2 September 2024

OIL & GAS

Flashnote

Marketing Communication (Connected Research)

Prospex Energy Plc#

BBG Ticker: PXEN LN *Price: 5.8p* *Mkt Cap: £23.2m* **BUY**

Spanish Gas Acquisition

Prospex Energy (PXEN LN) is an investment company with exposure to European gas and power markets which has now completed an investment into a third natural gas project; Viura in Northern Spain.

Viura Highlights

Viura is one of three producing onshore gas fields in Spain and the new well programme is expected to take production from 12mmcfd by year end to a peak of 30mmcfd and VSA estimates gross post tax cashflows averaging €50mpa following total capex of c€63m. PXEN now has a 7.5% interest in **HEYC Energy Iberia (HEI)** covering field development costs on a two for one promote basis plus a preferential payout for new investors to hasten capex payback. We value the net stake at €22m (4.4p/sh.) based on long term gas prices of €40/Mwh and a 10% discount rate. HEI is the operator and the major shareholder is **Heyco Energy Group Inc**, an independent US E&P group with a more than 20-year track record. As part of the deal, Heyco has taken a position in PXEN diversifying its exposure to European onshore gas production and supporting PXEN's entry into Viura.

Rising Gas Prices

Three wells are planned at Viura of which two are permitted and the first has been spudded with production expected to commence in October. The field economics published by PXEN are based on €30/MWh and at this price level a small cash call is required in 2025, however, a €1/MWh increase in pricing substantially reduces this by 45% to £2.7m while should the current price of €39/MWh be sustained or exceeded, the costs should be covered entirely by cashflows. Benchmark European prices have increased 70% from the February low with the recent move higher in part driven by the counter offensive into Russia. Following two mild Winters, gas price volatility has reduced, however, this recent escalation highlights the ongoing structural vulnerability of Europe's gas supply which remains reliant on Russia for c15% of its supply. This underpins the investment case for PXEN and its expanded footprint as a producer of domestic European natural gas.

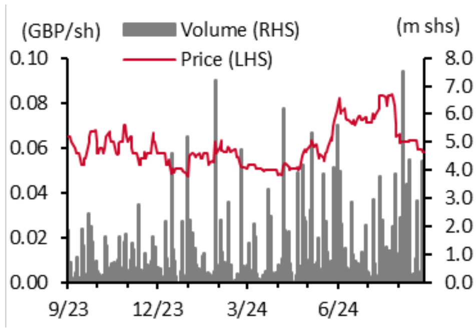
Recommendation and Target Price

Our risked sum of the parts NPV valuation is updated for the new shares issued (£4.2m raised at 6p/sh.) and stake in Viura. The transaction was supported by Heyco which becomes a 10.35% shareholder in PXEN and this highlights the attractive entry terms into the field. We believe the new interest in Viura is a beneficial addition to PXEN's portfolio, diversifying the company's exposure to advanced onshore European natural gas assets with attractive upside potential. **We reiterate our Buy recommendation and increase our target price to 20p/sh.**.

Company Description

Investment company with interests in producing gas assets in Spain and Italy.

One Year Price Performance



Price % chg	1mn	3mn	12mn
	-10.8%	-20.0%	-10.8%
12mn high/low:			8.4p/4.8p

***SOURCE**: Workspace, as of 30 August 2024 close*

Market:	LSE AIM
Price target:	20p
Shares in issue diluted:	402.54m
Free float:	85.6%
Net debt (End 2023):	£0.2m
Enterprise value:	£23.4m

Major shareholders	
Heyco Energy Group	10.35%
Simon Chantler	5.06%
Colin Wilson	4.99%

Oliver O'Donnell, CFA, Natural Resources
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Viura Project Highlights

PXEN has acquired 7.5% in HEYCO Energy Iberia S.L. (HEI) by committing to 15% of the 2024-2026 development costs. HEI holds an interest in the Viura concession of 96.4865% (subject to regulatory approval) meaning PXEN now has a net interest of 7.2365% in the project. The HEYCO Energy Group Inc is the majority owner of HEI and has been operator of Viura since 2022.

