

# Zargon Oil & Gas Ltd. Provides 2014 Second Quarter Results

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CALGARY, ALBERTA--(Marketwired - Aug 11, 2014) - Zargon Oil & Gas Ltd. ("Zargon" or the "Company") (TSX:ZAR)(TSX:ZAR.DB) -

## FINANCIAL AND OPERATING HIGHLIGHTS (THREE MONTHS ENDED JUNE 30, 2014)

- Funds flow from operating activities of \$11.9 million were 22 percent lower than the \$15.3 million recorded in the prior quarter due to a combination of higher effective royalty rates, additional operating costs relating to now operational ASP facilities and increased realized hedge losses. Funds flow from operating activities for the 2014 second quarter included reductions of \$3.7 million of realized hedge losses and \$0.5 million of asset retirement expenses.
- Second quarter 2014 production averaged 4,096 barrels of oil and liquids per day, a five percent decrease from the preceding quarter and second quarter 2014 natural gas production averaged 14.8 million cubic feet per day, a five percent increase from the preceding quarter. Total production averaged 6,558 barrels of oil equivalent per day, a two percent decrease from the preceding quarter. During the quarter, oil and liquids production represented 62 percent of total production based on a 6:1 equivalent basis.
- Three monthly cash dividends of \$0.06 per common share were declared in the second quarter of 2014 for a total of \$5.4 million. These cash dividends were equivalent to a payout ratio of 46 percent of funds flow from operating activities.
- Second quarter 2014 exploration and development capital expenditures (excluding property acquisitions and dispositions) were \$16.4 million and included \$4.9 million of expenditures related to the Little Bow ASP phase 1 project development and chemical costs. In the quarter, Zargon drilled 8.0 gross wells (8.0 net wells) that resulted in 8.0 net oil wells and completed four property dispositions and one property acquisition which realized \$3.2 million of net proceeds.
- On June 13, 2014, Zargon amended and renewed its syndicated committed credit facilities of \$150 million, a reduction from the previous facilities of \$165 million. Zargon's June 30, 2014 debt, net of working capital (excluding unrealized derivative assets/liabilities) and using the full future face value of the convertible debenture of \$57.5 million, was \$128.9 million and is approximately 2.4 times annualized 2014 first half funds flow from operating activities. At June 30, 2014, Zargon had \$75 million of available credit facilities remaining on its \$150 million borrowing base.
- Subsequent to quarter end, Alberta Energy announced revisions to the Enhanced Oil Recovery ("EOR") royalty program which effectively brings the Alberta conventional oil EOR royalties more in line with existing Alberta oil sands (in-situ) and Saskatchewan conventional oil EOR royalty programs. These revisions have a significant positive impact on the economics of Zargon's ASP enhanced oil recovery project at Little Bow in Southern Alberta (refer to Zargon's July 28, 2014 news release which is available at [www.zargon.ca](http://www.zargon.ca)).

	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	2013	Percent Change	2014	2013	Percent Change
<b>Financial Highlights</b>						
Income and Investments (\$ millions)						
Gross petroleum and natural gas sales	40.86	40.59	1	81.12	77.67	4
Funds flow from operating activities	11.88	15.99	(26 )	27.18	29.89	(9 )
Cash flows from operating activities	10.03	14.68	(32 )	24.89	27.14	(8 )

