Zephyr Energy PLC

Stock Data

Share Price:	6.8p
Market Cap.:	£88.7m
Shares in issue:	1,304.8m
52 week high/low:	7.3p/0.6p

Company Profile

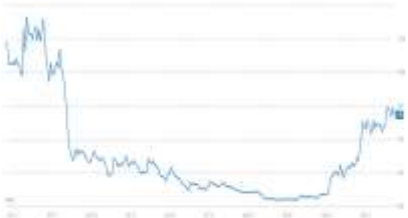
Sector:	Oil & Gas
Ticker:	ZPHR
Exchange:	AIM

Activities

Zephyr Energy is an independent oil and gas E&P company with a strategic focus on carbon-neutral hydrocarbon development projects in the Rocky Mountain region of the US.

Company website:
www.zephyrplc.com

5-year share price performance



Source: LSE

Past performance is not an indication of future performance.

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TPI acts as broker to Zephyr Energy.

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Zephyr Energy has entered into a binding agreement to acquire a large portfolio of working interests in 228 wells, of which 163 are already producing, from Kaiser Acquisition and Development – Sanish Non-op LLC for a consideration of US$36m. This deal is forecasted to be highly accretive as well as non-dilutive for shareholders and following the payment of a non-refundable deposit of US$3.0m, the balance is expected to be funded through a structured debt facility. We believe that this transaction will be transformational for Zephyr, contributing an initial 871 boepd of production to the company upon the anticipated closing date of 22 December 2021. However, we expect net output to increase to over 1,100 boepd net to Zephyr as additional wells are brought on stream in early 2022.

Zephyr has agreed to acquire a portfolio of 163 producing wells in addition to 5 proved not producing (PNP) and 13 drilled but uncompleted wells (DUC) from Kaiser Acquisition and Development. With these 18 additional wells scheduled to come on line over the next few months, we expect that net production will increase from a current level of 871 boepd to more than 1,100 boepd net to Zephyr in early 2022.

The assets also have longer term upside in that the transaction also includes 47 further proved undeveloped (PUD) well locations for further low risk drilling activity. Zephyr states that the average per well interest across the portfolio is approximately 5.9% net to the company.

Zephyr will pay an immediate non-refundable deposit of US$3.0m to the vendor from an existing bridge loan facility and the balance will be funded from a senior debt facility which will be non-dilutive for shareholders. The company is evaluating several financing options and has already received term sheets from potential lenders. Zephyr has calculated that the acquisition cost equates to 2.1x forecast EBITDA from the assets in 2022, a metric that the board considers suitably conservative.

In an environment of strengthening oil and gas prices in the US, average opex across the portfolio of interests is less than US$14.00/boe indicating high cash margins. In this regard, Zephyr estimates that the acquisition's undiscounted free cash flow after capital expenditure will be up to US$13.8m in 2022 and c.US$73.6m over the life of the project based on commodity price estimates outlined by independent consultant, Sproule. On a discounted basis, Sproule has attached an NPV (10%) of US$46.3m to the assets representing a significant uplift on the acquisition price.

In combination with Zephyr's existing producing well portfolio in the Williston Basin, the company expects that the combined non-operated asset portfolios could generate up to US$19.3m of free cash flow after capex in 2022. Even after factoring in interest and capital repayments on the company's prospective senior loan facility, these proceeds will provide significant resources to accelerate the company's activities in the Paradox Basin.

With cash flow from Zephyr's initial non-operated Williston Basin assets, the company has already accelerated the development of its Paradox Basin assets and funded four other acquisitions in 2021. However, we believe that this latest deal will further transform the company and provide Zephyr with the financial capacity to grow the business aggressively in both basins over the course of 2022 and beyond. With commodity prices also showing indications of remaining robust next year, we believe that the economics outlined above could be conservative, providing Zephyr with additional headroom for further portfolio expansion.

Transformational acquisition in the Williston Basin

Zephyr Energy has entered into a binding agreement with Kaiser Acquisition and Development – Sanish Non-op LLC, a private US E&P company, to acquire a sizable portfolio of non-operated interests in wells located on the Sanish field in the Williston Basin. This is a region where Zephyr already holds several non-operated well interests.

The assets that Zephyr is acquiring are operated by Whiting Petroleum Corporation, a large and highly experienced operator in the Williston Basin and a company that already operates a number of Zephyr's existing assets. The acquisition has an effective date of 1 October 2021 and is expected to close on 22 December 2021.

The assets under consideration

Zephyr will acquire working interests in 163 proved developed producing (PDP) wells which currently produce c.871 boepd (September 2021 numbers). These wells are located on 1,960 net acres in the Williston Basin in North Dakota. The average working interest across the acreage is approximately 5.9% per well net to Zephyr.

