EDISON

# SDX Energy

## Full year results

Full year results

Oil & gas

**3 April 2017**

| | |
|---|---|
| **Price** | **49.25p** |
| **Market cap** | **£92m** |
| | US$/£0.8 |
| Net cash ($m) at 28 February 2017 | 18.3 |
| Shares in issue | 186.9m |
| Free float | 59% |
| Code | SDX |
| Primary exchange | AIM |
| Secondary exchange | TSX Venture |

**SDX Energy has grown significantly over the past 12 months. To some degree, the full year results of 24 March 2017 are less relevant as an indicator of current operations of the company. The January acquisition of Circle Oil's Moroccan and Egyptian assets and current drilling of South Disouq stand to add to the production assets of Meseda and North West Gemsa, from which SDX produced 2.1kboe/d in 2016. SDX is in good health, holding $18m in cash as of March and has material new cash flows from the Moroccan gas production. Newsflow from South Disouq will remain the near-term catalyst and could be transformational if successful. We have adjusted our valuation, leaving an updated full NAV of 57p/share.**

| Year end | Revenue ($m) | PBT* ($m) | Operating cash flows ($m) | Net (debt)/ cash ($m) | Cash from investing ($m) |
|---|---|---|---|---|---|
| 12/15 | 11.4 | 11.1 | (5.2) | 8.2 | (0.3) |
| 12/16 | 12.9 | (26.7) | (1.9) | 4.7 | (11.1) |
| 12/17e | 43.6 | 8.9 | 28.5 | 31.0 | (40.3) |
| 12/18e | 57.5 | 24.4 | 40.5 | 58.0 | (13.5) |

Note: *PBT is normalised. Note: the financials above do not include the impact of South Disouq, given its potential impact on the company (but uncertain result).

## Moroccan and Egypt ramping up in 2017

At North West Gemsa, the workover and ESP installation programme continues. Meseda's waterflood operations should ramp up as ESPs are replaced, facilities are upgraded, and two development and two exploration wells are drilled. In Morocco, the company plans an aggressive campaign, drilling up to five wells in H217 in order to supply existing and new customers in a gas-deprived market.

## South Disouq results in mid to late April

We have remodelled our indicative South Disouq development to start commercial production in late 2017 and ramp up to reach a six-year plateau of 25mboe/d. With such a large target (585bcfe gross), successful exploration would be transformational, more than doubling cash flows from current levels (should SDX retain its current working interest). Development could be fast and cheap, helped by nearby infrastructure. These factors drive a pre-drill risked (20%) value for the prospect at around 12p/share.

## Valuation: Full NAV stays at 57p/share

We have adjusted our modelling to reflect slightly lower than expected production for Meseda and North West Gemsa. Meseda's waterflood development should ramp-up in 2017 as facilities are brought online, with significant production increases expected by year end. Factoring in these changes and adjusting for full year results, our full NAV is essentially unchanged, at 57p/share. This includes the risked value of South Disouq, which we expect to complete in mid- to late April.

### Share price performance


| % | 1m | 3m | 12m |
|---|---|---|---|
| Abs | 0.5 | 49.2 | N/A |
| Rel (local) | (0.4) | 44.9 | N/A |
| 52-week high/low | | 50p | 18p |

### Business description

SDX Energy is a North African onshore player listed in Toronto and London. It has plans to increase net production in Egypt (primarily through workovers and waterflood) while 2017 should see a carried exploration well. It has recently added high-value gas production in Morocco.

### Next events

| | |
|---|---|
| South Disouq results | April |
| Meseda waterflood ramp-up | Mid-2017 |

### Analysts


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## Summary of full year results

Given the changes within the company ($30m acquisition of Circle Oil assets on 27 January 2017), and with macro factors (Brent oil briefly traded at less than $30/bbl in January 2016) over the past 12 months, the 2016 financial results are largely irrelevant to investors.

Reported net loss of $28m was affected by material one-off items (primarily exploration expense and impairments totalling $29.1m). The exploration write-down is mainly due to Bakassi West well failure ($24.4m), while the impairment included a $4.3m charge at North West Gemsa, which is mainly the result of lower oil price assumptions used by the auditors (of approximately $58/bbl going forward). The assets absorbed cash from operations of $1.9m and investments of $12m.

Operationally, the 10% WI in North West Gemsa and 50% interest in Meseda generated average oil and production service fee production of 2,131boe/d. Average realised oil prices were $38/bbl (vs Brent of $45/bbl). Importantly, operating costs of $6.77/boe over the year were down year-on-year (from $14.7/boe). These reductions in opex are crucial for cash generation going forward.

