

15 June 2023

Stock Data

Ticker	SOU LN
Share Price:	1.80p
Market Cap:	£33m

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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Funding secured and likely partner revealed

Sound Energy has announced bridge financing of up to £4m through the issue of convertible bonds, which has secured its near term funding needs until YE23. The Company has also entered into a 45-day period of exclusivity with Calvalley Petroleum for the partial divestment of a 40% equity interest in both the Tendirra development project and the Grand Tendirra exploration permit (75% WI) in Morocco.

We update our financial forecasts and NAV for the terms of the proposed deal and reiterate our BUY rating with a revised 4.6p/share target price.

Near term funding secured via convertible bonds

Sound announced a financing of up to £4m by way of a senior unsecured convertible bond that provides the Company with additional near-term liquidity. The first £2.5m tranche of the 5-Yr convertible 15% notes have a fixed conversion price of 2.25p/sh (28% premium to close), and together with the second £1.5m tranche is expected to fully fund the Company's operations until YE23. In our view, this should remove some of the funding overhang on the shares following management's prior announcement that it only had sufficient working capital to last until July 2023. The facility provides Sound with sufficient cash resources to execute its Phase 1 micro-LNG development and to progress the higher impact Phase 2 pipeline gas project, while minimising dilution to existing shareholders compared to a discounted equity raise.

Proposed deal would provide the equity component for Phase 2

Sound has also entered into a 45-day period of exclusivity with Calvalley Petroleum (private) for a partial divestment of a 40% stake in the Tendirra and Grand Tendirra licences (75% WI). Under the terms of the transaction, Calvalley would pay \$8m in historic costs on the Phase 1 capex, contribute the first \$48m of the JV's Phase 2 equity portion of development costs, and assume the first \$7m of exploration costs in the Grand Tendirra Exploration Permit. In effect, Sound believes the deal would provide the required equity financing to achieve first gas under its Phase 2 development plan and also fund the costs of drilling an appraisal well on the TE-4 Horst.

Greater visibility on getting the debt & equity financing package in place

Calvalley, which already operates 6.2kb/d of gross production (3.1kb/d net) in onshore Yemen, was previously listed on the Toronto Stock Exchange and taken private in 2016 backed by a consortium of deep-pocketed regional investors. 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. We await further updates from Sound on the completion of the senior debt term sheet with the Moroccan Attijariwafa Bank that will provide project finance of 2.25bn Dirhams (c.\$220m), and on the exclusive farm-out process with Calvalley for the Tendirra development project and adjacent exploration acreage.

Reiterate BUY rating and revised 4.6p/share TP

The deal offers Sound's stakeholders the chance to fully realise the potential of the Tendirra asset that was first identified by the TE-6 well in 2016, with Calvalley providing the equity (plus standby) financing needed for a full field development. We model the implied equity dilution to our financial models and NAV and reiterate our BUY rating with a new 12-month target price of 4.6p/share, which is based solely on the Core NAV assets plus the TE-4 Horst appraisal well. This implies a ~£100m valuation for Sound, with gas sales expected to generate a run-rate of ~\$40m annual EBITDA net to the Company following the start-up of Phase 2 production 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 mark-to-market our assumptions 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 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.

We set our Target Price on a DCF-based valuation of Sound's Core assets

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)							-0.3			-7.5	-6.0	-0.3
2023 adj (Options, etc.)							0.7			18.2	14.6	0.7
Moroccan tax settlement							0.1			-1.6	-1.3	-0.1
Core NAV		377.0			22.8		5.6		18.9	118.7	94.9	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	488.2	390.6	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 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.

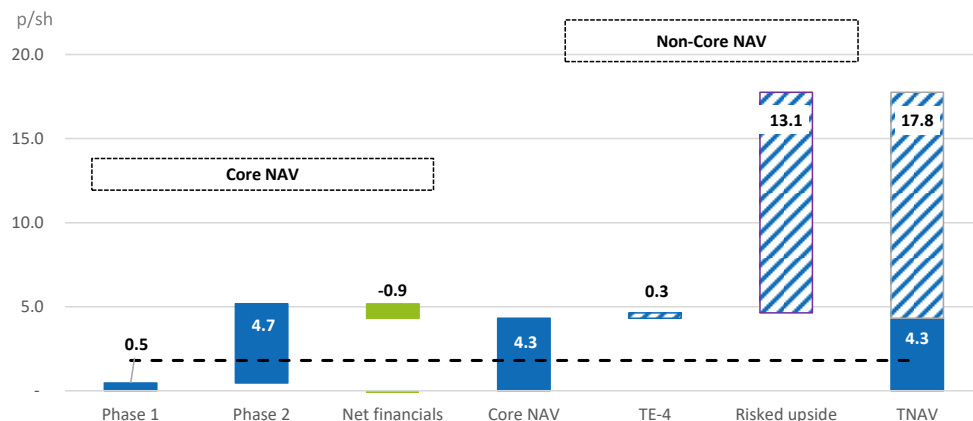
We allow flexibility to 'upgrade' the CoS factor on positive news flow and commercial milestones

