

Energy Flash Note

Sound Energy plc*

SOU LN

BUY

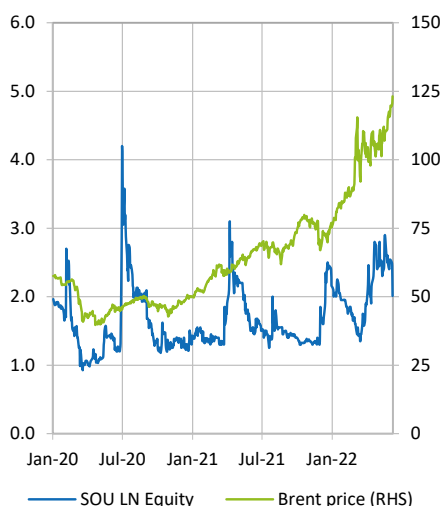
TP 7.3p (from 8.2p)

9 June 2022

Stock Data

Ticker	SOU LN
Share Price:	2.01
Market Cap:	£33m

Price Chart



£4m raise provides running room

Sound Energy is a transition energy company with strong ESG credentials and a clear route to first gas production and revenues in early 2024 through its low-cost onshore gas development in Morocco. The share price currently offers investors an attractive entry point to those seeking exposure to a low-risk and low-carbon energy play in an emerging setting that benefits from attractive gas pricing, excellent fiscal terms, strong and growing domestic demand, together with direct access to the gas-short European market. Following a strategic re-set in 2020 when it sets its sights on a development-led commercialisation approach, management has made good on its promises by entering the execution phase of its Tendirra gas development in Morocco.

We have updated our financial forecasts and risked NAV to reflect yesterday's announcement of a £4m raise through the issue of 200 million new shares @ 2p/share. We reiterate our **BUY** rating with an updated **7.3p/share** price target.

£4m raised through equity fundraise fully finances next stage of activities

Sound announced yesterday that it has conditionally placed 200 million new ordinary shares at 2p/share to raise £4m in gross proceeds, with subscriptions from existing shareholders like Afriquia Gaz S.A. as well as significant director participation. Application has been made for admission to trading and it is expected that admission of the shares will occur in or around 13 June 2022. The net proceeds of the fundraise, together with an estimated £1m current cash balance, will be applied towards Phase 2 Tendirra pre-development work up to FID, preliminary Annual exploration pre-drill activities, and to provide additional working capital for corporate and debt servicing purposes. In the Board's opinion the net proceeds will, alongside current cash resources and existing Phase 1 Tendirra micro-LNG funding arrangements, be sufficient to continue to advance the Company's projects and meet its present working capital obligations through to April 2023.

Primary use of funds is to progress its Phase 2 pipeline project to FID

In our view, management has taken the strategic decision to issue equity (12.15% dilution) in order to buy itself sufficient running room in which to deliver the pre-development work up to a final investment decision (FID) on its Phase 2 gas pipeline development. Phase 2 will use the existing Maghreb-Europe Gas Pipeline in Morocco to supply gas to ONEE (the state-owned power company) to fuel its two existing CCGTs which, following the cessation of gas imports from Algeria in 2021 have over 800MW of power capacity currently unutilised. Financing talks are reported to be progressing positively, with commercial and development banks, vendors with balance sheet capability and mezzanine financiers, and an FID decision is expected in 4Q22. We expect the Phase 2 FID to realise a step-change in the market perception of the Company and a valuation inflection point for investors.

Reiterate BUY rating with a revised TP of 7.3p/share

We have updated our financial forecasts and risked valuation to reflect yesterday's announcement of a £4m raise through the issue of 200 million new shares @ 2p/share. The raise has diluted our Core NAV by 10% from 8.2p to 7.3p/sh, but has also provided some valuable breathing space for the Company to complete the Phase 2 Tendirra pre-development work up to a final investment decision, as it looks in 4Q22 to secure financing and enter the execution phase on the larger and higher impact pipeline gas project. We have updated our financial models for recent news flow and reiterate our BUY rating and a revised TP of 7.3p/sh (from 8.2p/share).

