EDISON

SDX Energy

Significant work programme starting

Funds and H2 drilling update

Oil & gas

SDX Energy has completed the $10m equity raising to fund an accelerated drilling programme in Egypt and Morocco. This means it will be drilling wells with unrisked returns generating IRRs of more than 100%, according to the company, underlining the value of the H217 drilling programme. After the fund-raise, SDX will be fully funded to take the South Disouq discovery to first gas in early 2018, and to drill two exploration wells to explore for a further 150bcf in Egypt while increasing its Moroccan drilling programme to nine wells to boost resources and increase production. These will have the effect of increasing certainty on future developments and bringing forward valuable cash flows. These positive effects have been offset by a reduction in our long-term oil price assumption and some modelling adjustments. Our full NAV is now 64p/share.

Year end	Revenues ($m)	PBT ($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	23.8	(22.2)
12/18e	51.7	18.3	33.6	15.1	(44.7)

Note: Figures are as reported.

Expanding and delineating resources in Egypt

At South Disouq, the extra funding will allow the company to understand the true extent of the resources in the block sooner (targeting an incremental 150bcf in the Kelvin and Bragg prospects combined), enabling full development facilities to be right-sized and reducing costs in the long-term. Two development wells in the SD-1X structure (which is up-dip and may be connected to the Kelvin prospect) are also planned, potentially increasing resources there.

Adding to heavy drilling campaign in Morocco

In Morocco, the addition of two wells to the existing programme of seven increases the likelihood of finding valuable gas resources that can be put on production quickly and supply a hungry gas market (while also reducing mob/de-mob costs). SDX hopes to increase production by 50% in the next one to two years. Management estimates unrisked IRRs for these wells at significantly above 100% in an area where historical success has been 80%, underlining the commercial attractiveness of the assets.

Valuation: Full NAV of 64p/share

The added wells funded by the equity raise have the net effect of increasing the value in the company. Egyptian drilling will allow processing and pipeline facilities to be right-sized while drilling in Morocco should increase net resources and allow for quicker production increases. However, our NAV falls slightly as a result of reducing our long-term oil price assumption to $70/bbl in 2022 (from c $80/bbl) and reducing our nearer-term Egyptian gas price assumptions.

29 September 2017

Price	**52.1p**
Market cap	**£103m**
	£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	11.8	(3.5)	131.7
Rel (local)	12.7	(3.0)	115.0
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

Heavy work programme in Egypt	H217/2018
Heavy work programme in Morocco	H217/2018

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Edison profile page

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Investment summary

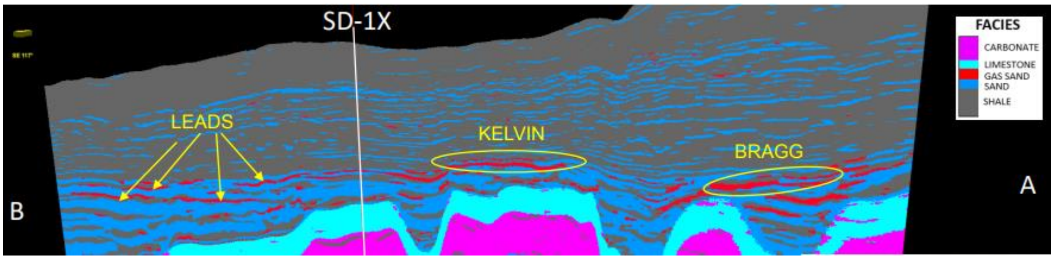
The over-subscribed fund-raising, completed on 15 September 2017, raised $10m and will enable SDX to drill four additional wells. Two exploration wells will be drilled in Egypt, targeting two prospects close to the South Disouq SD-1X discovery which together could add a further 150bcfe (78% gas/ 22% condensate assuming a similar gas oil ratio to the independent resource report). In Morocco, two further wells will target additional resources of 1.91bcf in aggregate, adding to the five development wells and two exploration wells already slated.

Egypt

The two additional exploration wells in Egypt are important to gauge the size of the resource as soon as possible. This will be used to right-size the processing facilities required to give the most economic development concept over the fields/prospects identified. SDX Energy has also committed to two appraisal/development wells that will target the first discovery, where the company believes substantially more gas could be de-risked by drilling on the flanks of the structure (which is thought to thicken out).

