

Stock Data

Share Price:	2.90p
Market Cap.:	£48.91m
Shares in issue:	1,686.50m
52 week high/low:	7.49p/2.90p

Company Profile

Sector:	Oil & Gas
Ticker:	ZPHR
Exchange:	AIM

Activities

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

www.zephyrplc.com

5-year share price performance



Source: [LSE](https://www.lse.com)

Past performance is not an indication of future performance.

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Zephyr Energy plc

Zephyr has released its interim financial report for the six months ended 30 June 2023. Detailing financials very much in line with expectations, investor focus remains the significant new capital invested both into the Williston assets and the Paradox project during the period. Initial returns from this are expected to be seen in Q4 2023 when the Slawson wells come online for the first time, followed in due course by the Group's first sustained revenues from the Paradox project as it completes and ties-in its recently drilled wells. While progress on the latter has been hindered by State 36-2's well control incident, the Board remains confident that this was in fact an illustration of the overall project's significant and larger production potential. With respect to this, over US\$3.7 million has been collected from its insurer to date, with full coverage for potential future work including additional costings for a sidetrack or re-drill of the original well from the same pad. This will all form part of 2024's continuing work to transform the Paradox project into a consistent revenue generating development, which will include export of natural gas volumes through Dominion Energy's recently completed pipeline by tying Zephyr's acreage to the multi-state Williams Northwest Gas Pipeline system. Recognising 36-2's substantial pressures and hydrocarbon potential along with the demonstrated potential of the previously drilled State 16-2 LN-CC well, the scale of the overall project is increasingly clear. In order to ensure its pace of development accelerates while seeking to seize the ultimate goal of opening up the next prolific onshore US oil and gas play, the Board continues to explore various alternatives, including partnership, joint-ventures ('JV') and farm-in structures, in order to deliver the highest, timely returns for its shareholders.

Key financials for the six months to end-June 2023

- Revenues were US\$13.4m (H1 2022: US\$25.9m), driven by hydrocarbon production from the Group's Williston assets, reflecting standard decline rates and the period's lower commodity price environment
- Hedged production volumes of c.69,000 barrels ('bbls') produced a realised gain of US\$1.2m on these contracts
- Capital expenditure across the Paradox project and the Williston assets totalled US\$21.6m
- Adjusted EBITDA was US\$6.5m (H1 2022: US\$19 m)
- Period-end combined carrying value of the Paradox project and Williston assets was US\$103.2m (30 June 2022: US\$75.9m)
- Gross borrowings at period-end were US\$33.7m and net borrowings (gross borrowings less cash and cash equivalents) were US\$27.5m.

State 36-2 remains static and under control

January's well control incident and subsequent control efforts saw multiple joints of the well's 2 7/8-inch production tubing compressed and/or compromised, since when Zephyr's operations team has been working methodically to remove and inspect the remaining joints while keeping the wellbore static. Recently, operations to retrieve the damaged tubing have progressed rather slower than expected due to the poor condition of the tubing, as exhibited by the multiple damaged and buckled joints retrieved that

led to the need for milling operations and resulted in shorter retrievals per trip. As such, discussions have commenced with the Group's insurer to assess alternative options for realising the significant potential productivity of the reservoir at this location. Alternatives include both a potential sidetrack from, or a re-drill of, the original well. The company plans to update the market in the event any new course of action is taken.

State 16-2 – Operations team continues to assess precipitate issue

Having been brought online at an initial controlled rate of 2 million cubic feet of gas per day and 100 barrels of oil per day (an average of 433 boepd), the well flowed continuously and surface flow assurance efforts proved successful. As flow rates were increased above those levels early in March 2023, however, well performance became limited by freshwater pumping capacity and was subsequently impacted by the formation of down-hole salt precipitate.

This blocked and was subsequently cleared multiple times, impacting the well's flow capacity to achieve extended higher rates. In the early stages of testing higher rates, mandated flaring limits were reached, leaving the operational team to assess whether the precipitate issue is a function of continued flow back of injected completion fluids or a function of normal flowing conditions. Under either scenario, management is evaluating a series of mitigation solutions and plans to test these in the coming quarter (subject to regulatory approvals) in order to fully determine the potential of the reservoir at this location.

Prospective Gas Sales to Pacific Northwest

Earlier this month, Zephyr was notified by Dominion Energy, Utah, LLC ('Dominion') that its gas supply pipeline from the Northwest Gas Pipeline system to the Green River area (the 'pipeline') will be operational in the early part of Q4 2023, and that the pipeline will be available to accept natural gas volumes from third-party sources, slightly ahead of original timeframe estimates. It will then be available to receive Zephyr volumes when, in due course, the Group's own infrastructure and wells have been completed along with all necessary regulatory approvals and commercial agreements.

Given the State 36-2 LN-CC well's proximity to the existing pipeline, it should not need any substantive permits or approvals to commence commercial sales. The State 16-2 LN-CC needs first to have roughly a one-mile spur constructed to tie the well into Zephyr's existing pipeline network (which goes on to tie into Dominion's), although permitting should be straightforward and work with the relevant agencies is already underway.

The Group has not yet put out an estimate on 36-2's possible flow rate range. Given the strength and characteristics of the recent blowout, this is of significant market interest, but will have to wait until the necessary kit has been installed to take such a measurement. In terms of processing extracted gas at the historic Powerline Road facility, Zephyr's Board has been working with potential third-party processing companies regarding potential proposals to fund, install, operate (and own) the plant in exchange for a tariff-based structure levied on throughput volume. Its goal is to minimize our upfront capital expenditure related to infrastructure, while at the same time engaging an experienced operator to run the plant. The solution will likely be comprised of modular, skid mounted units which can be deployed fairly quickly (as little as just 8-12 weeks) when it is ready to sell volumes. Clearly, the key is having detailed knowledge of the range of volumes, hence the need to undertake a production test on the well first.