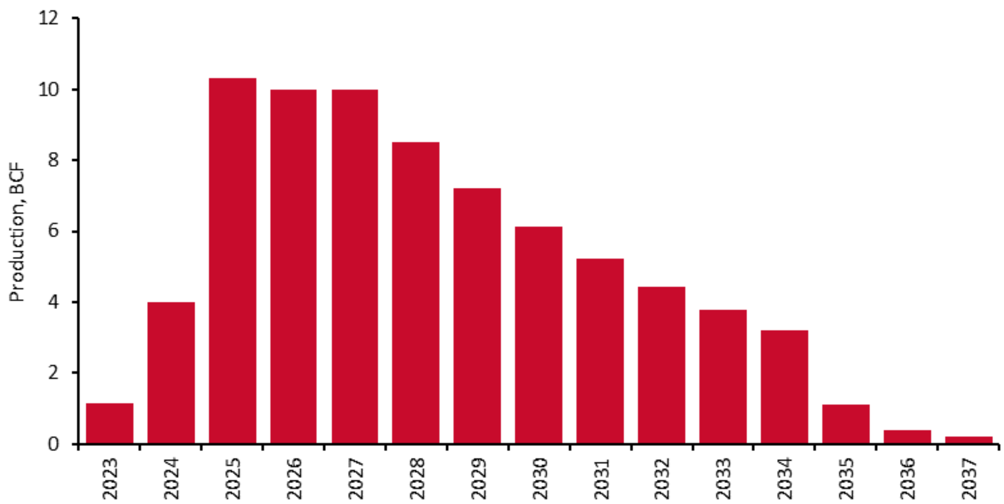
Viura is one of just three producing onshore natural gas fields in Spain, the others are El Romeral and Marismas. Viura was discovered in 2010 and developed over the following decade and now accounts for over 80% of Spain's domestic natural gas production. The investment opportunity comes at a key time for the operation with two wells recently permitted and a third planned. The first of these was spudded in late June 2024 and production is likely to reach 12mmcf/day by the end of 2024 with production commencing in October after reaching target depth in September. This is an inflection point in terms of production rates, revenue generation, and profitability for the project. Permits have been submitted to drill the third well which is currently targeted for H2 2025. The production upside from this is not currently included in our valuation.

The reservoir is known to be highly pressurised and peak production is expected to be considerably higher than the 2024 run rate rising to a peak of 30mmcf/day. Over the minimum 12-year life of the currently modelled production, life production is expected to average 18mmcf/day. Gas in place stands at 205Bcf while our forecasted production from these next two wells (Viura 1B and 3B) is likely to be around 80Bcf and does not incorporate the third unpermitted well. Gross remaining reserves stand at 90BCF.

Being a brownfield expansion, US$87m has been spent on development and building infrastructure to date meaning this round of capital investment is being focused on well drilling and tying in the wells to the gas plant and infrastructure. Viura is linked into the Spanish Gas System of pipelines which connect across the country.

The single well is currently producing intermittently due to water production. Therefore, alongside the development well a water injection test will be run to enable this well to be used for water disposal. Assuming this is successful this well will be converted. The new well is therefore targeting areas of the reservoir with lower water production and this water disposal solution will be lower cost for the new water disposal requirements.

Viura Production Outlook



SOURCE: *Company data, VSA Capital Research*

Prior to the transaction HEI held a 58.7964% stake with the other participants in the field being **Sociedad de Hidrocarburos de Euskadi, S.A.** (SHESA, 37.6901%) and **Oil and Gas Skills, S.A.** (3.5135%). On 5 April 2024, HEI entered into an asset purchase agreement with SHESA for the acquisition of the participation of SHESA in the Viura Field Development which is subject to approval by the regulator. Following the acquisition of SHESA's interest, HEI will have a 96.4865% interest in Viura, therefore Prospex will indirectly own 7.2365% of the Viura concession, its reserves and the existing surface production facilities of the Viura gas plant, which is connected to the Spanish national grid, through its 7.5% shareholding in HEI.

