

Epsilon Reports Third Quarter 2020 Results

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HOUSTON, Nov. 10, 2020 - [Epsilon Energy Ltd.](#) (Epsilon; or the Company) (NASDAQ: EPSN) today reported third 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 \$3.8 million and \$12.1 million for the three and nine months ended September 30, 2020, respectively, with free cash flow (FCF) of \$2.4 million and \$6.6 million for the same periods.
- Realized gas prices of \$1.18/Mcf, (excluding hedges) and \$1.72/Mcf (including hedges) for the three months ended September 30, 2020.
- 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. During the first nine months of 2020 the company returned a total of \$9.1 million to shareholders through share repurchases representing a reduction of 11.2% of outstanding shares as at December 31, 2019.
- Marcellus net revenue interest (NRI) gas production averaged 32.5 MMcf/d (Working Interest of 37.4 MMcf/d) for the third quarter. Due to the usual weak shoulder season demand the operator curtailed the third quarter NRI exit rate to 26.0 MMcf/d (Working Interest of 29.9 MMcf/d).
- Auburn System gathered and delivered 15.3 Bcfe gross (5.4 Bcfe net to Epsilon's interest) which represents approximately 83% of maximum throughput as currently configured. The September 30th exit gathering volume rate was 107.2 MMcf/d due to the aforementioned well curtailments and elevated pipeline pressures.
- Total revenues of \$5.8 million; net loss of \$0.3 million; and EBITDA of \$3.9 million for the quarter.
- Cash at quarter end of \$11.6 million.
- Net loss before tax of \$0.3 million for the quarter.
- Operating expenses including SG&A was \$1.22/Mcfe and \$1.12/Mcfe excluding \$0.3 million of non-recurring legal costs.

Michael Raleigh, CEO, commented, "The impact of the oil and gas shale industry adopting capital spending discipline is becoming evident in restrained production volumes and higher forward price expectations for natural gas. The rig count in the US onshore oil basins remains 60-80% below the peak rig counts observed in March 2020. The resulting associated natural gas production from new wells is not expected to make up for natural declines from the existing onshore well inventory. Despite improving pricing for natural gas, Appalachia rig counts remain approximately 35% below the peak rig levels observed in March. During the third quarter, NYMEX Henry Hub natural gas futures prices for 2021 increased 10%. We expect the market environment to be positive for natural gas prices as LNG and heating related demand begin to ramp up as domestic natural gas supply is expected to be flat to declining.

Epsilon remains focused on free cash flow generation. Given the current production rate and prices for natural gas, we continue to anticipate the company will generate \$9.0 - \$10.0 million of free cash flow for 2020. We are currently working through our development options for our 2021 capital program including discussions with the upstream operator on a regular basis. Our goal is to deploy capital to maintain yearly average production levels for the coming year and continue to generate free cash flow. We look forward to sharing our 2021 budget plans with our shareholders at the appropriate time.

Financial and Operating Results

	Three months ended September 30, 2020		Nine months ended September 30, 2020	
	2020	2019	2020	2019
Revenues				
Natural gas revenue	\$ 3,573,908	\$ 2,933,695	\$ 11,470,012	\$ 12,698,643
Volume (MMcf)	3,037	1,790	8,622	5,533
Avg. Price (\$/Mcf)	\$ 1.18	\$ 1.64	\$ 1.33	\$ 2.29

PA Exit Rate (MMcfpd)	29.9	16.7	29.9	16.7
Oil and other liquids revenue	\$ 16,798	\$ 65,886	\$ 246,885	\$ 307,079
Volume (MBO)	3.4	2.8	11.3	10.6
Avg. Price (\$/Bbl)	\$ 4.99	\$ 23.69	\$ 21.93	\$ 28.99
Gathering system revenue	\$ 2,219,905	\$ 2,219,613	\$ 6,800,347	\$ 6,923,058
Total Revenues	\$ 5,810,611	\$ 5,219,194	\$ 18,517,244	\$ 19,928,780

Capital Expenditures

Epsilon's capital expenditures were \$1.0 million for the three months ended September 30, 2020. This capital was mainly residual spending for the completion of the four wells drilled in Q2 2020, the drilling capital for the 3 gross (.03 net) wells spud in Q3 2020, lease acquisition capital as well as expenditures for the Auburn Gas Gathering system. We do not expect any significant capital expenditures for the remainder of 2020.

Marcellus Operational Guidance

During the third quarter of 2020, the operator spud and completed 3 gross (0.03 net to EPSN) wells. It is expected that these wells will be turned in line in November.

Third Quarter Results

Epsilon generated revenues of \$5.8 million for the three months ended September 30, 2020 compared to \$5.2 million for the three months ended September 30, 2019.