Williston non-operated assets - High-margin production with significant near-term potential

At 30 June 2023, Zephyr's portfolio comprised 223 wells available for production. Net working-interests across the portfolio now average 7% per well, equivalent to 15.1 gross wells in total. H1 2023 gross profit (after operating and transportation expenses, production taxes, gains from derivative contracts and excluding DD&A) was US\$9.6m, which is a clear demonstration of the high margins realised from the produced barrels. As expected, overall performance for the six months, which included sales volumes averaged 1,225 barrels of oil equivalent per day

('boepd') and revenues totalling US\$13.4m, was below the comparative period, reflected both anticipated standard decline rates and the lower commodity price environment of the period.

The wellbore interests operated by the Slawson Exploration Company, which were acquired by Zephyr in 2H 2022, are now fully drilled and completed. Production from these working interests is forecast to be online in Q4 2023, following completion of surface facilities on the well pad. These are estimated by management to contain 2P reserves, net to Zephyr, of 550,000 boe and will provide a significant near-term production boost to the Company when they come online. In addition, Zephyr has elected to participate in ten new wells operated by Continental Resources Inc ('Continental'). These are located in a highly attractive area of the Williston Basin, with associated CAPEX being funded from the Group's existing cash resources.

Paradox project expected to shortly enter an inflection point

The Paradox project is expected to shortly enter a pivotal moment in its development. Two wells have been drilled to date, both identifying hydrocarbons and appearing capable of commercial production. Although the project still remains relatively early in its 'learning curve', its offering of two forms of development (natural fractures and hydraulically stimulated resource play) along with 8 overlying reservoirs, suggests significant potential upside.

With all key pieces, including acreage and infrastructure, for wider development having been assembled, it seems Q4 2023 could become an inflection point for Paradox as it moves from appraisal into development with both State 36-2 and 16-2 coming online with flush production. Upcoming news flow for both the Group's operated and non-operated assets during this period could possibly include the following:

- Continued progress with insurance claims and move to new drilling following State 36-2 well control incident;
- State 36-2 well production test results;
- Updated CAPEX and drilling plans (dependent on State 36-2 well production test results);
- Potential discussions with third-party processing companies in preparation of Dominion's gas supply pipeline accepting initial volumes from 36-2 in Q4 2023/Q1 2024;
- Updated Competent Persons Report (post State 36-2 well production test);
- Details of mitigation solution and move to initial production for State 16-2 and;
- Initial production volumes from the Slawson wells;

Around the same time as Zephyr publishes initial production volumes from the Slawson acquisition, the Group is expected to release updated FY 2023 production guidance for its non-operated assets. Starting 1 April 2023, Zephyr had hedged 164,000 barrels of oil over the following 12 months at a weighted-average price of US\$84.34 per barrel and will continue to evaluate its commodity price risk management strategy on a regular basis. Significantly, the Group is already achieving carbon net zero through an offsetting programme using Verified Emissions Reduction credits.

Although June's £3.15m (gross) fund-raising perhaps served to highlight the present sensitivity of Zephyr's balance sheet to any surprise additional costings and/or delays in anticipated receipts, it nevertheless underlined the fact that management are fully committed to the Paradox project's development schedule. Despite the fact that the 2023 net average production guidance of 1,550 to 1,750 boepd provided by Zephyr back in December 2022 for its aggregate Williston Basin interests will need to be trimmed back somewhat as a result of slippage in Slawson's initial production, year-end run-rate should approach or exceed that total. And while the Paradox well tie-ins have clearly been delayed while awaiting resolution of the 36-2 operations and production test, it's worth remembering that the vast majority of capex has already been spent drilling two productive wells, and those wells have the potential to significantly increase the overall production when ultimately tied in.

On this basis Zephyr's operations could start throwing off quite significant cash early in 2024. Recognising the Group has identified c.150 additional locations across 9 reservoir targets to date, there clearly remains significant

scope and scale to be unlocked over the coming years upon delineation and exploration success. Understanding that the Group is committed to accelerating the Paradox project drilling programme in the optimal way possible and that it is now also exploring partnerships, joint-ventures and farm-in alternatives to support development of what could become the US's next prolific onshore oil & gas play. Any announcement on this front is still likely to be months away, but scope for a formal expression of interest sometime during 2024 suggests Zephyr's shares have already become significantly oversold.

Potential Contingent & Prospective Resources worth well in excess of US\$1 billion

Zephyr's active land management strategy appears to be delivering a defensible and growing portfolio of development opportunities, something which is increasingly difficult to replicate in today's regulatory and political environment. Following recent events, management's immediate focus remains on restarting State 36-2's production testing, followed by safely completing the well and the recommissioning of a recently acquired processing plant before being tied-in to gas infrastructure.

Publication of the Group's Competent Person's Report ('CPR') 2022 on 26 April 2022, highlighted Zephyr's substantial remaining potential in the Paradox Basin. While the range of values illustrated in Sproule's report presently remain very wide, recognising also that there are still significant underlying technical/operational risks to be surmounted, Zephyr's management and exploration team have demonstrated a high level of intuition along with the capacity to meet and optimise such challenges through carefully calculated process. The drilling programme now underway will enable further delineation and increase overall understanding of the Paradox asset base. Management continues to assess potential upside and is shortly expected to determine additional steps with a view to delivering increases in all reserve and resource classes before end-2023.

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