

SERICA ENERGY PLC (AIM: SQZ)

July 30, 2024

Share price: £1.23

Target: £2.90

Reflections on the UK fiscal regime changes

- As expected, the rate of the Energy Profits Levy (EPL) will increase from 35% to 38% and the 29% investment allowance introduced with the EPL will be removed. The changes will be effective from 01 November 2024 and run until 31 March 2030.
- The government has also signalled that capital allowances (including first year allowances) in relation to the EPL will be reduced, but has said that the extent of this will be established after consultation with stakeholders and published in the 30 October fiscal event.
- While the continued uncertainty is unhelpful for new investment decisions, the government did confirm that the permanent regime (CT of 40% plus SCT of 10%) would remain unchanged. This is a positive surprise as this implies that the 62.5% uplift on capex for SCT purposes will also be retained. This means that for each £1 of capex, £1.625 is deducted from taxable profits for SCT purposes. We had anticipated that this uplift would be removed. This feature together with statements that they would consult on a long-term replacement for EPL could be read as an intention to provide some stability to the industry.
- Assuming that the new oil & gas UK fiscal regime will be in line with Norway's (which was the Labour party's indication before the election) where 100% of capex is deductible against taxable profits, then the reduction in capital allowances for EPL purposes might only be changed so that it offsets the retained uplift on SCT. Our model and valuations are based on these assumptions.
- The Energy Security Investment Mechanism will remain and the decarbonation allowance is unchanged. Pending further details expected in the 30 October fiscal event, we have not changed our forecasts re-iterate our target price of £2.90/sh in line with our ReNAV.

Implications for Serica

- Notwithstanding the proposed fiscal regime changes, the fact that the 62.5% capex uplift for SCT purposes remains in place means that our valuation for Serica on a worst case scenario (of capex not being deductible for EPL purposes and no sunset date for the EPL) has increased to ~£1.90/sh from ~£1.80/sh. Under this scenario Buchan would however not be developed. This valuation still represents >50% upside to the current share price.
- Assuming a sunset date of 2030 for the EPL (in line with the government's announcement) sees our valuation increase to ~£2.30 per share (=90% upside). This assumes that Buchan is not developed.
- Under a low commodity price scenario (GBP57/th for NBP UK gas prices and US\$74.21/bbl for Brent, the level below which the EPL would fall away), Buchan is sanctioned and our valuation for Serica would be ~£4.00/sh.

Rating & target	Old	New	
Target	n.a.	£2.90	
Yield		19%	
Implied total return		154%	
Share data	2023	2024e	2025e
Shares dil, mm	402	403	403
Mkt cap, US\$mm	\$1,166	\$637	\$644
EV, US\$mm	\$1,068	\$503	\$378
Financial Data	2023	2024e	2025e
Gas, mmcf/d	103.0	132.6	117.4
Liquids, bbl/d	20,318	20,475	23,533
Total boe/d (6:1)	40,121	43,333	43,767
CFO, US\$mm	\$99	\$465	\$468
Net capex, US\$mm	\$136	\$297	\$221
Net debt, US\$mm*	(\$98)	(\$134)	(\$265)
CFPS dil., US\$/shr	\$0.25	\$1.16	\$1.25
EPS dil., US\$/shr	\$0.29	\$0.36	\$0.41
Valuation	2023	2024e	2025e
Share price, £/shr	£2.32	£1.23	£1.23
EV/DACF	8.7x	1.0x	0.8x
EV per boe/d (US\$)	\$26,616	\$11,599	\$8,646
Net asset value			
CNAV, £/shr			£2.61
RENAV, £/shr			£2.92
Unrisked NAV, £/shr			£3.48
P/CNAV			0.5x
P/RENAV			0.4x
P/ENAV			0.4x

All figures in US\$ unless otherwise noted
* based on cash rather than working capital

