

Epsilon Reports Second Quarter 2020 Results

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HOUSTON, Aug. 13, 2020 - [Epsilon Energy Ltd.](#) (NYSE:EPSN) today reported second quarter 2020 financial and operating results and material subsequent events following the end of the quarter through the date of this release.

- Net cash provided by operations of \$3.1 million and \$8.3 million for the three and six months ended June 30, 2020, respectively, with free cash flow (FCF) of \$1.3 million and \$4.2 million for the same periods.
- Realized gas prices of \$1.36/Mcfe, (excluding hedges) and \$1.75/Mcfe (including hedges).
- Returned \$0.4 million to shareholders through open market purchases of 169,285 shares through June 30, 2020 for an average price of \$2.51/share. Following the June 30, 2020 deadline for the previously announced Tender Offer, \$7.15 million was returned to shareholders in exchange for 2,337,034 shares which were properly tendered representing 8.9% of outstanding shares for \$3.06/share.
- Marcellus net revenue interest (NRI) gas production averaged 30.6 MMcf/d (Working Interest of 35.2 MMcf/d) for the second quarter.
- During the second quarter the Marcellus operator turned to sales 4 Gross wells (0.16 Net wells). In addition, during the quarter, at the request of the upstream producers (including Epsilon), the operator of the Auburn System reduced the gathering pressure in a step-wise manner to 550 psi from the historical gathering pressure of 700 psi. This reduced pressure allowed all wells to increase production in varying degrees. The June 30th, 2020 NRI exit rate was 39.6 MMcf/d (Working Interest of 45.5 MMcf/d).
- Auburn System gathered and delivered 15.6 Bcfe gross (5.5 Bcfe net to Epsilon's interest) which represents approximately 86% of maximum throughput as currently configured. The June 30th exit gathering volume rate was 183.6 MMcf/d.
- Total revenues of \$6.3 million; net loss of \$0.6 million; and EBITDA of \$3.1 million for the quarter.
- Cash at quarter end of \$16.3 million.
- Net loss before tax of \$0.74 million for the quarter included a bad debt allowance of \$0.82 million.
- Operating expenses including SG&A was \$1.19/Mcfe and \$1.09/Mcfe excluding \$0.3 million of non-recurring legal costs.

Michael Raleigh, CEO, commented, "We are very pleased with the financial performance of the company as we continue to generate free cash flow even within a challenged price environment. At the current production rate and natural gas prices for the remainder of the year we anticipate the company should be able to generate \$9.0 - \$10.0 million of free cash flow for the full year. We anticipate exiting the year between 32-33 MMcf/d of NRI production. Epsilon recorded a bad debt reserve of \$0.8 million related to a receivable from a shipper on the Auburn Gas Gathering system who filed for bankruptcy protection during the quarter. Post-filing, the shipper continues to invest capital in both existing and new wells in the contract area. While we ultimately believe that it is possible that some, if not all, of this receivable may be collected, the timing is uncertain, and therefore we recognized this as an allowance for bad debt. As anticipated, the restraint in capital spending across the E&P industry that began in the first quarter of 2020 is having a meaningful impact on natural gas supply. Although the natural gas supply/demand balance has been disappointing this past quarter due to exiting the mild winter with high storage levels and the curtailment of LNG exports, the market is beginning to discount a much tighter balance in 2021 as evidenced by higher prices for future delivery of natural gas."

In June, Epsilon elected to participate in three new wells proposed by the operator. While Epsilon's net interest is minor, these wells are all long reach horizontals, and two of the wells are targeting the Upper Marcellus zone which should provide more productivity data on the Upper Marcellus helping us to better understand how to efficiently develop the significant potential of our acreage."