Viura Investment Highlights

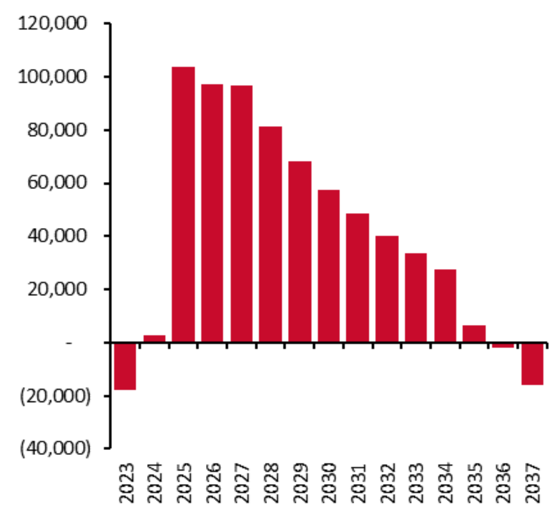
The assumptions presented by Heyco and PXEN are highly conservative, in our view, and represent a low-risk entry point from the perspective of valuation and operating risk, particularly given Heyco's more than twenty-year track record as an operator at Viura and elsewhere in the UK and US. Our assumptions are more closely aligned with current market conditions and therefore demonstrate a closer reflection of fair market value, in our view. We highlight that new investors in the field including PXEN benefit from preferential payouts to aid capex payback. PXEN's initial contribution is £3.51m (US$4.62m) for 2024 costs and we believe this is an attractive entry point into a profitable project given a €22m valuation of the stake on our assumptions. Heyco's decision to invest in PXEN also highlights the attractive terms, in our view, as well as diversifying its exposure to European onshore gas.

The base case assumptions are based on €30/MWh and a 15% discount rate, and Spanish gas prices which correlate closely with the European TTF benchmark with a typical spread of up to €4/MWh. The benchmark price is up 70% from the February low to €39/MWh currently.

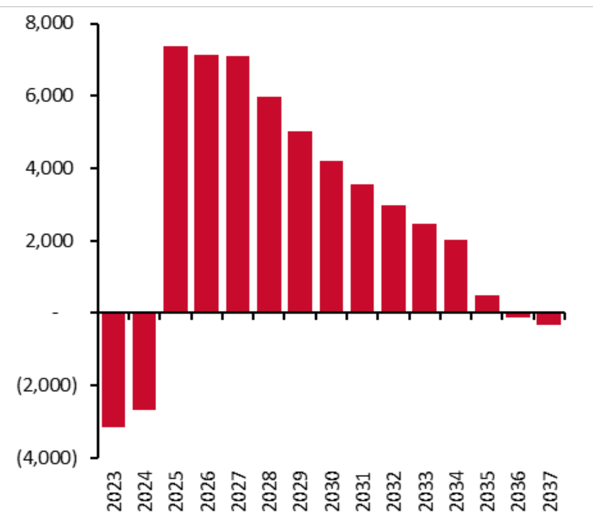
On the assumptions published by PXEN, the gross NPV15 is €64m which aligns with the forecast capex, however as highlighted, these assumptions are conservative. At a discount rate of 10% which we believe is more appropriate for the project being in a stable jurisdiction, combined with nearer spot pricing implies a gross NPV10 of €357m with average annual free cash flow of €50m after royalties and taxes. Phase 1 development costs are expected to be US$26m in 2024 and US$44.2m in 2025 and 2026 heavily weighted to 2025.

For its 7.5% interest, PXEN is required to cover 15% of the development costs, receiving a net share of 7.5% in production and reserves as well as preferential payouts to sweeten capex repayment for new investors. PXEN contribution to 2025 and 2026 costs is expected to be £4.84m (US$6.36m) assuming the base case assumptions at €30/MWh. This reduces to £2.7m (US$3.55m) assuming a flat price of €31/MWh and is entirely paid for by cashflows at €39/MWh.

Viura Gross Cashflows (€'000)



PXEN Net Viura Cashflows (€'000)



SOURCE: *Company data, VSA Capital Research.*

From PXEN's perspective, reflecting PXEN's 7.5% interest, two for one promote, and the preference payout to which new investors are entitled, we determine an NPV10 of €22m. The preferred payback mechanism gives new investors a 10% return on their invested capital until the initial capital is repaid by cashflow on a gross basis in addition to their underlying interest. During this period, Heyco Energy Group will not receive production income on their 50% over and above expenses including taxation other than via its interest in PXEN.

Thereafter the structure of the limited partnership allows for regular distributions of capital to the underlying investors once the capital is repaid. Our analysis indicates this could commence as soon as 2026.

