

Canacol Energy

Third Quarter 2022 Financial Results Call

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**CORPORATE PARTICIPANTS**

**Carolina Orozco** - *Vice President-Investor Relations & Communications*

**Charle Gamba** - *President & Chief Executive Officer*

**Jason Bednar** - *Chief Financial Officer*

## **PRESENTATION**

### **Operator**

Good day and welcome to the Canacol Energy Third Quarter 2022 Financial Results Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your touchtone phone. To withdraw your question, please press star then two. Please note, this event is being recorded.

I would now like to turn the conference over to Carolina Orozco, Vice President of Investor Relations. Please go ahead.

### **Carolina Orozco**

Good morning and welcome to Canacol's Third Quarter 2022 Financial Results Conference call. I am with Mr. Charle Gamba, President and Chief Executive Officer; and Mr. Jason Bednar, Chief Financial Officer.

Before we begin, it's important to mention that the comments on this call by Canacol's senior management can include projections of the corporation's future performance. These projections neither constitute any commitment as to future results nor take into account risks or uncertainties that could materialize. As a result, Canacol assumes no responsibility in the event that future results are different from the projections shared on this conference call.

Please note that all finance figures on this call are denominated in US dollars. We will begin the presentation with our President and CEO, Mr. Charle Gamba, who will summarize highlights from our third quarter results. Mr. Jason Bednar, our CFO, will then discuss financial highlights. Mr. Gamba will close with a discussion of the corporation's outlook for the remainder of 2022 and looking out to 2023. At the end, we will have a Q&A session.

I will now turn the call over to Mr. Charle Gamba, President and CEO of Canacol Energy. Charle, we cannot hear you.

### **Charle Gamba**

Hello?

### **Carolina Orozco**

Yes. Yes. We can hear you now.

### **Charle Gamba**

Can you hear me now, Carolina?

### **Carolina Orozco**

Yes.

### **Charle Gamba**

Hello.

### **Carolina Orozco**

Yes, Charle. We can hear you now.

**Operator**

It appears we've lost connection with our speaker Charle. Please wait as we reconnect. [hold music]. Ladies and gentlemen, we've reconnected with our speakers. Charle, please go ahead.

**Charle Gamba**

Good morning, everybody. I apologize for the delay I had connecting. Anyway, good morning and good afternoon, and welcome to Canacol's Third Quarter 2022 conference call. In

the third quarter of 2022, we realized natural gas sales of 184 million standard cubic feet per day, which is above the midpoint of our annual guidance of 160 million to 200 million standard cubic feet per day. Tesorito, the 200-megawatt thermal electric plant, in which we hold a 10% equity interest and for which we are the sole supplier of gas, began generating electricity in mid-September. I'd like to, again, congratulate Celsia, our operating partner, for the successful conclusion of the construction process and look forward to this investment contributing to continued growth in our business, both through our equity investment and, of course, through increased demand of our gas.

Our relatively stable production and operating conditions allowed us to report another quarter with high netbacks and operating margin of 78% and a relatively high return on capital employed of 17% annualized for the quarter. We continue with the execution of our drilling program planned this year with a total of nine development and exploration wells drilled to-date, which includes four successful exploration tests.

Finally, subsequent to quarter-end, we signed a strategic renewal with SETCO to build on, operate and maintain the Jobo to Medellin pipeline project, which I will discuss in more detail, when I talk about the outlook for the remainder of this year and beyond.

I'll now turn the presentation over to Jason Bednar, our CFO, who will discuss our third quarter financials in more detail.

**Jason Bednar**

Thanks, Charle. We continue to execute our plan and develop our natural gas business in the third quarter. We reported the following for the third quarter of 2022: \$70 million of production revenue net of royalties and transportation, which represents a 6% increase from Q3 of 2021. The increase was driven by higher realized prices more than offsetting slightly lower sales volumes. We reported \$39 million in adjusted funds from operations, which represents a 1% increase from the same period in 2021 and also reported EBITDAX of \$56 million, which represents a 4% increase from the same period in 2021. Finally, we reported a net loss of \$5 million compared to a net profit of \$9 million in the same period in 2021.

