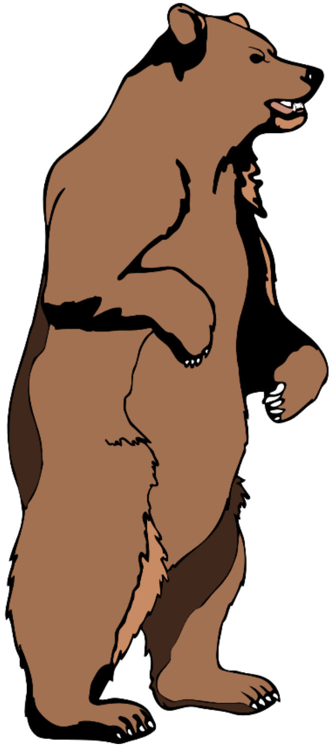
Bear	Base	Bull
US$21	**US$25**	**US$28**
(Downside 25%)	(Downside 11%)	(Upside 0%)



World Class Benchmarking Scorecard

- We identify a company's competitive position relative to global peers
- We use a composite rank of profitability and growth, called "Profitable Growth"
- Scale from 1 (Best) to 10 (Worst)

Both growth and profitability are not spectacular

VALUATION MASTER CLASS

Sales

Story

FVMR

Value

WCB

Risks

Profitability remains average

Profitable Growth

'17	'18	'19	'20	PTM
1	3	5	5	6

Poor growth recently

Profitability

'17	'18	'19	'20	PTM
6	3	5	5	6

Growth

'17	'18	'19	'20	PTM
1	3	7	6	8

Benchmarked against 310 large Energy companies worldwide.

Sources: A. Stotz Investment Research, Refinitiv

This is not investment advice and it's not a recommendation.

Key risk is a slowing economy

- ★ Potential economic slowdown could lead to a rapid decline in energy prices
- ★ Unexpected weather damages of gas and oil plants
- ★ Failure to realize fast shift to green energy

Sources: A. Stotz Investment Research, company data

CONCLUSION

- Revenue explosion is solely energy price-driven, while production is stable
- Falling energy prices could lead to negative market sentiment
- Attractive dividend yield and repurchases might not be enough to compensate a potential fall

CASE STUDY

VALUATION MASTER CLASS

by

A. Stotz INVESTMENT RESEARCH

How much can Equinor exploit Europe's energy crisis?