Cash dividends (net of Dividend Reinvestment Plan)	5.42	5.01	8	10.84	9.76	11
Net earnings/(loss)	(2.02 )	1.13	(279 )	(1.85 )	1.35	(237 )
Field capital and administrative asset expenditures	16.57	13.96	19	33.51	33.24	1
Net property and corporate dispositions	(3.20 )	(11.54 )	72	(4.66 )	(14.63 )	68
Net capital expenditures	13.37	2.42	452	28.85	18.61	55
Per Share, Basic						
Funds flow from operating activities (\$/share)	0.39	0.53	(26 )	0.90	1.00	(10 )
Net earnings/(loss) (\$/share)	(0.07 )	0.04	(275 )	(0.06 )	0.05	(220 )
Cash Dividends (\$/common share)						
	0.18	0.18	-	0.36	0.36	-
Balance Sheet at Period End (\$ millions)						
Property and equipment (D&P)				414.08	386.37	7
Exploration and evaluation assets (E&E)				12.25	17.92	(32 )
Total assets				461.70	437.88	5
Working capital deficiency				15.01	11.76	28
Long term bank debt				56.37	42.06	34
Convertible debentures at maturity				57.50	57.50	-
Shareholders' equity				161.75	190.07	(15 )
Weighted Average Shares Outstanding for the Period (millions) - Basic						
	30.13	30.00	-	30.11	29.95	1
Total Common Shares Outstanding at Period End (millions)						
				30.13	30.04	-
Funds flow from operating activities is an additional GAAP term that represents net earnings/loss and asset retirement expenditures except for non-cash items.						
Working capital deficiency excludes derivative assets/liabilities.						
Cash dividends are net of the Dividend Reinvestment Plan in 2013. The Dividend Reinvestment Plan was suspended September 2013.						
	Three Months Ended June 30,			Six Months Ended June 30,		
	2014	2013	Percent Change	2014	2013	Percent Change
Operating Highlights						
Average Daily Production						
Oil and liquids (bbl/d)	4,096	4,930	(17 )	4,208	5,021	(16 )
Natural gas (mmcf/d)	14.77	14.77	-	14.41	14.99	(4 )
Equivalent (boe/d)	6,558	7,392	(11 )	6,610	7,519	(12 )
Average Selling Price (before the impact of financial risk management contracts)						
Oil and liquids (\$/bbl)	93.26	80.44	16	89.92	75.97	18
Natural gas (\$/mcf)	4.54	3.35	36	4.85	3.18	53
Netback (\$/boe)						
Gross petroleum and natural gas sales	68.46	60.34	13	67.81	57.07	19
Royalties	(13.73 )	(10.51 )	31	(12.47 )	(10.09 )	24

Realized gain/(loss) on derivatives	(6.25 )	1.43	(537 )	(5.05 )	1.64	(408 )
Operating expenses	(19.07 )	(18.10 )	5	(18.05 )	(17.68 )	2
Transportation expenses	(0.63 )	(0.66 )	(5 )	(0.74 )	(0.66 )	12
Operating netback	28.78	32.50	(11 )	31.50	30.28	4
Wells Drilled, Net	8.0	-	-	11.7	5.1	129
Undeveloped Land at Period End (thousand net acres)						
				183	300	(39 )

The calculation of barrels of oil equivalent ("boe") is based on the conversion ratio that six thousand cubic feet of natural gas is equivalent to one barrel of oil.

## Message to Shareholders

Zargon Oil & Gas Ltd. has released its financial and operating results for the second quarter of 2014 that is highlighted by encouraging facility operations and injection performance for the Little Bow Alkaline Surfactant Polymer ("ASP") enhanced oil recovery project.

## Little Bow Alkaline Surfactant Polymer ("ASP") Project

Zargon commenced chemical injections at the Little Bow ASP enhanced oil recovery project in March 2014. This ASP project entails the injection of large volumes of a dilute chemical solution into a partially depleted oil reservoir to recover incremental oil reserves. Since the commencement of ASP injection more than one million barrels of ASP solution have been injected into the phase 1 area of the Little Bow Mannville I Pool, at an average injection rate of 102 percent of design capacity. Encouragingly, pattern injection rates are balanced and are meeting or exceeding reservoir models, and to date we have observed no evidence of ASP fluid breakthrough and the related oil production volumes. We interpret the delay in oil production volumes positively, as it provides us supporting evidence that the ASP injections are not bypassing the reservoir in a short circuited path from injectors to producers but instead are forming oil banks that will be conformably swept to producers over the multi-year life of the project.

