EDISON

SDX Energy

Well results

Solid well results kick off the campaign

Oil & gas

SDX Energy has announced two successful well results in recent weeks, with additional oil discovered in Egypt and more net pay found in its first Moroccan gas well than expected. The next six months are busy ones for SDX, with eight more wells to be drilled in Morocco to supply a high value gas market. Two wells will be drilled in Egypt to delineate its existing South Disouq discovery and two exploration wells will target prospects that could materially increase the gas resources. In addition, programmes at NW Gemsa and Meseda should materially increase production. Our NAV increases from 64p to 65p/share (increases in absolute terms are partially offset by foreign exchange movements).

Year end	Revenue ($m)	PBT ($m)	Cash from operations ($m)	Net cash ($m)	Capex ($m)
12/15	11.4	11.1	(5.2)	8.2	(5.1)
12/16	12.9	(26.7)	(1.9)	4.7	(11.9)
12/17e	35.8	4.8	22.8	23.3	(22.7)
12/18e	54.9	20.2	34.5	16.1	(44.9)

Note: Figures are as reported

First operated Moroccan well better than expected

KSR-14 was the first well in Morocco to be drilled by SDX since its acquisition of the assets. As a result, the safe drilling operations and better than expected results (20m of net pay was encountered vs 10m expected) bodes well for the rest of the campaign. These results appear to suggest the target may contain at least 50% higher volumes than the 1bcf expected pre-drill. We believe the Kenitra market will be able to absorb all extra gas in the near term. The company is now guiding that the gas will start to flow at the end of Q118, giving time for additional sales and marketing activities to fit with the (high value) gas discovered.

Egypt: Rabul wells add nearer-term volumes

The company was committed to drill the two Rabul wells and we had not expected results to be material. However, the second well (Rabul-2) encountered significantly more net pay than anticipated. As a result, management expects the well will test much more than the 500bopd that Rabul-1 produced and add to production in the coming months (with limited additional costs). The oil is heavy (20° API) and for the moment, we expect the discovery to produce between 1-2mmbbls over time.

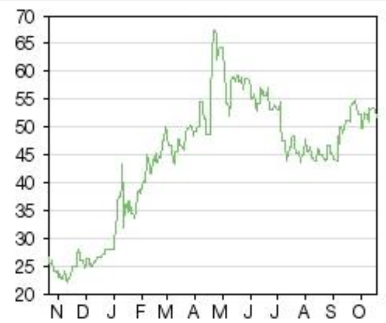
Valuation: Increased NAV to 65p/share

We have revised our modelling to include the incremental value from Rabul discovery wells, moving our NAV to 65p/share from 64p/share. We have not increased our expectations for Moroccan production for the moment, though expect to revisit this as more wells are drilled and results announced. The nine-well programme in Morocco could see a 50% increase in gas produced, which, due to prices and tax terms, is very high value. Investors could also see material value created by the four wells planned around the South Disouq discovery. Success could add multiples of the existing discovery reserves in time and feed an increase in production over the current expectations of 50mcfd from the SD-1x discovery.

19 October 2017

Price	**51.75p**
Market cap	**£104m**
	£0.8/US$
Net cash ($m) at 30 June 2017	28
Shares in issue	204.5m
Free float	80%
Code	SDX
Primary exchange	AIM
Secondary exchange	TSX Venture

Share price performance



%	1m	3m	12m
Abs	1.5	7.3	93.5
Rel (local)	(2.4)	4.8	77.7
52-week high/low		67.4p	22.0p

Business description

SDX Energy is a North African onshore player listed in Toronto and London. It has oil and gas production in Egypt, and Moroccan gas production. A large gas discovery was recently made at South Disouq.

Next events

Moroccan well programmed	H217/2018
South Disouq wells	H217/2018

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Edison profile page

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Morocco

SDX has successfully drilled its first operated well in Morocco. The KSR-14 well encountered 20m of conventional net gas pay over four intervals. The well exceeded pre-drill estimates (around double the net pay) and should lead to an increase in reserves that can be exploited from this well. The well has yet to be tested, but given the numerous production wells already in the field, there should be a high degree of confidence in the well's potential.

