Capricorn Full Year Results

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Transcript

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Simon Thomson: Well, good morning, everybody, and welcome to Capricorn's results presentation. I'm Simon Thomson, Chief Executive. With me are James Smith, CFO, and Eric Hathon, Exploration Director. Also, not because we've fallen out, but because he's got COVID, joining us on the screen is Paul Mayland, COO. As in the usual way, we've got a presentation to run through with you this morning, and we'd be happy to take questions at the end. It is being webcast, so if you have a question, please state your name before asking. In case of fire alarm, the exits are there and there.

Okay, moving on to the presentation. Eight years ago, the Indian government froze our assets and removed a billion dollars of assets from our balance sheet. It's been a long, hard road, but I'm very happy to be standing in front of you today with that issue finally resolved, allowing us to move forward with our strategic delivery.

Simon Thomson: Quite rightly, shareholders ask us now, what will Capricorn be going forward? Well, fundamentally there's two characteristics that are unchanged, and two that are quite new. First of all, the familiar. We'll continue to seek opportunities that allow us to capture and realise value for shareholders and give us the ability to generate further returns. Secondly, we will continue to do that with a combination of speed, but also patience. Speed where matters are within our operational or strategic control, and patience, as demonstrated by India, when it is required.

Simon Thomson: What will be new? Well, first of all, technically we will increasingly focus on short cycle returns, and commercially, we will seek those returns from a more limited number of jurisdictions. Secondly, we will look to secure, create, or add to lower carbon barrels in our operations. Paul will talk about how we are doing that in Egypt. And wherever we operate, we will seek to contribute in that manner to achieve the common objective of energy security, affordability, and reduced carbon emissions.

Simon Thomson: What does that mean in practice? Well, first of all, it means that our strategic delivery will be ever more focused on disciplined allocation of capital between further investment and further returns. If you look at this slide from left to right, and first of all in the bottom left there, we will continue with what has been a transformation of the portfolio. Last year, obviously, saw the exit from the UK and the entry into Egypt. We intend to continue with the portfolio transformation, and there will be an increased emphasis, as we've seen in Egypt actually, in our assessment of local and regional demand, and underlying regulatory and fiscal support in every jurisdiction that we are assessing.

Simon Thomson: Secondly, given the supply demand forecast, given commodity prices, we continue to believe there is a strong rationale for capital allocation towards exploration activity. In our case, as I've said, that will be increasingly focused on short cycle returns, with the focus on Egypt and the UK. But we still retain option value in terms of our frontier acreage, principally in Mauritania and Suriname, progress in which will require the entry of an aligned partner, again, in relation to that capital discipline point.

Sustainable cashflow base: this is what we're very focused on right now. Egypt was the first step, the first of a number of steps. We're working very hard right now to add further assets into the portfolio as we seek to increase that sustainability of cash flow generation going forward.

Simon Thomson: Balance sheet flexibility and shareholder returns: we will continue to focus on retaining that differentiated balance sheet flexibility that allows us to both grow the portfolio, as I've been talking about, but also gives us the opportunity to make further material shareholder returns. I think it's worth reflecting that, in the period since the Indian IPO, we have raised capital from shareholders once during the financial crisis in 2009, when we raised around about US$160 million. But, in that same period, we've returned US$5.5 billion to shareholders, including the current returns. I think that clearly differentiates us, and it's a track record that we will look to continue going forward. In summary, we're renewed and refocused. We offer a combination of growth and further returns from a combination of differentiated balance sheet strength and continued fiscal discipline in everything that we look at. James.

James Smith: Thank you, Simon. Morning, everyone. As you've seen, 2021 was a genuinely transformational year for the company. Transformational for our portfolio, transformational for our balance sheet, and also in terms of the differentiated positioning of Capricorn to deliver our strategy from here. At the beginning of the year, we completed the sale of the Senegalese discoveries that we'd made and brought into development phase, and as a result, were able to return over US$250 million to shareholders via a special dividend. Then in March, we announced that we'd agreed the sale of the UK producing assets as the anti-decline phase, that for consideration of US$455 million, plus uncapped contingent consideration over five years, linked to oil price and production performance. We carry a fair value of that contingent consideration on the balance sheet of approximately US$200 million based on year end oil prices, but obviously at today's oil prices, that would be materially higher. The first instalment of that contingent payment is due in the second quarter of this year in respect to 2021 and is US$76 million.

