Flashnote

Marketing Communication (Connected Research)

Prospex Energy Plc#

BBG Ticker: PXEN LN *Price: 5.2p* *Mkt Cap: £17.1m* **BUY**

FY 2023 Results

Prospex Energy (PXEN LN) is an investment company with exposure to European gas and power markets. The company has recently reported full year results with a net loss of £1.2m which broadly represents the G&A of the investment company with cash generative performance from the underlying investments; an operating gas to power plant in Spain (49.9%) and producing gas assets in Italy (37%).

Stable Platform for Growth

A £7.1m profit in 2022 reflected the £9.4m positive revaluation based on a higher interest in the Italian Selva asset and rising gas prices. Despite moving into profitable production, 2023 experienced lower gas prices resulting in a £496k downward revaluation leaving PXEN with investments with a book value of £15.6m. Selva has now delivered three profitable quarters of production, most recently 6.5MMscm with net revenues to PXEN of €718k. The operating partner is preparing to run 3D seismic on the broader targets within the licence area. In Spain, production continued at the constrained output level with the company awaiting permitting for new gas well drilling that will enable an increase in output from 2.7MW up to 8.2MW. Gross revenue of €1.8m was down from €3.4m YoY due to lower power prices.

Due to the profitable performance of the underlying assets, the company announced that it had fully repaid all of its outstanding debt in February 2024 which stood at £2.6m at the start of 2023. With liabilities reduced and profitable investments the company can cover working capital requirements from current resources such as the repayment of the £5.5m in shareholder loans to the Selva operating company. This stable position is enabling the company to undertake an active business development strategy seeking assets which are complementary to the existing strategy.

Recommendation and Target Price

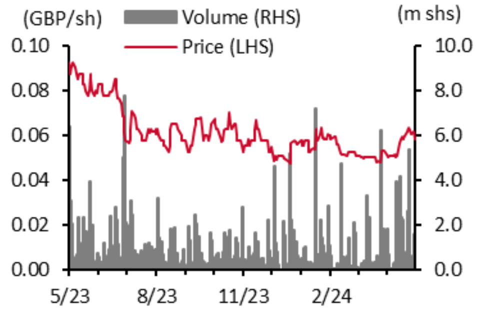
We have updated our valuation for recent changes to production outlook and pricing, however, highlight that recent favourable weather conditions, both the mild winter and recent strong winds have masked the fragility of Europe's higher cost import dependent gas market. A change in these conditions could quickly result in increased energy price volatility benefitting PXEN's near-term cashflows. We also highlight exploration activity at Selva with 3D seismic planned for the near term designed to determine well locations while well permits have been lodged to unlock underutilised capacity in Spain.

We reiterate our Buy recommendation and adjust our target price to 18p/sh..

Company Description

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

One Year Price Performance



Price % chg	1mn	3mn	12mn
	0.0%	-14.2%	-41.1%
12mn high/low:			9.3p/4.8p

***SOURCE**: Eikon, as of 14 May 2024 close*

Market:	LSE AIM
Price target:	18p
Shares in issue diluted:	332.6m
Free float:	67%
Net debt (End 2023):	£0.2m
Enterprise value:	£17.3m

Major shareholders	
Colin Wilson	6.0%
James & Olga Simmons	5.2%
Simon Chantler	4.3%

Oliver O'Donnell, CFA, Natural Resources
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Selva, Italy (37%)

PXEN owns 37% with the balance held by partner **PO Valley Energy (PVE AU).** During the period, the company achieved first gas and made positive progress at optimising flow rates.

During 2023, the partners secured the remaining outstanding permitting, successfully commissioned the project, and produced 9.8MMscm of gas over the balance of the year sold under the marketing agreement with BP. Management indicates that this marketing agreement which is for 18 months is expected to cover around 37MMscm implying production of around 27MMscm in 2024. This is slightly above the Q1 2024 run rate of 6.4MMscm (or 78,000-80,000scmd) but achievable, in our view.

Revenue and Production from Selva PM-1

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

SOURCE: *Company data, VSA Capital Research*

We are therefore adjusting our near-term forecasts against prior assumptions based on the 2022 CPR which indicated around 36.5MMscm for the initial peak production years. This level could still be achieved with further optimisation. Peak production is expected to be sustained for five to six years before dropping at a decline rate of around 10%. PVE has reported three quarters of positive net cashflow which has positive implications for PXEN. The most recent PVE announcement highlighted net cashflow of €874k with €940k in the prior quarter, we note that there is a pricing lag given the marketing offtake agreement. These steady cashflows are being used to repay shareholder loans to the investing companies as well as cover exploration of new targets within the licence area, the balance outstanding to PXEN is £5.5m. This is a highly tax efficient way of returning capital to the investing company.