Financial and Operating Results

Three months ended June 30,	Six months ended June 30,
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	2020	2019	2020	2019
Revenues				
Natural gas revenue	\$ 3,876,340	\$ 4,330,013	\$ 7,896,104	\$ 9,764,948
Volume (MMcf)	2,858	1,920	5,585	3,743
Avg. Price (\$/Mcf)	\$ 1.36	\$ 2.26	\$ 1.41	\$ 2.61
PA Exit Rate (MMcfpd)	45.5	21.2	45.5	21.2
Oil and other liquids revenue	\$ 138,707	\$ 168,465	\$ 230,087	\$ 241,193
Volume (MBO)	4.8	4.8	7.9	7.8
Avg. Price (\$/Bbl)	\$ 29.10	\$ 35.43	\$ 29.15	\$ 30.88
Gathering system revenue	\$ 2,263,740	\$ 2,265,094	\$ 4,580,442	\$ 4,703,445
Total Revenues	\$ 6,278,787	\$ 6,763,572	\$ 12,706,633	\$ 14,709,586

Capital Expenditures

Epsilon's capital expenditures were \$1.2 million for the three months ended June 30, 2020. This capital was mainly residual spending for the completion of four wells drilled in Q1 2020 in Pennsylvania as well as expenditures for the Auburn Gas Gathering system.

Marcellus Operational Guidance

During the second quarter of 2020, the operator completed, tested and turned to sales 4 gross (0.16 net to EPSN) wells. In June, the operator proposed 3 gross (.03 net to EPSN) wells in which Epsilon elected to participate with a required capital commitment of less than \$250,000.

Second Quarter Results

Epsilon generated revenues of \$6.3 million for the three months ended June 30, 2020 compared to \$6.8 million for the three months ended June 30, 2019.

Realized natural gas prices averaged \$1.36/Mcf (excluding hedges) for Marcellus Upstream operations in the second quarter of 2020. Operating expenses for Marcellus Upstream operations in the second quarter were \$1.4 million.

The Auburn Gas Gathering system delivered 15.6 Bcfe of natural gas during the quarter as compared to 23.3 Bcfe during the first quarter of 2020. Primary gathering volumes were flat quarter over quarter at 15.1 Bcfe. Imported cross-flow volumes decreased 94% to 0.5 Bcfe.

Epsilon reported net after tax loss of \$0.6 million attributable to common shareholders or \$0.02 per basic and diluted common share outstanding for the three months ended June 30, 2020, compared to net income of \$3.8 million, and \$0.14 per basic and diluted common share outstanding for the three months ended June 30, 2019.

For the three months ended June 30, 2020, Epsilon's Adjusted Earnings Before Interest, Taxes, Depreciation, Amortization ("Adjusted EBITDA") was \$3.1 million as compared to \$5.2 million for the three months ended June 30, 2019.

Recent Developments

Epsilon is closely monitoring the current and potential impacts of the COVID-19 pandemic on all aspects of our business and geographies, including how it has impacted, and may in the future impact our operations, financial results, liquidity, contractors, customers, employees and vendors. Epsilon has also taken, and is

continuing to take, proactive steps to manage any disruption in our business caused by COVID-19. For instance, the Company was an early adopter in employing a work-from-home system, even before any government mandate on non-essential businesses was enacted. Epsilon increased its technology platform, infrastructure and security to allow for a work-from-home environment ahead of the actual need, and therefore, once the hypothetical became a reality, we believe Epsilon was ahead of many companies in this respect. Epsilon has also deployed additional layered safety protocols at our office in order to keep our employees safe and to keep our operations running without material disruption.

About Epsilon

[Epsilon Energy Ltd.](#) is a North American onshore natural gas production and midstream company with a current focus on the Marcellus Shale of Pennsylvania and the Anadarko Basin in Oklahoma.

Forward-Looking Statements

Certain statements contained in this news release constitute forward looking statements. The use of any of the words "anticipate", "continue", "estimate", "expect", "may", "will", "project", "should", "believe", and similar expressions are intended to identify forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated. Forward-looking statements are based on reasonable assumptions, but no assurance can be given that these expectations will prove to be correct and the forward-looking statements included in this news release should not be unduly relied upon.

The reserves and associated future net revenue information set forth in this news release are estimates only. In general, estimates of oil and natural gas reserves and the future net revenue therefrom are based upon a number of variable factors and assumptions, such as production rates, ultimate reserves recovery, timing and amount of capital expenditures, ability to transport production, marketability of oil and natural gas, royalty rates, the assumed effects of regulation by governmental agencies and future operating costs, all of which may vary materially from actual results. For those reasons, estimates of the oil and natural gas reserves attributable to any particular group of properties, as well as the classification of such reserves and estimates of future net revenues associated with such reserves prepared by different engineers (or by the same engineers at different times) may vary. The actual reserves of the Company may be greater or less than those calculated. In addition, the Company's actual production, revenues, development and operating expenditures will vary from estimates thereof and such variations could be material.

