

# Energy Update Note

## Sound Energy plc\*

SOU LN

BUY

TP 7.3p

25 May 2023

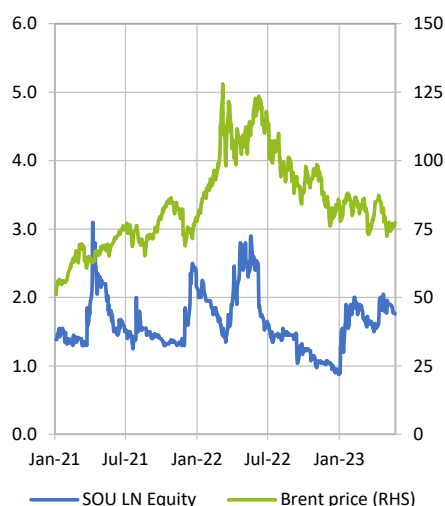
### Stock Data

|              |        |
|--------------|--------|
| Ticker       | SOU LN |
| Share Price: | 1.76p  |
| 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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## Tax dispute settled, project moving forward

Sound Energy is now within 12 months of first gas and revenues from the micro-LNG Phase 1 development of the Tendrara project (75% WI), with the larger pipeline-led Phase 2 development expected to FID in 2H23. The recent tax settlement with the Moroccan tax authorities has also removed an unhelpful overhang on the stock.

We update our financial forecasts and NAV for recent corporate updates and reiterate our BUY rating and 7.3p/share target price.

### Phase 1 micro-LNG development on schedule to commence gas sales in 1H24

Italfiuid is constructing the central processing and storage facilities to deliver mobile LNG to Afriquia Gaz, which has provided an \$18m loan note to fund the project to first gas. The main civil work to prepare the foundations for the micro-LNG facility at Tendrara is complete and work can now move on to erect the main storage tank. In parallel, Sound is negotiating with the rig contractor and the EPCM contractor on completion of the T6 & T7 wells and flowlines, with all parties working towards a delivery date of 1Q24. The structural changes in gas pricing means the phase 1 gas realisation should be at the top of its ceiling price and we expect first sales production in 2Q24 to generate a run-rate of ~\$10m EBITDA per annum net to the Company.

### Agreement with tax authorities clears the way for Phase 2 development

Sound has entered into an agreement on a phased c.\$2.5m payment schedule, back-ended over six years, as a full and final settlement with the Moroccan tax authorities. This agreement removes a significant risk for investors and clears the path to engage more positively with potential financiers, vendors and partners for the larger Phase 2 development, without the overhang of an impending tax bill or any ongoing dispute with the authorities. The agreement also endorses the wider in-country support within the Energy Ministry and Rabat for the Company and its vital gas developments.

### Project financing senior debt term sheet nearing completion

The real upside for investors is the Phase 2 pipeline project, which plans to tie-back the field to a nearby pipeline and supply existing CCGT power plants left to stand idle by Algeria's decision to halt gas exports. Sound has already signed a binding ten-year gas sales agreement with the state-owned power company (ONEE) to supply 120bcf of gas to the international GME pipeline via a 120km tie-in pipeline. The Moroccan Attijariwafa Bank is shortly expected to provide Sound with a conditioned term sheet to arrange a long-term project senior debt facility of 2.25bn Dirhams (c.\$220m), which the Company can then discuss with its EPC contractors to satisfy conditions precedent.

### Partner process essential to getting debt & equity financing package in place

Sound is in active negotiations with parties to identify a partner to fund its net 75% equity share of the Phase 2 development costs and to join an exploration and appraisal drilling programme on the surrounding permits. Management is looking to optimise the structure in terms of vendor financing vs an equity partner, but we think the latter would be more constructive in terms of sharing risk, mitigating costs and receiving industry validation on the prospectivity and commerciality of the resource base. We currently value Sound's 75% equity interest in Phase 2 at \$194m and expect first gas sales in 2H25 to generate a run-rate of ~\$60m EBITDA per annum net to the Company.

### Reiterate BUY rating and 7.3p/share TP

We have updated our financial models and NAV and reiterate our BUY rating with a 12-month target price of 7.3p/share, which is based solely on the Core NAV assets.