Contact details

Analyst:
Stephane Foucaud
 sf@auctusadvisors.co.uk
 +44 7854 891249

Figure 1. Financial & operating information

Serica Energy (SQZ LN)		Historical & Auctus Outlook					
Financial & Operating Information		2023	2024e	2025e	2026e	2027e	2028e
Commodity Prices							
Brent	US\$/bbl	\$82.99	\$85.52	\$76.22	\$70.00	\$70.00	\$70.00
UK NBP	p/th	GBP114	GBP81	GBP92	GBP90	GBP90	GBP90
UK NBP	US\$/mcf	\$14.26	\$10.43	\$12.02	\$11.70	\$11.70	\$11.70
USD / GBP	US\$/£	\$1.25	\$1.29	\$1.30	\$1.30	\$1.30	\$1.30
Production							
Oil and Liquids	bbl/d	20,318	20,475	23,533	23,073	20,231	16,740
Natural Gas	mmcf/d	103.0	132.6	117.4	125.3	140.2	124.8
Total (6 mcf = 1 boe)	boe/d	40,121	43,333	43,767	44,683	44,398	38,257
% Oil and Liquids	%	51%	47%	54%	52%	46%	44%
Netbacks							
Revenue	US\$/boe	\$61.61	\$67.10	\$69.01	\$64.54	\$63.80	\$63.53
Royalties	US\$/boe	\$0.79	\$0.64	\$0.63	\$0.62	\$0.50	\$0.43
Production & Transport Costs	US\$/boe	\$21.12	\$20.42	\$19.68	\$19.19	\$18.08	\$20.98
Operating Netback	US\$/boe	\$42.49	\$42.57	\$47.84	\$44.64	\$45.22	\$42.12
Taxes	US\$/boe	\$17.85	\$10.38	\$17.39	\$10.28	\$23.32	\$28.10
Cash Flow Netback	US\$/boe	\$9.54	\$30.84	\$30.72	\$30.51	\$24.62	\$12.50
Financials							
Cash Flow from Ops. before tax and fin.							
Costs (CFO)	US\$mm	\$447	\$672	\$731	\$702	\$707	\$562
CFO less current tax	US\$mm	\$243	\$508	\$453	\$534	\$329	\$170
CFO less cash tax and fin. Costs	US\$mm	\$99	\$465	\$468	\$475	\$377	\$152
CFPS - diluted	US\$/shr	\$0.25	\$1.16	\$1.25	\$1.27	\$1.02	\$0.45
EBITDAX	US\$mm	\$503	\$648	\$738	\$702	\$707	\$562
E&D Capex (incl. decom.)	US\$mm	\$98	\$274	\$221	\$273	\$36	\$0
A&D Capex, Net	US\$mm	\$38	\$22	\$0	\$0	\$0	\$0
Total Net Capex	US\$mm	\$136	\$297	\$221	\$273	\$36	\$0
Total Net Capex/CFO	x	1.4x	0.6x	0.5x	0.6x	0.1x	0.0x
Leverage							
Net Debt	US\$mm	(\$98)	(\$134)	(\$265)	(\$350)	(\$574)	(\$609)
Net debt/CFO (Trailing)	x	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Entry Net Debt/CFO	x	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Capital Structure							
Basic Shares o/s @ YE	mm	391	392	392	392	392	392
Diluted Shares o/s @ YE	mm	402	403	403	403	403	403
Market Capitalization	US\$mm	\$1,166	\$637	\$644	\$644	\$644	\$644
Enterprise Value	US\$mm	\$1,068	\$503	\$378	\$293	\$70	\$35
Dividends & Sustainability							
Dividends	US\$mm	\$111	\$116	\$117	\$117	\$117	\$117
Dividends	£/sh	£0.23	£0.23	£0.23	£0.23	£0.23	£0.23
Dividends	\$/shr	\$0.29	\$0.30	\$0.30	\$0.30	\$0.30	\$0.30
Dividend Yield	%	18.7%	18.7%	18.7%	18.7%	18.7%	18.7%
Share Buybacks	US\$mm	\$0	\$19	\$0	\$0	\$0	\$0
Free Cash Flow	US\$mm	\$1	\$190	\$247	\$202	\$341	\$152
Cash returned to shareholders as % of CFO	%	112.1%	29.0%	25.0%	24.7%	31.1%	77.1%
Cash invested/CFO	%	137%	64%	47%	57%	9%	0%
Performance							
Prod. Per Shr Growth (Y/Y) - dil.	%		-8%	1%	2%	-1%	-14%
PPS Growth (Y/Y) DDA - dil.	%		-7%	15%	24%	37%	-7%
CFPS Growth (Y/Y) - dil.	%		360%	7%	1%	-20%	-56%
CFPS Growth (Y/Y) DDA - dil.	%		297%	22%	23%	10%	-53%
ROCE	%		23%	26%	30%	33%	18%
Net Asset Value							
CNAV (Atax) - diluted	£/shr	£2.61					
RENAV (Atax) - diluted	£/shr	£2.92					
Unrisked NAV (Atax) - diluted	£/shr	£3.48					
P/CNAV	x	0.5x					
P/RENAV	x	0.4x					
P/Unrisked NAV	x	0.4x					
Valuation							
Share Price, YE/Current	£/shr	£2.32	£1.23	£1.23	£1.23	£1.23	£1.23
P/CF	x	11.4x	1.4x	1.3x	1.3x	1.6x	3.6x
EV/DACF	x	8.7x	1.0x	0.8x	0.6x	0.2x	0.2x
Target EV/DACF	x	16.2x	3.0x	2.6x	2.3x	2.4x	5.2x
EV per boe/d	\$/boepd	\$26,616	\$11,599	\$8,646	\$6,568	\$1,568	\$908
Proved Plus Probable		140	124	109	92	92	92
EV per 2P boe	US\$/boe	\$3.71	\$4.04	\$3.49	\$3.18	\$0.76	\$0.38
EV per 2P boe, with FDC	US\$/boe	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

