Stock Data

Share Price:	3.30p
Market Cap.:	£57.77m
Shares in issue:	1,750.72m
52 week high/low:	6.00p/1.91p

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

Past performance is not an indication of future performance.

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Zephyr Energy plc

Zephyr has released its half year results to end-June 2024. While detailing continued, significant progress at its flagship asset in the Paradox Basin and consecutive quarterly non-operated production growth from the Williston project, the period delivered financials very much in line with expectations. This clearly leaves investors to focus on next steps to be taken following the recent, highly successful State 36-2R LN-CC well ('State 36-2R') second phase production test. The acidisation operation successfully removed near-wellbore formation damage and generated very high reservoir deliverability, with a notable improvement to near-wellbore reservoir permeability after each treatment. Peak production rates achieved during the second test were over 2,100 barrels of oil equivalent per day ('boepd'), up from the 1,350 boepd reported following the first test, which is particularly high for an onshore US well with only 130 feet of completed reservoir interval. Elevated liquid-yields were observed along with continuing evidence of almost nil water production. Board observations have gone further, noting an additional, important and unanticipated benefit from the acidisation operation, in that it appears to have significantly enhanced the near-wellbore reservoir quality. From this, it concludes that similar utilisation across a longer lateral may offer a cost-effective completion technique compared to the hydraulic stimulation operations used in other US resource plays. Given the positive implications this holds for the broader Paradox project and underlying shareholder value, it is particularly significant that Zephyr's recently launched process to identify suitable asset-level and/or wellbore partnership opportunities with US-based institutional investors to accelerate further appraisal and field wide development has already reached an advanced stage.

Operational and financial highlights of H1 2024

- Revenue for H1 2024 increased to US$13.6 million, net to Zephyr, and was driven by the Group's hydrocarbon production from the Williston project:
  - Revenue for H1 2024 was higher than that in the six months ended 30 June 2023 ('H1 2023') of US$13.4 million. The increased revenues reflected the addition of production from the six wells operated by Slawson Exploration Company (the 'Slawson wells') and was partially offset by standard production decline rates from the underlying assets.
- H1 2024 gross profit (including operating and transportation expenses, production taxes and realised gains from hedging contracts, and excluding depreciation, depletion and amortisation ('DD&A')) increased to US$10.0 million (H1 2023: US$9.4 million), demonstrating the strong cashflows and high margins generated by the non-operated production during the period, covering the entirety of the Group's G&A and finance costs and providing net cash for reinvestment.
- H1 2024 net sales volumes averaged 1,239 barrels of oil equivalent per day ('boepd'), for a total of 225,622 barrels of oil equivalent ('boe') net to Zephyr, over the period.
- Adjusted earnings before interest, tax, DD&A, unrealised foreign exchange gains, share based payments and unrealised losses on hedging contracts (together 'Adjusted EBITDA') for H1 2024 were US$7.1 million.

- At 30 June 2024, the combined carrying value of the Paradox project and Williston project was US$98.0 million, demonstrating the scale of the Group's asset portfolio.
- The Group's gross borrowings at 30 June 2024 were US$29.2 million, a reduction from US$33.7 million at the end of H1 2023. By 6 September 2024, gross borrowings had been reduced further to US$27.9 million.
- During H1 2024, Zephyr embarked on the drilling of the State 36-2R well which was almost entirely funded by proceeds from its well control insurance policy for the State 36-2 well. The well control insurance policy requires the Group to make payments in advance, prior to making claims for reimbursement. As a result, cash balances during H1 2024 fluctuated considerably depending on the level of operational activity and timing of the reimbursement cycle, including at 30 June 2024 when drilling operations were particularly active. To date, US$15.3 million has been reimbursed to Zephyr in respect of the State 36-2 well control insurance policy, which relates to activity from the well control incident on the State 36-2 well and the State 36-2R well drilling programme.
- At 24 September 2024 (the most practicable date prior to this statement), the Group had cash balances of US$1.3 million. In addition, it expects to receive the following payments over the next few days:
  - Reimbursement of c.US$3.0 million from its insurer. The invoices relating to the US$3.0 million claim have already been paid in full by Zephyr.
  - A revenue payment of circa US$0.9 million related to a portion of its non-operated portfolio.
- Over the coming months, Zephyr expects to submit final claims under the well control insurance policy of circa US$1.3 million for which it also expects to be fully reimbursed.

