

SDX Energy

FY19 management guidance reset

Despite our last published FY19 forecasts reflecting a more conservative production ramp-up than management guidance, SDX's guidance revisions have resulted in a further downgrade to our short-term cash flow forecasts and NAV. We reduce FY19e production from 4.3kboed to 3.4kboed (-21%) and project more moderate growth in SDX's Morocco gas demand with an associated RENAV impact of -42%. Key drivers of management's downgrade include lower Sebou gas demand growth, a higher than anticipated water cut at North West Gemsa and a delay to production ramp-up at South Disouq. Our valuation falls from RENAV 86.5p/share to 49.8p/share (-42%), while our core NAV (producing assets and South Disouq) falls from 70.1p/share to 45.0p/share (-36%). Based on our latest estimates, we expect SDX to end FY19 with c \$4.9m of net cash on the balance sheet.

Year end	Revenue (\$m)	PBT* (\$m)	Operating cash flow (\$m)	Net cash (\$m)	Capex (\$m)	Production (kboed)
12/17	39.2	32.8	21.6	25.8	(24.9)**	3.2
12/18	53.7	7.1	36.2	17.3	(44.8)	3.6
12/19e	45.3	8.3	22.3	4.9	(36.1)	3.4
12/20e	51.5	14.0	31.7	17.2	(20.3)	6.7

Note: *PBT is normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Excludes Circle acquisition (\$28.1m).

Pragmatic FY19 guidance

SDX's latest guidance appears to be realistic, with the South Disouq timeline to first gas including an eight-week contingency and Sebou production estimates assuming minimal growth over the course of 2019. Equally, we do not believe guidance is overly conservative given the remaining customer connection/project execution risks. Our forecasts assume South Disouq first gas in January 2020 with a plateau of 50mmscfd reached in Q220 (management guidance first gas in November 2019 and plateau in Q120). At 6.0mmscfd, our Moroccan FY19 production forecast is at the lower end of company guidance at 6.0–6.5mmscfd.

H219 and H120 still an active period for the drill bit

Exploration drilling will focus on Ibn Yunus lookalikes in Egypt, with at least two wells planned for H219. In Morocco, SDX has an 87% appraisal/development well success rate based on calibrated 3D seismic and is looking to leverage this success, targeting c 20bcf of gross unrisked resource in H219/2020. Of the total 12-well programme planned for Morocco, three to four are expected in H219. We include risked exploration/appraisal potential in our valuation.

Valuation: 36% core NAV reduction

Our valuation has been reset to reflect new management guidance for FY19 and moderated production growth expectations. SDX remains fully funded for planned FY19 capital expenditure, and we expect year-end net cash of c \$4.9m. SDX's \$10m credit facility with the EBRD remains undrawn as of end March 2019.

Forecast and valuation
update

Oil & gas

20 June 2019

Price **21p**

Market cap **£43m**

US\$/£0.77

Net cash (\$m) at end March 2019 11.4

Shares in issue 204.7m

Free float 91%

Code SDX

Primary exchange AIM

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (12.2) (46.9) (64.8)

Rel (local) (12.6) (47.3) (63.5)

52-week high/low 61.5p 20.8p

Business description

SDX Energy is a North African E&P listed in London. SDX produces oil and gas in Egypt and gas in Morocco.

Next events

H119 results August 2019

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FY19 company guidance downgrade

Management has reset market guidance for FY19, reflecting asset performance to date, South Disouq project execution and Morocco gas demand growth projections. As a result, our FY19 forecast net production falls from 4.3kboed to 3.4kboed (-21%). In this note, we look at the short-term financial and NAV impact of these movements.

A summary of key changes in management guidance from the start of FY19 and the company's AGM in May 2019 are provided in Exhibit 1 below.