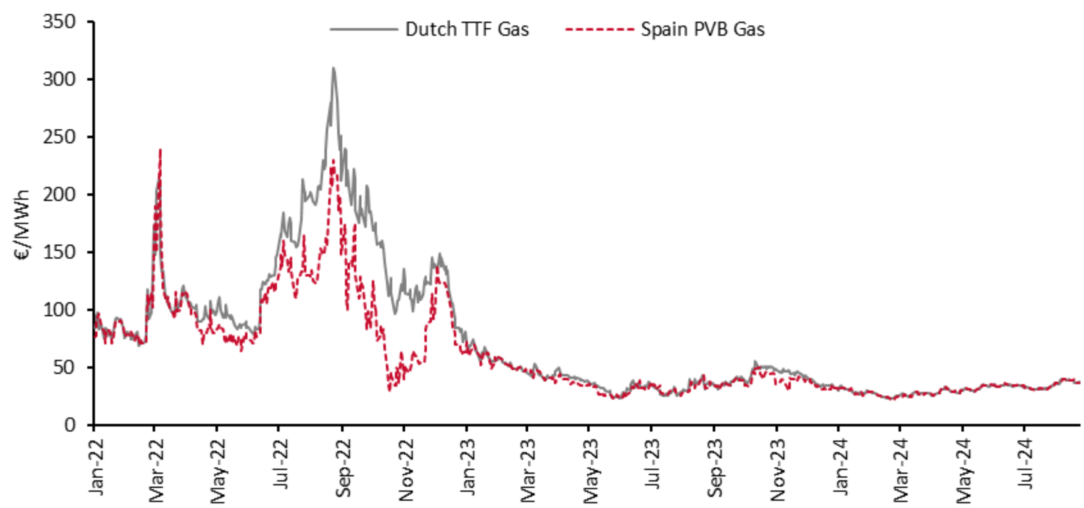
Corporate tax rates for hydrocarbon production in Spain are 35% and onshore oil and gas royalties are based on a sliding scale linked to production rates 3-5% (gas) and 2-8% (oil and condensate). Viura pays a 1% royalty to the landowner.

Spain Natural Gas Market

Spain imports the vast majority of its annual gas requirements and has one of the most well-developed gas networks in Europe with a higher number of underground storage facilities and regassification terminals compared to other countries. It is therefore a key entry point into Europe for LNG: this linkage into global markets and into the wider European market means that benchmark TTF prices are closely aligned with Spain's PVB benchmark with a narrow spread of only up to €4/MWh typically between the two.

In June 2022, the Spanish Government imposed a gas price cap initially set at €40/Mwh, which increased by €5/MWh after six months. This was set up as a temporary measure in response to the price increases owing to the Russian invasion of Ukraine. The cap provides producers with a grant covering the difference between the wholesale price and the cap level. Producers are paid through an adjustment mechanism funded through other levies and transmission charges on export. The outcome appears to have been a smoother than otherwise price performance, however, while the gap could be reinstated, should prices rise again, we would expect the same mechanisms to be in place so that projects such as El Romeral and Viura continue to receive a market rate.

Spain Gas Price and TTF Chart



SOURCE: *eikon, VSA Capital Research.*

Spain's power prices have been significantly impacted by the rise of renewables and the spread between day and night prices has been significantly exacerbated by growth in solar generation capacity with near zero prices during daylight hours. Gas is a key backup and baseload energy source forming around a quarter of power production. Wind (22%), nuclear (21%) and solar (10%) are the next most significant sources. Hydroelectric can also be a significant contributor, however, this has been variable in recent years due to droughts. Gas is a preferred back-up in this scenario as nuclear is more suited to baseload rather than load following power generation.

Selva Update

The July quarterly update from **Po Valley Energy (PVE AU)** confirmed that production in Q2 2024 had been maintained at c80,000smd with total production of 6,835scm and revenue of €2.3m each on a 100% basis and up 7% QoQ and 21% QoQ, respectively. Prices in the quarter increased to an average of €34/MWh accounting for the outsized revenue increase against production. Although overall production increased, the period did include some downtime for routine maintenance. PVE highlighted a further net operating cashflow figure of €1m for the period continuing the trend of rising profitability.