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VALUATION

Valuation Methodology

We have incorporated the following assumptions into our financial model:

Metric	Assumption
Potential shares in issue (diluted)	1,997.0
LT exchange \$/£	1.30
LT exchange £/€	1.10
LT Brent oil price	US\$80/bbl
bcf/mboe	5.8
LT uncontracted Moroccan Gas Price	US\$9/mmbtu
Eastern Morocco Working Interest	75%
NPV/boe Discount Rate	10%
Funding factor assigned to exploration licences	66.67%
Royalties - Gas	5%
Royalties - Liquids	10%

Source: SP Angel estimates

We mark-to-market our assumptions and use an \$80/b long-term flat Brent oil price from 2024 onwards, and a \$1.30:£1.00 FX rate, discounted to 1 January 2022. We model an \$8/mcf price for contracted gas and a slightly higher \$9/mcf price for uncontracted gas, reflecting the increasing slope of recently signed long term LNG deals indexed to Brent. Our 10% WACC for Sound's assets remains unchanged.

We value Sound Energy in the same way as we value all our E&P companies, with Risked NAV as the primary valuation metric. We do this by modelling a DCF of the key assets in detail, taking the Company's net effective interest and applying a risk factor. For Sound, we principally value the Company using a combination of a Discounted Cash Flow (DCF) model for both phase 1 and phase 2 of Tendirra and an appraisal of the Company's assets and liabilities to calculate Sound's Core Valuation.

We base our Valuation solely on Sound's Core NAV

Summary Valuation

Asset	Region	Resource (bcf)	Stage	Net WI	Net resource (mboe)	NPV (\$/b)	Unrisked value (pps)	Risk factor	Net risked resources (mboe)	Net risked value (\$m)	Net risked value (£m)	Net risked value (pps)
Tendirra Phase 1	Morocco	53.7	D	75.0%	6.9	3.2	0.9	90%	6.2	20.2	15.5	0.8
Phase 2a (contracted)	Morocco	128.0	pre-FID	75.0%	16.6	6.1	3.9	80%	13.2	80.7	62.1	3.1
Phase 2b (uncontracted)	Morocco	195.3	pre-FID	75.0%	25.3	5.7	5.5	75%	18.9	107.2	82.5	4.1
Core assets		377.0			48.8	4.3	10.3		38.4	208.1	160.1	8.0
Cash @ YE21							0.2			5.1	3.9	0.2
G&A (2Yr)							-0.2			-5.0	-3.9	-0.2
2022 adj (Eurobond, raise, warrants)							-0.7			-17.5	-13.5	-0.7
Core NAV		377.0			48.8		9.6		38.4	190.6	146.6	7.3
Greater Tendirra Upside	Morocco	2,685	E*	75.0%	347.1	3.6	47.6	14%	48.8	173.9	133.8	6.7
Anoual Upside	Morocco	4,184	E*	75.0%	541.0	1.6	32.5	11%	57.5	89.6	68.9	3.5
Sidi Mokhtar Upside	Morocco	4,453	E*	75.0%	575.8	2.1	47.3	16%	90.4	192.9	148.4	7.4
Exploration NAV		11,321			1,464		127.5		196.7	456.4	351.1	17.6
Total Risked NAV		11,698					137.1		235.1	647.1	497.7	24.9

Source: SP Angel estimates

Note: *additional 66.67% 'promote' funding factor assigned to geological CoS riskings (i.e. assumes 25% farm-down to 50% WI)

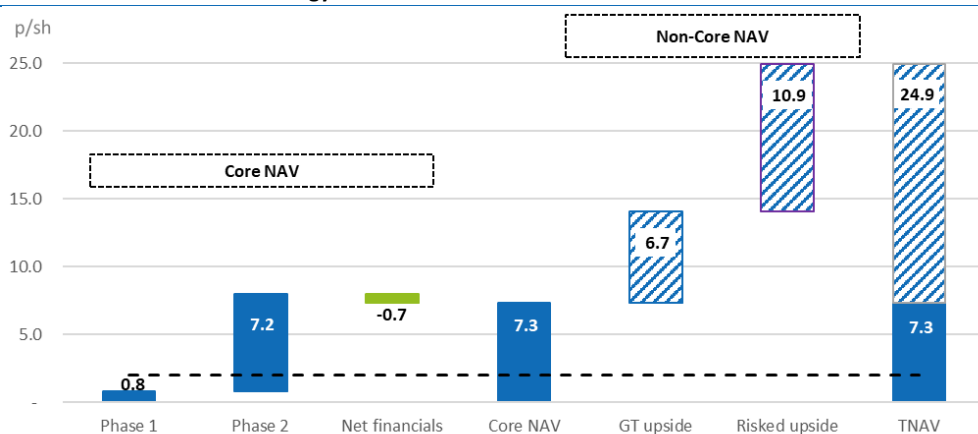
We think that it is useful for investors to think of Sound's asset base in terms of what can already be considered commercial (e.g. contracted gas under development) and what still has to be derisked by further approvals or drilling (Greater Tendirra prospectivity). This gives us greater flexibility to "upgrade" the CoS on positive news flow and commercial milestones, better reflecting the market's view on the asset base.