James Smith: At the same time in March, we announced that we'd agreed to acquire with our partner Cheiron, the Egyptian onshore business of Shell, for US$330 million, bringing in on acquisition 113 million barrels of oil equivalent of 2P reserves, and 36,000 barrels of oil equivalent of production a day, with the potential to significantly grow that production and to expand the resources through development and exploration, and selling all of that into an energy hungry and fiscally supportive market.

James Smith: Then in the summer of last year, we announced that following our success in the international arbitration case against India's retrospective tax claim, and our subsequent actions to enforce that arbitration award, the government of India agreed to repeal the retrospective tax act, resulting in a tax refund to us of US$1.06 billion, which was paid in February this year. That enables us to return up to a further US$700 million of cash to shareholders for a tender offer and ongoing buyback program, and at the same time, retain a very strong net cash position to drive further growth and expansion in the portfolio. Something which, as I said, we believe puts us in a strongly differentiated position in the sector.

James Smith: If we look at how all that translated into cash flows through the year, you can see on the left-hand side of this slide, the cash movements relating to that portfolio management. The special dividend, the inflows from the disposed UK assets, and the acquisition of Egypt, which was roughly 55% debt funded. On the right-hand side, you can see that after capex, admin expense, and other costs, that resulted in net cash at year end of US$133 million, comprising US$314m of gross cash and US$181m of debt, which was arranged for the Egypt acquisition. Now, all of that is clearly prior to the receipt of the India proceeds, so if you adjust that pro forma for the India tax refund and settlement of the US$500 million tender offer that we've announced, that would be US$870 million of gross cash, or US$690 million of net cash of which US$200m has been allocated for a buyback program over time.

James Smith: If we look now specifically at Egypt through Q4 of last year, following completion of the acquisition in September, our working interest production grew by about 8%, averaging 36,500 barrels of oil equivalent per day. The growth in this quarter was dominated by an increase in the liquids production. Revenues from that production were US$56 million off realised sales prices of US$77.80 a barrel for the liquids, and US$2.90 in MCF for the gas. Liquid sales accounted for approximately 70% of revenues in the quarter. Production costs in the quarter were US$22 million, or US$6 of BOE, and capex was US$20 million. You can see it was free cash flow generative on accruals basis.

James Smith: For this year, we expect production to average in the range of 37,000 to 43,000 barrels of oil equivalent per day, growing through the year, with the aim to exit 2022 with production well into the forties, and above the top end of that range. Capex to deliver that growth is forecast in the range of US$90 to US$110 million, and we expect to drive per unit opex down to around about US$5 of BOE. You can see from the chart on the slide here, the medium-term expectations we have for growing, sustaining that production basis over the next five years, and this will be from increased drilling activity in existing reserve space in the near term, as well as converting contingent resources into producing reserves from near field developments over the medium term. Paul will talk a bit more about the operational delivery of this plan, but in cash flow terms, at US$60 a barrel Brent, which seems relatively cautious at today's prices, that translates into a business that delivers around US$150 million of operating cash flow a year with very good visibility on sustaining that over to the medium term.

James Smith: Just briefly then on capex across the rest of the Group this year, which remains in line with previous guidance, in addition to the US$90million to US$110 million of production and development capex in Egypt, we expect around US$30 million of exploration capex, which includes the seismic acquisition and the expected drilling of two commitment wells later in the year.

James Smith: Outside of Egypt, across the rest of the portfolio, we have US$40 million in the UK this year for Jaws and Diadem wells south of Nelson, as well as seismic acquisition in the newly acquired mid-North Sea High Acreage. And then elsewhere, it's US$30million to US$35 million of expiration expenditure, which is principally in Mexico, completing our commitment wells there.

James Smith: Looking at how will that position us for delivering the future strategy, with the acquisition of the Egypt assets, we've begun to build a strong, sustainable cash flow base with characteristics aligned to our strategy that is low break-even production and advantageous hydrocarbon mix located in an energy hungry growth market with supportive fiscal regime, with production and result growth potential, with short capital investment cycles, and with a clear route to decarbonisation.