As I've explained on many previous conference calls, a big driver of our net income each quarter is unrealized foreign exchange gains and losses that can impact the valuation of our tax pools, which are in Colombian pesos.

In the third quarter, we recorded a deferred tax charge of \$11 million, the majority of which was due to a deterioration in the value of the Colombian peso versus the US dollar, and without which we would have reported substantial positive net income. In the event that the peso strengthens against the US dollar in the future, the corporation would realize a deferred income tax recovery.

Our gas operating netback was \$3.73 per Mcf in the three months ended September 30, 2022, which is 7% higher than in the same period in 2021, 2% higher than the prior quarter and 4% above our guidance for \$3.60 on average for 2022.

Our realized gas price of \$4.76 was the highest we've achieved since prior to COVID and was above our guidance for the year of \$4.61 to \$4.74 per Mcf, thanks to stronger interruptible prices. We're encouraged by the persistence of robust pricing for interruptible gas sales, despite lower absolute demand. Recall that the majority of our guidance is based on sales under fixed price take-or-pay contracts with an average fixed price of \$4.74 per Mcf.

Opex was \$0.28 per Mcf in Q3, down from \$0.36 in Q1 and \$0.31 in Q2, as we were undertaking less maintenance and benefiting from a lower Colombian peso when measuring our local costs in US dollars. We continue to anticipate very little maintenance in the second half of the year and expect 2022 average Opex to be approximately \$0.30 per Mcf. In percentage terms, our gas royalties were again 16% of gross revenue, which is in line with the average for the preceding two years.

I will highlight again, the return on capital employed implied by our financial statements over the last 15 quarters, averaging 16% over the last 12 months.

That concludes my comments on our third quarter financial results. I'll now hand it back to Charle.

#### **Charle Gamba**

Thanks, Jason. Our results for the third quarter once again demonstrated high and stable operating margins, as well as a very respectable return on capital employed. Our guidance for 2022 remains unchanged. We anticipate production and cash flow to near the high end for our guidance, which was based on 200 million standard cubic feet per day of average gas sales, with capex coming in closer to the lower end of our guidance at \$170 million.

Our exploration-driven program will continue at an increased pace through the remainder of this year and into early 2023, with four relatively high impact exploration wells, either spudded or due to spud within weeks, at Saxafon, Chimela, Dividivi and Natilla. This will allow us to meet our guidance for drilling 12 wells in 2022 with a 13th well Natilla reaching TD in early 2023.

In May-October, we issued an update on our Jobo to Medellin pipeline project. Specifically, we announced the successful execution of agreement with the Shanghai Engineering and Technology Corp. consortium, or SETCO, to build and operate the pipeline project. SETCO is a Chinese-based construction and pipe fabrication consortium with experience in building major gas pipelines in Asia and the Middle East.

Recall that this is the third time in Canacol's history that we have initially championed and funded a gas pipeline project with a different corporate entity has subsequently taken on and been built, owned, upgrade and maintain. The prior two projects with Promigas allowed us to grow pipeline takeaway capacity from our Jobo facilities from less than 50 million standard cubic feet per day in 2016 to 200 million standard cubic feet per day today. And this Jobo to Medellin pipeline project will increase total pipeline takeaway capacity to over 300 million standard cubic feet per day when it is completed in late 2024.

Consistent with what we did for those prior projects, we won't be committing or we won't be commenting on the cost of this project beyond stating that Canacol has agreed to pay a fixed fee for a certain volume of gas to be transported through the pipeline to Medellin over a certain period of time.

In combination with long-term sales contracts we have signed, we expect to achieve attractive impacts at a slight premium to what we're currently achieving selling exclusively to consumers in the Caribbean coast.

Our recent update on the Medellin, project highlighted that we now have two 12-year take-or-pay gas sales contracts for a total volume of 75 million standard cubic feet per day going to Medellin through the pipeline when it commences operation in 2024, late 2024. This project has significant strategic value for Canacol and for Colombia. As Canacol pursues its mission of improving the lives of millions of Colombians by supporting the Colombian government's vision of transitioning to a future with cleaner but no less abundant energy using natural gas as a key transition fuel.