Exhibit 1: Change in company guidance

Gross Production			Capex (net to SDX)		
	Current Guidance	Previous Guidance		Current Guidance	Previous Guidance
NW Gemsa - WI 50%	3,000 - 3,200 boe/d	3,400 - 3,600 boe/d	NW Gemsa - WI 50%	US\$2.0 million	US\$2.0 million
Meseda - WI 50%	4,000 - 4,200 bbl/d	4,000 - 4,200 bbl/d	Meseda - WI 50%	US\$2.7 million	US\$4.0 million
South Disouq - WI 55%	First gas by Q4'19. c.50 MMscf/d plateau by Q1'20	First gas by Q3'19. 50 - 60 MMscf/d plateau by Q4'19	South Disouq - WI 55%	US\$19.5 million	US\$22.0 million
Morocco - WI 75%	6.0 - 6.5 MMscf/d 2019 annual average rate	9 - 11 MMscf/d 2019 exit rate	Morocco - WI 75%	US\$12.0 million	US\$8.0 million

Source: SDX Energy

NW Gemsa (50% working interest) – higher water cut

SDX is targeting FY19 average gross production of 3,000–3,200boed, which is a reduction from previous guidance due to an increased water cut. Pump replacements and workovers have affected producer availability year to date, and SDX expects to provide further guidance on the AASE-5 well recompletion at the end of Q219. We currently assume field abandonment at the end of FY20.

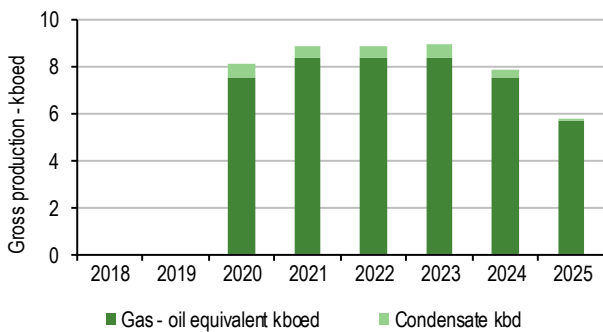
Meseda (50% working interest) – lower capex

SDX's guidance for Meseda remains unchanged, other than a reduction in 2019 capex. Net capex of US\$2.7m includes two planned wells and two water injection wells and US\$1.1m net for ESP replacement/facility upgrades. We see upside to our production forecasts assuming Rabul production rates are in line with competent person report (CPR) forecasts.

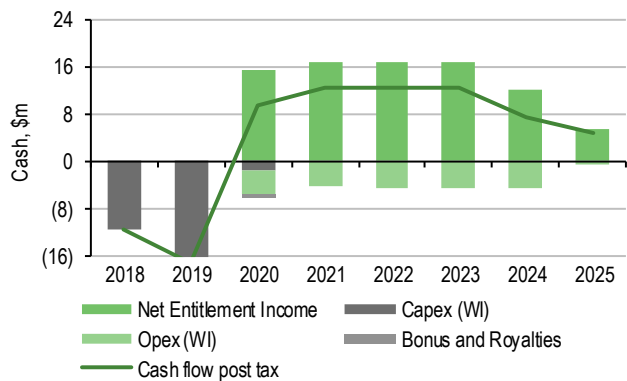
South Disouq (55% working interest) – slower ramp-up

Management expects first gas in Q419 (mid-November 2019), with production expected to ramp up to 50mmscfd by Q120. SDX outlines the key activities ahead of first gas as: 1) factory acceptance testing on completion of central processing facility (CPF) fabrication in Abu Dhabi at the end of June 2019; 2) transportation of the CPF from Abu Dhabi and customs clearance in Egypt, with transportation to site expected in mid-August 2019; and 3) management expects completion of installation and commissioning with first gas by mid-November 2019 (assuming an eight-week overall contingency). Gas prices remain fixed at US\$2.85/mcf, but netbacks are expected to remain high based on unit operational costs of less than US\$0.2/mcf at plateau production.

We assume start-up in January 2020, with production ramping over the course of the year reaching a 50mmscfd plateau.