James Smith: Exploration will remain an important part of the strategy but our capital allocation there is now very much focused on infrastructure-led opportunities that are fast to commercialise and will predominantly target reserves replacement in existing core areas. As we talked about the balance sheet, following the India tax refund and the US$500 million tender offer, we'd still retain a significant funding firepower to further build out our cash flow base through acquisition, focused on opportunities with similar characteristics to those I've just listed regarding Egypt. And then ultimately, we continue to see returning cash to shareholders as a key differentiator of Capricorn. Clearly, we're in the midst of a very significant capital return right now, but as we continue to build the business from here, we'll continue to ensure that fiscal discipline of investing for sustainable growth through the cycle, but also continuing to build opportunities to return further value to shareholders. With that I'll hand over to Paul.

Paul Mayland: Good morning, everyone. Thank you, James. I'm sorry I'm not able to be with everyone in London.

2021 has been our fourth consecutive year of delivering production and operating costs within guidance, and one in which we have transitioned out of our existing North Sea producing assets whilst retaining significant reservoir out- performance and oil price exposure and positioned ourselves with our first cornerstone to building a production portfolio that offers greater growth, longer life, more price resilience, and is cash generative. The Western Desert assets in Egypt acquired from Shell performed within expectations in 2021, delivering working interest average production during the full year of around 36,000 barrels of oil equivalent per day, and with the natural decline arrested from completion to year end.

Paul Mayland: I'll describe our short term and longer term investment plans for the assets that are expected to deliver production growth and cash generation in the coming years. In 2022, we anticipate to grow production on an annual average basis by at least 10% through successful deployment of our capital programme during the year. However, as James has already mentioned, a key objective in a higher oil price environment is to prioritise liquid opportunities over volumes, and we've already increased liquids to close to 40% of the total production by the year end.

Paul Mayland: The next slide shows the net working interest production by phase and total during 2021, illustrating the increase from transaction completion which occurred in late September of around 33,000 to 36,000 by the year end. And following some small revisions and re-classifications, and of course, adjusting for production in the year, our year end reserves sit at 91 million barrels of oil equivalent on a working interest basis and our contingent resources across all categories have grown to around 70 million barrels of oil equivalent. We will work together with our respective joint venture partners to optimise the exploitation plan for these reserves and resources. At the current levels of production, our reserves and resource life index is in excess of 12 years.

Paul Mayland: The next slide shows a picture of one of the rigs operating in the field. In 2021, 15 new wells were drilled across the fields in concessions. Seven new producers, three new water injectors, three field extension wells, and two exploration wells in NUMB and North Matruh concessions. In 2022, we anticipate to drill and complete three to four times as many producers, two to three times as many water injectors, and one and a half to two times as many field extension wells. We will do that by adding to the rig capacity that we inherited from Shell.

Paul Mayland: A third rig was added at the start of the year, and we anticipate adding two more rigs during the first half of 2022 to allow delivery of this overall programme. In addition, five work-over rigs are also operating to allow lift and pump optimisation and re-completion of new producing and injecting intervals in their respective reservoirs. On the facility side, we are adding further compression both at the BED facility, which is underway, and at Obaiyed where it is planned. This will allow gas recovery to be enhanced and wells to produce at lower pressures and for longer.

Paul Mayland: The next slide illustrates both our ability to grow and also the importance of maintaining the producing assets. The new wells to be drilled comprise infill opportunities, targeting undrained areas of the field and areas where reserves can be produced more effectively through better sweep or depletion plans. We will also target undrilled fault blocks and other field extension opportunities, and we've already had success with this approach to date, which we will follow up in 2022.

Paul Mayland: The Western Desert offers multiple reservoir targets, and this allows more economic wells to be drilled and completed often across two, three, or even four reservoir horizons. The key to maintaining and sustaining production through the rest of this decade and beyond will be to maintain and enhance the facilities. In November, the operator conducted a successful plant shutdown at the BED facility, which included 24-inch export pipeline pigging, turbine change-out, gas compressor servicing, and other routine planned maintenance. A similar shutdown is planned at the Obaiyed facility in the second half of this year.