Reiterate BUY rating, setting a revised 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 (£101m mkt cap.). This implies potential upside of ~150% 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	\$35.8m
\$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	1.80	1.80	1.80	1.80	1.80
Basic YE NOSH (m)		1,326	1,629	1,849	1,860	1,860	1,860	1,860	1,860
YE \$/£		1.37	1.35	1.21	1.25	1.25	1.25	1.25	1.25
Market cap (£m)		19	35	16	33	33	33	33	33
Market cap (\$m)		26	47	20	42	42	42	42	42
EV (\$m)		52	71	52	80	121	167	161	142
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	-4.0	-2.3	10.8	42.9	42.3
EBITDA	\$m	-16.3	3.5	3.1	-4.0	-2.3	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	-4.0	-3.5	6.0	31.1	30.5
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	-3.4	-4.9	-9.0	-11.5	-10.7
EBT	\$m	-24.2	3.4	8.1	-7.4	-8.4	-2.9	19.7	19.8
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	-0.2	-0.2	-0.2	-0.7	-0.7
Net income	\$m	-29.4	4.9	22.7	-7.6	-8.6	-3.1	19.0	19.2
EPS (basic)	Cents	-2.0	0.2	0.3	-0.4	-0.5	-0.2	1.0	1.0
Balance Sheet		2020A	2021A	2022A	2023E	2024E	2025E	2026E	2027E
Cash	\$m	5.8	4.0	4.8	10.2	8.9	9.8	9.4	16.5
Debt	\$m	31.8	27.6	37.3	48.7	88.0	135.2	129.0	116.5
Net debt/(cash) BV	\$m	26.1	23.6	32.6	38.5	79.0	125.4	119.6	99.9
Cash Flow		2020A	2021A	2022A	2023E	2024E	2025E	2026E	2027E
Cash flow from Operations	\$m	-2.4	-2.1	-4.8	-4.0	-2.4	9.0	39.5	42.3
Cash used in Investing	\$m	-1.7	-1.6	-7.7	1.8	-33.1	-46.4	-22.2	-8.2
Cash used in Financing	\$m	4.1	1.5	12.9	7.5	34.3	38.3	-17.7	-26.9
Change in cash	\$m	0.1	-2.3	0.4	5.4	-1.3	0.9	-0.4	7.2
FCF	\$m	-4.0	-4.1	-7.2	-2.5	-35.6	-37.4	17.3	34.0
DACF	\$m	-4.0	-3.3	-5.4	-7.4	-7.4	0.0	28.0	31.6
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	1.80	1.80	1.80	1.80	1.80
Market cap	\$m	25.9	47.4	19.5	41.9	41.9	41.9	41.9	41.9
EV	\$m	51.9	71.0	52.1	80.3	120.9	167.3	161.4	141.8
P/E	(x)	-0.9	13.4	3.1	-5.5	-4.9	-13.5	2.2	2.2
EV/DACF	(x)	-13.0	-21.2	-9.7	-10.8	-16.3	45723.3	5.8	4.5
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	272.6	95.8	37.4	32.8
Div yield	(%)	0%	0%	0%	0%	0%	0%	4%	9%
FCF yield	(%)	-15%	-9%	-37%	-6%	-85%	-89%	41%	81%
Net debt/EBITDA	(x)	-1.6	6.7	10.3	-9.7	-34.7	11.6	2.8	2.4
Net debt/Equity	(%)	14%	11%	15%	18%	38%	62%	54%	42%
Net debt/EBITDAX	(x)	-3.5	23.2	11.3	-9.7	-34.7	11.6	2.8	2.4
EBITDAX/interest	(x)	-1.8	0.3	1.6	-1.2	-0.5	1.2	3.7	4.0
Interest cover	(x)	-3.9	1.1	1.8	-1.2	-0.7	0.7	2.7	2.9
ROACE	(%)	-8%	2%	1%	-2%	-1%	2%	9%	9%
EV/EBITDAX	(x)	-7.0	69.9	18.1	-20.2	-53.1	15.5	3.8	3.4

Source: SP Angel estimates

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