In addition, the acquisition includes interests in 5 further proved not producing (PNP) wells and 13 drilled but uncompleted (DUC) wells, all of which are expected to come on stream over the next few months. When online in 2022, the 18 additional wells are expected to increase net production to more than 1,100 boepd. The deal also includes 47 further proved but undeveloped (PUD) locations for future drilling which illustrate the longer term potential of the assets.

The portfolio of wells are spread across 22 separate drilling pads in Mountrail County in North Dakota and independent consultant, Sproule Incorporated estimates that the assets contain 2.764 mmboe of proven reserves net to Zephyr's prospective interest. Of this amount, 68% is oil with 17% gas and 15% NGLs (natural gas liquids), the details of which are in the table below.

Proven reserves summary

Reserves category	Well count	Oil reserves Net (mbbl)	Gas reserves Net (mmcf)	NGL reserves Net (mbbl)	DCF (10%)
PDP*	179	1,097	1,823	281	30.5
PNP	5	48	71	11	1.2
DUC/PUD	13	325	372	57	7.5
PUD	47	415	473	73	7.2
Total	**244**	**1,885**	**2,739**	**422**	**46.3**

Source: Sproule

*Note that the PDP well count includes the 163 wells which constitute the assets being acquired in addition to 16 After Payout (APO) wells which are classified as PDP but do not convert to a paying interest. Only the abandonment costs have been included for these additional wells.

High cash margins on production

The well portfolio delivered some 290,730 boe in the 12 months prior to the effective acquisition date of 1 October 2021. This is equivalent to almost 797 boepd indicating historically stable production from the portfolio of wells. Over the same time period, the well interests delivered revenue of US$12.7m and net income of US$9.0m indicating an attractive cash margin.

“Net-zero” carbon mitigation efforts to continue

In line with Zephyr’s previously stated commitment, the company intends to ensure that all net hydrocarbons produced from the acquired assets will have a “net-zero” operational carbon impact. This will be achieved largely through the purchase of Verified Emission Reduction credits to mitigate all Scope 1 carbon emissions.

Terms of the acquisition

Consideration for the acquisition is US$36.0m, subject to various customary closing adjustments, of which US$3.0m will be paid immediately as a non-refundable deposit. This deposit has been drawn down on a short term bridge loan facility of £3.0m to secure the acquisition.

Zephyr is evaluating a range of financing options for the acquisition including senior debt with the potential to be non-dilutive for shareholders. In this event, the company has calculated that the pro forma net debt to adjusted EBITDA ratio will be approximately 1.6x which the board deems suitably conservative.

Bridge loan terms

In order to fund the non-refundable deposit of US$3.0m to secure the Williston Basin assets, Zephyr has drawn down on a £3.0m bridge loan provided by a group which includes existing shareholders and board members. The key terms of the loan are:

- Loan secured by existing assets
- Six-month term
- 2% drawdown fee
- 1% per month interest rate
- A minimum of three months interest payable in the event of an early redemption

The company will repay the loan from cash flow from producing assets and there will be no dilutive element attached to the loan. Of the current Zephyr board, Chairman Rick Grant has participated with a contribution of £100,000 and Origin Creek Energy LLC (of which Mr Grant and Zephyr’s CEO, Colin Harrington are shareholders and directors), has contributed £75,000. Lisa Brown, wife of Rick Grant and Zephyr CFO, Chris Eadie have also contributed £25,000 and £30,000 respectively. We believe that this participation is a strong signal of support from the existing board and key shareholders.

Financial metrics

Zephyr estimates that the acquisition cost of US$36m equates to 2.1x forecasted EBITDA for the assets in 2022 (est. c.US17.1m). With anticipated low opex of US$13.91 per boe across the portfolio, the company also forecasts high cash margins over the next three years. In this regard, Zephyr forecasts undiscounted free cash flow after capex of US$13.8m in 2022 and undiscounted free cash flow of US$73.6m over the life of the project.

In combination with the company’s existing Williston Basin assets, Zephyr has forecasted a pro-forma EBITDA of US$22.9m in 2022 and US$19.3m of free cash flow after capex commitments next year.

Current board estimates suggest an NPV (10%) of $46.3m using Sproule’s oil price forecasts of US$71/bbl in 2022 falling to US$68/bbl in 2023 and US$66/bbl in 2024. Gas prices are assumed to be US$5.00/mmbtu in 2021 falling to US$3.25/mmbtu over the same time period and NGL prices are estimated at US$30/bbl in 2021 declining to US$26.40/bbl in 2024. Prices are escalated at 2% per annum thereafter.

The economics of the acquisition are enhanced by Zephyr’s historical tax losses position which currently totals more than US$16m.

Risk warning: Future performance and forecasts are not a reliable indicator of future results.

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