In March 2017, SDX had net production of 2,794boe/d at North West Gemsa, 776bbl/d at Meseda and 663boe/d in Morocco. These compare to our 2017 full year estimates of 2,532boe/d, 950bbls/d and 810boe/d respectively. We expect North West Gemsa production to decline slightly. Increases are expected at Meseda due to waterflood operations and in Morocco because of expanded development and exploration drilling.

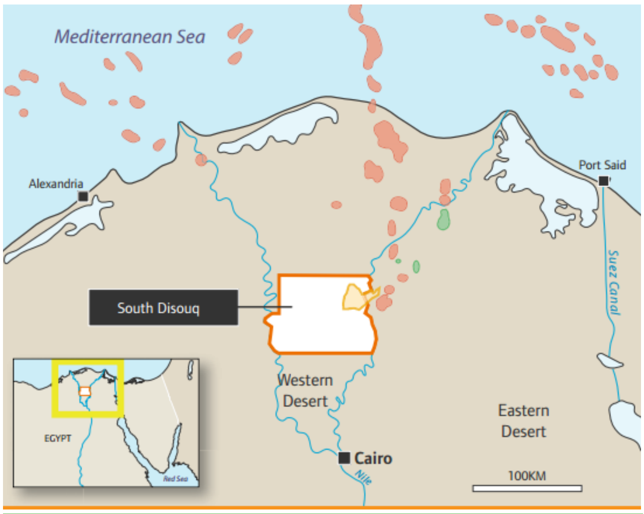
## South Disouq

The South Disouq well was spudded in mid-March and is expected to reach target depth in mid- to late April. The well is targeting a 585bcf gas accumulation (320bcf net to SDX’s 55% WI), but recent work has identified deeper, oily targets within the Abu Roash and AEB horizons (proven as prolific producers in the Western Desert) that would be valuable additions to any gas discovery. The majority of wells costs are carried by partner IPR (45% WI).

The prospect lies close to three major gas and oil trunk lines (5-11km); any discovery can be developed cost effectively within a relatively short time frame. The company believes target depth to first production can be achieved “in months”.

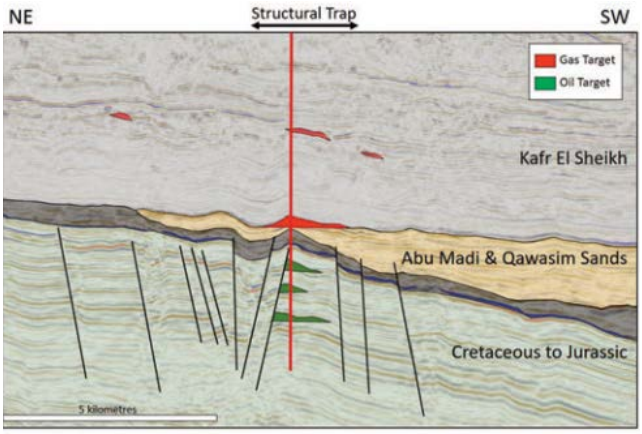
According to the company, a number of proposals have been received from operators looking to farm-in to the licence. This will enable the company to make appropriate decisions over risk reduction and capital investment in the event of a discovery.

Exhibit 1: South Disouq is close to the Mediterranean coast and on trend with production




Source: SDX

Exhibit 2: Multiple targets of gas and oil

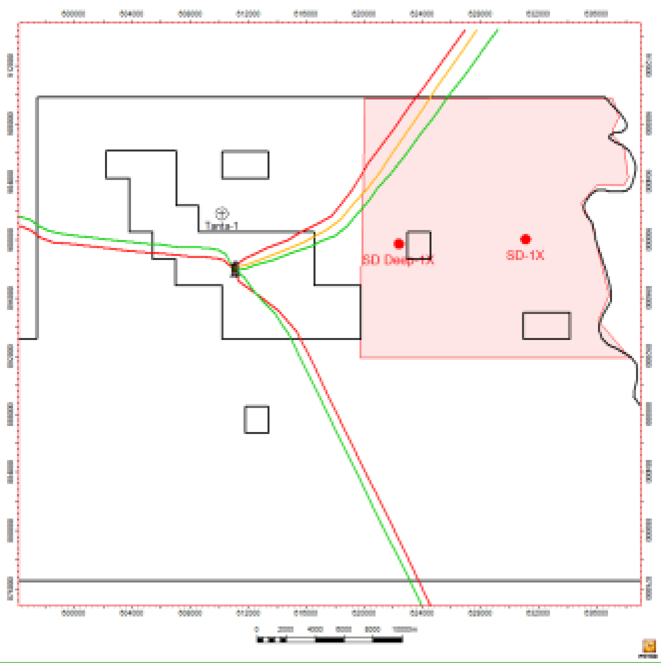



Source: SDX

We have updated our illustrative discovery at South Disouq. We assume 90% gas/10% condensate with a total size of 585bcfe. We assume first production in late 2017, ramping up over time as more wells are drilled and facilities are brought online. Well costs of around $3-4m imply life of field capex of $3/boe, although costs of wells/facilities/supporting infrastructure will be better known once the gas characteristics are better understood. We assume opex of $4.5/boe and a plateau of around 25mboe/d of around six years. These assumptions are subject to considerable uncertainty.