Exhibit 2: South Disouq gross production


Source: Edison Investment Research

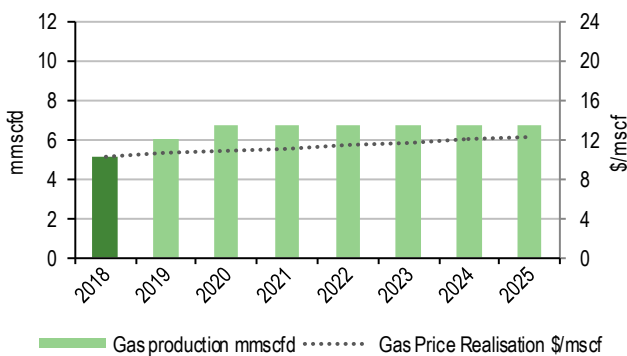
Exhibit 3: South Disouq cash flow forecasts


Source: Edison Investment Research

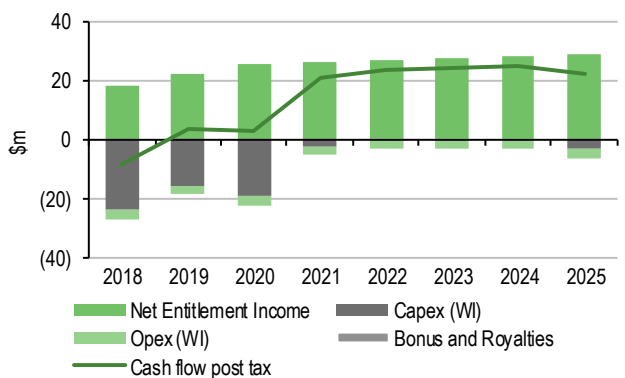
Morocco (75% working interest) – lower demand growth

SDX is now targeting 2019 average annual guidance of 6.0–6.5mmscfd (a change from a guidance exit rate of 9–11mmscfd by end 2019). Company guidance is based on customers under contract, in addition to a reduction in gas offtake by SDX's second largest customer, CMPC, a large pulp and paper company, reallocated a production line from Morocco to Spain and, as a result, reduced gas offtake by 30% in 2019 relative to 2018 levels. There has also been a slowdown in setting up the Atlantic Free Zone (AFZ), which will likely affect future forecasts of gas offtake.

Sebou gross production through to 28 February 2019 is shown in Exhibit 8, demonstrating a recent increase in offtake driven by new customer connections including Omnium Plastic and Citic Dicastal. GPC and Extralait have also increased gas demand since the end of 2018.

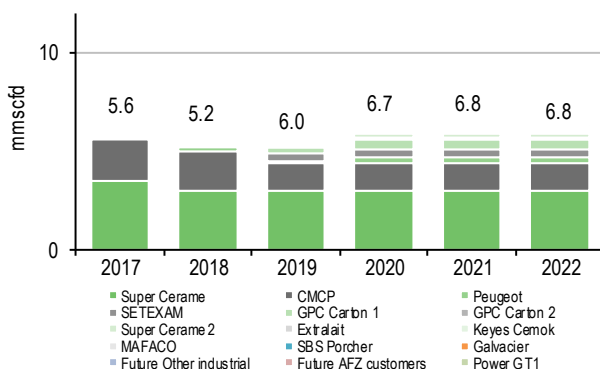
Exhibit 4: Morocco gross production and price forecast


Source: Edison Investment Research

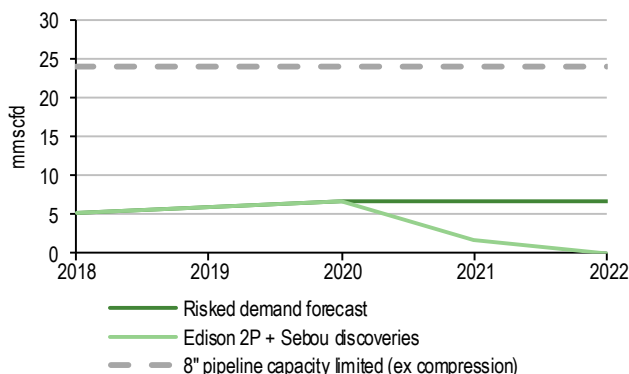
Exhibit 5: Morocco cash flow forecasts


Source: Edison Investment Research

We have updated our supply/demand model for gas in Kenitra to reflect SDX's latest comments in respect to existing customer offtake and potential demand growth from the AFZ. Based on Sebou production data year to date and 2019 guidance of 6.0–6.5mmscfd, we take a conservative approach and estimate average gas sales of 6.0mmscfd in FY19, growing to 6.7mmscfd in FY20, as shown in Exhibit 6. This is a reduction in growth compared to our previous forecasts and reflects a slowdown in new customers entering the AFZ. Incremental gas discoveries are required to infill our forecast risked demand through to 2022 but, based on SDX's high exploration success rate (c 80% chance of success) and proposed 12-well drilling programme starting in Q419, we do not see supply shortfall as a significant risk at this stage.