Kelvin and Bragg could add a combined 150bcf to resources (with additional condensates) and lie on trend with the existing discovery at South Disouq. As such, success here could add materially to the existing 47bcf (plus condensates) ascribed to the discovery by reserve auditor Gaffney Cline & Associates.

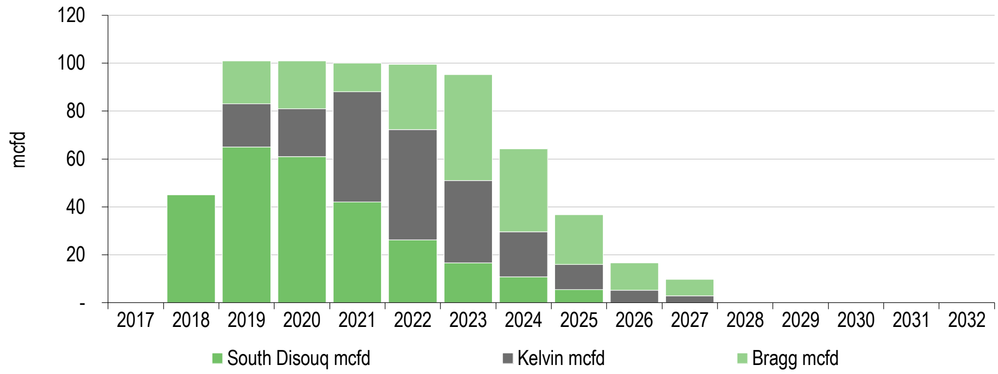
Exhibit 1: Kelvin and Bragg on trend with SD-1X



Source: SDX Energy

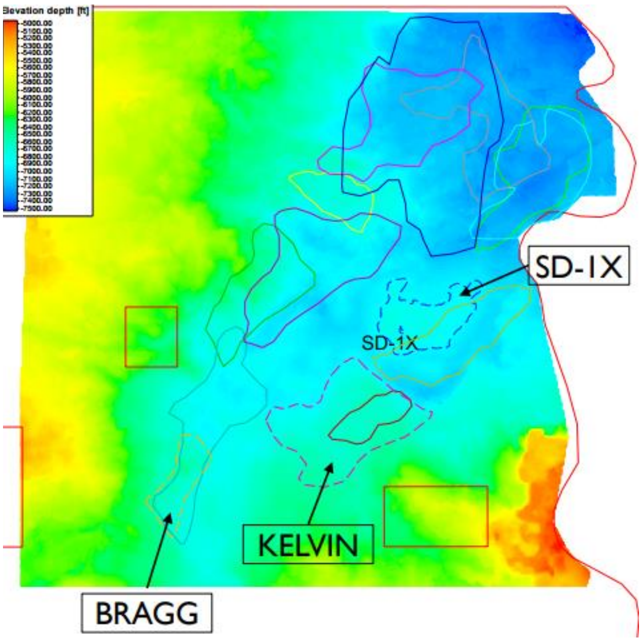
Success at both Kelvin and Bragg will likely justify capex invested in processing, while development of just the SD-1X resource would favour rented facilities. Success at both exploration wells would not mean that they are produced immediately. Instead, volumes would likely be produced over a staged period from all three fields, with gas being fed in as production from South Disouq (first discovery) starts to decline. The chart below gives an indication of our modelling – though this is open to modifications as and when drilling results come in.

Exhibit 2: South Disouq (and others) gas volumes modelled – assumes success in both follow-up wells at South Disouq



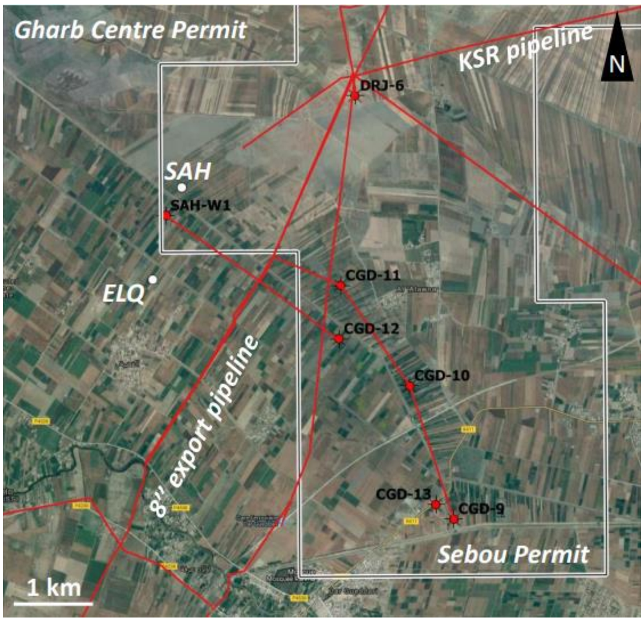
Source: Edison Investment Research. Note: Excludes condensate volumes in gas equivalent terms. In purely gas production.