The Moroccan programme will continue with eight more wells due to be drilled before the end of Q118 (the majority of which are development wells). KSR-14 continues a string of good results in the Sebou permit, with a success rate over 80%. As a result of this, and the better than expected results in net pay, we believe investors should have a high level of comfort in SDX's ability to increase production in Morocco from current levels (around 5.5-6.0mcfd) towards (and possibly over) 10mcfd.

These increasing volumes, the high gas prices ($9-12/mcf) achieved and the benevolent fiscal terms mean the programme should create meaningful cash flows for the company. The management has indicated it will look to contract discovered volumes before the end of Q118, which allows the required commercial sale agreements to be negotiated in conjunction with ever-increasing confidence on reserves.

Egypt: Rabul wells

We had not modelled volumes from the two commitment wells at Rabul, which means the positive results at Rabul-1 and Rabul-2 add to expected 2018 cash flows and value.

The initial results from the Rabul-1 well, which tested at 500bopd (and net pay of 14.5ft) were incremental. However, the net pay encountered at Rabul-2 of 101.5ft was much better and SDX expects the well (post cleanup and ESP installation) to produce up to 2,500bopd. The reservoir is high quality (porosity of around 20% and high permeability of c 1 Darcy), but the heavy oil (20° API) means relatively low recovery factors could be expected. For the moment, we have modelled the discovery as adding 1-2mmbbls to overall production.

Valuation

We have adjusted our modelling to include the value from production from the recent Rabul discovery, which should generate incremental production volumes from 2018 onwards. At this time, we have not increased our expectations for Moroccan gas despite the better results from KSR-14. For the moment, we await the results of the rest of the Moroccan well programme and indications from the company on its ability to sell any extra gas above and beyond our current modelling (we believe it should be able to). The inclusion of discovered Rabul volumes is partially offset by updated exchange rates. Our updated NAV is 65p/share (previously 64p/share).

Exhibit 1: Valuation summary

Asset	Number of shares: 204.5m			Recoverable reserves			Net risked value at 12.5% discount rate			
	Country	WI	CoS	Gross	Net WI	Net	NPV	Absolute	GBp/share	C$/share
		%	%		mmboe		$/boe	$m		
Net (debt)/cash – June 2017e		100%	100%					28	10.7	0.18
Cash in from equity raise		100%	100%					10	3.8	0.06
SG&A – NPV10 of 4 years		100%	100%					(10)	(4.0)	(0.07)
Receivable for gas and NGLs at Gemsa		100%	100%					8	3.3	0.05
Production										
Meseda Base case + Rabul	Egypt	50%	100%	6.0	3.0	1.1	5.3	16	6.1	0.10
Meseda Base + Workovers + Rabul	Egypt	50%	90%	5.8	2.9	1.1	4.1	11	4.2	0.07
Gemsa 1P	Egypt	50%	100%	3.3	1.6	1.6	9.5	15	5.9	0.10
Gemsa 2P	Egypt	50%	100%	1.4	0.7	0.7	4.3	3	1.2	0.02
Sebou 2P	Morocco	75%	100%	1.2	0.9	0.9	22.9	21	8.1	0.13
Sebou - accelerated programme (updated)	Morocco	75%	80%	1.0	0.8	0.8	11.8	7	2.8	0.05
South Disouq SD-1X well - GCA estimate	Egypt	55%	85%	10.1	5.6	5.6	4.6	22	8.4	0.14
Acquired working capital (NPV of 4 yr release)	Morocco	100%	100%					9	3.3	0.06
Core NAV				**28.8**	**15.5**	**11.8**	**6.1**	**139**	**53.7**	**0.89**
Development upside										
Meseda Base + Workovers + Waterflood + Rabul	Egypt	50%	50%	5.5	2.7	1.0	1.1	1	0.6	0.01
Gemsa - Edison modelling on full field	Egypt	50%	75%	1.6	0.8	0.8	4.3	3	1.0	0.02
Exploration (known)										
SouthDisouq-Kelvin	Egypt	55%	41%	15.1	8.3	8.3	3.4	11	4.4	0.07
SouthDisouq-Bragg	Egypt	55%	41%	14.6	8.0	8.0	3.2	11	4.1	0.07
South Disouq Upside	Egypt	55%	25%	11.3	3.1	3.1	4.2	3	1.3	0.02
Full NAV				**76.9**	**38.5**	**33.1**		**168**	**65.0**	**1.08**

Source: Edison Investment Research

Financials

The company remains well financed, holding $28m in cash as of June 2017. The active operational programme the company is embarking on across all fronts in H217 and early 2018 should reap substantial gains in adding production and cash flows in time. Development drilling and field improvements in Morocco and Egypt add low-risk cash flows, while exploration wells (two in Morocco, two in Egypt) could add significant value.