Balance sheet and funding

Despite Group borrowings having reduced to US$27.9 million as of 6 September 2024, which compares favourably with the US$29.2 million declared for 30 June 2024 (30 June 2023: £33.7 million), investor attention has recently refocussed on Zephyr's balance sheet. In response to this irregular market speculation, on 17 September 2024 Zephyr reassured by formally stating it has not been undertaking nor is it intending to undertake an equity fundraise, and that it knows of no notifiable reason for "the Company's [then] recent material share price movement."

Cash balances during H1 2024 fluctuated considerably, primarily due to well control insurance policy reimbursements for the State 36-2 well control incident. To date, US$15.3 million has been reimbursed to Zephyr in respect of this. As of 24 September, Zephyr had cash balances of US$1.3 million and notes that it expects to receive reimbursement of c. US$3.0 million from its insurer in the next few days, along with a revenue payment of c.US$0.9 million in relation to a portion of its non-operated portfolio. Altogether, this suggests a reasonable comfortable current position in addition to which, over the coming months, Zephyr expects to submit final claims under the same policy of circa US$1.3 million for which it also expects to be fully reimbursed. In May 2024, Zephyr retired US$3.88 million of existing debt through the issuance of US$3.88 million of equity comprised of 64,045,768 new Ordinary Shares to SGR Investments LLC ("SGRI"), a US-based institutional investor.at a price of 4.85 pence per new Ordinary Share. That same month, it announced that it had been awarded an additional US$250,000 of non-dilutive grant funding from the U.S. Department of Energy (the "DOE") for operations on the State 36-2R well. In June 2024, the Group announced a new US$5.6 million term loan that will amortise monthly over four years and has an interest rate of 10% per annum. Proceeds from the new term loan were used to fully repay the 12% SGRI loan. Gross borrowings as of 30 June 2024 (plus comparatives) are detailed below.

Zephyr Energy – Borrowings Profile

US$ - Period Ended	**30 June 2024**	**30 June 2023**	**31 December 2023**
Term loan	14,187	12,926	10,824
Revolving credit	14,981	20,788	24,438
Promissory note	-	-	89
Total	**29,168**	**33,714**	**35,351**

Source: Zephyr Energy, Interim Results for the six months ended 30 June 2024

Zephyr remains in active conversations with industry and financial parties regarding the potential funding of up to 100% of the costs of the Salt Wash project well at the asset level, and the Board continues to appraise the available options with the key objective of maximising value for Zephyr Shareholders. Based on this understanding, the Group's current revolving credit facilities, term loans, existing plus promised incoming (reimbursement) cash together with anticipated payments from its non-operated portfolio in the Williston Basin, which continues to fully fund all G&A and finance costs while allowing for continued investment in its Paradox and Williston projects, Zephyr's 'available' funding cushion appears more than sufficient at this time to cover the Group's currently envisioned work programme.

Positive key findings from State 36-2R second test

Following the completion of the State 36-2R well, two successful production tests were carried out on the well. Peak production rates achieved during the second test were over 2,100 boepd, a very significant and immediately commercial production rate for an onshore US well with only 130 feet of completed reservoir interval.

The acidisation operation successfully removed any remaining near-wellbore formation damage and generated very high reservoir deliverability, with a notable improvement to near-wellbore reservoir permeability after each acid treatment. As such, the operation not only removed damage but also enhanced reservoir productivity. This is the first known example of acidisation stimulation in the Paradox Basin, and the result is highly positive for the development of the play, with the potential for substantially reduced reservoir risk and removal of the need for costly hydraulic stimulation as used in other US onshore resource plays.

Variable liquid-yields were observed over the second test, all of which are higher than that at the Group's State 16-2 LN-CC well in the northern part of Zephyr's Paradox project acreage. At the peak production rates in the second test, condensate/light volatile oil represented approximately 510 boepd, and these liquid yields were on an increasing trend at the conclusion of the test. The elevated liquid yield has the potential to be a significant driver of improved economics and may increase recoverable liquid volumes across the Group's Paradox project acreage. A detailed fluid laboratory analysis is currently underway, and the results will help Zephyr further characterise the field's fluid fill and composition. Continued evidence of almost zero water production, another potential boost to the Well's economics by materially reducing the need for expensive water disposal. As a result, management is now evaluating the potential to lengthen the completed reservoir interval by drilling a lateral from the existing wellbore, which would serve to increase overall estimated ultimate recoveries and drain a larger portion of the reservoir. This analysis is expected to be completed shortly.

Given the highly positive observations, Zephyr has commenced the process of discussing potential well and wider Paradox Project development opportunities with US based industry partners in an effort to accelerate its additional appraisal and development.

