Cairn Energy PLC

Sale of Senegal interests and planned special dividend

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Transcript

Simon Thomson:

Good morning everybody and thanks for joining the call at such short notice. I'm Simon Thomson, CEO, and I've got James Smith here with me. I'd like to say a few words on the planned sale of our Senegal asset announced this morning. And following that, we'd be very happy to take any questions.

As you know, Cairn has a long-standing track record of active portfolio management and of returning capital to shareholders. And as a management team, we're continually assessing the balance of risks within the portfolio. As well as seeking to retain appropriate financial flexibility through the cycle. This ensures that we remain in strategic control of our capital allocation decisions, whatever the external environment. And the transaction today allows us to deliver on these strategic goals.

So, let me run very swiftly through the details. We've agreed to sell our 40% interest in the Sangomar project to Lukoil, subject to government and partner consents. We'll receive proceeds of up to $400 million, a $100 million of that being contingent. And on completion, we'll also receive a further amount of up to $330 million that will have been spent this year on the project development.

And what does that give us? Well, firstly, it significantly reduces the company's risk profile and strengthens our strategic flexibility at an important moment. The sale of Sangomar eliminates a substantial capital allocation to a multi-year deep-water project and reduces concentration of development and financing risk. In financial terms, Cairn now expects to end 2020 with material net cash approaching $600 million and limited future capital commitments. As opposed to net debt and a $1.5 billion commitment to a single development project during uncertain times.

Secondly, it allows us to make a further significant return to shareholders of at least $250 million. And to put that in context of our long-term strategy, it means we will have effected approaching $5 billion in cash returns since 2007 with a desire to add to that number as and when the opportunity arises.

Thirdly, even after that capital return, it provides us with sufficient financial flexibility to consider potential additions to the portfolio at a point in the cycle where there may be attractive counter-cyclical opportunities available.

Meanwhile, the rest of the business continues to perform well. Our cashflow generating assets in the North Sea are expected to produce between 19,000 and 23,000 barrels of oil equivalent per day this year. With oil and production costs below $20 a barrel. And crude realisations remaining strong relative to Brent.

In Mexico, we're working with operator, ENI, on the commercial potential of the Saasken discovery that we made. And elsewhere we retain an attractive exploration portfolio. But crucially one where we have successfully deferred all material expenditure in the current oil price environment in order to high grade the opportunity set.

And finally, we continue to expect a near term ruling on our Indian arbitration that's seen a recent announcement in that respect. And we remain confident in our case.

So to recap, we've always said that we intended to transact on Senegal and that the timing was likely to be at or around FID. The transaction today enables us to return capital to shareholders as well as to significantly enhance the group's strategic flexibility for growth. The rest of the business continues to perform well and our prospects for a successful Indian arbitration outcome, and our intentions for the use of proceeds once that is resolved remain unchanged.

With that, I'd now like to hand over for questions, operator. Thank you.

Chris Wheaton:

Thank you very much. Gentlemen, good morning. Thank you very much indeed for your time today. A couple of questions if I may. Firstly, could you talk about the hurdles to getting the deal closed. In particular, does the Government of Senegal need to give approval? And also what's in the contingent payment structure of that extra $100 million that is potentially payable 2023 onwards in terms of threshold, oil price, and also oil price first oil date please.

And then secondly, really a what next question. When do you see redeploying the capital? How much do you see split between say trying to do more exploration versus more development, given you've said in the past you do want to diversify your production base away from the two assets in the North Sea you've got at the moment?

Simon Thomson:

Thanks Chris. I'll answer on the partner points and James can talk about the contingent. Then I'll come back on the what next. I mean, the Government of Senegal have already met Lukoil. But yes, it does require government consent. And it also requires partner consent in the usual way as this is an asset transaction. There's a specific timeframe for that and fairly standard clauses.

James Smith:

It's worth also adding that obviously this is a class one transaction, so this will be subject to a shareholder vote in due course, which we'll be issuing a circular in relation to. But those are really the only conditions or the key conditions, and they're fairly standard of their type, to completion.

