Non-Independent Research
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Energy Update Note

Sound Energy plc*

SOU LN **BUY**

TP 4.6p

4 October 2023

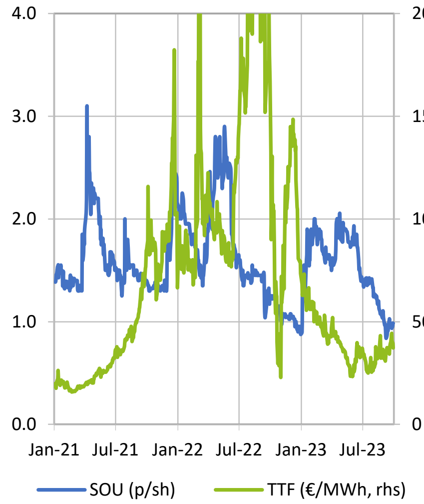
Stock Data

Ticker	SOU LN
Share Price:	0.94p
Market Cap:	£18m

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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Completing partner talks will unwind discount

Sound Energy is entering a critical phase of corporate activity as it looks to complete the funding for Phase 2 of the Tendrara development project (75% WI) in Morocco. We also expect the Company to issue further operational updates in 4Q23 on the ongoing execution of the Phase 1 micro-LNG project, with first gas due in 1H24.

We update our financial forecasts and NAV for recent corporate updates and reiterate our BUY rating and 4.6p/share target price.

Phase 1 progressing towards first gas next year

In 2Q23 Sound completed the civil works at the Tendrara site to provide the base for the micro-LNG facility. Fabrication has completed on the mLNG storage tank in Spain and the liquefaction unit in the US and both are anticipated to be delivered to site in late 2023 / early 2024, where the facility will be constructed by the contractor Italfluid. The Company's drilling contractor will also commence the workovers of the TE-6 and TE-7 wells in preparation for turning these gas wells into long term gas producers in 4Q23. We expect the start-up of Phase 1 gas production in late 1H24, which should generate $2.5m of monthly field revenues (75% WI) from the offtaker, Afriquia Gaz.

Funding partner expected to be in place by year-end

Sound is currently in a period of due diligence with Calvalley Petroleum (private) for a partial divestment of a 40% stake in the Tendrara and Grand Tendrara licences (75% WI). Sound believes the deal will provide the required equity financing to achieve first gas under its larger Phase 2 development plan and also fund the costs of drilling an appraisal well on the TE-4 Horst. In our view, attracting a highly regarded industry partner is essential to offset risk, mitigate costs and receive independent validation on the prospectivity and commerciality of the resource base. Completion of the deal would also represent a significant valuation milestone for the Company's portfolio.

Phase 2 debt & equity financing package nearing completion

Morocco's Attijariwafa Bank has made a conditioned offer to provide 2.365bn Dirhams (c.$235m) of project finance for the Phase 2 pipeline gas development, subject to certain conditions being met such as Governmental approvals, gas sales agreement amendments, further engineering and contractor contracts being in place. The bridge facility and receipt of receivables in 3Q23 has fully funded Sound until around YE23, when the combined closing of the transactions with Calvalley and Attijariwafa Bank will allow the Company to take the Final Investment Decision (FID) on the pipeline-based Phase 2 development on the Tendrara licence and restart exploration drilling.

Delivery is key to unlocking valuation upside

Despite the delivery of key objectives over the last 12M, the wider market remains sceptical of the Company's liquidity and management's ability to close out on the financing package that it has proposed. We expect cash inflows from completing the Calvalley deal will address any concerns over Sound's finances, whilst also minimising dilution to existing shareholders compared to the market's apparent default expectation for a discounted equity raise. We update our financial forecasts for 1H23 results and reiterate our BUY rating and 12M target price of 4.6p/share, which is based solely on the Core NAV assets plus the TE-4 Horst appraisal well. This provides investors with over 350% 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 over $40m in annual EBITDA net to the Company's 35% WI following the start-up of Phase 2 in 2H25.