Statements relating to "reserves" are deemed to be forward-looking statements as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described exist in the quantities predicted or estimated and can be profitably produced in the future. There is no assurance that forecast price and cost assumptions will be attained and variances could be material.

Proved reserves are those reserves which are most certain to be recovered. There is at least a 90% probability that the quantities actually recovered will equal or exceed the estimated proved reserves. Undeveloped reserves are those reserves expected to be recovered from known accumulations where a significant expenditure (for example, when compared to the cost of drilling a well) is required to render them capable of production. They must fully meet the requirements of the reserves classification (proved, probable) to which they are assigned. Proved undeveloped reserves are those reserves that can be estimated with a high degree of certainty and are expected to be recovered from known accumulations where a significant expenditure is required to render them capable of production.

The estimates of reserves and future net revenue for individual properties may not reflect the same confidence level as estimates of reserves and future net revenue for all properties due to the effects of aggregation. The estimated future net revenues contained in this news release do not necessarily represent the fair market value of the Company's reserves.

Contact Information:

281-670-0002

Michael Raleigh
 Chief Executive Officer
 Michael.Raleigh@EpsilonEnergyLTD.com

Special note for news distribution in the United States

The securities described in the news release have not been registered under the United States Securities Act of 1933, as amended, (the "1933 Act") or state securities laws. Any holder of these securities, by purchasing such securities, agrees for the benefit of [Epsilon Energy Ltd.](#) (the "Corporation") that such securities may not be offered, sold, or otherwise transferred only (A) to the Corporation or its affiliates; (B) outside the United States in accordance with applicable state laws and either (1) Rule 144(a) under the 1933 Act or (2) Rule 144 under the 1933 Act, if applicable.

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Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income

(All amounts stated in US\$)

	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Revenues from contracts with customers:				
Gas, oil, NGLs and condensate revenue	\$ 4,015,047	\$ 4,498,478	\$ 8,126,191	\$ 10,006,141
Gas gathering and compression revenue	2,263,740	2,265,094	4,580,442	4,703,445
Total revenue	6,278,787	6,763,572	12,706,633	14,709,586
Operating costs and expenses:				
Lease operating expenses	2,034,120	1,583,895	4,081,887	3,302,188
Gathering system operating expenses	79,702	238,886	177,480	551,673
Development geological and geophysical expenses	2,273	83,748	4,902	83,748
Depletion, depreciation, amortization, and accretion	2,577,770	1,953,171	4,992,146	3,778,903
Impairment of proved properties	—	—	1,760,000	—
Gain on sale of property	—	(929,827)	—	(929,827)
Bad debt expense	819,000	—	819,000	—
General and administrative expenses:				
Stock based compensation expense	172,052	133,721	345,971	267,441
Other general and administrative expenses	1,236,729	921,307	2,244,842	2,260,868
Total operating costs and expenses	6,921,646	3,984,901	14,426,228	9,314,994
Operating income (loss)	(642,859)	2,778,671	(1,719,595)	5,394,592
Other income (expense):				
Interest income	13,041	46,598	34,570	89,289
Interest expense	(28,317)	(29,010)	(56,323)	(56,619)
Gain (loss) on derivative contracts	(85,348)	2,734,988	1,635,669	2,224,234
Other income (expense)	(3)	431	(2,227)	454
Other income (expense), net	(100,627)	2,753,007	1,611,689	2,257,358
Income (loss) before income tax expense	(743,486)	5,531,678	(107,906)	7,651,950
Income tax expense (recovery)	(177,452)	1,693,820	147,829	2,440,416
NET INCOME (LOSS)	\$ (566,034)	\$ 3,837,858	\$ (255,735)	\$ 5,211,534
Currency translation adjustments	6,132	1,052	6,018	11,844
NET COMPREHENSIVE INCOME (LOSS)	\$ (559,902)	\$ 3,838,910	\$ (249,717)	\$ 5,223,378
Net income (loss) per share, basic	\$ (0.02)	\$ 0.14	\$ (0.01)	\$ 0.19
Net income (loss) per share, diluted	\$ (0.02)	\$ 0.14	\$ (0.01)	\$ 0.19