More specifically, this project will allow consumers in the interior of Colombia to maintain or grow gas use through the middle of this decade despite expected declines in production from the largest producing gas fields operated by Ecopetrol in the interior of Colombia. The project will also allow Canacol to increase our gas sales and netbacks by accessing what is a new market for us and doing so in a cost-effective manner. I'd like to thank everyone at Canacol and SETCO that worked so hard to bring us to this point, and I look forward to updating you over the coming quarters and years as SETCO works to complete the project.

As in prior years, we'll be announcing our 2023 guidance in the first half of December. In summary, we are continuing to deliver financial results within our previously stated guidance, and we continue to both return capital to shareholders at the same time investing for growth.

We're now ready to take your questions.

## **Question-and-Answer Session**

### **Operator**

We will now begin the question-and-answer session. To ask a question, you may press star then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press star then two. At this time we will pause momentarily to assemble our roster.

The first question today comes from Oriana Covault with Balanz. Please go ahead.

### **Oriana Covault**

Hi, good afternoon. Thanks for taking my question. This is Oriana Covault with Balanz. And I have two questions. If I can go one by one, that would be great.

First with regards to the Jobo managing pipeline, I just wanted to understand if this contract with EPM include any fines and/or penalties associated with delays of the entry in operations of the contract? And if so, if these events are caused because of construction delays on the EPC side, are they covered by Canacol or passed through the contractor? That was my first question.

### **Charle Gamba**

Thank you for that question. As with any of our gas sales contracts, we cannot comment on any of the particular details associated with the contract, including those.

### **Oriana Covault**

Okay. Understood. Just perhaps following up on the exploration plans, if you could share any updates around the deep gas wells, particularly Pola - 1 that I understood was under the schedule for the last quarter and how are these coming along?

**Charle Gamba**

Thank you. Pola-1 is the first deep La Luna target gas well we're drilling in our new acreage position in the middle Magdalena Valley of Colombia. We are using a 3,000 horsepower rig well that's quite deep, up to 19,000 feet in terms of total vertical depth, and we had some delays with respect to the contracting of that rig. We initially intended to spud that well the last quarter here of 2022, but we anticipate spudding that well now the first quarter of 2023. So the civil works for that well have been constructed and the site is prepared and ready to accept the 3,000 horsepower rig that will arrive here in the first quarter to drill that well.

That well will take approximately five months to drill and complete and test. So we expect the timing of that well in the first quarter of 2023.

**Oriana Covault**

Okay. Perfect. That's very good. Thank you.

**Operator**

The next question comes from Josef Schachter with SER. Please go ahead.

**Josef Schachter**

Good morning Charle and Jason, good to talk to you. First question, in your Note 18 of the results, it shows that where you're talking about the SETCO deal, it talks about the reimbursement of the \$12 million USD of cost. Is that something that's going to be paid to Canacol before yearend, or is that something that will happen in 2023?

**Charle Gamba**

Hi, Josef. Yes, that payment will be made upon the receipt of the environmental permit for the project, at which point SETCO will reimburse all costs up to that date to Canacol as anticipated in August of 2023.

**Josef Schachter**

Okay. So August 2023. Okay, good. Next question for me. The four wells that you're drilling; Saxafon, Chimela, Natilla, and Dividivi; two of them should be finished before yearend. Are we looking at 10 to 20 Bcf targets? Are they bigger than that? And do you expect that they will be included in your reserve report at yearend if they're finished and you get to test them before yearend?

**Charle Gamba**

Yes, three of them, Chimela, Saxafon and Dividivi will be completed and tested prior to yearend; only Natilla, which is a much deeper well, about 15,000 to 16,000 feet on SSJN-7, that will be finished drilling towards the end of January, early February. So we expect that should any of those three wells, which would be Saxafon, Chimela and Dividivi prove up gas, we will be booking those as reserves on our 2022 reserve balance, correct.