Given the ramp-up of production and the company's greater financial capacity after the fund raise and Circle assets acquisition, we apply a higher CoS of 20% (from 13.0% previously), as it has more capacity to fund its own development rather than required dilutive farm-down deals. This leads to an increase in South Disouq's value to the company.

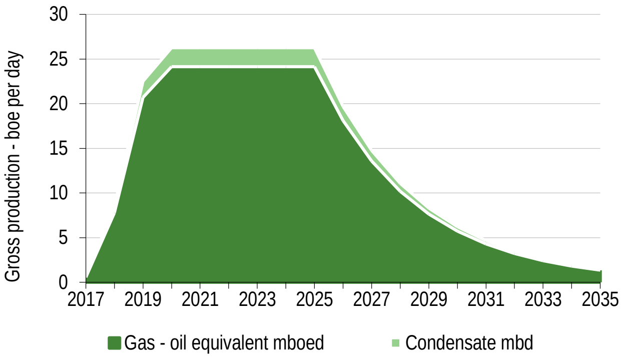
Exhibit 3: Proximity of targets to pipelines




Source: SDX

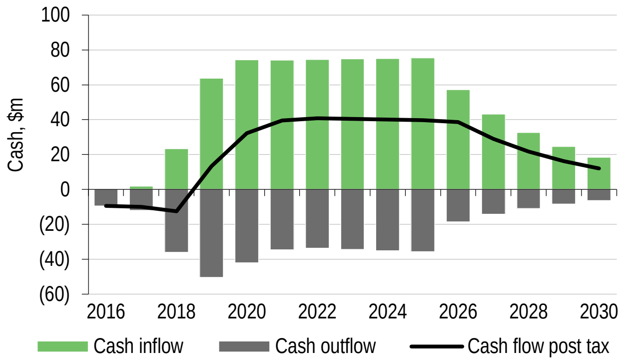
The success and subsequent development of South Disouq would transform the cash flow generation of the company. If SDX were to retain its current 55% working interest, it would have to fund material near-term capital investments, but may then see cash inflows that would dwarf current cash generation, as seen below.

**Exhibit 4: Modelled production rates at South Disouq (100% WI basis)**




Source: Edison Investment Research

**Exhibit 5: Modelled net cash flows for SDX (55% WI basis) for South Disouq**




Source: Edison Investment Research

## Valuation

We adjust our valuation to account for reduced production expectations from Meseda and North West Gemsa in 2017 and take the actual end-year cash figure. Reductions to core NAV are partially offset by an increase in value of the South Disouq well, where we have increased our volumes to match the 585bcfe as given by the company and raised our estimated CoS slightly. This results in a full NAV essentially unchanged at 57p/share.

