PROGRESSIVE EQUITY RESEARCH

12 April 2019

SDX ENERGY

OIL & GAS

SDX.L

32p

Market Cap: £65.4m

SHARE PRICE (p)

12m high/low	73p/32p

Source: LSE Data

KEY INFORMATION

Enterprise value	£49.1m
Index/market	AIM
Next news	Q1 earnings - Jun 2019
Gearing	N/A
Interest cover	N/A

SDX ENERGY IS A RESEARCH CLIENT OF PROGRESSIVE

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Final Results

SDX Energy released its final results on 22 March. The company reported net income in 2018 of US$0.1 million which was lower than expected due to an exploration expense and an impairment whilst the underlying performance was in line with expectations. After a quiet end to the year, the company is now gearing up to start an exciting exploration programme in both Morocco and Egypt in the second half of 2019 which has the potential of adding significant reserves and resources.

- **Financials**. The company reported net income of US$ 0.1 million which was lower than our forecast of US$7.7 million as the company was impacted by non-cash charges (exploration expense and impairments) of approximately US$9.3 million and transaction costs of US$2.5 million. Operating cash flow was strong, rising to US$36.2 million in 2018 compared to US$21.6 million a year earlier as the company was able to benefit from improved netbacks and a further reduction in Egyptian receivables. The balance sheet remains strong with the company having net cash of US$17.4 million. We are not changing our forecasts for FY 2019E or FY 2020E with guidance being unchanged on the corporate update released in January. We introduce estimates for FY 2021E.
- **Operational performance**. The operational performance was very much as set up in the January corporate update with a quiet second half of the year after the active drilling programmes at the start of the year. The company is now analysing its recently acquired 3D seismic data in Morocco and at South Disouq in Egypt and is looking to restart drilling in the second half of the year. The campaign will target two exploration wells in Egypt and twelve wells in Morocco, three of which will be drilled in 2019, and has the potential of providing a significant increase in reserves and resources. The company has also updated its 2P reserves which are standing at 13.1 mmboe which is a slight decline on a year earlier as the weaker oil price led to ERC Equipoise reducing the economic life of the NW Gemsa concession.
- **Valuation**. Using the industry standard valuation of a discounted cash flow analysis, we derive a RENAV (Risked Exploration Net Asset value) of 115.2 p/share which is unchanged from our previous valuation. Investors should view any valuation in the context of their own assessments of the relevant risks.

FYE DEC ($M)	2017	2018	2019E	2020E	2021E
Revenue	39.2	53.7	68.5	89.8	87.7
Operating profit	3.4	7.8	24.0	41.3	39.2
Net income	28.3	0.0	22.2	38.9	37.0
Fully Adj EPS (c)	15.1	0.0	10.8	19.0	18.1
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0
Net cash flow	21.0	(8.0)	4.0	46.6	49.1
Net (Debt)/Cash	28.9	20.9	24.9	71.4	120.6

Source: Company Information and Progressive Equity Research estimates

Final results

Financials

The company reported net income on US$0.1 million in 2018. This compared to our forecast of US$7.7 million and US$28.3 a year earlier. The main difference compared to our forecast was due to the charges taken. The company had non-cash charges of US$9.3 million for exploration expense and an impairment charge. The exploration expense of US$5.7 million was predominantly due to two sub-commercial wells in Morocco and one in Egypt. The impairment charge of US$3.5 million was on the NW Gemsa licence where the lower oil price led to a reduction in the economic life of the asset. The company also had a transaction charge of US$2.5 million reflecting M & A costs and the proposed re-domicile of the company from Canada to the UK.

The company had very strong netbacks over 2018 of US$41.7 million compared to US$28.9 million in the previous year driven by high production and pricing. Production in 2018 was 3,574 boe/day compared to 3,237 boe/day a year earlier which was mainly driven by the inclusion of the Circle Oil assets for a full year. Currently, production is standing at 3,408 boe/day with increases in its Morocco and Egyptian Mesada concession being offset by a decline in the NW Gemsa concession. Going forward the company will benefit from rising Moroccan production and the start up of the South Disouq fields within Egypt. SDX was able to benefit from stronger pricing. The realised oil price rose to US$62.43/bbl compared to US$46.70/bbl a year earlier while the Moroccan gas prices rose to US$10.33/mcf from US$9.51/mcf.

The balance sheet of the company remains strong. At the end of 2018, SDX had net cash of US$17.4 million. Although this is down US$8.4 million from a year earlier, the company executed a very large capex programme of approximately US$44.0 million with the incremental funding coming from strong operating cash flow and a further recovery of receivables in Egypt. The company has also secured a credit facility from the EBRD (European Bank of Reconstruction & Development) of US$10 million. The cash and credit facility should be more than sufficient to fund the anticipated capex programmes over the next few years.

We are not changing our financial forecasts for FY 2019E and FY 2020E which we lowered after the corporate update in January reflecting lower production guidance for its mature Egyptian assets. This guidance has not been changed with these FY 2018 results. We introduce estimates for FY 2021E.