Acidisation operation appears to significantly enhance the near-wellbore reservoir quality

The acidisation operation undertaken on the well had the effect of dissolving calcite and dolomite minerals known to exist in the reservoir, creating higher porosity and permeability in locations they previously occupied. During earlier drilling of the State 16-2 well and in other Cane Creek wells, Zephyr had already observed widespread minor fracturing in the reservoir cores. From this, it now concludes that acidisation could materially enhance the permeability of the overall reservoir matrix, including the minor fracturing (which may be present across the Group's entire Paradox project acreage position) as well as any major fracture networks encountered.

The implication is that acidisation, when utilised across a longer lateral, may offer a cost-effective completion technique to increase hydrocarbon recovery and decrease costs compared to the hydraulic stimulation operation used in other US resource plays. This potentially offers a transformative and lower risk method for the long-term development of the Paradox project, versus solely targeting major natural fracture networks (the development approach that is presently used elsewhere in the Basin). The Board believes this is the first modern acidisation operation used to improve overall well productivity in the Paradox Basin.

Next steps and broader considerations for the Paradox Basin

Data generated from the two production tests have considerably advanced Zephyr's understanding not only of its existing wells, but also of the Paradox Basin itself. 36-2R has demonstrated quite exceptional deliverability and permeability, leading to the strong peak production rates witnessed while also opening opportunity for a new, highly effective alternative development process for the White Sands Unit and its wider Paradox acreage.

Given the positive implications, Zephyr's Board has begun an immediate search to identify an industry or asset-level financial partner to accelerate further appraisal and field wide development. This could come in the form of a farm-in with an industry operator, a joint venture with a non-operator investor, or asset level funding. The Board now believes that the data generated from drilling the State 16-2, State 36-2 and State 36-2R wells, combined with the significant technical analysis developed from the Paradox project over the past four years (including extensive 3D seismic, core samples, log data and the recent production test results) provides a robust dataset for prospective counterparts to evaluate. Recognising the potential this presents to unlock significant additional value for shareholders, the Board is seeking to advance such discussions with some urgency.

Temporary shut-in of 36-2R while options are considered

36-2R has been temporarily shut in (as per standard operations) while Zephyr's operations team considers the new data produced and evaluates possible next steps. It now has sufficient information to know that State 36-2R is capable of considerable production rates in its current form, presenting opportunity to quite rapidly start monetising the Paradox asset. Doing so in its current form which only has a 130-foot completed interval, however, could make it more difficult to extend the Well in the future by causing depletion in the near well bore area. Before committing therefore, it is also reviewing the alternative option of deferring production to first extend the Well in expectation of increasing its overall hydrocarbon recovery potential. Being permitted for up to a 10,000-foot lateral extension, any such future play might be expected to benefit both from greater connected volumes and the material positive impact acidisation could have on its deliverability.

With Zephyr remaining adequately funded at this time, such a lateral could potentially be completed in the near term subject to service provider availability, making any such deferral a relatively short-term event, while not interfering with ongoing preparatory work for installation of processing plant to receive anticipated production or otherwise hindering completion of its tie-in to the nearby pipeline. The new data generated from the second test together with that collected from the its other Paradox wells, will also enable it to quite quickly produce an updated Competent Persons Report ('CPR').

Williston project (non-operated assets) provide robust cash flow

With production having increased for four consecutive quarters, the Williston project continues to generate robust, high margin cash flow for the Group. As expected, non-operated production during the period, covering the entirety of Zephyr's G&A and finance costs while providing net cash for reinvestment. As at 30 June 2024, 231 wells in Zephyr's portfolio were available for production. Net working interests now average 7.1% per well, equivalent to 16.3 gross wells in total.

H1 2024 sales volumes averaged 1,239 boepd (or 225,622 boe), net to Zephyr, over the six-month period, producing revenues net to Zephyr totalling US$13.6m. Gross profit for the period (including operating and transportation expenses, production taxes and realised gains from hedging contracts, and excluding DD&A) increased to US$10.0 million (H1 2023: US$9.4 million). Zephyr forecasts a range of 1,100-1,300 boepd for its 2024 full year non-operated production forecast, an increase from 1,040 boepd in the previous year. In H1 2024 the Company hedged 51,500 barrels of oil (with 45,000 bbl at a weighted-average price of US$81.67 and 6,000 bbl hedged by way of financial collar options providing a minimum price of US$74.0). The Board will continue to evaluate its commodity price risk management strategy on a regular basis

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