VALUATION

Valuation Methodology

We have incorporated the following assumptions into our financial model:

Metric	Assumption
Potential shares in issue (diluted)	2,198.8
LT exchange $/£	1.25
LT exchange £/€	1.10
LT Brent oil price	US$90/bbl
bcf/mboe	5.8
LT uncontracted Moroccan Gas Price	US$9/mmbtu
NPV/boe Discount Rate	10%
Net Working Interest	35%
Promote funding factor (additional risking applied to CoS)	66.67%
Royalties - Gas	5%

Source: SP Angel estimates

We update our financial forecasts for the 1H23 results and continue to use a $90/bbl long-term flat Brent oil price for 2024 onwards and a $1.25:£1.00 FX rate, discounted to 1 January 2023. 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	35.0%	3.2	4.3	0.5	90%	2.9	12.7	10.1	0.5
Phase 2a (contracted)	Morocco	128.0	pre-FID	35.0%	7.7	7.7	2.2	85%	6.6	50.7	40.5	1.8
Phase 2b (uncontracted)	Morocco	195.3	pre-FID	35.0%	11.8	8.4	3.6	80%	9.4	78.9	63.1	2.9
Core assets		**377.0**			**22.8**	6.3	**6.3**		**18.9**	**142.2**	**113.8**	**5.2**
Net debt @ YE22							-1.2			-32.6	-26.0	-1.2
G&A (2Yr)							-0.2			-5.9	-4.8	-0.2
2023 adj (Options, etc.)							0.6			17.0	13.6	0.6
Moroccan tax settlement							0.1			-1.6	-1.3	-0.1
Core NAV		**377.0**			**22.8**		**5.6**		**18.9**	**119.0**	**95.2**	**4.3**
TE-4 Horst Appraisal	Morocco	130	E	35.0%	7.8	3.0	0.9	36%	2.8	8.5	6.8	0.3
SBK-1 Appraisal	Morocco	65	E*	75.0%	8.4	3.0	0.9	33%	2.8	8.4	6.8	0.3
M5 Exploration	Morocco	400	E*	75.0%	51.7	2.2	4.1	14%	7.2	16.0	12.8	0.6
Greater Tendrara Upside	Morocco	2,267	E	35.0%	136.8	3.0	15.0	18%	24.1	72.6	58.1	2.6
Anoual Upside	Morocco	3,795	E*	75.0%	490.7	1.5	25.9	10%	49.1	71.2	56.9	2.6
Sidi Mokhtar Upside	Morocco	4,453	E*	75.0%	575.8	2.1	44.7	16%	90.4	192.9	154.3	7.0
Speculative NAV		**11,109**			**1,271**		**91.5**		**176.4**	**369.6**	**295.6**	**13.4**
Total Risked NAV		**11,486**					**97.1**		**195.3**	**488.6**	**390.9**	**17.8**

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

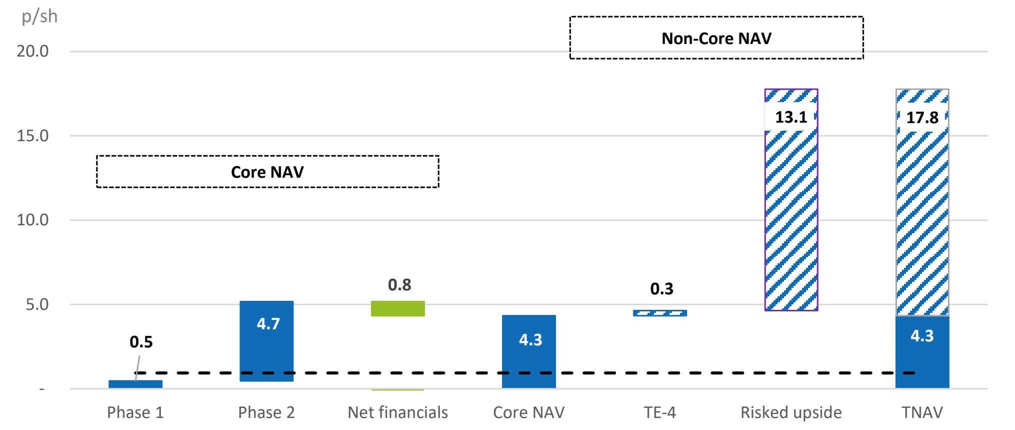
We think that it is useful for investors to think of Sound's asset base in terms of what can already be considered commercial (e.g. contracted gas under development) and what still has to be de-risked by further approvals or drilling (Greater Tendrara exploration prospectivity). This gives us greater 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 and 4.6p/share TP