The total cost to construct and commission phase 1 of the Little Bow ASP project was \$50.4 million of which \$1.8 million was spent in the 2014 second quarter. Phase 2 construction and implementation costs are expected to be \$12 million and are scheduled to be equally divided between the second half of 2015 and the first half of 2016. The estimated total phase 1 and 2 chemical cost for the 2014-2019 chemical injection period will be capitalized and is estimated at \$81 million (as spent dollars) of which \$1.4 and \$3.0 million have been spent in the first and second quarters of 2014, respectively.

Phase 1 of the Little Bow ASP project is now expected to commence initial production in the 2014 fourth quarter and increase to a 2014 year end rate of 150 barrels of oil per day. Incremental production is expected to exceed 700 barrels of oil per day in 2015 and then increase to 1,550 barrels of oil per day in 2016, when phase 2 injection begins.

Including the additional phase 3 and 4 working interests acquired in the second quarter, follow-on capital expenditures of \$105 million (including chemical costs) for phases 3 and 4 of the Little Bow ASP project are expected to yield an additional 4.7 million barrels of incremental oil. Zargon's combined Little Bow project (phases 1 through 4) total production is expected to stabilize at 2,300 barrels of oil per day in the 2020 through 2025 period. For further information regarding the Little Bow ASP project, please refer to our updated corporate presentation, which is available at [www.zargon.ca](http://www.zargon.ca).

## Other Field Activities

In addition to the second quarter's \$4.9 million of ASP phase 1 development and chemical capital expenditures, Zargon executed an \$11.5 million capital program in the 2014 second quarter on conventional oil exploitation assets. This program included the drilling of 8.0 net oil exploitation wells at the Bellshill Lake (5), Taber (2) and Williston Basin (1) properties. Zargon's remaining five (non-ASP) oil exploitation projects are (or will be) pressure supported by water injections or natural reservoir aquifers and consequently provide long-life low-decline oil volumes. In aggregate, these properties bring more than 60 horizontal locations that can be methodically drilled to maintain stable non-ASP oil production volumes for many years.

During the interim period, until ASP production volumes and related cash flows arrive, our non-ASP capital programs will be muted. For the remainder of the year, Zargon is planning a 5.0 net well drilling program at the Taber Sunburst (2) and Williston Basin Mississippian (3) properties.

### **Property Dispositions Update**

Zargon remains focused on consolidating our property footprint on higher netback oil exploitation assets. During the second quarter, \$6.4 million of property dispositions were concluded that were partially offset by \$3.2 million of property acquisitions. Subsequent to quarter end, an additional \$0.9 million of property dispositions have been concluded. The disposition properties were primarily non-strategic West Central Alberta natural gas assets that were partially offset by acquired Little Bow assets that take our interests in phases 3 and 4 of the Little Bow ASP project to more than 97 percent. In aggregate, the net effect of these eight completed transactions is the sale of 40 barrels of oil per day and 2.5 million cubic feet of natural gas per day (438 barrels of oil equivalent per day) for \$4.1 million of net proceeds.

### **2014 & 2015 Outlook**

Zargon's 2014 total capital budget continues to be set at \$52 million (before dispositions) of which approximately \$18 million remains to be spent in the second half of the year. The 2014 ASP capital budget is now set at \$19 million and includes \$8 million for the completed phase 1 development costs and \$11 million of chemical costs of which \$7 million is forecast to be spent in the second half of the year. For 2015, our preliminary \$19 million ASP capital budget includes \$13 million of chemical costs and \$6 million of phase 2 development costs.

Zargon's 2014 non-ASP field capital budget had been set at \$33 million (before dispositions) of which approximately \$12 million will be spent in the remaining two quarters. For 2015, the preliminary \$25 million non-ASP field capital budget will focus on existing oil exploitation projects. As additional corporate cash flows are realized, incremental capital may be allocated to these non-ASP oil exploitation properties.