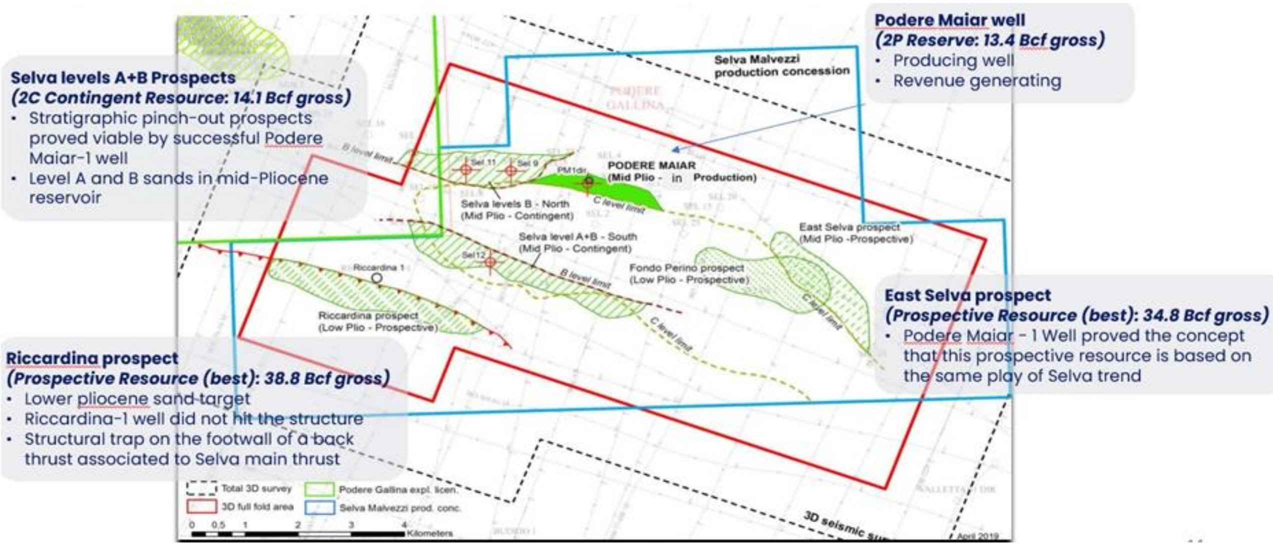
Selva NPV Sensitivity

Gas Price, €/MWh	40	100	150	200	250	300	350
100% NPV8, €m	25	73	106	140	173	206	239
37% NPV8, €m	10	28	40	53	65	77	89

SOURCE: *Company data, VSA Capital Research*.

Using an 8% discount rate we have updated our assumptions for recent pricing performance and production this implies a post-tax NPV of €48m on our adjusted price deck which net to PXEN is €18m.

Selva Malvezzi Production Concession



SOURCE: *Company data, VSA Capital Research.*

Exploration Upside Progress

Our valuation and DCF are based purely on the Podere Maiar-1 well. The company has a broader interest in the region's potential; Selva North and South, Fondo Perino, East Selva and Riccardina. The operating partner PVE recently updated its plans to run 3D seismic on several of the listed targets within the licence and a subsequent drilling programme subject to permitting and has been seeking agreements for landowner access etc.

Selva North and South have contingent resources of 8.9BCF and 5.2BCF respectively; these resources were defined off the back of the successful well drilling at the main Selva field in 2017 and are based on the same stratigraphic pinch-out concept. Given this is targeting remaining updip gas and previously produced commercially, these resources are contingent rather than prospective.

Fondo Perino is between the Selva-1 and 23 wells and is the updip gas-bearing level tested on Selva-1. East Selva has positive characteristics and is similar to the main Selva reservoirs, however, the estimates are based on limited seismic data compared to the other targets.

Riccardina is 5km from the PM-1 test well and was identified by ENI in 2004 and tested although this test encountered water-bearing sands. PVE has reinterpreted the seismic and believe that this test narrowly missed the prospect, hitting the wrong side of a thrust fault that defines the gas boundary. Previous seismic understanding is based on 2D seismic alone.

