![SP Angel]

Non-Independent Research

Energy NAV Update

Sound Energy

SOU LN **BUY**

TP 3.1p (from 4.6p)

25 June 2024

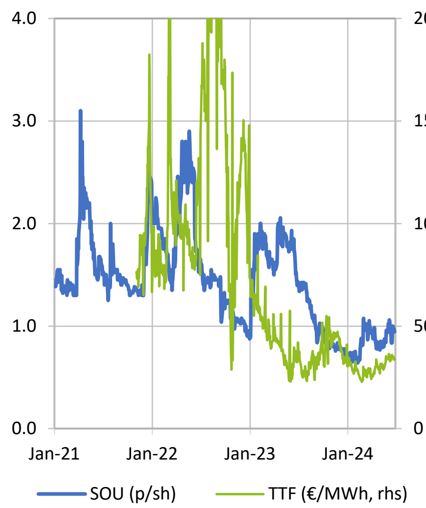
Stock Data

Ticker	SOU LN
Share Price:	0.945p
Market Cap:	£18.7m

Company description

Sound is a transition energy company with strong ESG credentials and a clear route to first gas production and revenues within the next 12M through its low-cost onshore gas development in Morocco.

Price Chart



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Managem announced as Moroccan partner

Sound announced a binding sale and purchase agreement with Managem to sell 55% of its 75% working interest in the Tendrara concession and a 47.5% interest in each of the Grand Tendrara and Anoual Exploration permits.

We update our financial forecasts and NAV based on the proposed terms of the deal and reiterate our BUY rating with a revised 3.1p/share target price.

Confirms farm-in partner for Moroccan development

Sound has signed a binding sale and purchase agreement of up to $45.2m with Managem for the partial divestment of the Company's Moroccan assets by way of the disposal of Sound Energy Morocco East Limited (SEME). On completion, Managem will pay $12m in Phase 1 and $1m in Phase 2 development back costs for its 55% interest and provide a full equity carry of Sound's remaining 20% interest for up to $24.5m in Phase 2 development costs. Managem will also fund Sound's remaining 27.5% interest in exploration/appraisal wells on the SBK-1 and M5 prospects, subject to the relevant authorisations and approval of Managem's board of directors by 12 July.

Managem participation carries fewer completion risks

Managem (MNG CSE) is a reputable mining group with a presence in several countries across Africa that is 82%-owned by the Al Mada fund, which is mainly controlled by the Moroccan royal family. Despite the deal being on inferior terms to the proposed non-binding agreement signed with Calvalley Petroleum last year (20% carried interest vs 30% carried interest), the market has responded positively to the deal. In our view, this reflects the position of Managem as a strong local partner with the requisite technical and financial capacity to deliver the Phase 2 Tendrara development, which is the real engine for cash flow generation and repayment of the Company's debt.

Line of sight on Phase 2 debt & equity financing package

Morocco's Attijariwafa Bank, whose main shareholder is also the Al Mada fund, has made a conditioned offer to provide 2.365bn Dirhams (c.$225m) of project finance for the Phase 2 pipeline gas development, subject to the fulfilment of certain conditions. Sound expects to close the transaction with Managem within the next three months, which would potentially allow the Company to take a Final Investment Decision (FID) on the pipeline-based Phase 2 development on the Tendrara licence by end-2024. We expect cash inflows from completing the Managem deal will address any market concerns over Sound's finances, as well as providing investors with exposure next year to two fully funded wells on the SBK-1 appraisal and M5 exploration targets.

Delivery remains key to unlocking valuation upside

In our view, Sound's management team has wrestled with some pretty tough legacy issues (bond, cost base, tax dispute, funding) over the last few years to get to this stage. We update our financial forecasts for the proposed terms of the Managem deal, assuming that the transaction will close in 4Q24. Based on our revised forecasts, we reiterate our BUY rating with a revised 12M target price of 3.1p/share, which is based solely on the Core NAV assets plus the risked upside from the two fully funded wells on SBK-1 and M5. This provides investors with over 225% potential upside if the Company is able to complete on the deal and unwind the market discount on the Tendrara development, which is expected to generate a run-rate of about $30m in annual EBITDA net to the Company's 20% WI following the start-up of Phase 2 in 2H26.