**Josef Schachter**

Okay. And Chimela, when I look at the map, is in VMM 45, just in the area of Pola-1, are you drilling this one to derisk Pola-1, or is this a totally different structure?

**Charle Gamba**

Yes. Chimela is targeting sandstones, conventional sandstones of the Tertiary Lisama formation. This formation is very productive in the area. Grant here produces from the same sandstones immediately to the west of Chimela from their Acordionero field. This is a little deep, however, deeper than there, about 2,000 to 3,000 feet deeper than their targets there. And we're expecting that the base of Lisama here will contain primarily natural gas as opposed to primarily oil.

So it's a separate target. It's a tertiary sandstone target. We expect it to be gas charged along the same fault systems that connected to the deeper La Luna Pola target, that's where all the gas is expected to be coming from, but it's a shallower test.

**Josef Schachter**

Okay. And as you go down to these zones, are these also zones that you expect to find in Pola, so that if Pola doesn't have the success of the lower zone than the uphole zones could be successful. Is that what you're looking at here, or is it totally different structurally?

**Jason Bednar**

Yes. We view it as certainly derisking the tertiary section associated with Pola, which also has tertiary targets and the presence of gas as well will be very important. So it somewhat derisks the deeper Pola location, even though Pola is a La Luna target.

**Josef Schachter**

Okay. And last one for me. Your capex budget is so large and, of course, you're also having the capital requirements on the dividend. Have you thought of having a DRIP so that people who see the stock is quite cheap could get in with using the DRIP format that's available for the company? Is that something you guys are considering as a way of rewarding shareholders without doing cash and then having more cash for other company needs?

**Jason Bednar**

I can answer that. It is indeed something the board has considered and is considering. So, thank you for bringing it up and expressing your interest in that.

**Josef Schachter**

Okay. I think I'll leave it there. Thanks, and hope you guys do move to consider the DRIP. I think that for retail shareholders, that might be something that would be of a great consideration. With that, thanks so much for answering my questions.

**Charle Gamba**

Thanks, Josef.

**Operator**

The next question comes from Chen Lin with Lin Asset Management. Please go ahead.

**Chen Lin**

Hi, thank you for taking my question. Actually, I just continue for the DRIP. For us in the United States, based in the United States, there is a tax withholding. Do you intend to offer that DRIP through Canadian only or open to potentially to investor like me in the United States?

**Jason Bednar**

Yes. Thanks, Chen. One of the reasons we started examining this was for exactly the reason you bring up. And my expectation, if it's offered is that we could offer it to all shareholders.

**Chen Lin**

Good. But for us, we will have to have a tax withholding first, or is this not taxed? I don't know. I mean, I'm not expert in tax laws, international tax laws.

**Jason Bednar**

Yes. If you want to give me a call after this conference call or any time next week. I am not the resident tax expert either, but I know we have worked through this situation.

**Chen Lin**

Okay. Great. Thank you. The other question I have is with this new government, they are not open for new concession, my understanding. And on your existing concession, you basically can continue to do all the exploration. Is that correct? Just want to confirm with you.

**Charle Gamba**

Yes. So with respect to the existing exploration and production blocks held by operators in Colombia, activity will continue as normal under those contracts. There will be the ability to drill exploration, appraisal and development wells on all existing contracts.

With respect to new exploration bid rounds and the availability of new exploration areas, initially the position of the government and the Ministry of Mines and Energy was not to award any new contracts as they viewed there being sufficient contracts already to explore during the next four years. However, in recent weeks, the President of the Republic has indicated that they are currently assessing the possibility of offering up new exploration and production areas sometime during the next four years. So it seems like they're backing a little off that position, but nothing definitive in either direction.

**Chen Lin**

Thank you. Hopefully, the EU energy crisis is a wake up for the government. And also, do you foresee any royalty changes going forward in the country?

**Charle Gamba**

Again, there's going to be no changes to existing E&P contracts, which means that the royalties that are associated with those contracts would not be changed. So no, there's no perspective on any changes in royalty. So those will remain as they are in existing contracts.