Paul Mayland: Moving on to the next slide, we recognise that in addition to providing vital cost effective, reliable energy to the host government, we must also help in the journey to reduce emissions. A key first step is to utilise gas as a substitute to diesel for power generation. This is underway and the plans are being extended. Additionally, we are examining the possibility of incorporating flare gas into this plan and potentially considering renewables, particularly solar, as part of the overall facilities and plant power mix. So, by 2025, we'd hope to see a step change in emissions reduction, reducing the level of emissions from stationary and mobile combustion and process flares. Longer term, we will also look at the feasibility of small and large scale CCS for deployment to aid in process emissions reductions. And we'd like to commend the initial steps on this journey taken proactively by the operating company Bapetco, who alongside Cheiron have had fruitful discussions with our energy transition team.

Paul Mayland: We see the Western Desert Assets in Egypt as a good template for other business development opportunities, ones that are within our technical, operational and commercial skill sets, and where the core infrastructure is built and has been maintained to a good standard, and where emissions improvements are meaningful and can form part of our net zero strategy. This, of course, is only possible with a supportive host government, Ministry and joint venture partners who we will continue to work with to deliver value for our respective stakeholders. In order to deliver value, we have to both sustain the production and grow the reserves both within the fields themselves and the surrounding exploration, which Eric will now talk you through.

Eric Hathon: Thank you, Paul. Good morning, everyone. In exploration at Capricorn, our primary focus is on our ongoing infrastructure led exploration or ILX programs in Egypt and the UK. As Simon and James both said, ILX is a good fit to our Advantaged Resources criteria because we are in proven basins. When a commercial discovery is made, we can get it online more quickly than in frontier or emerging basins. Volumes are often smaller, but so is the minimum field size needed, and NPV per barrel is attractive due to the shorter cycle time. In our plays in emerging basins like Mauritania and Suriname, where we're in the first phase of exploration, ahead of any well commitments, it's the potential volumes we see which drive value along with phased developments, which can optimise cycle time.

We continue to mature our exploration portfolio in the Western Desert, as Paul mentioned. We're in continual collaboration with our JV partner and we have resourced our in-country exploration team with folks who have significant experience in the Western Desert. As we collaborate and grow our knowledge base, we see multiple exploration themes emerging. In the producing assets, we see, too, near field exploration wells targeting intervals proven in nearby fields, such as the Assil C-106 well, which is drilling right now in the Alam El Shawish concession. It's a Cretaceous oil target in a separate fault block, but adjacent to the Assil field, which also produces from the Cretaceous. And success here would allow it to be online and producing in a matter of months. The other theme is new play concepts, which are not currently producing, but which show significant promise based upon historical activity, better data and new interpretations. These include various carbonate plays, stratigraphic sand plays, deeper tests, and even unconventional type potential. Given they're in and around producing fields, success in any of these could drive outsize value. In our exploration concessions, we have begun by maturing the typical targets which produce in offset fields.

Eric Hathon: Now, given the maturity of these areas, volumes are modest, but low cost and proximity to infrastructure keeps commerciality thresholds low. We're also working to map deeper targets in the Jurassic and even the Palaeozoic, which are overall much less explored, but have seen recent success. This is where the new broadband 3D seismic we will be acquiring will be especially helpful.

Now on slide 21, you can see our exploration timeline out to 2024, including our well and seismic acquisition campaigns. In aggregate, we're targeting over a hundred million barrels of oil equivalent gross unrisked in our first 10 wells with roughly US$30 million of gross well capital. Overall, that is an attractive metric. Now, we've already started the campaign with the NUMB-5 well in the Cheiron-operated North Um Baraka concession in the north part of the Western Desert. We drilled the well just a few kilometres away from an old well, which tested better than 2000 barrels of oil per day in the Jurassic.