The contingent payment of up to a $100 million at first oil is linked both to the timing of first oil and to the average oil price during the first six months of production. So first oil is still expected in mid-2023. And if it occurs on schedule, and indeed within 2023, then the contingent payment is $100 million if Brent averages over $60 a barrel during the first period of production. And $50 million if it averages between 55 and 60 during that period.

And then if first oil is somewhat delayed and doesn't occur until the first half of 2024, then that would step down to $50 million if the oil price is over 60. And $25million, if it's over $55 but under $60. Sorry, that was a lot of numbers all at once. That is in the back end of the announcement.

Chris Wheaton:

No, that's great. Thank you. Thank you very much indeed. Can I just ask a follow up before you go onto sort of the what next question?

Is there ... you're saying this is subject to partner consent, obviously FAR is in default with its partners. Are there risks around ... Lukoil is buying into the project knowing that is the case obviously. Are there risks around FAR being in default? And therefore if they don't pay that potentially some contingent payment is therefore reduced to you. And also, is there a risk that FAR interfere with this transaction for want of a better word?

Simon Thomson:

I think on the latter point obviously that's not for us to comment. And you'd have to ask FAR of their intentions. But we have no reason to believe that. And on the former, James?

James Smith:

So, the short answer is no. I mean, the contingent payment is not related to the actions of other partners or the interest that's acquired. Obviously, Lukoil is acquiring our 40% interest in the full knowledge of FAR's position. And in the knowledge that Petrosen has a right to back into the project, so that 40% could reduce down to 36.4 %if Petrosen do back in and increase their equity interest. All that is clear. And none of that affects the contingent payment rights.

In terms of the partners and FAR's attitude towards the transaction. Obviously we are writing to the partners seeking their consent, as the joint operating agreement requires. And the partners have 30 days to consent to that transaction, to pre-empt or to exercise their pre-emption rights or to bring any valid reason they think they have for not consenting to the transaction.

Simon Thomson:

Coming back to the kind of what's next, I mean, you're right. We have previously commented that we would look to diversify our production base. And that's something that we are still interested in doing. I think this puts us in a position where, with balance sheet strength and financial flexibility at the current point, that's arguably a good place to be given the fact that there are a number of opportunities around in the market. But I would emphasise that we will continue to remain very disciplined in relation to anything that we look at. It has to be accretive, it has to be the right kind of thing. But yes, obviously in due course, Kraken and Catcher will enter into decline and we'll be looking to backfill that.

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James,Barclays:

Congratulations on the deal. Just a couple from me. You're talking about the special dividend of at least $250 million. Just wondering in what circumstances you could be distributing a meaningfully higher proportion of the proceeds? And then on your remaining portfolio, do you anticipate spending more on your North Sea assets in 2021 and '22 now, than you have been this year?

Simon Thomson:

So, on the first point, we've been very clear, and I hope throughout long term in terms of strategy, that if we don't find a good use, what we believe is the best use of the proceeds in terms of deployment within the portfolio, then we believe it's better back in shareholders' hands. So, as Chris asked, we are looking at various opportunities. But if we don't find something that we believe is accretive, then there may be a situation where we believe there's more that should go back to shareholders. At the minute we believe that there are things that can be accretive and enhance our portfolio. James.

James Smith:

On the North Sea production. No, there isn't a current expectation that next year's spend will be significantly higher than this year's, or significantly higher than previously anticipated. There is some activity principally on Catcher that may well be undertaken next year, subject to joint venture approvals during the balance of this year. But no, there isn't a current expectation that there will be materially higher capex next year. That said, obviously as both of those assets, over the next couple of years, fall into natural decline based on the original field development plan, of course, we look at opportunities too, for near-field and infill drilling to arrest that decline and sustain production.

Rachel Fletcher:

Hi. Thanks for taking my question. Just a quick one from me please. I was hoping you could comment a little bit on valuation and the implied oil price in this transaction. Thanks.

James Smith:

Well, obviously the valuation, $300 to $400 million with an effective date of 1st of January 2020, it's worth pointing out that we've already entered obviously the capex intensive phase of the development activity. So that effective date is important. We expect to close during Q4. The total capex guidance net to us that we've given for this year is $330 million. So, the proceeds at completion will be $300 million of acquisition consideration plus we anticipate the bulk of this year's development capex that's been incurred.