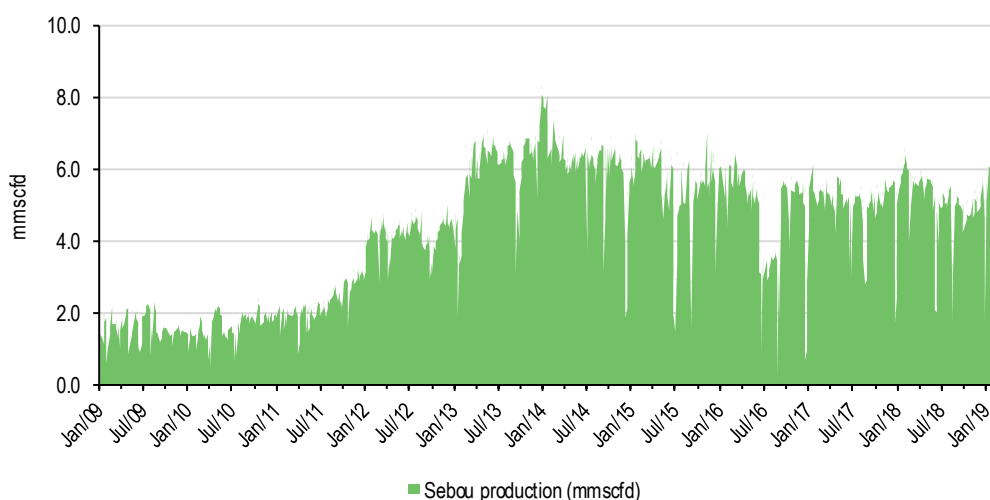
Exhibit 6: Edison risked demand forecasts by customer


Source: Edison Investment Research

Exhibit 7: Edison risked demand forecast compared to existing 2P volumes + Sebou discoveries


Source: Edison Investment Research

We remain confident in management's 2019 guidance of 6.0–6.5mmscfd based on volumes produced year to date and a February 2019 exit rate of just over 7mmscfd. Production data are available on the SDX website.

Exhibit 8: Sebou production (mmscfd)


Source: SDX Energy

Impact on forecasts and valuation

SDX's revised guidance has a material impact on our core valuation, in particular a reduction in FY19 Moroccan gas sales. A summary of key changes to our valuation is shown in Exhibit 9 below.

Exhibit 9: NAV old vs new

	New (GBp/share)	Old (GBp/share)	Change (%)	Comment
Cash net of admin	3.9	6.9	(43%)	Absolute change reflecting latest reported data, G&A forecast and reduced pipeline residual value.
Production/development	41.1	63.2	(35%)	Reduction in Morocco gas sales growth forecast, and lower South Disouq production plateau.
Core NAV	45.0	70.1	(36%)	
Exploration & Development	4.7	16.3	(71%)	Management now expects Young prospect to be gas rather than oil.
Group RENAV	49.8	86.5	(42%)	

Source: Edison Investment Research

Our updated NAV is provided in the table below.