Revenue and Production from Selva PM-1

	Q3 2023	Q4 2023	Q1 2024	Q2 2024
Production PM1 -100% (kscm)	5,658	4,180	6,385	6,835
Production PM1 - Net to PXEN (37%) (kscm)	2,094	1,547	2,363	2,529
Revenue PM1 -100% € '000	1,937.1	1,773	1,907	2,312
Revenue PM1 - Net to PXEN (37%) € '000	717	656	718	855

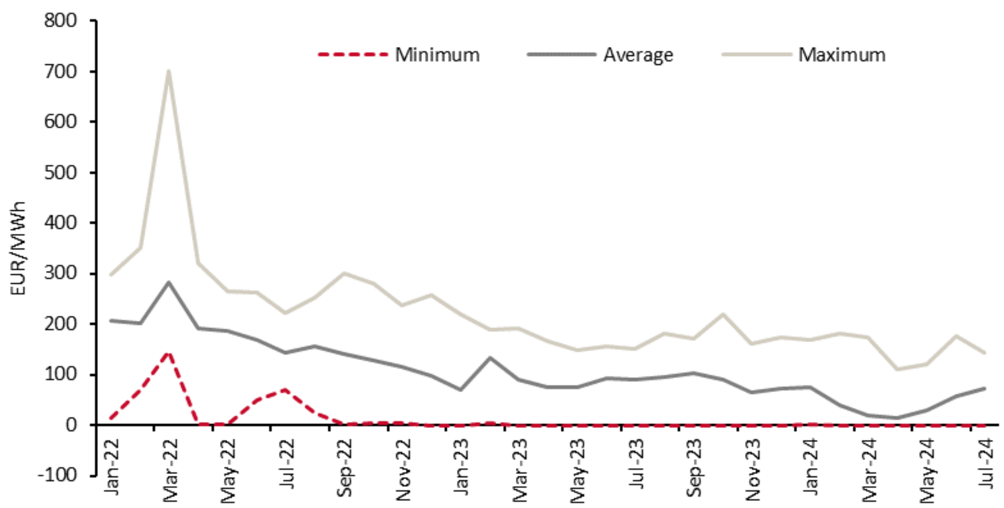
SOURCE: *Company data, VSA Capital Research*

Application for the 3D seismic survey was submitted in mid-June and is the next step towards development of the broader licence area.

El Romeral

The last update was PXEN's full year results which highlighted that gross revenue at the project in 2023 was €1.8m compared to €3.4m in the prior year, largely due to lower pricing. A widening daily spread has also been a feature of local power pricing with significant solar contribution bringing daytime prices down to close to zero while overnight averaged €177/MWh in 2023. PXEN production is interpreted to be flat YoY given the reported utilisation rates are broadly the same capped at c.33% or 2.7MW following the recent upgrades. This underutilised balance is expected to be unlocked by new permits which were lodged in 2023 to enable drilling of additional gas wells. Full capacity could be achieved from just two of the five wells the company is seeking to permit with stronger margins for the plant given greater coverage of fixed costs.

Spain Power Price Chart



SOURCE: *Omie, VSA Capital Research.*

There is no update on the potential timing of permits; the company had hoped for a swifter process that would enable production ramp up to 100% capacity utilisation or c.60MWh in 2024, generating long term annual cashflow in excess of €1mpa at normal pricing levels. At current levels, we expect the operation to be about breakeven. Royalties and taxes are, however, relatively high and on a net basis our NPV8 value for the asset is now €4.6m.

European Gas

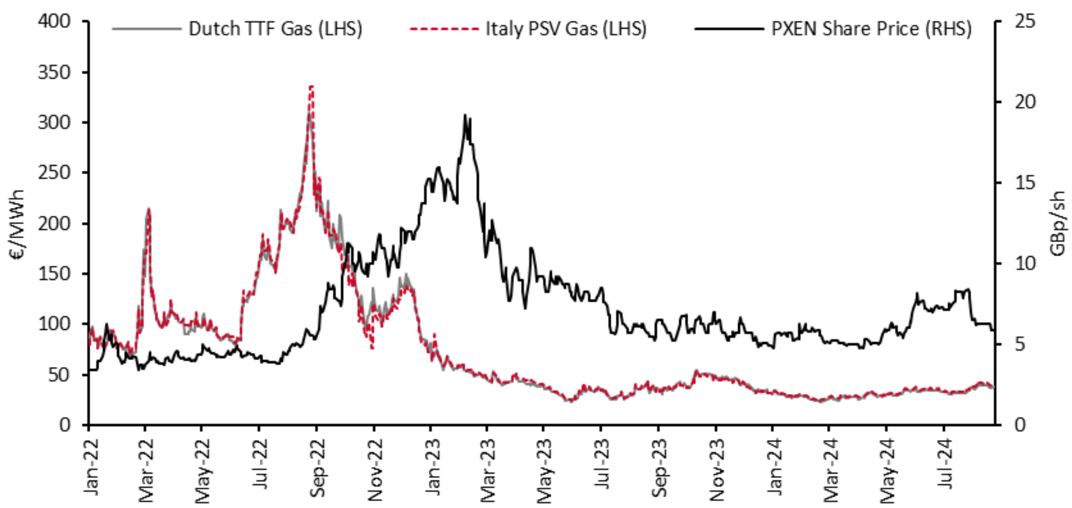
Having dropped to below pre-energy crisis levels, the European TTF gas benchmark has risen 71% from the February lows to €39/MWh. The recent Ukrainian offensive has raised concerns over continued supply of Russian gas into Europe.