So, there's lots of equity analysts on the call. There's a reasonably wide range of valuations for this asset, given the phase of development that it's in. But I think the average equity analyst valuation for phase one is about $400 million. That's on an average price deck of $60 Brent long term. So I guess it's in line with that. But obviously we wouldn't comment on what the buyer's price deck and risk in to the overall resource base is. But I think it's pretty much in line with a consensus of phase one analysts' valuations at about $60 Brent.

David Brown:

I think we can all see why you've done the deal given, like you say, what it does to the risk profile and balance sheet. Just want to pick up on the fact that it obviously comes a week after you announced a delay to the Cairn India announcement. So should we read anything into that, i.e would you have made the same decision if Cairn India was still a summer outcome and you were expected to receive a significant amount of proceeds or potentially receive a significant amount of proceeds in the near term?

Simon Thomson:

Absolutely. And actually, the positive of this transaction, one of the other positives, is it removes any uncertainty around deployment of any India proceeds towards the Senegal capex requirements. So, if anything, it increases our flexibility in relation to the Indian proceeds and the potential for returns to shareholders.

And as we've always said, we treat India to one side from the point of view of planning the business. We see it as positive upside. We remain confident of our case. But we plan on what's in front of us today. But no, it wouldn't make any difference. Our intention was always to farm down Senegal for that reason.

Nathan Piper:

As we look ahead, do we start to think of Cairn as a different type of company or will you reflect the time that we're actually in, so could you can begin to commit to a consistent dividend or is your asset base there to generate value for shareholders on a more regular basis? Because although it's $5 billion since 2007, there's a reasonable gap between 2007 and today. And so, how are you looking at the overall strategy of Cairn given the market environment, the uncertainty around oil price and perhaps investor appetite for our sector all together?

Simon Thomson:

By the way, it was 2014, when we were undertaking that $300 million buyback. Obviously not a special dividend, but buyback programme that was halted as a result of the Indian issue.

Our -term strategy remains, and we believe a differentiator remains, in our desire to return capital in one form or another. As you point out, that thus far has been relatively lumpy and relies on monetisation's. Depending on the asset base that underlies the portfolio, you could contemplate a more regular return to shareholders. We don't have that asset base today. But what I'd like to think is that this transaction gives us the flexibility that may allow us to access that kind of asset base.

I don't think therefore that in itself is a change of strategy in any way. We obviously remain very focused on the macro. And obviously we're in a different world I would say from the time of the Sangomar discovery, when oil prices were around about a $100 a barrel; we've seen a very consistent decline. And like all other E&P companies, we need to recognize that and we need to adapt accordingly.

And I think you can see us doing that. We've obviously deferred capital commitments in terms of our exploration programmes. We've done this deal today, which was always in our strategy, but actually at the current time gives us probably more relative strength than others might have. And allows us to opportunistically access things in the marketplace.

So I think you can continue to see us actively managing the portfolio, looking to increase value from existing assets and possibly through asset additions and ultimately looking to return. That won't change.

Nathan Piper:

Thanks. But I guess maybe the emphasis, I guess historically at certain points and today underlines it, the exploration drill bit has generated a lot of value for Cairn over the years. I mean, is there a sense that you're going to build out a production base as a first port of call because I guess that's the bit that gives you the ultimate strength and the ultimate optionality?

Simon Thomson:

I don't want to be too specific. I mean, obviously, as we've said, there's a desire to diversify the production base. So, we look hard at things. We do believe that we continue to have a good exploration team. And actually therefore, if there are things that come that maybe might have production and exploration upside then so much the better.

Al Stanton:

Most of my questions have actually been asked. So can I just go back to, I suppose, what Nathan was touching on. In terms of when I look at it, your portfolio, you've been known to be bidding on production assets in Egypt, and we could perhaps anticipate that going forward. You're not going to bid on Zama because you just sold an asset like Zama. So surely exploration then does have to come back to the fore. If you've got to have a USP relative to your peer group, should we be expecting more higher impact exploration in 2021?