## VALUATION

### Valuation Methodology

We have incorporated the following assumptions into our financial model:

| Metric   | Assumption  |
|--|-------------|
| Potential shares in issue (diluted)                        | 2,002.6     |
| 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%         |
| Current Working Interest                                   | 75%         |
| 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       | 75.0%  | 6.9                 | 4.3        | 1.2                  | 90%         | 6.2                         | 27.2                   | 21.7                  | 1.1                    |
| Phase 2a (contracted)    | Morocco | 128.0          | pre-FID | 75.0%  | 16.6                | 5.5        | 3.6                  | 80%         | 13.2                        | 72.2                   | 57.8                  | 2.9                    |
| Phase 2b (uncontracted)  | Morocco | 195.3          | pre-FID | 75.0%  | 25.3                | 6.4        | 6.5                  | 75%         | 18.9                        | 121.3                  | 97.0                  | 4.8                    |
| <b>Core assets</b>       |         | <b>377.0</b>   |         |        | <b>48.8</b>         | <b>4.5</b> | <b>11.3</b>          |             | <b>38.4</b>                 | <b>220.7</b>           | <b>176.6</b>          | <b>8.8</b>             |
| Net debt @ YE22          |         |                |         |        |                     |            | -1.3                 |             |                             | -32.6                  | -26.0                 | -1.3                   |
| G&A (2Yr)                |         |                |         |        |                     |            | -0.3                 |             |                             | -7.5                   | -6.0                  | -0.3                   |
| 2023 adj (Options, etc.) |         |                |         |        |                     |            | 0.2                  |             |                             | 5.0                    | 4.0                   | 0.2                    |
| Moroccan tax settlement  |         |                |         |        |                     |            | 0.1                  |             |                             | -1.6                   | -1.3                  | -0.1                   |
| <b>Core NAV</b>          |         | <b>377.0</b>   |         |        | <b>48.8</b>         |            | <b>10.0</b>          |             | <b>38.4</b>                 | <b>184.0</b>           | <b>147.2</b>          | <b>7.3</b>             |
| TE-4 Horst Appraisal     | Morocco | 130            | E*      | 75.0%  | 16.8                | 3.0        | 2.0                  | 24%         | 4.0                         | 12.2                   | 9.7                   | 0.5                    |
| SBK-1 Appraisal          | Morocco | 65             | E*      | 75.0%  | 8.4                 | 3.0        | 1.0                  | 33%         | 2.8                         | 8.4                    | 6.8                   | 0.3                    |
| M5 Exploration           | Morocco | 400            | E*      | 75.0%  | 51.7                | 2.2        | 4.6                  | 14%         | 7.2                         | 16.0                   | 12.8                  | 0.6                    |
| Greater Tendrara Upside  | Morocco | 2,267          | E*      | 75.0%  | 293.1               | 3.0        | 35.3                 | 12%         | 34.4                        | 103.7                  | 82.9                  | 4.1                    |
| Anoual Upside            | Morocco | 3,795          | E*      | 75.0%  | 490.7               | 1.5        | 28.4                 | 10%         | 49.1                        | 71.2                   | 56.9                  | 2.8                    |
| Sidi Mokhtar Upside      | Morocco | 4,453          | E*      | 75.0%  | 575.8               | 2.1        | 49.1                 | 16%         | 90.4                        | 192.9                  | 154.3                 | 7.7                    |
| <b>Speculative NAV</b>   |         | <b>11,109</b>  |         |        | <b>1,436</b>        |            | <b>120.4</b>         |             | <b>187.9</b>                | <b>404.3</b>           | <b>323.4</b>          | <b>16.2</b>            |
| <b>Total Risked NAV</b>  |         | <b>11,486</b>  |         |        |                     |            | <b>130.4</b>         |             | <b>226.4</b>                | <b>588.3</b>           | <b>470.6</b>          | <b>23.5</b>            |

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

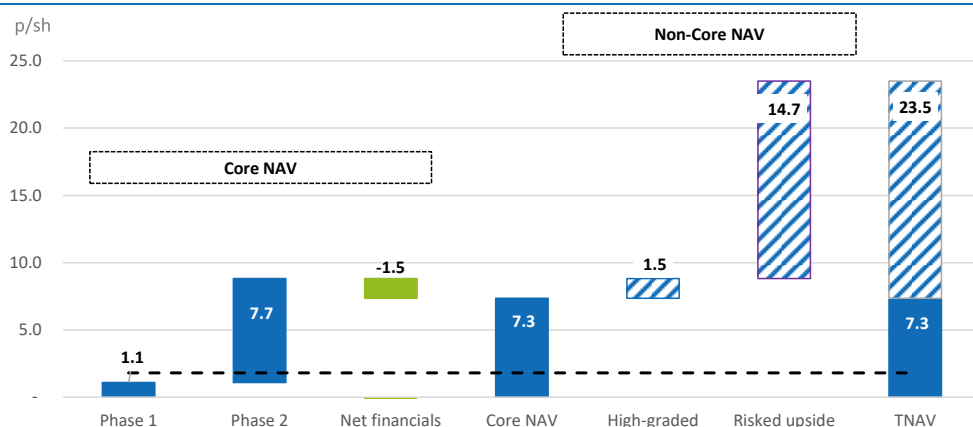
We think that it is useful for investors to think of Sound's asset base in terms of what can already be considered commercial (e.g. contracted gas under development) and what still has to be de-risked by further approvals or drilling (Greater Tendrara exploration prospectivity). This gives us greater 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, setting a revised 7.3p/share TP