Although Russian supplied gas to Europe has dropped 67% since the 2022 invasion, it still accounts for 15% of Europe's gas supply. Disruption for this could easily cause a significant increase in pricing.

Prices have been low in part due to favourable weather conditions which masked the fragility of Europe's new gas dependency. Now reliant on gas imports from the US, Qatar, and Nigeria, Europe must cover the gas of liquefaction, transport and regasification of natural gas from where it is produced as well as being exposed to demand trends in other regions. With the recent favourable weather depressing winter gas consumption, this has allowed storage to be filled and the low prices incentivised spot purchases rather than drawing on inventory during periods of stronger demand. Storage ended the Winter at around 60% (above the five-year average for this time of year) and Summer is the typical restocking period.

The recent geopolitical related buying highlights the vulnerabilities of the current European gas market structure which has not been tested due to two mild winters. Escalation in the conflict or a colder Winter could quickly change this while competition for global LNG supplies will increase volatility further should these scenarios play out.

PXEN Share Price vs. Dutch TTF & Italy PSV



SOURCE: *Eikon, VSA Capital Research.*

Valuation

PXEN remains debt free and now with a new investment in a second asset in Spain and the third for the group as a whole. We have updated our valuation to reflect the new Viura project alongside updates to other operating assumptions as well as the addition of 69.9m shares issued at 6p/sh. to raise £4.2m. Being an investment company, we do not forecast group level financials.

Our valuation is based on a sum of the parts methodology using DCF-based valuations for the producing and near-producing assets. These results are used to derive analogue-based valuations for the adjoining prospects in both Spain and Italy. We continue to exclude Tesorillo from our valuation, however, successful permitting on the El Romeral assets could prove indicative of the view of the Spanish Government on permitting.

Viura is now incorporated into the model on this basis and given the highly conservative assumptions used in the acquisition model we believe that the intrinsic value is higher, on our assumptions, and this should now be reflected in PXEN's share price. First gas from the new well is due in October and given Heyco's operating experience we believe that only a small discount is required for the chance of success adjustment.

Operational Snapshot, €'000

	2024 F	2025 F	2026 F
Selva			
Production (100%), mmscfd	2.8	2.8	2.8
Net Income	4,923	7,430	7,476
Capex	(50)	(50)	(50)
FCF	5,429	7,860	7,842
Production (Net 37%)	1.0	1.0	1.0
Net Income	1,822	2,749	2,766
Capex	(19)	(19)	(19)
FCF	2,009	2,908	2,901
El Romeral			
Production (100%), MWh	22,366	22,366	61,508
Net Income	2	(55)	806
Capex	(50)	(3,050)	(50)
FCF	25	(2,975)	868
Production (Net 49.9%)	11,161	11,161	30,692
Net Income	1	(27)	402
Capex	(25)	(1,522)	(25)
FCF	12	(1,484)	433
Viura			
Production (100%), BCF	1.2	4.0	10.3
Net Income	8,252	43,804	106,855
Capex	(23,526)	(36,900)	(2,844)
FCF	(17,888)	2,804	103,695
Production (Net 7.5%)	0.1	0.3	0.8
Capex	(3,921)	(6,150)	(474)
FCF	(3,162)	(2,684)	7,381

SOURCE: *Company data, VSA Capital Research.*

The third investment provides additional exposure to European onshore gas production while diversifying the investment risk and adding a material source of profitable production and brings a strategic shareholder to the register.