VALUATION

Valuation Methodology

We have incorporated the following assumptions into our financial model:

Metric	Assumption
Potential shares in issue (diluted)	2,258m
LT exchange $/£	1.25
LT exchange £/€	1.10
LT Brent oil price	US$90/bbl
mcf/boe	5.8
LT uncontracted Moroccan Gas Price	US$9/mmbtu
NPV/boe Discount Rate	10%
Net Working Interest	20%
Promote funding factor (additional risking applied to CoS)	50%
Royalties - Gas	5%

Source: SP Angel estimates

We update our financial forecasts for the FY23 results and continue to use a $90/bbl long-term flat Brent oil price for 2025 onwards and a $1.25:£1.00 FX rate, discounted to 1 January 2024. We model an unchanged ~$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 set our Target Price on a DCF-based valuation of Sound's Core assets

We value Sound 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 Discounted Cash Flow (DCF) model of the key assets in detail, taking the Company's net effective interest and applying a risk factor. For Sound, we use the DCF valuations for both Phase 1 and Phase 2 of Tendrara and an evaluation of the Company's assets and liabilities to calculate its Core valuation.

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)
Tendrara Phase 1	Morocco	53.7	D	20.0%	1.9	5.0	0.3	90%	1.7	8.3	6.7	0.3
Phase 2a (contracted)	Morocco	128.0	pre-FID	20.0%	4.4	8.5	1.3	85%	3.8	32.1	25.7	1.1
Phase 2b (uncontracted)	Morocco	195.3	pre-FID	20.0%	6.7	9.6	2.3	80%	5.4	51.5	41.2	1.8
Core assets		**377.0**			**13.0**	7.1	**3.9**		**10.8**	**91.9**	**73.5**	**3.3**
Net debt @ YE23							-1.3			-37.7	-30.1	-1.3
G&A (2Yr)							-0.3			-7.5	-6.0	-0.3
2024 adj (Options, etc.)							0.8			21.7	17.4	0.8
Moroccan tax settlement							0.1			-1.3	-1.0	0.0
Core NAV		**377.0**			**13.0**		**3.2**		**10.8**	**67.1**	**53.7**	**2.4**
SBK-1 Appraisal	Morocco	70	E	27.5%	3.3	4.2	0.5	50%	1.7	6.9	5.5	0.2
M5 Exploration	Morocco	472	E	27.5%	22.4	3.0	2.4	21%	4.7	14.1	11.3	0.5
TE-4 Horst Appraisal	Morocco	137	E	27.5%	6.5	4.7	1.1	36%	2.3	10.9	8.7	0.4
Greater Tendrara Upside	Morocco	2,267	E	27.5%	107.5	3.0	11.5	18%	18.9	57.0	45.6	2.0
Anoual Upside	Morocco	3,795	E	27.5%	179.9	3.0	19.2	15%	27.0	81.3	65.1	2.9
Sidi Mokhtar Upside	Morocco	4,453	E*	75.0%	575.8	3.0	61.5	12%	67.8	204.3	163.4	7.2
Speculative NAV		**11,192**			**895**		**96.1**		**122.4**	**374.6**	**299.7**	**13.3**
Total Risked NAV		**11,569**					**99.3**		**133.2**	**441.7**	**353.3**	**15.6**

Source: SP Angel estimates

*Note: *additional 50% 'promote' funding factor assigned to geological CoS riskings (i.e. assumes 2-for-1 farm-down to 37.5% WI)*

We allow flexibility to 'upgrade' the CoS factor on positive news flow and commercial milestones

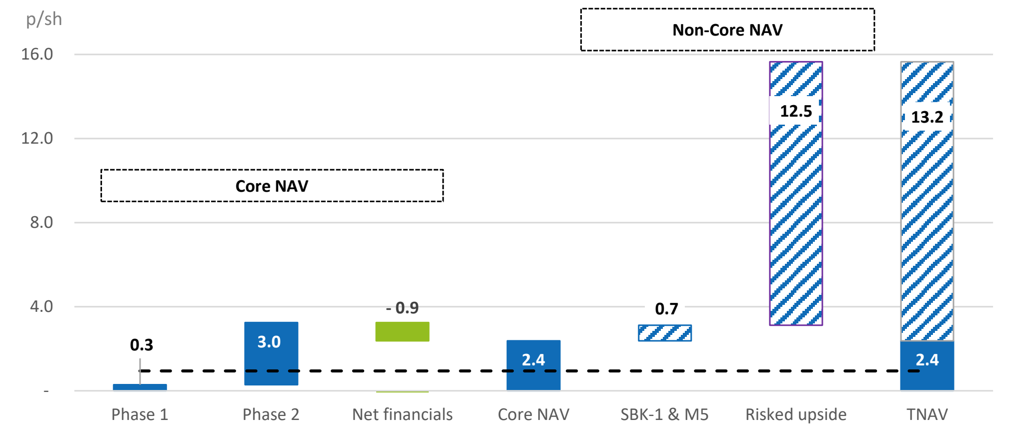
We think that it is useful for investors to think of Sound's asset base in terms of what can already be considered commercial (e.g. contracted gas under development) and what still has to be de-risked by further approvals or drilling (Greater Tendrara exploration prospectivity). This gives us greater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