Reiterate our BUY stance setting an 7.3p/share TP

Reiterate BUY rating, setting a revised 7.3p/share TP

Our updated Sum-Of-The-Parts (SOTP) valuation of Sound Energy estimates a revised Core Target Price of 7.3p/share (~£147m mkt cap.), indicating that the Company currently trades at a deep c.70% discount to our risked NAV. Our Core valuation focuses solely on Sound Energy’s planned phased development of its flagship Tendrara concession and its financial assets and liabilities. We highlight that our prudent approach to setting our Target Price at this stage does not include recognition of its potentially transformational exploration portfolio at Greater Tendrara, Anoual, and Sidi Mokhtar, instead focusing on the near-term cash flow potential under development at Tendrara.

Waterfall Chart for Sound Energy



Source: SP Angel estimates

Risk-Reward profile

As reflected in our valuation approach, Sound will undertake the commercialisation of its prolific gas development at Tendrara through a phased approach. In this development, the Company is ably assisted by strong local industry partners in Afriquia Gaz, ONEE and ONYM, coupled with a very attractive fiscal regime that generates robust project economics. With an urgent need to substitute domestic gas resources for higher carbon-intensive imported LNG and coal, we think that Sound Energy investors and its Moroccan stakeholders are uniquely aligned and see further upside from a range of gas exploration opportunities and diversification into energy transition / renewable projects.

In relation to its Moroccan tax dispute, Sound has continued to constructively engage with the Moroccan Tax Administration in relation to a number of tax notifications. The Company remains clear that the assessments by the Moroccan Tax Administration, as previously announced, arise from a fundamental misunderstanding of the historical licensing changes (relinquishing old licences and entering new licences covering revised acreage with revised terms – with no continuation or transfer of the original licence) and inter-group ownership outside of Morocco. SP Angel currently carries no value for this unlikely tax claim, but would expect any court decision to be appealed by the losing party leading to any effective resolution being at least 12 to 24 months away.

The capital-intensive nature of large gas projects in the early phase tends to mask the potential strength and reliability of the long-term free cash flows that they can generate. Following the initial investment period over 2022-2025e, we estimate these two gas projects can generate upwards of £60m in aggregate annual EBITDA with relatively light capex requirements. As such, we think that a yield-based valuation may be more appropriate once the project is onstream. Given the high energy prices currently seen in the macro environment, it is also useful to recognise that a \$1/mcf move in uncontracted gas prices results in a £2m boost to annual EDITDA and an 8% increase in our Core NAV.