We base our 7.3p/sh Price Target solely on Sound's Core NAV

Our updated valuation of Sound's Core assets produces a Target Price of 7.3p/share (£147m mkt cap.), implying potential upside of ~300% to our Core NAV if the Company is able to unwind the market discount on the Tendrara development over the next 12 months. Our Core valuation focuses solely on Sound's phased development of the 283bcf in net 2C contingent resources on the 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



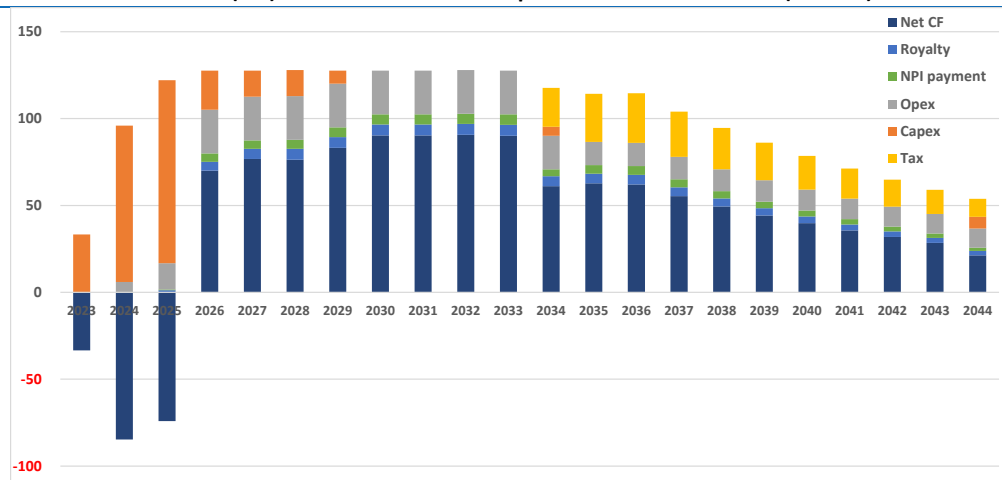
Source: SP Angel estimates

#### Risk-Reward profile

There is an urgent need to substitute domestic gas resources for higher carbon-intensive imported LNG and coal

The capital-intensive nature of large development 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 \$75m in aggregate annual EBITDA with relatively light capex requirements. If this capital is then reinvested into new development wells that exploit the wider resource potential from the surrounding exploration acreage, we think that Sound can adopt a more industrial-type business model to fully develop its portfolio.

#### Cash flow breakdown (\$m) for combined Tendrara phases 1 & 2 net to Sound (75% WI)



Source: SP Angel estimates

We think that a yield-based valuation may be more appropriate once production is ramping up, future stable cash flows have been substantially de-risked and a dividend-paying strategy adopted. Whilst we appreciate that it is too soon to apply yield metrics to Sound at this stage, it is important to recognise the longer-term potential of this significant asset base to investors as the Company's strategy evolves, such that we forecast for cash returns to commence in 2026.

A \$1/mcf move in uncontracted gas prices boosts EBITDA by \$2.5m p.a.

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 \$2.5m boost to annual EBITDA and an 8% increase in our Core NAV.

#### Sound NAV & EBITDA Sensitivity Matrix

| LT uncontracted gas price | Core NAV, p/sh | EBITDA (2025e), \$m | FCF (2027e), \$m |
|---------------------------|----------------|---------------------|------------------|
| \$8.0/mcf                 | 6.9p/sh        | \$26.3m             | \$67.3m          |
| <b>\$9.0/mcf</b>          | <b>7.3p/sh</b> | <b>\$26.3m</b>      | <b>\$70.0m</b>   |
| \$10.0/mcf                | 7.7p/sh        | \$26.3m             | \$72.6m          |
| \$15.0/mcf                | 10.2p/sh       | \$26.3m             | \$85.9m          |

Source: SP Angel estimates

Morocco is a fast-growing emerging economy and demand for domestic gas production stems from existing gas power stations, industrial customers and as a future 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 Tendirra 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. We think that Sound's 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.