Realized natural gas prices averaged \$1.18/Mcf (excluding hedges) for Marcellus Upstream operations in the third quarter of 2020. Operating expenses for Marcellus Upstream operations in the third quarter were \$1.9 million.

The Auburn Gas Gathering system delivered 15.3 Bcfe of natural gas during the quarter as compared to 15.6 Bcfe during the second quarter of 2020. Primary gathering volumes were flat quarter over quarter at 15.1 Bcfe. Imported cross-flow volumes increased 26% to 1.0 Bcfe.

Epsilon reported net after tax loss of \$0.3 million attributable to common shareholders or (\$0.01) per basic and diluted common share outstanding for the three months ended September 30, 2020, compared to net income of \$1.5 million, and \$0.05 per basic and diluted common share outstanding for the three months ended September 30, 2019.

For the three months ended September 30, 2020, Epsilon's Adjusted Earnings Before Interest, Taxes, Depreciation, Amortization ("Adjusted EBITDA") was \$3.9 million as compared to \$3.9 million for the three months ended September 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 employees, operations, financial results, liquidity, contractors, customers, and vendors. Epsilon has also taken, and is continuing to take, proactive steps to ensure a safe working environment and 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, 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.

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.

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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(as) 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 September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
Revenues from contracts with customers:				
Gas, oil, NGLs and condensate revenue	\$ 3,590,706	\$ 2,999,581	\$ 11,716,897	\$ 11,716,897
Gas gathering and compression revenue	2,219,905	2,219,613	6,800,347	6,800,347
Total revenue	5,810,611	5,219,194	18,517,244	18,517,244
Operating costs and expenses:				
Lease operating expenses	2,147,795	1,548,902	6,229,682	4,711,111
Gathering system operating expenses	43,711	461,036	221,191	1,111,111
Development geological and geophysical expenses	2,693	—	7,595	83,333
Depletion, depreciation, amortization, and accretion	2,769,193	1,851,466	7,761,339	5,555,556
Impairment of proved properties	—	—	1,760,000	—
Gain on sale of property	—	(445,173)	—	(1,111,111)
Bad debt expense	—	—	819,000	—
General and administrative expenses:				
Stock based compensation expense	239,134	133,720	585,105	400,000
Other general and administrative expenses	1,330,604	952,503	3,575,445	3,111,111
Total operating costs and expenses	6,533,130	4,502,454	20,959,357	13,911,111
Operating income (loss)	(722,519)	716,740	(2,442,113)	6,606,133
Other income (expense):				
Interest income	4,724	38,618	39,294	12,222
Interest expense	(28,629)	(29,416)	(84,952)	(8,889)
Gain on derivative contracts	419,879	1,270,494	2,055,548	3,111,111
Other income (expense)	—	1	(2,228)	44,444
Other income, net	395,974	1,279,697	2,007,662	3,111,111
Income (loss) before income tax expense	(326,545)	1,996,437	(434,451)	9,999,999
Income tax expense (benefit)	(33,762)	543,139	114,067	2,222,222
NET INCOME (LOSS)	\$ (292,783)	\$ 1,453,298	\$ (548,518)	\$ 6,666,667
Currency translation adjustments	2,273	(900)	8,291	10,000
NET COMPREHENSIVE INCOME (LOSS)	\$ (290,510)	\$ 1,452,398	\$ (540,227)	\$ 6,676,667
Net income (loss) per share, basic	\$ (0.01)	\$ 0.05	\$ (0.02)	\$ 0.05
Net income (loss) per share, diluted	\$ (0.01)	\$ 0.05	\$ (0.02)	\$ 0.05
Weighted average number of shares outstanding, basic	23,955,619	27,060,387	25,550,194	27,060,387
Weighted average number of shares outstanding, diluted	23,955,619	27,094,391	25,550,194	27,060,387

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Unaudited Condensed Consolidated Balance Sheets

(All amounts stated in US\$)

	September 2020
ASSETS	
<i>Current assets</i>	
Cash and cash equivalents	\$ 11,580,27
Accounts receivable, net of allowance for doubtful accounts of \$819,000 at September 30, 2020 and nil at December 31, 2019	3,652,030
Fair value of derivatives	20,258
Prepaid income taxes	2,091,399
Other current assets	511,483
Total current assets	17,855,430
<i>Non-current assets</i>	
Property and equipment:	
Oil and gas properties, successful efforts method	
Proved properties	133,138,400
Unproved properties	21,448,500
Accumulated depletion, depreciation, amortization and impairment	(96,864,900)
Total oil and gas properties, net	57,721,970
Gathering system	41,912,200
Accumulated depletion, depreciation, amortization and impairment	(31,697,700)
Total gathering system, net	10,214,470
Land	637,464
Buildings and other property and equipment, net	343,677
Total property and equipment, net	68,917,600
Other assets:	
Restricted cash	565,049
Prepaid drilling costs	1,341
Total non-current assets	69,483,990
Total assets	\$ 87,339,420
LIABILITIES AND SHAREHOLDERS' EQUITY	
<i>Current liabilities</i>	
Accounts payable trade	\$ 1,638,760
Royalties payable	1,046,899
Accrued capital expenditures	95,237
Accrued gathering fees	529,722
Other accrued liabilities	1,427,488
Asset retirement obligation	1,581,560
Total current liabilities	6,319,670
<i>Non-current liabilities</i>	
Asset retirement obligation	1,489,380
Deferred income taxes	12,201,040
Total non-current liabilities	13,690,420
Total liabilities	20,010,090
Commitments and contingencies	
<i>Shareholders' equity</i>	
Common shares, no par value, unlimited shares authorized and 23,817,470 issued and outstanding at September 30, 2020 and 26,790,985 shares issued and outstanding at December 31, 2019.	131,730,400