Summary of Gas Prospective Resources

	MMscm			BCF		
Prospect	**Low**	**Best**	**High**	**Low**	**Best**	**High**
East Selva	824.1	985.6	1,149.8	29.1	34.8	40.6
Riccardina	367.2	1,097.8	3,651.5	13.0	38.8	128.9
Fondo Perino	288.9	413.5	580.6	10.2	14.6	20.5

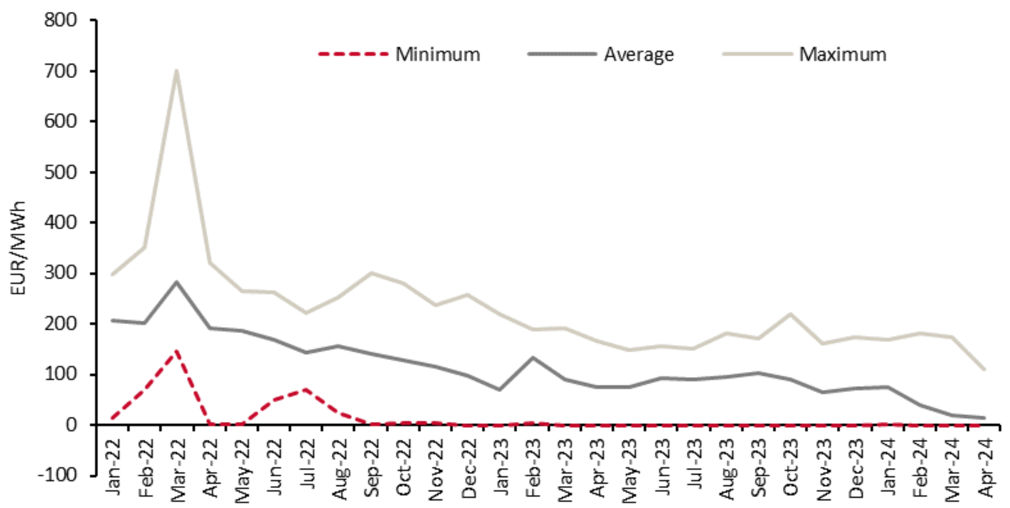
SOURCE: *Company Data, VSA Capital Research.*

El Romeral, Spain (49.9%)

El Romeral is a gas-to-power project located in Southern Spain close to Carmona. Oil and gas have been found in a handful of sedimentary basins in Spain of which the Guadalquivir is one, where El Romeral is located.

Gross revenue at the project 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 0 while overnight averaged €177/MWh in 2023. Although prices have fallen, as a gas to power producer the project is not subject to the Spanish gas producers' price cap since it sells electricity directly. 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. This 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.

Once permitting is secured for the El Romeral concession wells, the Spanish regulator had agreed to reconsider the Tesorillo permit which is currently suspended and to which we ascribe no value currently. Clearly a reversal of this decision would unlock value, in our view.

Solar Progress

As well as gas-related strategies, the company also recently announced the rollout of solar projects. The first project, installing panels on the roof of the plant, was small-scale and deployed at a cost of €50,000. It enabled El Romeral plant to limit turbine-generated electricity used for running the operation in daylight hours, freeing up greater capacity for sales. Following the success of this initial project, the company is now advancing a 5MW solar panel field in a 20-hectare plot now leased for an initial two years at a cost of €800 per hectare for an initial two years with a break clause should FID not be positive. The lease rate will increase to €2,000 per hectare once the authorisations are received rising by CPI for the next 25 years. Permitting, procurement and installation is expected to take 12 months and the spare capacity from the current plant underutilisation will enable the project to feed into the grid.

Currently, gas is generating around 2.7MW of the available 8.2MW capacity while the maximum output of the solar plant would be an incremental 5MW. The company highlights that there is grid capacity available using existing infrastructure and up to 20,000 local homes could benefit. Future revenues from solar are not currently included in our forecasts.

We highlight that this is not simply about the economics of the solar project as the progress to date means that the company was re-categorised by the authorities as an integrated energy company because of its use of renewables. This should, in our view, be supportive the company's case to gain new permitting for the gas assets.

Financial Results

As an investment company, we highlight that the reported performance does not directly correlate with the underlying project performance and largely relates to updated accounting assumptions relating to the investments. Commodity price assumptions play a significant role given PXEN's two primary assets are producing gas and gas to power projects. The company does not report the net or consolidated revenue receipts for the underlying investments. The operating loss of £1.4m widened YoY with higher SG&A, up 14% YoY to £1.1m. Share based expenses increased to £296k in part offset by consultancy fees of £37k.

After a £9.37m positive revaluation of the underlying investments, a significant proportion related to the increase in interest in Selva during the prior year, the pullback in gas prices in 2023 meant that the revaluation of the assets was a modest reduction of £470k, offset in part by an increase in the chance of success attributed to the exploration potential. An income tax credit and net finance income also offset the operating loss and the net income result was a loss of £1.2m broadly aligning with cash expenditure of the holding company, in our view.