**Chen Lin**

Okay. Great. Thank you. Hopefully, this will discourage your competitor from exploring where you grow your production. Just to confirm, your Pola 1 is due for drilling next year, right? And shareholders, we should hear something by midyear. Is that correct?

**Charle Gamba**

Yes, yes. We'll be publishing our guidance for 2023, including our drilling program by mid-December and the plan rate now, Chen, is to initiate the drilling of Pola 1 in Q1 of 2023, and that well will take approximately five months to drill, complete and test.

**Chen Lin**

Thank you. Can you just remind us what the target risk and risk target of this Pola 1?

**Charle Gamba**

The target is La Luna, for cretaceous La Luna it's gas. We have unrisks gross recoverable resource, mean resources of around 500 Bcf with risk prospective resource of around 200 Bcf. So it's a very large target for us, a very important well. And of course, this is the first deep we'll be drilling into our La Luna



position into middle May. We have just under 1 million net hectares under license there for the La Luna with some 15 Tcf of gross mean unrisked prospective resource identified in the La Luna by third-party auditors.

**Chen Lin**

Great. Thank you. Good luck.

**Charle Gamba**

Thank you. Thank you, Chen.

**Operator**

The next question comes from Christine Ronac with HSBC. Please go ahead.

**Christina Ronac**

Hi. Thank you. Question, on the new tax royalty, I know it's not finalized yet, it's going to happen next week, remind me, I think your corporate tax rate of 35% does not go up, like it does for the oil companies? I wasn't sure if you just don't have any step-up like the oil producers. And then if you don't have a royalty tax deduction anymore, I just take whatever you have been deducting your royalty times 35%, so I'm getting roughly like \$20 million that wouldn't be paid until 2024? If I'm just at all roughly close, that would be great. Thank you.

**Jason Bednar**

Okay. Thanks, Christina. I can handle this. And I see on our e-mail questions that we've got multiple on the exact same topics, so I'll try and make this fulsome.

So, first of all, to my knowledge, the reform is not yet passed. As it currently stands in front of Congress, natural gas is not subject to the income surtax. So you're correct on that. But royalties will not be deductible. So when we go down this last path, so once again, our income tax rate of 35%, we do not expect that to change as it sits now, but we will not be able to deduct royalties, which is the same as oil, which will be the same effect that all companies will also have, right?

So that effect would be our 35% tax rate on the base royalty of 6.4%. So not to make this too complicated, but some of our blocks have royalties of 20%, some have a 6.4%. What's the delta? The delta's generally an x factor that people bid on when they first bid on the block from the ANH. The non-deductibility, as we currently understand it, is on the base royalty of 6.4%. So the effect would be 35% of 6.4% of revenue.

**Operator**

I will now pass the conference over to Carolina Orozco, for more questions from the webcast.

**Carolina Orozco**

Thank you. The first question that we have is from Andres Duarte from Corficolombiana. Andreas is asking, "Can you please brief us on the difference between gas input prices and local contract prices currently and in the near future?"

**Charle Gamba**

Importation prices compared to domestic, correct?

**Carolina Orozco**

Correct.

**Charle Gamba**

Yes, domestic wellhead pricing this year in 2022 has averaged between 450 and 550 from gas producers. Imported LNG loads delivered in Cartagena have been very few this year. There were some loads imported earlier on in 2022, at landed prices of \$14 to \$16, not regasified. So the LNG loads that have landed here in Cartagena this year have been approximately 3x the price prior to being the regasified and commercialized as domestic wellhead prices.

**Carolina Orozco**

Thank you, Charle. The next question is from Roberto Paniagua from Casa Voca. Roberto is asking, "What is the impact on shareholder value creation with Canadian proposal to impose 2% tax on a stock buyback as of January 2024?"

**Jason Bednar**

Yes, I can answer that. So our share buybacks this year totaled approximately \$13 million USD. So 2%, of course, would be, I think that's \$260,000. So I don't think any corporate company is in favor of this. Having said that, it's a \$260,000 for us. I don't think it's going to impair any value creation.

**Carolina Orozco**

Thanks, Jason. We have another question from Pierre Groner. Pierre is asking, "I would like to know more on the company's rationale on the proposed consolidation mentioned in October 24 press release?"