Simon Thomson:

No. I think basically we have our existing portfolio and we've been quite clear about the deferment of expenditure into '21 and '22 in terms of exploration spend. And that hasn't changed, Al. I think that being the case, we believe we still have a strong exploration team. We believe that we can add value through exploration. Obviously in recent times that's been in relation to Mexico, and not elsewhere. But there are opportunities that we're looking at where there may be exploration. And we'll assess that and see if there's something that we think that we can add value to it.

So, I don't think, if you're asking, are we going to suddenly go and spend hundreds of millions of dollars on a big deep water well? The answer is no. We continue to assess all opportunities. And I would hope actually that before this deal, in our actions in relation to our exploration portfolio; show that we're being pretty prudent in terms of equity exposure, and in terms of level of risk appetite that we are prepared to access. But that we still want to have exploration as part of our USP, as you say.

Al Stanton:

Okay. And then if I may, can I ask a follow up question about the contingent payments? On some analyst decks, that might be zero, it's quite a narrow range, I suppose it's 55 and over. But the 55 to 60, I was wondering if there were many hours spent haggling the bottom end of that range and just how you finalized the numbers?

James Smith:

I don't think you expect us to comment on the blow-by-blow negotiations. I mean, obviously, we think this is a fair value at this point of relatively volatile oil price. It's not unexpected, to have some contingent consideration linked to oil price at the time of first oil. And, as I said earlier, if you look at the range of analyst valuations at $60 Brent for phase one, then we think this is ... the contingent consideration included in this puts us broadly in line with that.

Michael Alford:

Thanks for taking my question. I've just got one actually. If it's possible to talk a little bit more around how you see a diversified production base, Simon. So would that be simply just geographically, are we thinking oil versus gas, how should we think about the Cairn's future production base going forward? Admittedly, you need to find the right deals, but I'm just trying to get a sense as to how you see that production base going forwards. Thanks.

Simon Thomson:

It's a good question. And actually, obviously I can't be too specific, there are things we're looking at, there are things we have been looking at, and will continue to look at. Diversification, whether it's geographic or whether it's by virtue of hydrocarbon type, really depends on value from our perspective. Number one. There are obviously associated considerations in relation to ESG and so on that you consider on an asset specific basis. But it's value driven. And at the end of the day, I'll come back to the point; we will not do a deal just for the sake of it. If there's something that we believe enhances the portfolio and results in a better-diversified production base, then we will pursue it. But if that's not the case, then we'll look at alternatives. And I've said previously, we have a desire to return more to shareholders.

Rachel Fletcher:

Just to follow up to some of the things that have been said. I was just wondering what Cairn's ideal balance sheet position is going forward? You'll be going into year end with a net cash position around $600 million. How long do you anticipate giving yourself to secure opportunities before considering returns to shareholders? Thanks.

James Smith:

Just to be clear, that $600 million at year end is pre-dividend. So, what we've already said is that we expect to return at least $250m of that to shareholders. And I think as Simon has said, we think this is a good time in the cycle to have some financial and strategic flexibility. And a good time in our portfolio development to have that flexibility.

But obviously the way things play out over the balance of this year and into next year, will determine how much of that balance sheet flexibility is appropriate to keep. I think generally speaking in terms of our leverage strategy and our appetite for debt capacity, it's generally speaking been quite risk averse in a cyclical capital-intensive industry. But it's very much relative to the portfolio. So, based on today's portfolio, we've got some leverage capacity, but we wouldn't imagine drawing down heavily on that, unless the base of the producing asset base is diversified and expanded.

Simon Thomson:

Just to sum up. What we've announced today is absolutely consistent with our long-term strategy of monetizing and returning. It puts us in a place where we'll end this year with, as James has just said, around $600 million of cash pre-dividend. Very limited future capital commitments as opposed to significant net debt and a one and a half billion-dollar commitment to a single development project. We believe that is the right thing for us, the right thing for shareholders. And it gives us a lot of flexibility and option value when we can consider the opportunity set that currently sits out there. But thanks for your time and obviously happy to take any follow up questions separately. Thank you.