Additional paid-in capital	7,614,593
Accumulated deficit	(81,834,4
Accumulated other comprehensive income	9,818,769
Total shareholders' equity	67,329,35
Total liabilities and shareholders' equity	\$ 87,339,45

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Unaudited Condensed Consolidated Statements of Cash Flows (All amounts stated in US\$)

	Nine months ended September	
	2020	2019
Cash flows from operating activities:		
Net income (loss)	\$ (548,518	) \$ 6,664,83
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depletion, depreciation, amortization, and accretion	7,761,339	5,630,36
Impairment of proved properties	1,760,000	—
Bad debt expense	819,000	—
Gain on sale/disposal of properties	—	(1,375,00
Gain on derivative contracts	(2,055,548	) (3,494,72
Cash received from settlements of derivative contracts	4,035,092	1,344,69
Stock-based compensation expense	585,105	401,161
Deferred income tax expense (benefit)	(200,418	) 853,116
Changes in assets and liabilities:		
Accounts receivable	(174,119	) 1,869,41
Prepaid income taxes and other current assets	(527,694	) 19,321
Accounts payable, royalties payable and other accrued liabilities	639,224	(1,422,23
Income taxes payable	—	1,338,22
Net cash provided by operating activities	12,093,463	11,829,1
Cash flows from investing activities:		
Acquisition of unproved oil and gas properties	—	(596,500
Additions to unproved oil and gas properties	(401,034	) (919,873
Additions to proved oil and gas properties	(4,238,580	) (5,452,16
Additions to gathering system properties	(436,111	) (238,823
Additions to land, buildings and property and equipment	(415,674) —
Prepaid drilling costs	(217	) (1,739
Proceeds from sale of leases	—	1,375,00
Net cash used in investing activities	(5,491,616	) (5,834,10
Cash flows from financing activities:		
Buyback of common shares	(9,078,522	) (1,714,23
Exercise of stock options	—	54,250
Net cash used in financing activities	(9,078,522	) (1,660,04
Effect of currency rates on cash, cash equivalents and restricted cash	8,291	10,944

Increase (decrease) in cash, cash equivalents and restricted cash	(2,468,384)	4,345,96
Cash, cash equivalents and restricted cash, beginning of period	14,613,711	14,959,5
Cash, cash equivalents and restricted cash, end of period	\$ 12,145,327	\$ 19,305,4
Supplemental cash flow disclosures:		
Income taxes paid	\$ 760,000	\$ 733,200
Interest paid	\$ 84,952	\$ 89,817
Non-cash investing activities:		
Change in proved properties accrued in accounts payable and accrued liabilities	\$ (1,926,910)	\$ 1,129,97
Change in gathering system accrued in accounts payable and accrued liabilities	\$ 30,906	\$ (1,142
Asset retirement obligation asset additions and adjustments	\$ 7,487	\$ 9,997

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Adjusted EBITDA Reconciliation

(All amounts stated in US\$)

	Three months ended September 30,		
	2020	2019	
Net income (loss)	\$ (292,783)	\$ 1,453,298	\$
Add Back:			
Net interest (income) expense	23,905	(9,202))
Income tax expense (benefit)	(33,762)	543,139)
Depreciation, depletion, amortization, and accretion	2,769,193	1,851,466	
Impairment expense	—	—	
Stock based compensation expense	239,134	133,720	
(Gain) loss on derivative contracts net of cash received or paid on settlement	1,237,444	(113,223))
Foreign currency translation (gain) loss	—	(1))
Adjusted EBITDA	\$ 3,943,131	\$ 3,859,197	\$

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 September 30,		Nine Months
	2020	2019	2020
Net cash provided by operating activities	\$ 3,791,378	\$ 3,793,714	\$ 12,093,463
Less: Net cash used in investing activities (Capital Expenditures)	(1,366,451)	(1,234,796)	(5,491,616)
Free cash flow	\$ 2,424,926	\$ 2,558,918	\$ 6,601,847

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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