

ZEPHYR ENERGY PLC (AIM: ZPHR)

April 12, 2023

Share price: £0.04

Target: £0.20

Blow-out at State 36-2 under control. The fracture network could be very large.

- The State 36-2 LNW-CC well experienced a significant well control incident. The well is now under control. Because of the nature of the hydrocarbons (gas and condensate), the surface impacted by hydrocarbon residue is mostly limited to the well pad and the area immediately around it. Impacted soil will be removed and the required remediation is expected to be limited.
- During the incident, the well's safety valve failed and subsequently the ram on the BOP did not close properly. The company is investigating the root cause of the failures.
- Zephyr's incident management process managed the response to the incident very well. Utah state regulators were notified and were on site shortly after the beginning of the incident and approved the different steps taken by the company to contain the flow. This is very important in our view, as it mitigates future risk that the state authorities take punitive action against the company.
- Zephyr has a well control insurance in place. As experienced by Tullow a few years ago in Ghana, this can cover containment and remediation costs, and while it is early days, Zephyr is working closely with its insurance provider (including by utilizing the insurers preferred well control group).
- While the well has been "killed", at present Zephyr does not expect to have to redrill the well in order to production test it. This assessment is supported by the fact that the well did not have to be redrilled after having been brought under control following the kick while drilling experienced in January. This suggests that even if the insurance does not cover the additional costs associated with the blow out, they remain manageable within the context of the company's balance sheet.
- The well test is expected to resume in the coming weeks, subject to closer evaluation and potential additional preparatory well work. Pending further details on next steps and the flow test results of the State 36-2 well, we have not changed our forecasts.
- Our target price of £0.20/sh is unchanged.

Other reflections

The apparent pressures encountered and flow rate of the well appeared very high during the blow-out, which might suggest that the volumes and the fracture network encountered by the well are very large. An analog well, the Cane Creek 12-1 well flowed at a rate of 10 mmcf/d for months while in production.

Valuation

Our ReNAV is unchanged at £0.19 per share.

Rating & target	Old	New	
Target	£0.20	n.c.	
Yield		0%	
Implied total return		365%	
Share data	2021	2022e	2023e
Shares dil., mm	1,310	1,752	1,793
Mkt cap, US\$m	\$125	\$93	\$93
EV, US\$m	\$128	\$104	\$99
Financial Data	2021	2022e	2023e
Gas, mmcf/d**	0.1	1.3	3.6
Liquids, bbl/d**	216	1,280	1,723
Total boe/d (6:1)**	238.1	1,490	2,325
CFO, US\$m	\$1	\$24	\$38
Net capex, US\$m	\$21	\$53	\$35
Net debt, US\$m*	\$3	\$11	\$6
CFPS dil., US\$/shr	\$0.00	\$0.03	\$0.03
EPS dil., US\$/shr	\$0.00	\$0.02	\$0.01
Valuation	2021	2022e	2023e
Share price, £/shr	£0.07	£0.04	£0.04
EV/DACF	53.1x	3.3x	2.4x
EV per boe/d (US\$)**	\$537,805	\$70,120	\$42,534
Net asset value			
CNAV, £/shr			£0.04
RENAV, £/shr			£0.19
Unrisked NAV, £/shr			£1.10
P/CNAV			1.1x
P/RENAV			0.2x
P/Unrisked NAV			0.0x

All figures in US\$ unless otherwise noted
* based on working capital rather than cash
** based on net production (NRI)

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Figure 1. Financial & operating information