Exhibit 10: SDX Energy detailed valuation									
Asset	Country	Diluted WI	CoS	Recoverable reserves			Net risked value @12.5%		
		%	%	Gross mmboe	Net WI mmboe	Net mmboe	NPV \$/boe	Absolute \$m	GBp/share
Net cash at December 2018								17.3	6.6
SG&A - NPV _{12.5} of 3yrs								(19.4)	(7.3)
E&A expense for exploration prospects								(14.2)	(5.4)
NPV of net receivable recovery								16.8	6.3
Sebou Pipeline residual value (30% cost)								9.8	3.7
Production									
Meseda Base + Workovers + Rabul	Egypt	50%	90%	8.0	4.0	1.5	6.9	24.7	9.3
Gemsa – abandoned end 2020	Egypt	50%	100%	1.8	0.9	0.9	0.8	0.7	0.3
Sebou 2P + discoveries to be booked	Morocco	75%	100%	0.9	0.7	0.7	33.4	22.0	8.3
LM discoveries and 2019/2020 10 shallow wells	Morocco	75%	75%	3.2	2.4	2.4	22.8	40.9	15.5
South Disouq/Ibn Yunus	Egypt	55%	100%	17.7	9.7	9.7	2.1	20.3	7.7
Core NAV				31.5	17.6	15.2		119.1	45.0
Exploration (known)									
Lalla Mimouna 2 wells	Morocco	75%	23%	1.7	1.3	1.36	22.8	6.4	2.4
Kafr el Sheik prospect x2	Egypt	55%	27%	15.3	8.4	8.4	1.6	3.6	1.4
Abu Madi prospect x2	Egypt	55%	23%	1.1	0.6	0.6	1.6	0.3	0.1
Young gas prospect	Egypt	55%	19%	13.5	7.4	7.4	1.6	2.2	0.8
Group RENAV				63.1	35.3	32.9		131.7	49.8

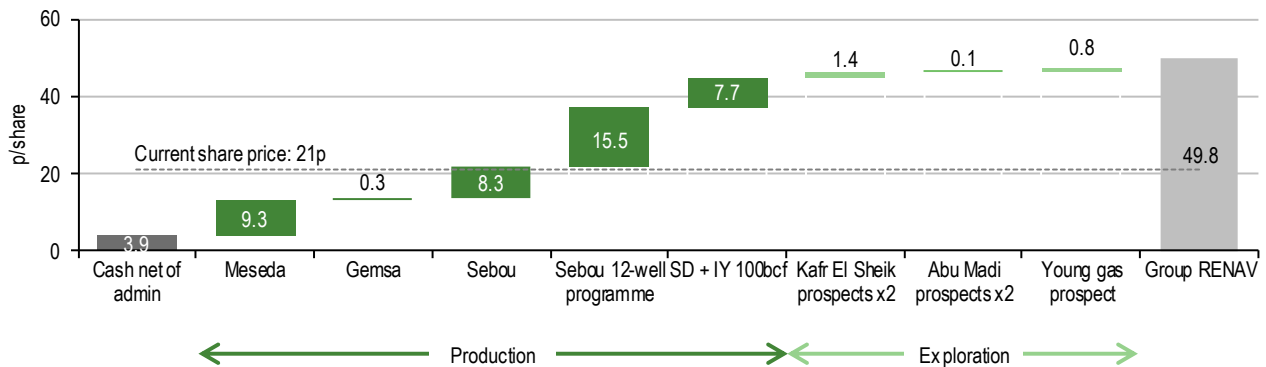
Source: Edison Investment Research. Note: Number of shares = 204.7m, FX = US\$/£0.77.

Our key forecast changes are highlighted in the table below. Lower production forecasts for 2019, 2020 and 2021 are the key driver of lower revenues, EBITDA and FCF for this period. Production downgrades are driven by a lower South Disouq gross production plateau (50mmscfd from 60mmscfd) and a decline in forecast Morocco gas sales.

Exhibit 11: Edison updated forecasts									
	New			Old			Change		
	2019e	2020e	2021e	2019e	2020e	2021e	2019e	2020e	2021e
Production (kboed)	3.4	6.7	6.3	4.3	9.7	9.4	(21%)	(32%)	(33%)
Revenue (\$m)	45.3	51.5	46.0	57.8	79.3	78.9	(22%)	(35%)	(42%)
EBITDA (\$m)	19.5	29.7	28.4	35.8	53.9	53.8	(46%)	(45%)	(47%)
FCF (\$m)	(12.5)	12.4	27.4	(6.1)	25.2	52.8	N/M	(51%)	(48%)
Brent (\$/bbl)	65.15	62.00	65.92	65.15	62.00	65.92	0%	0%	0%
SD gas price (\$/mcf)	2.85	2.85	2.85	2.85	2.85	2.85	0%	0%	0%
Sebou gas price (\$/mcf)	10.59	10.85	11.12	10.47	10.55	10.44	1%	3%	7%