Exhibit 3: Kelvin and Bragg locations



Source: SDX Energy

Exhibit 4: Well locations in Morocco



Source: SDX Energy

Morocco

In Morocco, SDX Energy plans to continue drilling the types of structures that have seen historical success rates in the licences of over 80%. As a result, the first seven of the nine wells that will now be drilled (with the first having spudded on 18 September) have a high chance of adding useful resources to the portfolio, with two wells at the end of the programme targeting riskier exploration opportunities. With around 0.8-1.0bcf per well, the company should be well-placed to increase production quickly to a market that is gas hungry.

The company believes the work programme can drive an increase in production of more than 50% above current levels (of net 639boe/d on a pro-forma basis in H117) in the next one to two years and increase resources by 100%. This should be absorbed by the market in Kenitra as the competing fuels (diesel or CNG) are substantially more expensive than the current prices paid; CNG prices are around $18/mcf, while the company expects to sign a future contract with customers at $10-12/mcf. This would boost cash flows expected from the development which can be recycled to help develop the Egyptian assets.

While the addition of two wells in the Moroccan programme was not obligatory and does add near-term capex, it does mean that virtually all the drilling required to boost production is done in one campaign, reducing the material mob/demob costs on a per well basis. It also fulfils a commitment well in the Gharb Centre licence.

Valuation

In our view the funding round was sensible despite the 9.4% increase in share count – the additional drilling funded by the equity raise is positive for the company, enabling it to firm up its resources faster, right-size development facilities and reduce long-term costs. The demand for the shares was strong, underlining the faith the institutional holders have in the story.

We have introduced our new long-term oil price assumption, with a $70/bbl Brent in 2022 (equivalent to $60/bbl real in 2016), inflating at 2.5% thereafter. This is around $10/bbl lower than our previous long-term assumption. In the nearer term, price assumptions remain the same with $50.8/bbl in 2017 and $51.6/bbl in 2018 moving steadily up to our long-term view. In addition, we have reviewed our expectations of gas prices in Egypt which reduces the value for the South Disouq discovery on a dollar per barrel basis.

As a result of the changes, our NAV falls slightly to 64p/share, but this is made up of a core production development NAV of 52p/share and relatively low risk development/exploration making up a further 12p/share. Importantly, the development of the assets/prospects should be internally funded with production from the SD-1X development generating cash flows as early as Q118 and Moroccan additions benefiting from the high gas prices.

Exhibit 5: NAV summary

Asset	Number of shares: 204.5m			Recoverable reserves				Net risked value @ 12.5% discount rate		
	Country	WI	CoS	Gross	Net WI	Net	NPV		GBp	C$
		%	%	mmboe			$/boe	$m	per share	
Net (debt)/cash - June 2017		100%	100%					28	10.8	0.17
Cash in from equity raise		100%	100%					10	3.8	0.06
SG&A - NPV10 of 4yrs		100%	100%					(12)	(4.5)	(0.07)
Receivable for gas and NGLs at Gemsa		100%	100%					8	3.3	0.05
Production										
Meseda Base case - Edison	Egypt	50%	100%	4.3	2.1	0.8	5.3	11	4.5	0.07
Meseda Base + Workovers - Edison	Egypt	50%	90%	5.8	2.9	1.1	4.4	12	4.5	0.07
Gemsa 1P	Egypt	50%	100%	3.3	1.6	1.6	9.5	15	6.0	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	8.2	0.13
Sebou - accelerated programme (updated)	Morocco	75%	60%	1.0	0.8	0.8	11.8	7	2.9	0.05
South Disouq SD-1X well - GCA estimate	Egypt	55%	85%	10.1	5.6	5.6	4.6	22	8.5	0.14
Acquired working capital (NPV of four-year release)	Morocco	100%	100%					9	3.4	0.05
Core NAV				**27.1**	**14.6**	**11.5**	**6.2**	**134**	**52.5**	**0.84**
Development upside										
Meseda Base + Workovers + Waterflood - Edison	Egypt	50%	50%	5.5	2.7	1.0	1.1	2	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 and funded)										
South Disouq - Kelvin	Egypt	55%	41%	15.1	8.3	8.3	3.4	11	4.4	0.07
South Disouq - 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				**75.2**	**37.6**	**32.8**		**164**	**64.0**	**1.03**