Operational performance

The group has reported that its reserves, on a 2P basis, were standing at 13.1 mmboe which is a small reduction from the 13.5 mmboe at the end of 2017. Although the company booked significant new gas reserves in Egypt and Morocco, this was more than offset by production and a downward revision in reserves in its NW Gemsa concession in Egypt. In the NW Gemsa concession the decline in the oil price has led to ERC Equipoise reducing SDX's proved and probable reserves by approximately 1.2 mmbbl which was predominantly due to the lower oil price reducing the asset's economic life. Going forward, the exciting drilling programme discussed below has the potential of adding significant reserves and resources.

The company had an active drilling programme in FY 2018 that concluded in the first half of the year. The company has now been acquiring more seismic data which is being analysed by management in advance of an exciting drilling programme which is expected to start in the second half of the current year.

In Egypt, the company is planning two exploration wells in the South Disouq concession (SDX 55% working interest) looking for further gas accumulations similar to recent discoveries. There are additional prospects that will be drilled in future periods and the recently acquired 3D seismic is expected to add to this prospect inventory. Management is currently concentrating on bringing on stream the South Disouq and Ibn Yunus discoveries. Construction of the central processing unit is proceeding and start up is expected in Q3/Q4 2019 with a plateau rate of 50 – 60 mmcf/day. This will provide a significant step change in the group production and cash flow. Elsewhere in Egypt, the company continues to analyse the data from its SRM-3 well in the Ramadan concession (SDX 12.5%) in the Gulf of Suez where 110 feet of net pay was found. The partners are looking to determine if this is a commercial discovery.

In Morocco, SDX completed its nine well programme which resulted in seven discoveries. Since this programme, SDX has acquired additional 3D seismic on its Gharb Centre concession. This has now been interpreted and the company is looking to start an additional 12 well programme in Q3 2019 with the aim of drilling three wells before the end of FY 2019 and the remainder in H1 2020. SDX has also built up its acreage position in this area with the award of the Moulay Bouchta concession which is located adjacent and to the south of its Sebou concession where most of its production is located. On top of this, the company has been re-awarded the Lalla Mimouna Sud exploration concession which was acquired as part of the acquisition of Circle Oil's assets but the licence had expired. Management has been signing additional gas sales contracts with new buyers in order to secure a market for its gas.

Valuation

Using the industry standard valuation of a discounted cash flow analysis, we derive a RENAV (Risked Exploration Net Asset value) of 115.2 p/share which is unchanged on our previous valuation. Investors should view any valuation in the context of their own assessments of the relevant risks.

Financial Summary: SDX Energy

Year end: December (U$m unless shown)

PROFIT & LOSS	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Revenue	39.2	53.7	68.5	89.8	87.7
Operating profit	3.4	7.8	24.0	41.3	39.2
Pre-tax profit	32.8	7.1	24.0	41.3	39.2
Taxation	(4.5)	(7.0)	(1.9)	(2.4)	(2.2)
Net income	28.3	0.0	22.2	38.9	37.0
Reported EPS (c)	15.1	0.0	10.8	19.0	18.1
Fully Adj EPS (c)	15.1	0.0	10.8	19.0	18.1
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0

CASH FLOW & BALANCE SHEET	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Operating cash flow	16.6	28.7	45.3	62.6	60.3
Free Cash flow	21.6	36.2	40.5	56.0	58.5
FCF per share (c)	10.6	17.7	19.8	27.4	28.6
Acquisitions	(28.1)	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	48.5	0.0	0.0	0.0	0.0
Net cash flow	21.0	(8.0)	4.0	46.6	49.1
Overdrafts / borrowings	0.0	0.0	0.0	0.0	0.0
Cash & equivalents	25.8	17.3	24.9	71.4	120.6
Net (Debt)/Cash	28.9	20.9	24.9	71.4	120.6

NAV AND RETURNS	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Net asset value	114.6	116.0	142.4	173.9	212.7
NAV/share (c)	56.0	56.7	69.7	85.0	104.0
Net Tangible Asset Value	114.6	116.0	142.4	173.9	212.7
NTAV/share (c)	56.0	56.7	69.7	85.0	104.0
Average equity	71.3	115.3	129.2	158.2	193.3
Post-tax ROE (%)	39.6%	0.0%	17.1%	24.6%	19.1%

METRICS	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Revenue growth	13.6%	37.1%	27.6%	31.0%	(2.3%)
Operating profit growth	274.1%	129.3%	209.1%	71.9%	(5.1%)
Pre-tax profit growth	(338.5%)	(78.5%)	240.5%	71.9%	(5.1%)
Adj EPS growth	(280.1%)	(99.9%)	59,803.6%	75.5%	(5.0%)
Dividend growth	N/A	N/A	N/A	N/A	N/A

Source: Company information and Progressive Equity Research estimates

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