Finally, Zargon's 2014 net property disposition program has been set at \$5 million. Including the \$0.9 million of property dispositions that have been concluded after quarter end, Zargon's 2014 year-to-date property disposition program has realized net proceeds of \$5.6 million. Additional natural gas property dispositions are anticipated.

Also, Zargon has entered into a significant oil hedging program to provide a measure of stability and predictability to cash flows as we wait for the ASP production volumes to ramp up. For the remainder of 2014, Zargon has hedged 2,600 barrels per day at \$90.92 US/bbl WTI and 400 barrels per day at \$99.60 Cdn/bbl WTI, while for the first half of 2015 an average of 1,400 barrels per day is hedged at \$93.68 US/bbl WTI.

### **Production Guidance**

In the May 14, 2014 first quarter results press release, Zargon provided second quarter 2014 oil production rate guidance of 4,200 barrels of oil and liquids per day. Actual second quarter volumes were 4,096 barrels of oil and liquids per day and were two percent less than guidance. The press release also set Zargon's second quarter 2014 natural gas production guidance of 14.0 million cubic feet per day. Second quarter actual volumes were 14.8 million cubic feet per day and exceeded guidance by six percent.

Oil and liquids production for the 2014 third quarter is set at 4,100 barrels of oil per day and includes the impact of the second quarter drilling program plus the completed property dispositions. Third quarter natural gas production guidance is set at 12.0 million cubic feet per day. For the remainder of the year, production volumes will depend on the magnitude and timing of our remaining property dispositions.

### **Forward-Looking Statements**

This press release offers our assessment of Zargon's future plans and operations as at August 11, 2014, and

contains certain forward-looking information and statements within the meaning of applicable securities laws. The use of any of the words "anticipate", "continue", "estimate", "expect", "forecast", "may", "will", "project", "should", "plan", "intend", "believe" and similar expressions (including the negatives thereof) are intended to identify forward-looking information or statements. In particular, but without limiting the foregoing, this news release contains forward-looking information and statements pertaining to the following: guidance as to our 2014 capital budgets, including the allocation thereof and the sources of funding and various plans, forecasts and estimates as to drilling cost reduction initiatives, and other operational forecasts and plans and results therefrom under the heading "Little Bow Alkaline Surfactant Polymer ("ASP") Project", "Other Field Activities", "Property Dispositions Update" and "2014 & 2015 Outlook"; our plans with respect to our Little Bow ASP project and the results therefrom referred to under the headings "Little Bow Alkaline Surfactant Polymer ("ASP") Project" and "Production Guidance"; our plans for our hedges under the heading "2014 & 2015 Outlook"; and all matters, including guidance as to our estimated 2014 production and production mix, under the heading "Production Guidance".

The forward-looking information and statements included in this news release are not guarantees of future performance and should not be unduly relied upon. Such information and statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking information or statements including, without limitation: those relating to results of operations and financial condition; general economic conditions; industry conditions; changes in regulatory and taxation regimes; volatility of commodity prices; escalation of operating and capital costs; currency fluctuations; the availability of services; imprecision of reserve estimates; geological, technical, drilling and processing problems; environmental risks; weather; the lack of availability of qualified personnel or management; stock market volatility; the ability to access sufficient capital from internal and external sources; and competition from other industry participants for, among other things, capital, services, acquisitions of reserves, undeveloped lands and skilled personnel. Risks are described in more detail in our Annual Information Form, which is available on [www.zargon.ca](http://www.zargon.ca) and on [www.sedar.com](http://www.sedar.com). Forward-looking statements are provided to allow investors to have a greater understanding of our business.