Source: Edison Investment Research

Financials

As of the end of June 2017, SDX held $27.6m in cash and is well funded to execute its aggressive work programme in Egypt and Morocco in H217. We anticipate capex in H217 of $20.4m (after $1.8m in H1, excluding acquisitions and cash acquired), leaving full 2017 capex as $22.2m. After the additional cash flows that Egyptian and Moroccan production contributes and a release of working capital, we expect year end cash of $23m.

This level of cash flow generation and balance sheet strength should ensure the company's ability to develop any discoveries, especially given the early cash flows we expect from the SD-1X discovery and the short timelines from discovery to production in Morocco.

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Exhibit 6: Financial summary

Accounts: IFRS, Year-end: December, US$000s	2014	2015	2016	2017e	2018e
Total revenues	**24,533**	**11,372**	**12,914**	**35,809**	**51,675**
Cost of sales	(3,639)	(4,973)	(5,282)	(11,681)	(16,176)
Gross profit	**20,894**	**6,399**	**7,632**	**24,128**	**35,499**
SG&A (expenses)	(1,768)	(3,746)	(2,457)	(3,419)	(1,846)
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)	(14,913)	(14,397)
Reported EBIT	**13,693**	**(7,083)**	**(26,701)**	**4,797**	**18,256**
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)**	**4,797**	**18,256**
Income tax expense (includes exceptionals)	(4,328)	(1,063)	(1,503)	(273)	(1,108)
Reported net income	8,356	10,047	(28,200)	4,524	17,148
End period number of shares, m	376	38	80	204	204
Balance sheet					
Property, plant and equipment	9,392	18,401	12,605	33,894	59,710
Intangible assets	16,460	23,473	10,623	8,645	13,113
Other non-current assets	1,999	2,106	2,503	2,879	2,879
Total non-current assets	**27,851**	**43,980**	**25,731**	**45,418**	**75,702**
Cash and equivalents	17,935	8,170	4,725	23,812	15,081
Inventories	0	1,188	1,698	1,698	2,351
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**	**63,973**	**48,203**
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	90,538	108,687
Non-controlling interest	0	0	0	0	0
Cash flow statement					
Profit before tax	12,684	11,110	(26,697)	4,797	18,256
Depreciation and amortisation	1,602	2,057	3,266	14,913	14,397
Share based payments	1,064	761	(47)	1,000	1,000
Other adjustments	1,670	(12,281)	25,742	(1,156)	(2,354)
Movements in working capital	12,941	(2,183)	(3,440)	3,500	3,404
Interest paid/received	0	0	0	0	0
Income taxes paid	(4,430)	(4,678)	(766)	(273)	(1,108)
Cash from operations (CFO)	**25,531**	**(5,214)**	**(1,942)**	**22,781**	**33,596**
Capex	(13,634)	(5,120)	(11,890)	(22,224)	(44,680)
Acquisitions & disposals net	0	0	0	(30,000)	0
Other investing activities	1,110	4,836	825	781	2,354
Cash used in investing activities (CFIA)	**(12,524)**	**(284)**	**(11,065)**	**(51,444)**	**(42,327)**
Net proceeds from issue of shares	0	0	10,127	47,750	0
Movements in debt	0	(3,702)	(96)	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)	19,087	(8,731)
Currency translation differences and other	(615)	(565)	(469)	0	0
Cash and equivalents at end of period	17,935	8,170	4,725	23,812	15,081
Net (debt) cash	**15,728**	**8,170**	**4,725**	**23,812**	**15,081**
Movement in net (debt) cash over period	12,392	(7,558)	(3,445)	19,087	(8,731)

Source: Edison Investment Research, company accounts

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