Whilst management has strategically prioritised its gas monetisation strategy through the phased development of the TE-5 Horst (Tendirra Production Concession), the Company has also re-evaluated the extensive exploration portfolio within the Greater Tendirra and Anoual exploration permits surrounding the Tendirra Production Concession. Looking past the Tendirra 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 proven and prolific Algerian Triassic & Palaeozoic gas plays into Morocco. We model that Sound should be able to fund further exploration activities through the 'promote' farm-down of up to 1/3 of its 75% equity interest in the licences to an industry partner.

Since 2020, aside from the ongoing development of its existing portfolio, Sound has been assessing a basket of opportunities to build out, diversify and grow the Company both organically and inorganically. These assessments have included potential further gas related opportunities and potential renewable energy projects, including wind and solar power generation, by leveraging the Company's skills, relationships and existing position in Morocco. As with a number of other E&P players in the space, Sound's management has recognised that clean solar energy is a stable investment that can utilise its existing in-country experience to provide attractive investment opportunities and returns.

As at 31 March 2023, Sound reported a £2.6m cash balance, which included c.£2m held as collateral for a bank guarantee against licence commitments. Sound commented that it has scheduled work schedules and managed the corporate cost base such that its remaining cash resources are now expected to be sufficient to meet the Company's present working capital requirements through to July 2023. The Company's forecasts and projections indicate that to fulfil its obligations will require additional funding. Sound continues to exercise rigorous cost control to conserve cash resources, and the Board believes that there are several corporate funding options available, including a farm-down on some of the Company's licences, various debt funding options together with settlement of outstanding Tendirra Production Concession receivable balance of £2.1m from ONHYM. Furthermore, based upon Sound's proven success in raising capital in the London equity market, and on feedback from ongoing financing discussions, the Board has a reasonable expectation that the Company will be able to secure the funding required to continue in operational existence for the foreseeable future.