We base our 4.6p/sh Price Target solely on Sound's Core NAV and the fully funded TE-4 Horst appraisal well

Based on the proposed term of the deal, we calculate Sound's 35% equity interest in the flagship Tendrara development assets produces a risked Core NAV of 4.3p/share, with an additional 0.3p/sh of risked valuation for the TE-4 Horst appraisal well (£102m mkt cap.). This implies potential upside of ~350% if the Company is able to complete on the deal and unwind the market discount on the Tendrara development over the next 12 months. As part of the proposed deal with Calvalley, investors can also look forward to a fully funded appraisal well on the TE-4 structure, which could potentially add up to ~1p/sh to our Core NAV on success.

Waterfall Chart for Sound Energy



Source: SP Angel estimates

Sensitivities

A $1/mcf move in uncontracted gas prices boosts EBITDA by $1.8m 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 high 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 $1.8m 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 (2026e), $m	FCF (2027e), $m
$8.0/mcf	4.1p/sh	$41.1m	$32.3m
$9.0/mcf	**4.3p/sh**	**$42.9m**	**$34.0m**
$10.0/mcf	4.6p/sh	$44.7m	$35.2m
$15.0/mcf	5.8p/sh	$53.7m	$44.8m

Source: SP Angel estimates

An infrastructure-led exploration strategy has been identified with over 1Tcf of prospective gas-in-place