**Exhibit 6: NAV summary**

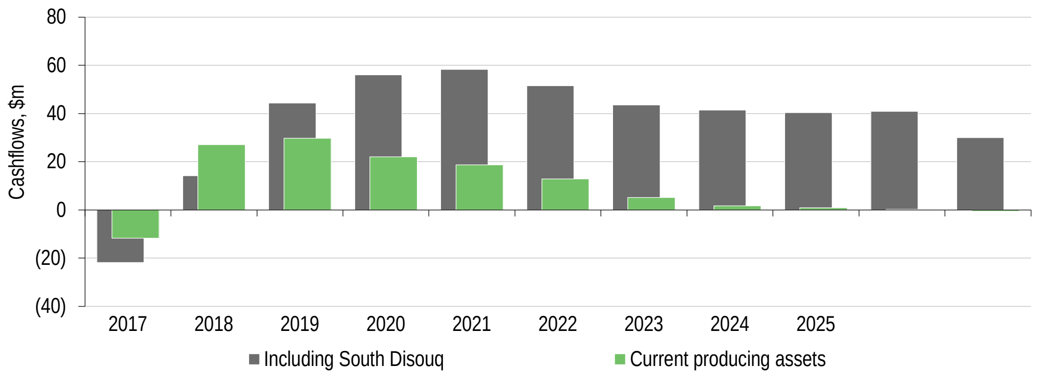
| Asset | Number of shares: 187m | | | Recoverable reserves | | | | Net risked value | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Country | Diluted WI | CoS | Gross | Net | Net attributable | NPV | Absolute | GBp/share | C$/share |
| | | % | % | | mmboe | | $/boe | $m | DR of 12.5% | |
| Net (debt)/cash - Dec 2016 | | 100% | 100% | | | | | 5 | 2.0 | 0.03 |
| Cash raised minus acqn minus costs | | 100% | 100% | | | | | 7 | 3.1 | 0.05 |
| SG&A - NPV10 of 4 years | | 100% | 100% | | | | | (11) | (4.6) | (0.08) |
| Net financial income (expenses) NPV 2 years | | 100% | 100% | | | | | 0 | 0.0 | 0.00 |
| 2017 Exploration | | 100% | 100% | | | | | (4) | (1.7) | (0.03) |
| Receivable for gas and NGLs at NW Gemsa (as yet not invoiced) | | 100% | 100% | | | | | 2 | 0.6 | 0.01 |
| Production | | | | | | | | | | |
| Meseda Base case - Edison | Egypt | 50% | 100% | 3.9 | 2.0 | 0.7 | 6.2 | 12 | 5.2 | 0.09 |
| Meseda Base + Workovers - Edison | Egypt | 50% | 90% | 4.5 | 2.3 | 0.9 | 6.0 | 12 | 5.3 | 0.09 |
| Gemsa 1P | Egypt | 50% | 100% | 4.1 | 2.1 | 2.1 | 9.4 | 19 | 8.3 | 0.14 |
| Gemsa 2P | Egypt | 50% | 100% | 1.9 | 1.0 | 1.0 | 9.9 | 10 | 4.1 | 0.07 |
| Sebou 2P | Morocco | 75% | 100% | 1.0 | 0.8 | 0.8 | 34.6 | 26 | 11.3 | 0.19 |
| Acquired working capital (NPV of 4-year release) | Morocco | 100% | 100% | | | | | 15 | 6.2 | 0.10 |
| Core NAV | | | | 15.5 | 8.0 | 5.4 | 9.9 | 93 | 39.9 | 0.67 |
| Development upside | | | | | | | | | | |
| Meseda Base + Workovers + Waterflood - Edison | Egypt | 50% | 40% | 9.1 | 4.6 | 1.7 | 4.0 | 7 | 3.2 | 0.05 |
| Gemsa - Edison modelling on full field | Egypt | 50% | 75% | 1.2 | 0.6 | 0.6 | 5.7 | 3 | 1.1 | 0.02 |
| Sebou - Accelerated programme | Morocco | 75% | 40% | 0.9 | 0.7 | 0.7 | 7.9 | 2 | 0.9 | 0.02 |
| South Disouq | Egypt | 55% | 20% | 96 | 53 | 52.9 | 2.5 | 27 | 11.5 | 0.19 |
| Full NAV | | | | 122.9 | 66.7 | 61.3 | 1.8 | 132 | 56.5 | 0.94 |

Source: Edison Investment Research, company accounts

## Financials

As of December 2016, SDX Energy held $4.7m in cash. After the acquisition and equity raise, SDX held $18.3m as of 28 February 2017. Together with the cash generation capability of the Egyptian and Moroccan assets, this puts the company in a robust financial position.

**Exhibit 7: Cash flows with and without South Disouq**




Source: Source: Edison Investment Research. Note: there are significant capital investments in 2017 and 2018 that are offset by cash outflows. Depending on the eventual timing of investments and production, the actual cash flows in 2017 and 2018 may swing notably.