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

## 5Yr financial projection for Sound Energy plc (shown on a 75% WI basis, subject to expected farm down)

| In US\$ (unless stated)   |          | 2020A        | 2021A      | 2022A       | 2023E       | 2024E        | 2025E       | 2026E       | 2027E       |
|---------------------------|----------|--------------|------------|-------------|-------------|--------------|-------------|-------------|-------------|
| Avshare price (p)         |          | 1.43         | 2.15       | 0.88        | 1.76        | 1.76         | 1.76        | 1.76        | 1.76        |
| Basic YE NOSH (m)         |          | 1,326        | 1,629      | 1,849       | 1,849       | 1,849        | 1,849       | 1,849       | 1,849       |
| 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          | 41          | 41           | 41          | 41          | 41          |
| EV (\$m)                  |          | 52           | 71         | 52          | 115         | 215          | 318         | 299         | 264         |
| <b>Income Statement</b>   |          |              |            |             |             |              |             |             |             |
| 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         | 11.3         | 48.1        | 127.6       | 127.6       |
| Opex                      | \$m      | 0.0          | 0.0        | 0.0         | 0.0         | -5.9         | -15.1       | -25.1       | -25.1       |
| EBITDAX                   | \$m      | -7.4         | 1.0        | 2.9         | -4.0        | 0.6          | 26.3        | 87.3        | 86.2        |
| EBITDA                    | \$m      | -16.3        | 3.5        | 3.1         | -4.0        | 0.6          | 26.3        | 87.3        | 86.2        |
| DDA                       | \$m      | 0.0          | 0.0        | 0.0         | 0.0         | -2.6         | -9.7        | -23.3       | -23.3       |
| EBIT                      | \$m      | -16.3        | 3.5        | 3.1         | -4.0        | -2.0         | 16.6        | 64.0        | 62.9        |
| 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        | -3.6        | -8.8         | -18.6       | -23.9       | -21.9       |
| EBT                       | \$m      | -24.2        | 3.4        | 8.1         | -7.6        | -10.9        | -2.0        | 40.1        | 40.9        |
| 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        | -0.2        | -0.2         | -0.2        | -0.7        | -0.7        |
| <b>Net income</b>         | \$m      | <b>-29.4</b> | <b>4.9</b> | <b>22.7</b> | <b>-7.8</b> | <b>-11.0</b> | <b>-2.2</b> | <b>39.4</b> | <b>40.3</b> |
| EPS (basic)               | Cents    | -2.0         | 0.2        | 0.3         | -0.4        | -0.6         | -0.1        | 2.1         | 2.2         |
| <b>Balance Sheet</b>      |          |              |            |             |             |              |             |             |             |
| Cash                      | \$m      | 5.8          | 4.0        | 4.8         | 3.2         | 6.2          | 9.6         | 10.1        | 6.8         |
| Debt                      | \$m      | 31.8         | 27.6       | 37.3        | 78.0        | 180.8        | 286.8       | 268.0       | 230.5       |
| Net debt/(cash) BV        | \$m      | 26.1         | 23.6       | 32.6        | 74.8        | 174.6        | 277.1       | 257.9       | 223.7       |
| <b>Cash Flow</b>          |          |              |            |             |             |              |             |             |             |
| Cash flow from Operations | \$m      | -2.4         | -2.1       | -4.8        | -4.0        | 0.3          | 22.7        | 80.8        | 86.2        |
| Cash used in Investing    | \$m      | -1.7         | -1.6       | -7.7        | -34.3       | -91.2        | -106.6      | -23.7       | -16.2       |
| Cash used in Financing    | \$m      | 4.1          | 1.5        | 12.9        | 36.6        | 94.1         | 87.4        | -56.6       | -73.3       |
| Change in cash            | \$m      | 0.1          | -2.3       | 0.4         | -1.7        | 3.1          | 3.4         | 0.5         | -3.3        |
| FCF                       | \$m      | -4.0         | -4.1       | -7.2        | -38.6       | -91.0        | -84.0       | 57.1        | 70.0        |
| DACF                      | \$m      | -4.0         | -3.3       | -5.4        | -7.6        | -8.6         | 4.1         | 56.8        | 64.2        |
| <b>Production (WI)</b>    |          |              |            |             |             |              |             |             |             |
| Oil production            | kbopd    | 0.00         | 0.00       | 0.00        | 0.00        | 0.00         | 0.03        | 0.11        | 0.11        |
| Gas production            | mmscfd   | 0.0          | 0.0        | 0.0         | 0.0         | 5.5          | 20.5        | 48.8        | 48.8        |
| Total production          | kboepd   | 0.00         | 0.00       | 0.00        | 0.00        | 0.95         | 3.56        | 8.52        | 8.52        |
| Production growth         | %        | 0%           | 0%         | 0%          | 0%          | 0%           | 274%        | 140%        | 0%          |
| 2P reserves               | mboe     | 0.0          | 0.0        | 0.0         |             |              |             |             |             |
| 2C resources              | mboe     | 48.8         | 48.8       | 48.8        |             |              |             |             |             |
| <b>Valuation</b>          |          |              |            |             |             |              |             |             |             |
| Share price               | (p)      | 1.43         | 2.15       | 0.88        | 1.76        | 1.76         | 1.76        | 1.76        | 1.76        |
| Market cap                | \$m      | 25.9         | 47.4       | 19.5        | 40.7        | 40.7         | 40.7        | 40.7        | 40.7        |
| EV                        | \$m      | 51.9         | 71.0       | 52.1        | 115.5       | 215.3        | 317.8       | 298.6       | 264.4       |
| P/E                       | (x)      | -0.9         | 13.4       | 3.1         | -5.2        | -3.7         | -18.8       | 1.0         | 1.0         |
| EV/DACF                   | (x)      | -13.0        | -21.2      | -9.7        | -15.2       | -25.1        | 77.9        | 5.3         | 4.1         |
| 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          | 226.5        | 89.4        | 35.0        | 31.0        |
| Div yield                 | (%)      | 0%           | 0%         | 0%          | 0%          | 0%           | 17%         | 34%         | 34%         |
| FCF yield                 | (%)      | -15%         | -9%        | -37%        | -95%        | -224%        | -206%       | 140%        | 172%        |
| Net debt/EBITDA           | (x)      | -1.6         | 6.7        | 10.3        | -18.8       | 310.3        | 10.5        | 3.0         | 2.6         |
| Net debt/Equity           | (%)      | 14%          | 11%        | 15%         | 35%         | 86%          | 137%        | 113%        | 88%         |
| Net debt/EBITDAX          | (x)      | -3.5         | 23.2       | 11.3        | -18.8       | 310.3        | 10.5        | 3.0         | 2.6         |
| EBITDAX/interest          | (x)      | -1.8         | 0.3        | 1.6         | -1.1        | 0.1          | 1.4         | 3.6         | 3.9         |
| Interest cover            | (x)      | -3.9         | 1.1        | 1.8         | -1.1        | -0.2         | 0.9         | 2.7         | 2.9         |
| ROACE                     | (%)      | -8%          | 2%         | 1%          | -1%         | -1%          | 4%          | 13%         | 13%         |
| EV/EBITDAX                | (x)      | -7.0         | 69.9       | 18.1        | -29.1       | 382.6        | 12.1        | 3.4         | 3.1         |

Source: SP Angel estimates

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