TURNER POPE INVESTMENTS

Marketing Communication
Your Capital is at Risk

RESEARCH 23 April 2020

Sound Energy plc

Stock Data

Share Price:	1.15p
Market Cap.:	£13.3m
Shares in issue:	1,156m

Company Profile

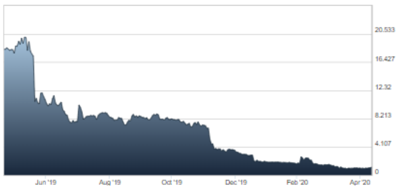
Sector:	Oil, Gas and Coal
Ticker:	SOU
Exchange:	AIM

Activities

Sound Energy ('SOU, 'the Group') is a Moroccan exploration company focused onshore gas with a low cost 0.65 Tcf discovery (TE-5 Horst). It has supportive cornerstone investors, multiple strategic partners and a regional gas strategy that is underpinned by strong demand and local pricing.

Website: www.soundenergyplc.com

1-Year Share Price Performance



Source: *LSE*

Note: Past performance is not an indication of future performance.

Turner Pope contact details

Turner Pope Investments ('TPI') Limited
8 Frederick's Place
London
EC2R 8AB

Tel: 0203 657 0050
Email: info@turnerpope.com
Web: www.turnerpope.com

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Barry Gibb
Research Analyst
Tel: 0203 657 0050
barry.gibb@turnerpope.com

Andrew Thacker
Corporate Broking & Sales
Tel: 0203 657 0050
andy.thacker@turnerpope.com

Zoe Alexander
Corporate Broking & Sales
Tel: 0203 657 0050
zoe.alexander@turnerpope.com

The Moroccan focused upstream oil and gas company has announced its audited final results for the year ended 31 December 2019. These highlight a period during which SOU's Board successfully faced up to numerous challenges, as a result of which it effected a programme of structural cost reduction and explored options on monetising its Eastern Moroccan Portfolio, which presently remains ongoing. While the more recent COVID-19 Pandemic is not expected to significantly alter the anticipated schedule or broad economics of TE-5 Horst's full field development, nearer-term it could possibly impose some delay on the Group's micro-LNG ('mLNG') implementation. Given the expectation that this strategy was considered capable of generating relatively short-term positive cash flow, sufficient to bolster its relatively weak balance sheet while also providing funding to continue limited higher risk exploration drilling, this could be unfortunate. Measures announced by the UK Chancellor to support businesses impacted by the Pandemic could potentially provide some financial relief, while opportunity for near-term partial sale of its Eastern Morocco portfolio also remains notwithstanding which, the Group's cashflow forecast for the 12-months to end-April 2021 indicates that additional funding will be required to enable it to meet its forward obligations.

Having seen SOU undertake two modest equity placings in the past 10 months, investors are already clear regarding the Group's need to strengthen its balance sheet. Post its structural reduction, TPI estimates SOU presently has a continuing cash burn of c.£0.5m/month, which suggests a runway that goes no further than its December 2020 year end. Yet the fact that the Group's share price remains marginally higher than the levels being achieved five weeks ago, reflects the belief that the COVID-19 Pandemic is unlikely to undermine its central business plan to complete TE-5 Horst's full field development and commercialisation, while continuing regulatory/planning/environmental development progressively reduces its risk profile.

The Group's full year 2019 results themselves held few surprises. The loss for the year before tax from continuing operations was £16.4 million (2018: £11.7 million); exploration costs of £6.6 million (2018: £4.1 million) were related to the impairment charge of TE-10 drilling and well test costs given that it failed to achieve a commercial gas flow rate. Administrative costs at £6.1 million were lower than the 2018 figure of £8.9 million due to the structural cost reduction initiative taken during the year which included staff reduction. As at 31 December 2019, the Group's carrying amount of property, plant and equipment was £147.3 million (2018: £151.0 million) primarily related to the development and production assets in Morocco with a carrying amount of £146.9 million (2018: £150.6 million) after taking account of additions and foreign exchange movement. Its period-end cash balance was £4.6 million, while an equity placing priced to 2 pence/share completed in January 2020 added a further £1.5 million (gross).

Prudent modelling of SOU's discovery alone suggests considerable value is being created as it inexorably moves toward commencing full field development. Interest in the Group's surrounding licence areas should also magnify once the Concession demonstrates meaningful production. Against the near-term background of exceptional plummeting oil and gas prices, which in any case is expected to have somewhat corrected before TE-5 Horst's commecialisation, SOU's profitability remains dependent more on regional gas pricing mechanisms than international spot and so provides it with a significant degree of protection from such volatility. Industry standard $DCF_{10\%}$ analysis for the prospect has been based on highly prudent farm-down assumptions and a certified mid-case original gas in place ('OGIP') of 0.65Tcf, leading to clean output of 66MMscf/d commencing Q3'2022E and sustained for 10 full years thereafter. This indicates a Project post-tax $NPV_{10\%}$ of US$587m, and a project IRR of 44%. TPI has assumed SOU holds just a (post-deal) 23.3% WI (compared with 47.5% presently) which, after adjusting for estimated current net debt of £18.4m, derives a valuation of 7.5p/share, although successful negotiation that results in lower dilution, commencement of mLNG extraction and/or further exploration success offers significant upside potential. As TPI detailed in its SOU initiation research released in March 2020, while as much as a year's slippage of the Group's original development timetable might be foreseen and notwithstanding its relatively modest short-term funding needs, the share price still appears to belie the true scale of the opportunity presented in this highly prospective, virgin territory.

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