Eric Hathon: Now we did find Jurassic pay in this well, but the reservoir was tighter. That just points to the overall, you can have somewhat predictable reservoir results in the Western Desert. So, you have to be careful and do your homework. With this new information, we're evaluating our options for the area, but overall, we see significant running room across the concession. Now, we'll begin our own operated exploration campaign midyear. As you can see on the chart, in the South Abu Sennan concession with the Saqr and Seman wells. From there, we hope to have a more or less continuous exploration drilling program moving then to the South East Horus concession and finally, West El Fayum by the end of next year. We will begin our 3D seismic acquisition in South Abu Sennan after completion of 3D in the North Um Baraka concession, which starts towards the end of this month. Then we'll finish acquisition in South East Horus. Each of these programs is 500 square kilometres of wide azimuth 3D seismic.

Eric Hathon: Now finally on slide 22, we'll turn to the UK, where we have two focus areas for ILX. The Nelson field area in the central North Sea, as you can see at the top, and the Southern Gas Basin in what we call the Mid North Sea High, and you can see our concessions at the bottom of the slide. We kicked off the campaign with the Shell operated Jaws Well, late last year. Now, we did find a thick section of Jurassic sands, but unfortunately, they were wet. We plan to spud the Capricorn-operated Diadem well in the second quarter of this year. Now, while Jaws was disappointing, each of these Fulmar sand pods is distinct. The Jaws result does not impact on Diadem prospectivity. In the Mid North Sea High, we've completed the acquisition of 3D seismic over the main Plymouth prospect and we should have the data in hand in May of this year.

Eric Hathon: Now, we have ample time ahead of the drill decision to assess the prospectivity, but we're committed to accelerating our timeline just as we are in all of our concessions.

In summary, we have a refocused exploration program targeting infrastructure led opportunities, which drive value with relatively short cycle time to first production while we're still maturing, select impact opportunities in emerging basins, where scale will drive the value. Now back to you, Simon.

Simon Thomson: Thank you, Eric. In summary, as we continue to renew the portfolio, we remain focused on discipline allocation of capital towards delivery of value growth, sustainability, and further returns. Egypt was the first step in the renewal, and we believe we're well positioned to enhance the platform for sustainable growth within strict value criteria. In Egypt itself, we're pleased with the initial progress and the assets as you've seen. The near term focus is on liquids rich production opportunities. Distribution of the Indian proceeds continues our track record of significant shareholder returns. As I've said, that is a track record that we are enthusiastic to continue. As demonstrated in Egypt, we're focused on safely and responsibly producing hydrocarbons with a number of decarbonisation activities already underway. So, much to look forward to from our perspective. That concludes the presentation. Now, I'd like to hand over for any questions.

Speaker 1: Just question on the ops side of things, first of all. On slide 9, you've got a production capex profile chart there, which shows production growth for your 2P and 2C. I was just wondering how much contribution does the 2C make to that profile?

James Smith: The 2C starts to make a contribution towards the back end of that chart. So '25, '26, predominantly.

Speaker 1: Okay. Thank you. Just another quick one on carbon intensity. Just wondering what your carbon intensity was last year in absolute terms. And what your target might be for this year?

Paul Mayland: The carbon intensity last year is obviously a function of a blended production. Production from the North Sea for essentially, ten months, which was about 95,000 tonnes of CO2 equivalent. Then the three and a bit months of production associated with Egypt, which was about 45,000 tonnes of CO2 equivalent. Then there's some operated emissions associated with other surveys. I think our total equity emissions reported for 2021 is going to be 146,000 tonnes, which on an equivalent basis, I think, is approximately 20. Obviously, going forward, we will have a full year of Egypt production, which we anticipate associated equity emissions of between 180,000 and 200,000 tonnes of CO2 equivalent. Though obviously, the intensity will be higher. That's what we are targeting in terms of reducing over the next three years.

James Carmichael...: Hi. James Carmichael from Berenberg. Just a couple... I'm just wondering if there's any sensitivities you can give us on the UK contingent payments, I guess, in the context of the current price environment, first of all.

James Smith: The terms of the contingent payment were set out in the circular we've got, so you can see, and I can point you in the direction of them afterwards, but the percentage of revenue generated above US$52 brent, which is basically how it works over the next 5 years. But as I said, at year end prices, so prices in the US$70s, the balance sheet valuation was about US$200 million. At today's prices, the total proceeds would be well in excess of US$300 million, if that gives you an indication.