PXEN is expected to receive distributions from Viura once the initial capital is invested and free cash flow is being generated. We note that a third well is planned subject to permitting and is not included in the production or cashflow forecasts and may impact this.

Valuation Summary, £'000

NAV Asset Name	Stage	Timing	Unrisked BCF	Equity %	Net unrisked BCF	CoS %	Net risked BCF	EMV €/mscf	EMV €m	Net unrisked €m	Net risked p/sh (GBp)
Selva	**Producing**	**Production**	**11.6**	**37%**	**4.3**	**100%**	**4.3**	**3.8**	**16**	**16**	**3.6**
Selva North & South	Contingent Resources	TBD	8.9	37%	3.3	70%	2.3	3.8	9	12	2.0
Fondo Perino	Contingent Resources	TBD	9.2	37%	3.4	70%	2.4	3.8	9	13	2.0
East Selva	Contingent Resources	TBD	21.9	37%	8.1	70%	5.7	3.8	21	30	4.7
Riccardina	Contingent Resources	TBD	24.4	37%	9.0	70%	6.3	3.8	24	34	5.2
El Romeral	**Producing / Development**	**Production**	**6.3**	**49.9%**	**3.1**	**85%**	**2.7**	**0.7**	**2**	**2**	**0.4**
El Romeral	Resources	TBD	89.8	49.9%	44.8	10%	4.5	0.4	2	17	0.4
El Tesorillo	Suspended Licence	N/A	0.0	49.9%	0.0	0%	0.0	0.0	0.0	0.0	0.0
Viura	**Producing**	**Production**	**90.0**	**7.5%**	**6.8**	**90%**	**6.1**	**3.3**	**20**	**22**	**4.4**
Adjustments									**£m**		
	SG&A (£)								(6.9)		(1.7)
	Debt (£)								0.0		0.0
	Cash, (£)								0.0		0.0
Total									95.2		21.0
								DLOC	**5%**		**20.0**

SOURCE: *Company Data, VSA Capital Research.*

Our twelve-month target price is 20p/sh.

Historical Financials

Profit & Loss , £'000 December Year End

Income Statement (GBP 000's)	Dec-20	Dec-21	Dec-22	Dec-23
Revenue	–	–	–	36,936
Cost of Sales	–	–	–	–
Gross Profit	**–**	**–**	**–**	**36,936**
SG&A	(972,193)	(891,676)	(975,725)	(1,112,513)
D&A	–	–	–	–
Other Operating	247,143	86,604	(187,417)	(296,191)
EBIT	**(725,050)**	**(805,072)**	**(1,163,142)**	**(1,371,768)**
Interest Payable	(50,989)	(80,771)	(173,023)	(241,056)
Interest Receivable	91,362	109,618	324,052	519,982
Net Interest	40,373	28,847	151,029	278,926
Gain / Loss from Investments	(1,121,815)	3,076,415	9,367,435	(469,709)
Impairment Charge	–	–	–	–
PBT	**(1,806,492)**	**2,300,190**	**8,355,322**	**(1,562,551)**
Tax Expense	–	(40,394)	(1,218,415)	331,151
Net Income	(1,806,492)	2,259,796	7,136,907	(1,231,400)
EBIT	(725,050)	(805,072)	(1,163,142)	(1,371,768)
Depreciation	–	–	–	–
Amortisation	–	–	–	–
EBITDA	**(725,050)**	**(805,072)**	**(1,163,142)**	**(1,371,768)**