Financial Statements

In US\$ (unless stated)		2020A	2021A	2022E	2023E	2024E	2025E	2026E	2027E
Avshare price (p)		1.4	2.2	2.0	2.0	2.0	2.0	2.0	2.0
Basic YE NOSH (m)		1326	1629	1845	1845	1845	1845	1845	1845
YE \$/£		1.30	1.34	1.30	1.30	1.30	1.30	1.30	1.30
Market cap (£m)		19	35	37	37	37	37	37	37
Market cap (\$m)		25	47	48	48	48	48	48	48
EV (\$m)		51	70	79	185	308	290	250	208
Income Statement		2020A	2021A	2022E	2023E	2024E	2025E	2026E	2027E
Brent	\$/bbl	43.0	71.0	100.0	90.0	80.0	80.0	80.0	80.0
Natural gas	\$/mcf	17.0	17.0	18.0	9.0	9.0	9.0	9.0	9.0
Revenue	\$m	0.0	0.3	0.0	0.0	22.7	126.3	126.3	126.3
Opex	\$m	0.0	0.0	0.0	0.0	-12.6	-25.9	-25.9	-25.9
EBITDAX	\$m	-7.5	1.0	-3.3	-3.3	5.4	86.6	86.3	84.9
EBITDA	\$m	-16.5	3.4	-3.3	-3.3	5.4	86.6	86.3	84.9
DDA	\$m	0.0	0.0	0.0	0.0	-5.4	-24.1	-24.1	-24.1
EBIT	\$m	-16.5	3.4	-3.3	-3.3	0.0	62.4	62.2	60.8
Exceptionals	\$m	-12.7	5.4	0.0	0.0	0.0	0.0	0.0	0.0
Net finance income	\$m	-4.2	-3.1	-1.6	-3.8	-10.8	-15.6	-14.8	-13.1
EBT	\$m	-24.5	3.3	-4.8	-7.0	-10.8	46.8	47.4	47.7
Tax	\$m	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other	\$m	-5.2	1.6	0.0	0.0	0.0	0.0	0.0	0.0
Net income	\$m	-29.7	4.8	-4.8	-7.0	-10.8	46.8	47.4	47.7
EPS (basic)	Cents	-2.0	0.2	-0.3	-0.4	-0.6	2.5	2.6	2.6
Balance Sheet		2020A	2021A	2022E	2023E	2024E	2025E	2026E	2027E
Cash	\$m	5.8	3.9	1.9	17.2	-0.5	11.8	26.6	41.7
Debt	\$m	32.1	26.9	32.5	154.4	259.5	254.0	228.0	202.0
Net debt/(cash) BV	\$m	26.3	22.9	30.6	137.1	259.9	242.2	201.3	160.3
Cash Flow		2020A	2021A	2022E	2023E	2024E	2025E	2026E	2027E
Cash flow from Operations	\$m	-2.4	-2.1	-3.3	-3.3	4.8	76.8	86.3	84.9
Cash used in Investing	\$m	-1.7	-1.6	-8.4	-99.5	-116.7	-36.2	-16.2	-16.1
Cash used in Financing	\$m	4.1	1.5	9.8	118.1	94.3	-28.4	-55.2	-53.7
Change in cash	\$m	0.1	-2.2	-1.9	15.4	-17.7	12.3	14.8	15.1
FCF	\$m	-4.0	-4.0	-12.1	-102.8	-112.0	40.6	70.0	68.6
DACF	\$m	-4.0	-3.3	-4.9	-7.1	-6.1	61.2	71.4	71.6
Production (WI)									
Oil production	kbopd	0.00	0.00	0.00	0.00	0.00	0.11	0.11	0.11
Gas production	mmscfd	0.0	0.0	0.0	0.0	11.0	48.5	48.5	48.5
Total production	kboepd	0.00	0.00	0.00	0.00	1.90	8.47	8.47	8.47
Production growth	%	0%	0%	0%	0%	0%	346%	0%	0%
2P reserves	mboe	0.0	0.0	0.0					
2C resources	mboe	48.8	48.8	48.8					
Valuation									
Share price	(p)	1.4	2.2	2.0	2.0	2.0	2.0	2.0	2.0
Market cap	\$m	24.7	46.9	48.2	48.2	48.2	48.2	48.2	48.2
EV	\$m	51.0	69.9	78.8	185.4	308.2	290.4	249.6	208.5
P/E	(x)	-0.9	13.4	-9.4	-6.9	-4.5	1.0	1.0	1.0
EV/DACF	(x)	-12.7	-21.5	-16.2	-26.2	-50.8	4.7	3.5	2.9
EV/2P	(\$/boe)	nm	nm	nm	nm	nm	nm	nm	nm
EV/2P+2C	(\$/boe)	1.0	1.4	1.6	nm	nm	nm	nm	nm
EV/boe/d	\$/boe/d	nm	nm	nm	nm	162.1	34.3	29.5	24.6
Div yield	(%)	0%	0%	0%	0%	0%	30%	30%	30%
FCF yield	(%)	-16%	-8%	-25%	-213%	-232%	84%	145%	142%
Net debt/EBITDA	(x)	-1.6	6.7	-9.4	-42.2	48.1	2.8	2.3	1.9
Net debt/Equity	(%)	14%	11%	15%	70%	141%	108%	79%	55%
Net debt/EBITDAX	(x)	-3.5	23.2	-9.4	-42.2	48.1	2.8	2.3	1.9
EBITDAX/interest	(x)	-1.8	0.3	-2.0	-0.9	0.5	5.5	5.8	6.5
Interest cover	(x)	-3.9	1.1	-2.0	-0.9	0.0	4.0	4.2	4.6
ROACE	(%)	-8%	2%	-1%	-1%	0%	14%	13%	12%
EV/EBITDAX	(x)	-6.8	70.7	-24.2	-57.0	57.1	3.4	2.9	2.5

Source: SP Angel estimates

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