James Carmichael: Great. Thanks. Then I guess just on M&A, just wondering how the current price environment is affecting any negotiations that you're in, if it is. Then when we think about the Egypt assets, there's obviously quite a large component of that which is fixed gas pricing. Just wondering how, when you're looking at new assets, how do you weigh up the long-term visibility that fixed pricing gives you, versus maybe bringing in some more price exposure? Thanks.

Simon Thomson: Maybe I can let James answer the first part of that question. On the second part, I think Egypt, for us, remains a very attractive asset from the point of view of, there is downside protection... It's easy in today's environment to only think about today's price and easy to forget that this time two years ago, it was US$20. What we're all used to in this industry is extreme volatility. What you look to as a long-term player in terms of planning, is to protect against the downside in that volatility, but also have exposure to the upside. Egypt's got a fixed gas price component, but that does protect against the downside. We are obviously focused on increasing the liquids element of the production, as you've seen today as a result. I think, that kind of asset remains very attractive to us on a go forward basis.

James Smith: Well, just to comment further on that part of the question. As I said, 70% of the revenues in Q4 of last year were liquids from Egypt, although two thirds of the volumes were gas. Obviously, this month that'll be a high percentage. We've got significant exposure to current liquids price strength in that portfolio, and as Simon alluded to, downside protection from the significant part of the volumes that are fixed price. So, we like that mix, that balance, in terms of hydrocarbon pricing.

On M&A, clearly, we've indicated that we are very much in an acquisitive phase for further building out the portfolio. We are building a portfolio for the longer- term and I think the strategic decisions that sellers of assets in this market are thinking about the longer-term as well. So of course, you have to think of ways to structure around near term oil prices, but we've always done that. We did that in Egypt with upside sharing with Shell. Clearly you can hedge around that near term oil prices to increase leverage capacity over the near term, and those are all things we're doing. But longer term structurally, both with sellers, with our view, with financing counterparties view, we haven't seen a fundamental shift in terms of what we're looking at. So, for us, it's a long-term planning around about US$60 Brent and that's how we think about acquisitions. Clearly, we structure around upside sharing in excess of that, and obviously in terms of the near term. That's a market you can hedge around and finance around.

Rachel Fletcher: Hi, Rachel Fletcher from Morgan Stanley. Just a quick follow up on the M&A question. What would the criteria be for potential acquisitions in terms of how you're thinking about cost, emissions, hydrocarbon mix? Should we expect further investment in gas-focused assets in the Eastern Mediterranean or are you looking at kind of broader options?

Simon Thomson: I can answer and maybe James can add if there's anything I missed. But I mean, I think, we're relatively agnostic in terms of oil and gas. Each asset has its own specific emissions profile, whether gas or oil, and it's down to whether or not you can see an improvement pathway - like we have in Egypt - to be able to influence and drive down those emissions. So that very much remains a criteria.

It's important for us as I was emphasising to have a clear understanding of the kind of local market and indeed any regional market dynamics that a particular asset might benefit from. But also actually increasingly, the supportiveness or otherwise of the regulatory and fiscal regime.I think, for the industry, that's becoming ever more a driving factor in terms of areas in which you are free to or operate.

Other than that, obviously I wouldn't comment on where we're looking specifically, but characteristics like Egypt, we find attractive. Emerging markets have a number of attractive qualities. But there are a number of discussions on-going and we'll see where we get to. But the focus is to have low-cost production, a clear emissions pathway for reduction and a growth pathway for us as well.

Ashley Kelty: Morning. It's Ashley Kelty from Panmure Gordon. I'm just wondering if you could talk about any hedging that you have in place given the sort of volatility in commodities at the moment.

James Smith: We're un-hedged at present, which in retrospect is probably a happy outcome. We historically have looked to hedge at the appropriate point in the cycle to protect debt capacity and to protect capital programmes, as opposed to as being the primary drivers of our hedging strategy, and we'll continue to do that. Obviously, with the Egypt portfolio, as we've just been talking about, there is some downside protection built into the gas component of that. There's downside protection already there. And obviously at the moment, we're happy to have the exposure on the upside to liquids.

Simon Thomson: Any other questions? No? Well, thank you everybody for attending and look forward to coming back to you with further progress. Thank you.