Reiterate BUY rating with 3.1p/share TP

We base our 3.1p/sh Price Target solely on Sound's Core NAV and the fully funded SBK-1 & M5 wells

Based on the proposed terms of the deal, we calculate Sound's carried 20% equity interest in the flagship Tendrara development assets produces a risked Core NAV of 2.4p/share, with an additional 0.7p/sh of risked valuation for the SBK-1 & M5 wells (~£70m mkt cap). This implies potential upside of 228% if the Company is able to complete on the deal and unwind the market discount on the Tendrara development in 2H24. As part of the proposed deal with Managem, investors can also look forward in 2025 to a fully funded exploration well on the M5 structure, which could potentially double the resource base on commercial success.

Waterfall Chart for Sound Energy



Source: SP Angel estimates

Sensitivities

A $1/mcf move in uncontracted gas prices boosts EBITDA by c.$1m p.a.

Morocco is a fast-growing emerging economy and demand for domestic gas production stems from existing gas power stations, industrial customers and as a substitute for imported coal in base load power to meet decarbonisation targets. As reflected in our valuation approach, Sound will undertake the commercialisation of the significant gas resource at Tendrara through a phased approach. In this development, the Company is ably assisted by strong local industry partners in Afriquia Gaz, ONEE and ONHYM, coupled with a very attractive fiscal regime that generates robust project economics. Given the robust energy prices currently seen in the macro environment, it is also useful to recognise that a $1/mcf move in our assumed uncontracted gas prices of $9/mcf results in a ~$1m boost to annual EBITDA and a 6% increase to Core NAV.

Sound NAV & EBITDA Sensitivity Matrix

LT uncontracted gas price	Core NAV, p/sh	EBITDA (2027e), $m	FCF (2027e), $m
$8.0/mcf	2.2p/sh	$22.4m	$8.3m
$9.0/mcf	**2.4p/sh**	**$23.5m**	**$9.3m**
$10.0/mcf	2.5p/sh	$24.7m	$10.4m
$12.0/mcf	2.8p/sh	$26.9m	$12.5m

Source: SP Angel estimates

The M5 exploration well is targeting the largest identified undrilled structural closure at TAGI level in the basin

Whilst management has strategically prioritised its gas monetisation strategy through the phased development of the TE-5 Horst (Tendrara Production Concession), the Company has also re-evaluated the extensive exploration portfolio. Looking past the Tendrara development, Sound also provides investors with significant upside potential through the multi-TCF exploration prospectivity across its acreage in Morocco, where it is the largest permit holder. Management is particularly focussed on investigating the continuity of the prolific Algerian Triassic & Palaeozoic gas plays into Morocco. Outside of the SBK-1 appraisal well and M5 exploration wells, there remains significant prospective resource potential within the Greater Tendrara and Anoual exploration permits surrounding the Tendrara Production Concession.