Financial Highlights, £

	2021	2022	2023
Operating Loss	(805,072)	(1,163,142)	(1,371,768)
Gain on Investments	3,076,415	9,367,435	(469,709)
Net finance Costs	28,847	151,029	278,926
Net Income	2,259,796	7,136,907	(1,231,400
Cash	220,060	1,482,762	3.186
Borrowings	388,201	2,611,889	168,487
Investments Value	6,697,305	16,064,640	15,594,931

***SOURCE:** Company data, VSA Capital Research.*

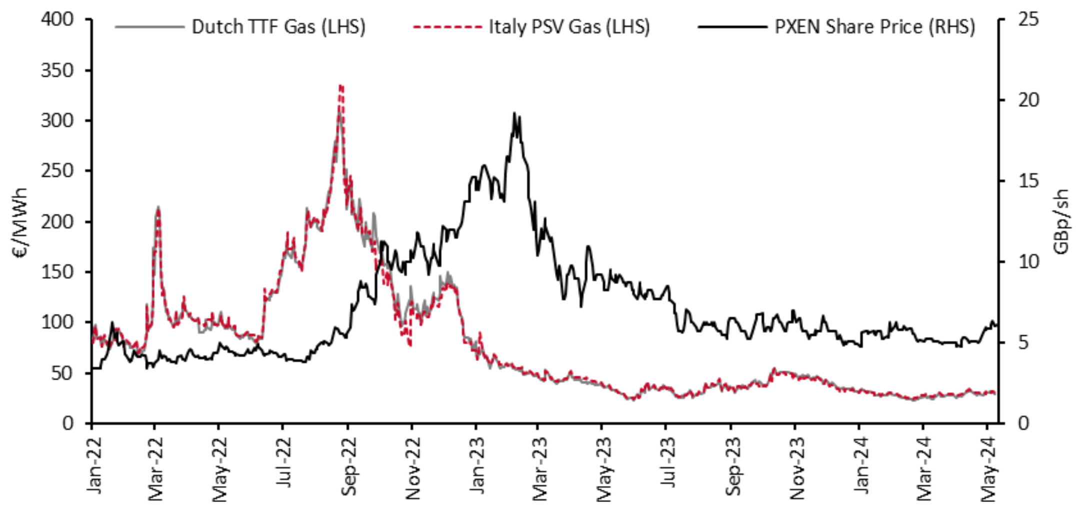
The company did not raise external funds during the year but made considerable progress in reducing outstanding convertible loan liabilities, either through the conversion of the loan notes to equity or through cash repayments. The company fully repaid the balance post period end. At the start of 2023, the outstanding balance of loan liabilities was £2.6m with £1.5m in cash. The company finished the year with £168k in loans and £3k in cash. However, this is not reflective of the full position as PXEN is able to draw on cash from the underlying investing companies through repayment of instruments such as shareholder loans (£5.5m) and other similar structures and mechanisms. Post period end the company paid off the remaining convertible loans and has the necessary resources to cover working capital requirements.

European Gas

During 2023, European TTF gas prices continued their pull-back after the extreme highs of 2022, down 60.5% to €32.1/MWH through the year averaging €41.4/MWh. The current price of €29.7/MWh is below pre-crisis levels. Despite the ongoing risk of supply disruption to European gas supply from the war in Ukraine, mild winters in both 2022 and 2023 meant that the continent has entered the restocking season with high levels of gas in storage. Storage was already at 65% in May last year and with a further mild winter this year, stock levels hit 99% before entering winter and only dropped to 59% by the end of April 2024. The other factor that has held gas prices lower during recent months are strong winds reducing local demand particularly in the UK, however, with less pressure on back up gas this has a wider impact on Europe as a whole.

We highlight, however, that favourable weather conditions have 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. Although the recent weather has not tested this fragility we expect that in the event of less favourable conditions prices would exhibit significant volatility. Demand is set to be robust given the need for back up alternatives to intermittent renewable energy generation and the designation by Governments of natural gas as a key energy transition fuel.

PXEN Share Price vs. Dutch TTF & Italy PSV



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

Valuation

The company is now debt free and with profitable underlying investments, management expects to cover its costs through returns from investments thereby establishing a strong platform for growth. The share price has been broadly flat further underpinning this stability. Management has highlighted that it is actively pursuing a business development programme seeking complementary assets to the existing business and underlying strategy.

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. To the advanced projects, we have reduced the risk factors to reflect the fact first gas has now been achieved and there is now funding coming being allocated to exploration of the wider licence area. We continue to exclude Tesorillo from our valuation, however, successful permitting on the El Romeral assets could prove indicative of the view of the Government on permitting.