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Unaudited Condensed Consolidated Balance Sheets

(All amounts stated in US\$)

	June 30, 2020
ASSETS	
<i>Current assets</i>	
Cash and cash equivalents	\$ 16,305,2
and nil at December 31, 2019	3,306,64
Fair value of derivatives	1,257,70
Prepaid income taxes	1,515,95
Other current assets	199,441
Total current assets	22,584,9
<i>Non-current assets</i>	
Property and equipment:	
Oil and gas properties, successful efforts method	
Proved properties	132,997
Unproved properties	21,175,9
Accumulated depletion, depreciation, amortization and impairment	(94,789,
Total oil and gas properties, net	59,383,9
Gathering system	41,587,1
Accumulated depletion, depreciation, amortization and impairment	(31,064,
Total gathering system, net	10,522,4
Land	375,314
Buildings and other property and equipment, net	350,270
Total property and equipment, net	70,631,9
Other assets:	
Restricted cash	564,248
Prepaid drilling costs	2,425
Total non-current assets	71,198,6
Total assets	\$ 93,783,5
LIABILITIES AND SHAREHOLDERS' EQUITY	
<i>Current liabilities</i>	
Accounts payable trade	\$ 1,542,63
Royalties payable	1,095,34
Accrued capital expenditures	197,158
Accrued gathering fees	615,548
Other accrued liabilities	386,686
Asset retirement obligation	1,555,07
Total current liabilities	5,392,44
<i>Non-current liabilities</i>	
Asset retirement obligation	1,459,83
Deferred income taxes	12,399,2
Total non-current liabilities	13,859,1
Total liabilities	19,251,5
Commitments and contingencies (Note 10)	
<i>Shareholders' equity</i>	
Common shares, no par value, unlimited shares authorized and 26,790,985 issued and 26,133,671 shares outstanding at June 30, 2020 and 26,790,985 shares issued and outstanding at December 31, 2019.	140,808
Treasury shares, 657,314 at June 30, 2020	(1,927,1
Additional paid-in capital	7,375,45
Accumulated deficit	(81,541,
Accumulated other comprehensive income	9,816,49

Total shareholders' equity	74,532,0
Total liabilities and shareholders' equity	\$ 93,783,5

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Unaudited Condensed Consolidated Statements of Cash Flows

(All amounts stated in US\$)

	Six months ended June 30,	
	2020	2019
Cash flows from operating activities:		
Net income (loss)	\$ (255,735)	\$ 5,211,534
Adjustments to reconcile net income to net cash provided by operating activities:		
Depletion, depreciation, amortization, and accretion	4,992,146	3,778,903
Impairment of proved properties	1,760,000	—
Bad debt expense	819,000	—
Gain on sale/disposal of properties	—	(929,827)
Gain on derivative contracts	(1,635,669)	(2,224,234)
Cash received from (paid for) settlements of derivative contracts	2,377,769	187,420
Stock-based compensation expense	345,971	267,441
Deferred income tax expense (benefit)	(2,201)	2,393,228
Changes in assets and liabilities:		
Accounts receivable	171,271	1,473,287
Prepaid income taxes and other current assets	359,795	(595,604)
Accounts payable, royalties payable and other accrued liabilities	(630,262)	(1,526,708)
Net cash provided by operating activities	8,302,085	8,035,440
Cash flows from investing activities:		
Acquisition of unproved oil and gas properties	—	(596,500)
Additions to unproved oil and gas properties	(128,398)	(822,006)
Additions to proved oil and gas properties	(3,691,409)	(1,846,040)
Additions to gathering system properties	(152,256)	(163,075)
Additions to land, buildings and property and equipment	(151,800)	—
Prepaid drilling costs	(1,301)	(2,101,510)
Proceeds from sale of leases	—	929,827
Net cash used in investing activities	(4,125,164)	(4,599,304)
Cash flows from financing activities:		
Buyback of common shares	(1,927,198)	(1,233,645)
Net cash used in financing activities	(1,927,198)	(1,233,645)
Effect of currency rates on cash, cash equivalents and restricted cash	6,018	11,844
Increase in cash, cash equivalents and restricted cash	2,255,741	2,214,335
Cash, cash equivalents and restricted cash, beginning of period	14,613,711	14,959,518
Cash, cash equivalents and restricted cash, end of period	\$ 16,869,452	\$ 17,173,853
Supplemental cash flow disclosures:		
Income taxes paid	\$ —	\$ 733,200
Interest paid	\$ 56,323	\$ 60,401
Non-cash investing activities:		
Change in proved properties accrued in accounts payable and accrued liabilities	\$ (1,516,946)	\$ 12,198
Change in gathering system accrued in accounts payable and accrued liabilities	\$ (10,310)	\$ 82,550
Asset retirement obligation asset additions and adjustments	\$ 3,937	\$ 7,975