You are cautioned that the assumptions used in the preparation of such information and statements, including, among other things: future oil and natural gas prices; future capital expenditure levels; future production levels; future exchange rates; the cost of developing and expanding our assets; our ability to obtain equipment in a timely manner to carry out development activities; our ability to market our oil and natural gas successfully to current and new customers; the impact of increasing competition; the availability of adequate and acceptable debt and equity financing and funds from operations to fund our planned expenditures; and our ability to add production and reserves through our development and acquisition activities, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Our actual results, performance, or achievement could differ materially from those expressed in, or implied by, these forward-looking statements. We can give no assurance that any of the events anticipated will transpire or occur, or if any of them do, what benefits we will derive from them. The forward-looking information and statements contained in this document is expressly qualified by this cautionary statement. Our policy for updating forward-looking statements is that Zargon disclaims, except as required by law, any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

### **Additional GAAP and Non-GAAP Financial Measures**

Zargon uses the following terms for measurement within this press release that do not have a standardized prescribed meaning under Canadian generally accepted accounting principles ("GAAP") and these measurements may not be comparable with the calculation of similar measurements of other entities.

The terms "funds flow from operating activities" and "operating netback per boe" in this press release are not recognized measures under GAAP. Management of Zargon believes that in addition to net earnings and cash flows from operating activities as defined by GAAP, these terms are useful supplemental measures to evaluate operating performance and assess leverage. Users are cautioned; however, that these measures should not be construed as an alternative to net earnings or cash flows from operating activities determined in accordance with GAAP as an indication of Zargon's performance.

Zargon considers funds flow from operating activities to be an important measure of Zargon's ability to generate the funds necessary to finance capital expenditures, pay dividends and repay debt. All references to funds flow from operating activities throughout this press release are based on cash provided by operating activities before the change in non-cash working capital since Zargon believes the timing of collection,

payment or incurrence of these items involves a high degree of discretion and, as such, may not be useful for evaluating Zargon's operating performance. Zargon's method of calculating funds flow from operating activities may differ from that of other companies and, accordingly, may not be comparable to measures used by other companies. Funds flow from operating activities per basic share is calculated using the same weighted average basic shares outstanding as is used in calculating earnings per basic share. See Zargon's Management's Discussion and Analysis ("MD&A") as filed on [www.zargon.ca](http://www.zargon.ca) and on [www.sedar.com](http://www.sedar.com) for the periods ended June 30, 2014 and 2013 for a discussion of cash flows from operating activities and funds flow from operating activities.

### **51-101 Advisory**

In conformity with National Instrument 51-101, Standards for Disclosure of Oil and Gas Activities ("NI 51-101"), natural gas volumes have been converted to barrels of oil equivalent ("boe") using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil. In certain circumstances, natural gas liquid volumes have been converted to a thousand cubic feet equivalent ("mcf") on the basis of one barrel of natural gas liquids to six thousand cubic feet of gas. Boes and mcfes may be misleading, particularly if used in isolation. A conversion ratio of one barrel to six thousand cubic feet of natural gas is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Given that the value ratio based on the current price of crude oil as compared to natural gas is significantly different from the energy equivalency of 6:1, utilizing a conversion ratio on a 6:1 basis may be misleading as an indication of value.

### **Filings**

Zargon has filed with Canadian securities regulatory authorities its unaudited financial statements for the three and six months ended June 30, 2014 and the accompanying MD&A. These filings are available on [www.zargon.ca](http://www.zargon.ca) and under Zargon's SEDAR profile on [www.sedar.com](http://www.sedar.com).

### **About Zargon**

Based in Calgary, Alberta, Zargon's securities trade on the Toronto Stock Exchange and there are currently approximately 30.134 million common shares outstanding.

Zargon Oil & Gas Ltd. is a Calgary based oil and natural gas company working in the Western Canadian and Williston sedimentary basins that has delivered a long history of returns and dividends (distributions). Zargon's business is focused on oil exploitation projects that profitably increase oil production and recovery factors from existing oil reservoirs.

In order to learn more about Zargon, we encourage you to visit Zargon's website at [www.zargon.ca](http://www.zargon.ca) where you will find a current shareholder presentation, financial reports and historical news releases.

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