Source: Edison Investment Research

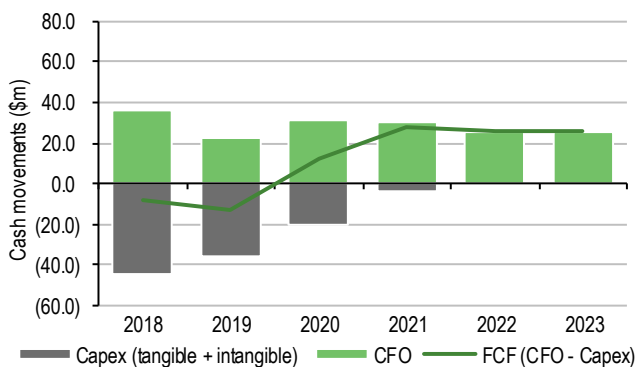
Our valuation has been reset to reflect new management guidance for FY19 and moderated production growth expectations, and is now at 45.0p/share fully funded core NAV. This is materially different to the current share price of 21p. As it can be seen in Exhibit 12, based on the current share price, the market is pricing in the bulk of SDX's existing producing assets, but allocating minimal value for its Sebou exploration/development programme, South Disouq (management expects onstream in November 2019) or risked prospective resource.

Exhibit 12: SDX Energy valuation waterfall


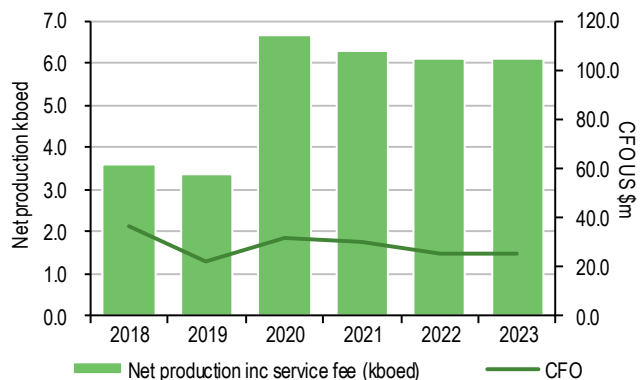
Source: Edison Investment Research

Financials

We forecast year-end 2019 net cash of c \$4.9m and, as of end March 2019, SDX's EBRD loan facility of \$10m remains undrawn. Based on the capex projections that underpin our production forecasts and SDX's committed exploration programme, we forecast positive FCF after South Disouq first gas (we forecast first gas at the start of FY20). We do not foresee the need for further equity capital at this stage, unless incremental growth capex, over and above our forecasts, is dedicated to new projects or acquisitions. We also note that SDX's recently announced capital reduction programme paves the way for the payment of dividends as and when management feels it is appropriate to do so.