Zephyr Energy Plc (ZPHR LN)		Historical & Auctus Outlook						
Financial & Operating Information		2020	2021	2022e	2023e	2024e	2025e	2026e
Commodity Prices								
WTI	US\$/bbl	\$38.23	\$65.74	\$95.27	\$88.05	\$89.45	\$70.71	\$67.00
Henry Hub	US\$/mcf	\$2.43	\$3.19	\$6.13	\$3.63	\$6.50	\$6.50	\$6.50
USD/CAD	US\$/C\$	\$0.78	\$0.78	\$0.78	\$0.78	\$0.75	\$0.75	\$0.75
USD / GBP	US\$/£	\$1.30	\$1.37	\$1.24	\$1.20	\$1.30	\$1.30	\$1.30
Production								
Oil and Liquids	bbl/d	0	216	1,280	1,723	3,225	3,509	3,034
Natural Gas	mmcf/d	0.0	0.1	1.3	3.6	16.5	25.5	22.5
Total (6 mcf = 1 boe)	boe/d	0	238	1,490	2,325	5,969	7,763	6,788
% Oil and Liquids	%	1%	91%	86%	74%	54%	45%	45%
Netbacks								
Realized Price	US\$/boe	\$0.00	\$69	\$79	\$64	\$57	\$46	\$44
Royalties	US\$/boe	\$0.00	\$0	\$0	\$0	\$0	\$0	\$0
Opex and production tax	US\$/boe	\$0.00	\$11	\$13	\$13	\$11	\$10	\$10
Operating Netback	US\$/boe	\$0.00	\$58	\$65	\$52	\$46	\$36	\$34
Taxes	US\$/boe	\$0.00	\$0	\$0	\$0	\$5	\$4	\$3
Cash Flow Netback	US\$/boe	\$0.00	\$28	\$58	\$47	\$39	\$31	\$29
Government Take	%	0%	0%	0%	0%	8%	8%	8%
Financials								
Cash Flow (CFO)	US\$mm	(\$1)	\$1	\$24	\$37	\$84	\$86	\$72
CFPS - diluted	US\$/shr	(\$0.00)	\$0.00	\$0.03	\$0.03	\$0.07	\$0.07	\$0.06
EBITDAX	US\$mm	(\$3)	\$2	\$31	\$40	\$96	\$97	\$81
E&D Capex	US\$mm	(\$1)	\$16	\$16	\$33	\$58	\$36	\$12
A&D Capex, Net	US\$mm	\$0	\$5	\$37	\$2	\$0	\$0	\$0
Total Net Capex	US\$mm	(\$1)	\$21	\$53	\$35	\$58	\$36	\$12
Total Net Capex/CFO	x	1.1x	-26.6x	-2.2x	-1.0x	-0.7x	-0.4x	-0.2x
Leverage								
Net Debt	US\$mm	(\$2)	\$3	\$11	\$8	(\$18)	(\$68)	(\$128)
Net debt/CFO (Trailing)	x	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Entry Net Debt/CFO	x	n.a.	n.a.	0.1x	0.3x	0.1x	n.a.	n.a.
Capital Structure								
Basic Shares o/s @ YE	mm	696	1290	1583	1625	1625	1625	1625
Diluted Shares o/s @ YE	mm	798	1310	1752	1793	1793	1793	1793
Market Capitalization	US\$mm	\$9	\$125	\$93	\$93	\$100	\$100	\$100
Enterprise Value	US\$mm	\$8	\$128	\$104	\$100	\$82	\$32	(\$28)
Dividends & Sustainability								
Dividends	US\$mm	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Dividends	\$/shr	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
Dividend Yield	%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Free Cash Flow	US\$mm	\$0	(\$15)	\$8	\$4	\$26	\$50	\$60
Cash Use/CFO	%	-107%	-2657%	-220%	-95%	-69%	-42%	-17%
Performance								
Prod. Per Shr Growth (Y/Y) - dil.	%	n.a.	n.a.	333%	40%	153%	30%	-13%
PPS Growth (Y/Y) DDA - dil.	%	n.a.	n.a.	301%	37%	200%	134%	-666%
CFPS Growth (Y/Y) - dil.	%	n.a.	-183%	808%	9%	129%	2%	-16%
CFPS Growth (Y/Y) DDA - dil.	%	n.a.	n.a.	481%	-4%	167%	83%	-644%
ROCE	%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net Asset Value								
CNAV (Atax) - diluted	£/shr	£0.04						
RENAV (Atax) - diluted	£/shr	£0.19						
Unrisked NAV (Atax) - diluted	£/shr	£1.10						
P/CNAV	x	1.1x						
P/RENAV	x	0.2x						
P/Unrisked NAV	x	0.0x						
Valuation								
Share Price, YE/Current	£/shr	£0.01	£0.07	£0.04	£0.04	£0.04	£0.04	£0.04
P/CF	x	n.a.	31.7x	2.0x	1.7x	0.8x	0.8x	1.0x
EV/DACF	x	n.a.	53.1x	3.3x	2.5x	1.0x	0.4x	-0.4x
Target EV/DACF	x	n.a.	105.7x	130.6x	9.8x	7.7x	3.0x	2.7x
EV per boe/d	\$/boepd	n.a.	\$537,805	\$70,120	\$43,110	\$13,722	\$4,142	(\$4,129)
EV per 2P boe	US\$/boe	n.a.	\$22.86	\$20.66	\$23.48	\$36.71	(\$75.16)	\$10.20
EV per 2P boe, with FDC	US\$/boe	n.a.	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

d) NRI Production, reserves and resources

Source: Auctus Advisors, Company Disclosures

**Futures strip as of 11-Apr-23

Figure 2. NAV Table

Asset Valuation	2P/2C/P50 (mboe)	CoS (%)	Unrisked (US\$ mm)	EMV (US\$ mm)	Risked £/Share	Unrisked £/Share	% Total
Net Cash (YE22)			-11	-11	0.00	0.00	-3%
G&A			-19	-19	-0.01	-0.01	-5%
Williston Basin 2P Reserves	4.00	100%	71	71	0.03	0.03	
Paradox Basin 2P Reserves	2.57	100%	45	45	0.02	0.02	
Total Core NAV			86	86	0.04	0.04	20%
Paradox Basin 2C Resources	39	65%	326	212	0.10	0.15	50%
Paradox Basin Prospective Resources - C9 Reservoir	30	50%	275	126	0.06	0.12	30%
Paradox Basin Prospective Resources - Other overlying Reservoirs	210	33%	1747	0	0.00	0.79	0%
Total Risked Exploration			2349	338	0.15	1.06	80%
Total NAV			2435	424	0.19	1.10	100%
P/Core NAV							111%
P/NAV							23%
P/Unrisked NAV							4%

Note: NRI reserves and resources

Source: Auctus Advisors, Company Disclosures

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