SOURCE: *Company data, VSA Capital Research.*

Balance Sheet, £'000 December Year End

Balance Sheet (GBP 000's)	Dec-20	Dec-21	Dec-22	Dec-23
Current Assets				
Cash and cash equivalents	220,618	220,060	1,482,762	3,186
Trade and Other Receivables	917,058	841,502	5,515,237	6,201,093
Inventory	-	-	-	-
Other	-	-	100	100
Total	**1,137,676**	**1,061,562**	**6,998,099**	**6,204,379**
Non-Current Assets				
Investments	3,620,890	6,697,305	16,064,640	15,594,931
Intangible assets	-	-	-	-
PP&E	-	-	-	-
Other	989,645	1,225,570	-	-
Total	**4,610,535**	**7,922,875**	**16,064,640**	**15,594,931**
Total Assets	**5,748,211**	**8,984,437**	**23,062,739**	**21,799,310**
Current Liabilities	-	-	-	-
Borrowings	287,573	140,969	1,812,744	168,487
Trade creditors	164,262	52,892	41,440	126,117
Other	-	-	-	-
Total	**451,835**	**193,861**	**1,854,184**	**294,604**
Non-Current Liabilities				
Borrowings	579,998	247,232	799,145	-
Deferred tax	-	40,394	1,258,809	927,658
Other	-	-	-	-
Total	**579,998**	**287,626**	**2,057,954**	**927,658**
Total Liabilities	**1,031,833**	**481,487**	**3,912,138**	**1,222,262**
Net Assets	**4,716,378**	**8,502,950**	**19,150,601**	**20,577,048**
Equity				
Paid-in capital	7,035,589	7,124,355	7,225,893	7,279,630
Retained earnings	- 14,965,030	- 18,748,005	- 20,141,952	- 20,938,603
Other	12,645,819	20,126,600	32,066,660	34,236,021
Total	**4,716,378**	**8,502,950**	**19,150,601**	**20,577,048**

SOURCE: *Company data, VSA Capital Research.*

Cashflow Statement, £'000 December Year End

Cashflow Statement (GBP 000's)	Dec-20	Dec-21	Dec-22	Dec-23
Operating Activities				
EBIT	(725,050)	(805,072)	(1,163,142)	(1,371,768)
D&A	–	–	–	–
Changes in WC	(522,236)	(136,170)	(3,137,812)	(86,135)
Changes in Other CA and CL	–	–	–	–
Income tax paid	–	–	–	–
Other	140,425	–	187,417	296,191
Cash flow from operations	**(1,106,861)**	**(941,242)**	**(4,113,537)**	**(1,161,712)**
Investing Activities				
Capital Expenditure	–	–	–	–
Increase in intangibles	–	–	–	–
Change in NCA and NCL	(51,664)	(106,722)	(122,091)	(161,427)
Cash flow from investing	**(51,664)**	**(106,722)**	**(122,091)**	**(161,427)**
Financing Activities		–	–	–
New issuance of shares	720,000	1,165,838	3,414,181	58,017
Net Debt (Repayment) / drawdown	619,293	(63,532)	2,196,253	(214,454)
Net interest charges	–	–	–	–
Other	(29,537)	(54,900)	(112,104)	–
Cash flow from financing	**1,309,756**	**1,047,406**	**5,498,330**	**(156,437)**
Net change in cash	151,231	(558)	1,262,702	(1,479,576)
Beginning cash balance	69,387	220,618	220,060	1,482,762
FX differences	–	–	–	–
Ending cash balance	**220,618**	**220,060**	**1,482,762**	**3,186**

SOURCE: *Company data, VSA Capital Research.*

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BUY: The stock is expected to increase by in excess of 10% in absolute terms over the next twelve months.
HOLD: The price of the stock is expected to move in a range between -10% and +10% in absolute terms over the next twelve months.
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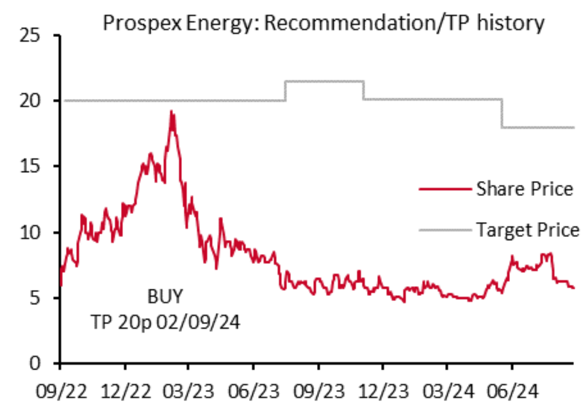
Equities breakdown: 28/08/24	BUY	SPEC BUY	HOLD	SELL
Overall equities coverage	90%	10%	0%	0%
Companies to which VSA has supplied investment banking services	100%	100%	n/a	n/a

Recommendation and Target Price History



***SOURCE**: Workspace, VSA Capital Research.*

Valuation basis

Our valuation is derived from a risked NAV for the producing assets and analogue derived resource valuations for the contingent resources.

Risks to that valuation

Risks to our valuation include possible disappointing drilling results delays to farm-outs and oil price uncertainty.

This recommendation was first published on 6 September 2022.