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Adjusted EBITDA Reconciliation

(All amounts stated in US\$)

	Three months ended June 30,		Six months ended June 30,
	2020	2019	2020
Net income (loss)	\$ (566,034)	\$ 3,837,858	\$ (255,710)
Add Back:			
Net interest (income) expense	15,276	(17,588)	21,753
Income tax expense (benefit)	(177,452)	1,693,820	147,820
Depreciation, depletion, amortization, and accretion	2,577,770	1,953,171	4,992,100
Impairment expense	—	—	1,760,000
Stock based compensation expense	172,052	133,721	345,973
(Gain) loss on derivative contracts net of cash received or paid on settlement	1,117,176	(2,363,324)	742,100
Foreign currency translation (gain) loss	3	(431)	2,228
Adjusted EBITDA	\$ 3,138,791	\$ 5,237,227	\$ 7,756,041

Epsilon defines Adjusted EBITDA as earnings before (1) net interest expense, (2) taxes, (3) depreciation, depletion, amortization and accretion expense, (4) impairments of natural gas and oil properties, (5) non-cash stock compensation expense, (6) gain or loss on derivative contracts net of cash received or paid on settlement, and (7) other income. Adjusted EBITDA is not a measure of financial performance as determined under U.S. GAAP and should not be considered in isolation from or as a substitute for net income or cash flow measures prepared in accordance with U.S. GAAP or as a measure of profitability or liquidity.

Additionally, Adjusted EBITDA may not be comparable to other similarly titled measures of other companies. Epsilon has included Adjusted EBITDA as a supplemental disclosure because its management believes that EBITDA provides useful information regarding its ability to service debt and to fund capital expenditures. It further provides investors a helpful measure for comparing operating performance on a "normalized" or recurring basis with the performance of other companies, without giving effect to certain non-cash expenses and other items. This provides management, investors and analysts with comparative information for evaluating the Company in relation to other natural gas and oil companies providing corresponding non-U.S. GAAP financial measures or that have different financing and capital structures or tax rates. These non-U.S. GAAP financial measures should be considered in addition to, but not as a substitute for, measures for financial performance prepared in accordance with U.S. GAAP.

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Free Cash Flow Reconciliation

(All amounts stated in US\$)

	Three months ended June 30,		Six Months ended June 30,
	2020	2019	2020
Net cash provided by operating activities	\$ 3,088,563	\$ 4,096,726	\$ 8,302,085
Less: Net cash used in investing activities (Capital Expenditures)	(1,770,877)	(3,088,587)	(4,125,164)
Free cash flow	\$ 1,317,686	\$ 1,008,139	\$ 4,176,921

Epsilon defines Free cash flow (“FCF”) as net cash provided by operating activities in the period minus payments for property and equipment made in the period. FCF is considered a non-GAAP financial measure under the SEC’s rules. Management believes, however, that FCF is an important financial measure for use in evaluating the Company’s financial performance, as it measures our ability to generate additional cash from our business operations. FCF should be considered in addition to, rather than as a substitute for, net income as a measure of our performance or net cash provided by operating activities as a measure of our liquidity. Additionally, our definition of FCF is limited and does not represent residual cash flows available for discretionary expenditures due to the fact that the measure does not deduct the payments required for debt service and other obligations, payments made for business acquisitions, or amounts spent to buy back shares. Therefore, we believe it is important to view FCF as

supplemental to our entire statement of cash flows.

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