Operational Snapshot, €'000

	2024 F	2025 F	2026 F
Selva			
Production (100%), Mscf	2.8	2.8	3.1
Net Income	2,870	5,645	9,975
Capex	(50)	(50)	(50)
FCF	3,376	6,075	10,340
Production (Net 37%)	1.0	1.0	1.1
Net Income	1,062	2,089	3,691
Capex	(19)	(19)	(19)
FCF	1,249	2,248	3,826
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

***SOURCE:** Company data, VSA Capital Research.*

Being an investment company, we do not forecast group level financials as redistribution of asset level cash is based on agreement with the other operating partners beyond the repayment of the loans advanced for capital development while asset revaluation if based on accounting assumptions which can deviate significantly from fair value.

We have adjusted near-term forecasts to reflect that gas prices have pulled back to pre-crisis levels as well as a longer period for production optimisation than previously expected, this is in part offset by new capital alowance assumptions. Our forecasts demonstrate that Selva continues to deliver strong profitability. Our share count has been updated regularly for the additional shares owing to loan conversion, although this is now completed. The current market capitalisation gives little credit for the exploration upside or expansion potential, well permitting in Spain may provide the necessary catalyst to unlock this in part while in Italy exploration also provides potential catalysts along with continued profitable performance.

Valuation Summary, £'000

NAV			**Unrisked**	**Equity**	**Net unrisked**	**CoS**	**Net risked**	**EMV**	**EMV**	**Net unrisked**	**Net risked**
Asset Name	**Stage**	**Timing**	BCF	%	BCF	%	BCF	€/mscf	€m	€m	per/sh (GBp)
Selva	**Producing**	**2023**	**12.4**	**37%**	**4.6**	**100%**	**4.6**	**3.5**	**16**	**16**	**4.3**
Selva North & South	Contingent Resources	TBD	8.9	37%	3.3	70%	2.3	3.5	8	11	2.2
Fondo Perino	Contingent Resources	TBD	9.2	37%	3.4	70%	2.4	3.5	8	12	2.3
East Selva	Contingent Resources	TBD	21.9	37%	8.1	70%	5.7	3.5	20	28	5.3
Riccardina	Contingent Resources	TBD	24.4	37%	9.0	70%	6.3	3.5	22	31	5.9
El Romeral	**Producing / Development**	**Production**	**6.3**	**50%**	**3.1**	**85%**	**2.7**	**0.7**	**2**	**2**	**0.5**
El Romeral	Resources	TBD	89.8	50%	44.8	10%	4.5	0.4	2	17	0.5
El Tesorillo	Suspended Licence	N/A	0.0	50%	0.0	0%	0.0	0.0	0.0	0.0	0.0
Adjustments									£m		
	SG&A (£)								(6.9)		(2.1)
	Debt (£)								(0.2)		(0.1)
	Cash, £ (YE23)								0.0		0.0
Total									70.3		19.0
								DLOC	**5%**		**18.0**

SOURCE: *Company Data, VSA Capital Research.*

Our twelve-month target price is 18p/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 LIABILITES	**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.
SELL:	The stock is expected to decrease by in excess of 10% in absolute terms over the next twelve months.

In addition, on occasion, if the stock has the potential to increase by in excess of 10%, but on qualitative grounds rather than quantitative, a SPECULATIVE BUY may be used.

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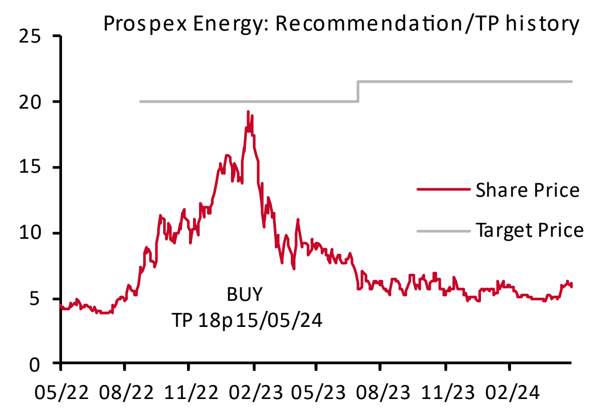
VSA Capital Limited must disclose in each research report the percentage of all securities rated by the member to which the member would assign a "BUY", "HOLD, or "SELL" rating, and also the proportion of relevant investments in each category issued by the issuers to which the firm supplied investment banking services during the previous twelve months. The said ratings are updated on a quarterly basis.

Equities breakdown: 15/05/24	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**: Eikon, 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.