a) EBITDAX = Pre-Int. & Pre-Tax Cash Flow; b) DDA = Debt-and-Dividend-Adjusted

c) CNAV incl. 2P reserves, RENAV incl. 2P reserves + Risked LT inventory upside, ENAV incl. 2P reserves + Unrisked LT inventory upside

Source: Auctus Advisors, Company Disclosures

**Futures strip as of 30-Jul-24

Figure 2. NAV Table

Asset Valuation	2P/2C/P50 (mmboe)	CoS (%)	Unrisked (US\$ mm)	EMV (US\$ mm)	Riskd £/Share	Unrisked £/Share	% Total
Net Cash (YE24)			134	134	0.26	0.26	9%
Dividend 2024			116	116	0.22	0.22	8%
G&A			-90	-90	-0.17	-0.17	-6%
Bruce Hub 2P (NNS)	84		527	527	1.02	1.02	35%
Triton Hub 2P (CNS)	49		602	602	1.16	1.16	40%
Other assets							
Orlando 2P (NNS)	2		13	13	0.02	0.02	1%
Columbus 2P (CNS)	2		26	26	0.05	0.05	2%
Erskine 2P (CNS)	2		25	25	0.05	0.05	2%
Total Core NAV			1,352	1,352	2.61	2.61	90%
Buchan area (OMF)							
Buchan main 2C	21		67	40	0.08	0.13	3%
J2 2C	4		12	4	0.01	0.02	0%
Verbier 2C	7		23	8	0.02	0.04	1%
Bruce Hub (NNS)							
Bruce field further infill (3 wells)	20		111	55	0.11	0.21	4%
Kyle redevelopment 2C							
Kyle redevelopment 2C	10		52	26	0.05	0.10	2%
Other assets							
Mansell redevelopment 2C	16		83	0	0.00	0.16	0%
Skerryvore Exploration Mey target (Shallow)	10		33	5	0.01	0.06	0%
Skerryvore Exploration Chalk target (Deep)	21		67	18	0.03	0.13	1%
Total Risked Appraisal & Exploration			448	156	0.30	0.86	10%
Total NAV			1800	1509	2.92	3.48	100%
P/Core NAV				53%			
P/NAV				47%			
P/Unrisked NAV				40%			

Source: Auctus Advisors, Company Disclosures

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The research analyst who prepared this research report was Stephane Foucaud, a partner of Auctus.

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