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 TE-4 appraisal well that would be funded by Calvalley on completion of the deal, 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	2023E	2024E	2025E	2026E	2027E
Avshare price (p)		**1.43**	**2.15**	**0.88**	**0.94**	**0.94**	**0.94**	**0.94**	**0.94**
Basic YE NOSH (m)		**1,326**	**1,629**	**1,849**	**1,930**	**1,930**	**1,930**	**1,930**	**1,930**
YE $/£		**1.37**	**1.35**	**1.21**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**
Market cap (£m)		**19**	**35**	**16**	**18**	**18**	**18**	**18**	**18**
Market cap ($m)		**26**	**47**	**20**	**23**	**23**	**23**	**23**	**23**
EV ($m)		**52**	**71**	**52**	**53**	**81**	**124**	**115**	**92**
Income Statement		**2020A**	**2021A**	**2022A**	**2023E**	**2024E**	**2025E**	**2026E**	**2027E**
Brent	$/bbl	43.4	70.8	99.0	85.0	90.0	90.0	90.0	90.0
Natural gas	$/mcf	3.1	12.0	12.0	15.6	9.0	9.0	9.0	9.0
Revenue	$m	0.0	0.3	0.1	0.0	5.3	23.8	65.5	65.5
Opex	$m	0.0	0.0	0.0	0.0	-2.8	-7.1	-12.0	-12.0
EBITDAX	$m	-7.4	1.0	2.9	-6.1	-1.3	10.8	42.9	42.3
EBITDA	$m	-16.3	3.5	3.1	-11.4	-1.3	10.8	42.9	42.3
DDA	$m	0.0	0.0	0.0	0.0	-1.2	-4.8	-11.8	-11.8
EBIT	$m	-16.3	3.5	3.1	-11.4	-2.5	6.0	31.1	30.5
Exceptionals	$m	-12.6	5.5	7.0	-5.3	0.0	0.0	0.0	0.0
Net finance income	$m	-4.2	-3.2	-1.8	-2.3	-3.5	-6.9	-8.7	-7.6
EBT	$m	-24.2	3.4	8.1	-13.7	-6.0	-0.8	22.4	22.9
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	-7.3	-0.2	-0.2	-0.7	-0.7
Net income	$m	**-29.4**	**4.9**	**22.7**	**-21.0**	**-6.2**	**-1.0**	**21.8**	**22.2**
EPS (basic)	Cents	-2.0	0.2	0.3	-1.3	-0.3	-0.1	1.1	1.2
Balance Sheet		**2020A**	**2021A**	**2022A**	**2023E**	**2024E**	**2025E**	**2026E**	**2027E**
Cash	$m	5.8	4.0	4.8	7.1	10.3	4.6	1.8	12.0
Debt	$m	31.8	27.6	37.3	37.1	68.6	106.4	93.9	81.4
Net debt/(cash) BV	$m	26.1	23.6	32.6	30.0	58.3	101.7	92.0	69.4
Cash Flow		**2020A**	**2021A**	**2022A**	**2023E**	**2024E**	**2025E**	**2026E**	**2027E**
Cash flow from Operations	$m	-2.4	-2.1	-4.8	-0.7	-1.6	9.8	40.7	42.3
Cash used in Investing	$m	-1.7	-1.6	-7.7	1.7	-22.9	-46.2	-22.2	-8.1
Cash used in Financing	$m	4.1	1.5	12.9	1.3	27.6	30.8	-21.3	-24.1
Change in cash	$m	0.1	-2.3	0.4	2.2	3.1	-5.7	-2.8	10.1
FCF	$m	-4.0	-4.1	-7.2	0.7	-34.7	-36.6	18.4	34.0
DACF	$m	-4.0	-3.3	-5.4	-1.3	-2.1	2.8	31.9	34.6
Production (WI)									
Oil production	kbopd	0.00	0.00	0.00	0.00	0.00	0.01	0.05	0.05
Gas production	mmscfd	0.0	0.0	0.0	0.0	2.6	10.0	24.7	24.7
Total production	kboepd	0.00	0.00	0.00	0.00	0.44	1.75	4.32	4.32
Production growth	%	0%	0%	0%	0%	0%	294%	148%	0%
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	0.94	0.94	0.94	0.94	0.94
Market cap	$m	25.9	47.4	19.5	22.7	22.7	22.7	22.7	22.7
EV	$m	51.9	71.0	52.1	52.7	81.0	124.4	114.7	92.1
P/E	(x)	-0.9	13.4	3.1	-0.9	-3.7	-23.1	1.0	1.0
EV/DACF	(x)	-13.0	-21.2	-9.7	-40.4	-37.8	45.2	3.6	2.7
EV/2P	($/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	182.5	71.3	26.5	21.3
Div yield	(%)	0%	0%	0%	0%	0%	0%	9%	17%
FCF yield	(%)	-15%	-9%	-37%	3%	-153%	-161%	81%	150%
Net debt/EBITDA	(x)	-1.6	6.7	10.3	-2.6	-46.1	9.4	2.1	1.6
Net debt/Equity	(%)	14%	11%	15%	15%	29%	51%	42%	29%
Net debt/EBITDAX	(x)	-3.5	23.2	11.3	-4.9	-46.1	9.4	2.1	1.6
EBITDAX/interest	(x)	-1.8	0.3	1.6	-2.7	-0.4	1.6	4.9	5.6
Interest cover	(x)	-3.9	1.1	1.8	-4.9	-0.7	0.9	3.6	4.0
ROACE	(%)	-8%	2%	1%	-5%	-1%	2%	10%	9%
EV/EBITDAX	(x)	-7.0	69.9	18.1	-8.6	-64.0	11.5	2.7	2.2

Source: SP Angel estimates

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Expected performance over 12 months: Buy - Expected return of greater than +15%, Hold - Expected return from -15% to +15%, Sell - Expected return

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