Exhibit 13: Capex and cash flow forecasts


Source: Edison Investment Research

Exhibit 14: Production expectations


Source: Edison Investment Research

Exhibit 15: Financial summary

Accounts: IFRS, year-end: December, US\$000s	2015	2016	2017	2018	2019e	2020e	2021e
INCOME STATEMENT							
Total revenues	11,372	12,914	39,166	53,679	45,317	51,509	46,001
Cost of sales (direct expense)	(4,973)	(5,282)	(10,254)	(11,934)	(18,360)	(13,598)	(8,784)
Gross profit	6,399	7,632	28,912	41,745	26,957	37,911	37,218
SG&A (expenses)	(4,770)	(3,679)	(8,793)	(7,270)	(7,634)	(8,015)	(8,416)
Other income/(expense)	1,021	1,701	1,820	1,025	1,333	1,018	751
Exceptionals and adjustments	(7,676)	(29,089)	(725)	(10,458)	(1,194)	(1,194)	(1,194)
Depreciation and amortisation	(2,057)	(3,266)	(17,824)	(17,268)	(10,948)	(15,558)	(13,788)
Reported EBIT	(7,083)	(26,701)	3,390	7,774	8,515	14,162	14,571
Finance income/(expense)	(96)	4	(129)	(542)	0	0	0
Other income/(expense)	18,289	0	29,558	(174)	(174)	(174)	(174)
Exceptionals and adjustments	0	0	0	0	0	0	0
Reported PBT	11,110	(26,697)	32,819	7,058	8,341	13,988	14,397
Income tax expense (includes exceptionals)	(1,063)	(1,503)	(4,541)	(7,021)	(1,543)	(1,849)	(1,475)
Reported net income	10,047	(28,200)	28,278	37	6,798	12,139	12,922
Shares at end of period - basic	38	80	204	205	205	205	205
BALANCE SHEET							
Property, plant and equipment	18,401	12,605	54,445	48,680	68,349	70,009	59,349
Goodwill	0	0	0	0	0	0	0
Intangible assets	23,473	10,623	15,231	39,128	44,612	47,696	48,256
Other non-current assets	2,106	2,503	2,724	3,394	3,394	3,394	3,394
Total non-current assets	43,980	25,731	72,400	91,202	116,354	121,099	110,998
Cash and equivalents	8,170	4,725	25,844	17,345	4,867	17,245	44,626
Inventories	1,188	1,698	5,157	5,236	5,000	3,703	2,392
Trade and other receivables	6,678	9,463	37,656	24,324	19,459	15,567	12,454
Other current assets	0	0	0	0	0	0	0
Total current assets	16,036	15,886	68,657	46,905	29,327	36,515	59,472
Non-current loans and borrowings	0	0	0	0	0	0	0
Other non-current liabilities	286	290	4,506	4,572	4,572	4,572	4,572
Total non-current liabilities	286	290	4,506	4,572	4,572	4,572	4,572
Trade and other payables	3,556	3,674	19,459	14,418	14,000	12,600	11,340
Current loans and borrowings	0	0	0	0	0	0	0
Other current liabilities	928	389	2,473	3,078	3,078	3,078	3,078
Total current liabilities	4,484	4,063	21,932	17,496	17,078	15,678	14,418
Equity attributable to company	55,246	37,264	114,619	116,039	124,031	137,364	151,480
Non-controlling interest	0	0	0	0	0	0	0
CASH FLOW STATEMENT							
Profit before tax	11,110	(26,697)	32,819	7,058	8,341	13,988	14,397
Net finance expenses	0	0	0	0	0	0	0
Depreciation and amortisation	2,057	3,266	17,824	17,268	10,948	15,558	13,788
Share based payments	761	(47)	538	1,194	1,194	1,194	1,194
Other adjustments	(12,281)	25,742	(34,613)	3,224	(1,333)	(1,018)	(751)
Movements in working capital	(2,183)	(3,440)	5,412	8,584	4,683	3,789	3,164
Interest paid / received	0	0	0	0	0	0	0
Income taxes paid	(4,678)	(766)	(364)	(1,091)	(1,543)	(1,849)	(1,475)
Cash from operations (CFO)	(5,214)	(1,942)	21,616	36,237	22,289	31,662	30,317
Capex	(5,120)	(11,890)	(24,917)	(44,810)	(36,100)	(20,303)	(3,688)
Acquisitions & disposals net	0	0	(24,948)	0	0	0	0
Other investing activities	4,836	825	760	525	1,333	1,018	751
Cash used in investing activities (CFIA)	(284)	(11,065)	(49,105)	(44,285)	(34,767)	(19,284)	(2,936)
Net proceeds from issue of shares	0	10,127	48,510	114	0	0	0
Movements in debt	(3,702)	(96)	(43)	(197)	0	0	0
Other financing activities	0	0	0	0	0	0	0
Cash from financing activities (CFF)	(3,702)	10,031	48,467	(83)	0	0	0
Increase/(decrease) in cash and equivalents	(9,200)	(2,976)	20,978	(8,131)	(12,478)	12,377	27,381
Currency translation differences and other	(565)	(469)	141	(368)	0	0	0
Cash and equivalents at end of period	8,170	4,725	25,844	17,345	4,867	17,245	44,626

Source: Company accounts, Edison Investment Research

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