**Jason Bednar**

Yes. Okay. So our share price has slid a bit; some of our peers have higher share prices. That's not the motivation. The thought process here, many corporate accounts have discussed trading fees with us. We believe that a long -- sorry, trading fees, meaning the price they pay on a per share basis and they can lower their trading costs, perhaps attract more interest. I think it's important to note that we decided to do this consolidation alongside the SETCO pipeline announcement, which we think will be transformational to the company in a year or two's time and took the opportunity to address some of the concerns raised by some of our shareholders alongside this monumental announcement for us.

**Operator**

We have another question from...

**Carolina Orozco**

Yes, please, go ahead, operator.

**Operator**

The next question from the audio side comes from Steven Bodzin with REDD Intelligence. Please go ahead.

**Steven Bodzin**

Hi, thank you very much. There's been some news reporting about the possibility of reopening that Venezuela pipeline and reversing it, bringing some gas imports. Not a lot of details so far. I don't even know if it's realistic. I'm curious if you have any thoughts about it or whether that could pose any challenges over the next 5 to 10 years?

**Charle Gamba**

Yes. Thanks for that question. There has been some speculation earlier on in the summertime about the possibility of gas from Venezuela. Of course, Venezuela contains various gas reserves, and there's

plenty of gas in Venezuelan. Most of the current gas production there is being used for internal consumption, of course.

So, there's sort of three issues associated with the possibility of importing gas from Venezuela. There's infrastructure. There is a pipeline between Venezuela and Colombia that was built back in 2008. That pipeline used to be used to transport gas from Colombia to Venezuela, and Venezuela uses quite a bit of gas in the Maracaibo area for reinjection into oil-producing reservoirs to maintain reservoir pressure.

That pipeline went into disuse in 2014. The pipeline has a capacity of about 300 million cubic feet per day. So, the pipeline has essentially been shut in for almost eight years. So, there is quite a bit of uncertainty with respect to what investments are required to make into that pipeline, which is about 350 kilometers long to repair it as well as install the correct new compression equipment and reverse the flow. So there is an investment of uncertain magnitude required to regain that pipeline. And the pipeline, I should add, is owned and operated by PDVSA, The Venezuelan National Company.

The second question is the availability of gas. As I mentioned, the majority of produced gas in Venezuela, particularly in Western Venezuela, which has access to that pipeline, is currently used in the domestic market. There is not much of a surplus of gas in the Venezuelan market currently to export in Colombia.

And the third question, of course, is price. The price of that gas sent from Venezuela to Colombia. Naturally, PDVSA and the Venezuelan government is thinking about exporting gas, in particular to the European market in liquefied form where pricing, of course, is much better. As I mentioned on the call here to a question a little earlier, well-head prices in Colombia are \$4.50 to \$5.50 per MMBtu. And of course, gas prices in Europe are as high as \$40. So with respect to exporting gas, it's very likely that the government of Venezuela and PDVSA, would focus on liquefying and exporting gas to Europe for much higher pricing as opposed to Colombia.

But having said that, those are sort of the three main elements associated with that possibility of importing gas from Venezuela to Colombia.

**Steven Bodzin**

Sounds like you're not especially concerned about the competitive threat.

**Charle Gamba**

Not in the near-term, no, certainly not within the next two to five years. And again, I think that realistically and very sensibly, I would imagine the Venezuelan government will be more focused on exporting that gas to much higher value markets.

**Steven Bodzin**

I guess, the reason I asked about the five-year plus timeline is just looking at the time line for the bond maturity and thinking long-term. But it sounds like you're just keeping an eye on it, not an immediate issue.

**Charle Gamba**

No, it's not any issue. And again, I don't think anyone is expecting Venezuela to give away its gas. I think that there will be a price associated with that, and it will be closer to international prices than to Colombian domestic prices.

**Steven Bodzin**

Okay. Thank you.

## **CONCLUSION**

### **Operator**

This concludes our question-and-answer session and concludes the conference call. Thank you for attending today's presentation. You may now disconnect.