5Yr financial projection for Sound Energy

In US$ (unless stated)		**2020A**	**2021A**	**2022A**	**2023A**	**2024E**	**2025E**	**2026E**	**2027E**
Avshare price (p)		**1.43**	**2.15**	**0.88**	**0.72**	**0.95**	**0.95**	**0.95**	**0.95**
Basic YE NOSH (m)		**1,326**	**1,629**	**1,849**	**1,963**	**1,993**	**1,993**	**1,993**	**1,993**
YE $/£		**1.37**	**1.35**	**1.21**	**1.24**	**1.25**	**1.25**	**1.25**	**1.25**
Market cap (£m)		**19**	**35**	**16**	**14**	**19**	**19**	**19**	**19**
Market cap ($m)		**26**	**47**	**20**	**17**	**24**	**24**	**24**	**24**
EV ($m)		**52**	**71**	**52**	**55**	**60**	**88**	**143**	**144**
Income Statement		**2020A**	**2021A**	**2022A**	**2023A**	**2024E**	**2025E**	**2026E**	**2027E**
Brent	$/bbl	43.4	70.8	99.0	82.2	85.0	90.0	90.0	90.0
Natural gas	$/mcf	3.1	12.0	12.0	12.6	11.0	9.0	9.0	9.0
Revenue	$m	0.0	0.3	0.1	0.1	0.0	4.5	13.6	37.4
Opex	$m	0.0	0.0	0.0	0.0	0.0	-3.1	-4.7	-6.8
EBITDAX	$m	-7.4	1.0	2.9	-6.5	-3.8	-3.5	3.3	23.5
EBITDA	$m	-16.3	3.5	3.1	-2.9	-3.8	-3.5	3.3	23.5
DDA	$m	0.0	0.0	0.0	0.0	0.0	-1.0	-2.7	-6.8
EBIT	$m	-16.3	3.5	3.1	-2.9	-3.8	-4.6	0.6	16.8
Exceptionals	$m	-12.6	5.5	7.0	0.0	0.0	0.0	0.0	0.0
Net finance income	$m	-4.2	-3.2	-1.8	-2.4	-3.7	-4.0	-6.8	-10.3
EBT	$m	-24.2	3.4	8.1	-8.9	-7.4	-8.6	-6.2	6.4
Tax	$m	0.0	-0.1	-2.0	0.0	0.0	0.0	0.0	0.0
Other	$m	-5.2	1.6	16.5	-8.2	-0.2	-0.2	-0.7	-0.7
Net income	$m	**-29.4**	**4.9**	**22.7**	**-17.1**	**-7.6**	**-8.7**	**-6.9**	**5.8**
EPS (basic)	Cents	-2.0	0.2	0.3	-0.5	-0.5	-0.4	-0.3	0.3
Balance Sheet		**2020A**	**2021A**	**2022A**	**2023A**	**2024E**	**2025E**	**2026E**	**2027E**
Cash	$m	5.8	4.0	4.8	3.8	4.5	1.5	2.8	1.8
Debt	$m	31.8	27.6	37.3	41.4	41.3	66.2	122.4	122.4
Net debt/(cash) BV	$m	26.1	23.6	32.6	37.7	36.8	64.7	119.6	120.6
Cash Flow		**2020A**	**2021A**	**2022A**	**2023A**	**2024E**	**2025E**	**2026E**	**2027E**
Cash flow from Operations	$m	-2.4	-2.1	-4.8	-1.9	-4.7	-3.9	2.1	21.6
Cash used in Investing	$m	-1.7	-1.6	-7.7	-3.7	9.5	-19.9	-50.2	-12.2
Cash used in Financing	$m	4.1	1.5	12.9	4.8	-4.1	20.9	49.3	-10.4
Change in cash	$m	0.1	-2.3	0.4	-0.8	0.7	-2.9	1.3	-1.0
FCF	$m	-4.0	-4.1	-7.2	-4.7	-10.3	-23.9	-48.1	9.3
DACF	$m	-4.0	-3.3	-5.4	-2.4	-5.3	-8.0	-4.7	11.2
Production (WI)									
Oil production	kbopd	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.03
Gas production	mmscfd	0.0	0.0	0.0	0.0	0.0	2.2	5.7	14.1
Total production	kboepd	0.00	0.00	0.00	0.00	0.00	0.38	1.00	2.47
Production growth	%	0%	0%	0%	0%	0%	0%	162%	148%
2P reserves	mboe	0.0	0.0	0.0					
2C resources	mboe	48.8	48.8	48.8					
Valuation									
Share price	(p)	1.43	2.15	0.88	0.72	0.95	0.95	0.95	0.95
Market cap	$m	25.9	47.4	19.5	17.5	23.5	23.5	23.5	23.5
EV	$m	51.9	71.0	52.1	55.1	60.4	88.2	143.1	144.1
P/E	(x)	-0.9	13.4	3.1	-1.9	-2.6	-2.7	-3.4	4.1
EV/DACF	(x)	-13.0	-21.2	-9.7	-22.9	-11.4	-11.1	-30.5	12.9
EV/2P	($/boe)	nm	nm	nm	nm	nm	nm	nm	nm
EV/2P+2C	($/boe)	1.1	1.5	1.1	nm	nm	nm	nm	nm
EV/boe/d	$/boe/d	nm	nm	nm	nm	nm	232.1	143.5	58.4
Div yield	(%)	0%	0%	0%	0%	0%	0%	8%	17%
FCF yield	(%)	-15%	-9%	-37%	-27%	-44%	-101%	-204%	40%
Net debt/EBITDA	(x)	-1.6	6.7	10.3	-12.9	-9.8	-18.3	36.3	5.1
Net debt/Equity	(%)	14%	11%	15%	18%	18%	34%	64%	63%
Net debt/EBITDAX	(x)	-3.5	23.2	11.3	-5.8	-9.8	-18.3	36.3	5.1
EBITDAX/interest	(x)	-1.8	0.3	1.6	-2.7	-1.0	-0.9	0.5	2.3
Interest cover	(x)	-3.9	1.1	1.8	-1.2	-1.0	-1.1	0.1	1.6
ROACE	(%)	-8%	2%	1%	-1%	-2%	-2%	0%	5%
EV/EBITDAX	(x)	-7.0	69.9	18.1	-8.5	-16.1	-25.0	43.4	6.1

Source: SP Angel estimates

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