Cashflows in 2018 will be affected by the success of the exploration and development campaign. If the two exploration wells at South Disouq are successful, the company will look to rightsize the production facilities and pipelines for the development, which may require the construction of a larger central processing unit (rather than a smaller rental unit). We would expect the company to be able to fund these expenditures from cash flows, although debt could be raised if required.

Exhibit 2: Financial summary

Accounts: IFRS; year end: December; US$000s	2014	2015	2016	2017e	2018e
Profit & loss					
Total revenues	**24,533**	**11,372**	**12,914**	**35,809**	**54,894**
Cost of sales	(3,639)	(4,973)	(5,282)	(11,681)	(17,889)
Gross profit	20,894	6,399	7,632	24,128	37,005
SG&A (expenses)	(1,768)	(3,746)	(2,457)	(3,419)	(1,065)
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)	(14,862)	(14,785)
Reported EBIT	**13,693**	**(7,083)**	**(26,701)**	**4,848**	**20,156**
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)**	**4,848**	**20,156**
Income tax expense (includes exceptionals)	(4,328)	(1,063)	(1,503)	(250)	(1,413)
Reported net income	**8,356**	**10,047**	**(28,200)**	**4,598**	**18,743**
End of period number of shares, m	376	38	80	204	204
Balance sheet					
Property, plant and equipment	9,392	18,401	12,605	34,395	60,048
Intangible assets	16,460	23,473	10,623	8,695	13,188
Other non-current assets	1,999	2,106	2,503	2,879	2,879
Total non-current assets	**27,851**	**43,980**	**25,731**	**45,969**	**76,115**
Cash and equivalents	17,935	8,170	4,725	23,335	16,087
Inventories	0	1,188	1,698	1,698	2,600
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**	**63,496**	**49,458**
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	90,612	110,354
Cash flow statement					
Profit before tax	**12,684**	**11,110**	**(26,697)**	**4,848**	**20,156**
Depreciation and amortisation	1,602	2,057	3,266	14,862	14,785
Share based payments	1,064	761	(47)	1,000	1,000
Other adjustments	1,670	(12,281)	25,742	(1,156)	(3,135)
Movements in working capital	12,941	(2,183)	(3,440)	3,500	3,155
Income taxes paid	(4,430)	(4,678)	(766)	(250)	(1,413)
Cash from operations (CFO)	**25,531**	**(5,214)**	**(1,942)**	**22,803**	**34,548**
Capex	(13,634)	(5,120)	(11,890)	(22,724)	(44,930)
Acquisitions & disposals net	0	0	0	(30,000)	0
Other investing activities (includes associates)	1,110	4,836	825	781	3,135
Cash used in investing activities (CFIA)	**(12,524)**	**(284)**	**(11,065)**	**(51,944)**	**(41,796)**
Net proceeds from issue of shares	0	0	10,127	47,750	0
Movements in debt	0	(3,702)	(96)	0	0
Other financing activities	0	0	0	0	0
Cash from financing activities (CFF)	**0**	**(3,702)**	**10,031**	**47,750**	**0**
Increase/(decrease) in cash and equivalents	13,007	(9,200)	(2,976)	18,610	(7,248)
Currency translation differences and other	(615)	(565)	(469)	0	0
Cash and equivalents at end of period	17,935	8,170	4,725	23,335	16,087
Net (debt) cash	**15,728**	**8,170**	**4,725**	**23,335**	**16,087**
Movement in net (debt) cash over period	12,392	(7,558)	(3,445)	18,610	(7,248)

Source: Edison Investment Research, company accounts