**Exhibit 8: Financial summary**

| Accounts: IFRS; year end: December | $'000s | 2014A | 2015A | 2016A | 2017E | 2018E |
|---|---|---|---|---|---|---|
| Total revenues | | 24,533 | 11,372 | 12,914 | 43,638 | 57,501 |
| Cost of sales | | (3,639) | (4,973) | (5,282) | (13,221) | (14,558) |
| Gross profit | | 20,894 | 6,399 | 7,632 | 30,417 | 42,943 |
| SG&A (expenses) | | (1,768) | (3,746) | (2,457) | (2,809) | (1,665) |
| Other income/(expense) | | 0 | (3) | 479 | 0 | 0 |
| Exceptionals and adjustments | | (3,831) | (7,676) | (29,089) | (1,000) | (1,000) |
| Depreciation and amortisation | | (1,602) | (2,057) | (3,266) | (17,670) | (15,872) |
| Reported EBIT | | 13,693 | (7,083) | (26,701) | 8,938 | 24,405 |
| Finance income/(expense) | | (1,009) | (96) | 4 | 0 | 0 |
| Other income/(expense) | | 0 | 18,289 | 0 | 0 | 0 |
| Reported PBT | | 12,684 | 11,110 | (26,697) | 8,938 | 24,405 |
| Income tax expense (includes exceptionals) | | (4,328) | (1,063) | (1,503) | (823) | (2,085) |
| Reported net income | | 8,356 | 10,047 | (28,200) | 8,115 | 22,320 |
| Basic average number of shares, m | | 376 | 52 | 72 | 187 | 187 |
| Basic EPS | | 0.1 | 0.2 | (0.4) | 0.0 | 0.1 |
| | | | | | | |
| Balance sheet | | | | | | |
| Property, plant and equipment | | 9,392 | 18,401 | 12,605 | 17,273 | 15,831 |
| Goodwill | | 0 | 0 | 0 | 0 | 0 |
| Intangible assets | | 16,460 | 23,473 | 10,623 | 11,772 | 13,375 |
| Other non-current assets | | 1,999 | 2,106 | 2,503 | 3,077 | 3,077 |
| Total non-current assets | | 27,851 | 43,980 | 25,731 | 32,121 | 32,283 |
| Cash and equivalents | | 17,935 | 8,170 | 4,725 | 30,950 | 57,995 |
| Inventories | | 0 | 1,188 | 1,698 | 1,698 | 1,870 |
| Trade and other receivables | | 3,306 | 6,678 | 9,463 | 38,463 | 30,770 |
| Other current assets | | 0 | 0 | 0 | 0 | 0 |
| Total current assets | | 21,241 | 16,036 | 15,886 | 71,111 | 90,635 |
| Non-current loans and borrowings | | 0 | 0 | 0 | 0 | 0 |
| Other non-current liabilities | | 608 | 286 | 290 | 290 | 290 |
| Total non-current liabilities | | 608 | 286 | 290 | 290 | 290 |
| Trade and other payables | | 1,686 | 3,556 | 3,674 | 18,174 | 14,539 |
| Current loans and borrowings | | 2,207 | 0 | 0 | 0 | 0 |
| Other current liabilities | | 5,142 | 928 | 389 | 389 | 389 |
| Total current liabilities | | 9,035 | 4,484 | 4,063 | 18,563 | 14,928 |
| Equity attributable to company | | 39,449 | 55,246 | 37,264 | 84,379 | 107,700 |
| | | | | | | |
| Cashflow statement | | | | | | |
| Profit before tax | | 12,684 | 11,110 | (26,697) | 8,938 | 24,405 |
| Depreciation and amortisation | | 1,602 | 2,057 | 3,266 | 17,670 | 15,872 |
| Share based payments | | 1,064 | 761 | (47) | 1,000 | 1,000 |
| Other adjustments | | 1,670 | (12,281) | 25,742 | (1,766) | (2,535) |
| Movements in working capital | | 12,941 | (2,183) | (3,440) | 3,500 | 3,886 |
| Income taxes paid | | (4,430) | (4,678) | (766) | (823) | (2,085) |
| Cash from operations (CFO) | | 25,531 | (5,214) | (1,942) | 28,519 | 40,544 |
| Capex | | (13,634) | (5,120) | (11,890) | (11,486) | (16,034) |
| Acquisitions & disposals net | | 0 | 0 | 0 | (30,000) | 0 |
| Other investing activities | | 1,110 | 4,836 | 825 | 1,192 | 2,535 |
| Cash used in investing activities (CFIA) | | (12,524) | (284) | (11,065) | (40,294) | (13,500) |
| Net proceeds from issue of shares | | 0 | 0 | 10,127 | 38,000 | 0 |
| Movements in debt | | 0 | (3,702) | (96) | 0 | 0 |
| Cash from financing activities (CFF) | | 0 | (3,702) | 10,031 | 38,000 | 0 |
| Increase/(decrease) in cash and equivalents | | 13,007 | (9,200) | (2,976) | 26,225 | 27,045 |
| Currency translation differences and other | | (615) | (565) | (469) | 0 | 0 |
| Cash and equivalents at end of period | | 17,935 | 8,170 | 4,725 | 30,950 | 57,995 |
| Net (debt) cash | | 15,728 | 8,170 | 4,725 | 30,950 | 57,995 |

Source: Edison Investment Research, company accounts. Note: excludes South Disouq due to distortionary nature of development in the case of drilling success.

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