

Canacol Energy, Ltd.

Second Quarter 2022 Financial Results

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CORPORATE PARTICIPANTS

Carolina Orozco – *VP of Investor Relations*

Charle Gamba – *President and Chief Executive Officer*

Jason Bednar – *Chief Financial Officer*

PRESENTATION

Operator

Hello, and welcome to the Canacol Second Quarter 2022 Financial Results Conference Call. All participants will be in 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 a 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 Vice President of Investor Relations, Carolina Orozco. Please go ahead.

Carolina Orozco

Good morning, and welcome to Canacol's Second Quarter 2022 Financial Results conference call. This is Carolina Orozco, Vice President of Investor Relations. 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 commitments 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 for our second 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. At the end, we will have a Q&A session.

I will now turn over the call to Mr. Charle Gamba, President and CEO of Canacol Energy.

Charle Gamba

Thank you, Carolina. Good morning, or good afternoon to everyone, and welcome to Canacol's Second Quarter 2022 conference call. In the second quarter, we realized natural gas sales of 188 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; 10% higher than the same quarter in 2021, and 3% higher than the first quarter of this year, thanks to the growing demand for gas in Colombia.

If you've been following our monthly updates, you'll also know we sold 198 million standard cubic feet per day in both June and July. So, we're clearly trending towards the upper end of our guidance in terms of sales lines for the year.

In line with what we said on our last conference call in May, what we've be seeing this year, here in Columbia gas markets, is that the economy has started to grow again, as the effects of the COVID pandemic wane, just translated into higher energy demand, and hence, higher demand for our natural gas.

Our stable production and operating conditions allowed us to report another quarter with high operating margins of 77%, and relatively high return on capital employed of 16% annualized for the quarter.

With respect to our current drilling activity, we continue with the execution of our drilling programs after

this year, with a total of six developments and exploration wells drilled to date, from which three successful exploration wells have been realized.

Finally, at the end of the quarter, we published our 2021 ESG report, in which we reported Scope 1 and 2 GHG emission intensities that are more than 50% lower on average than our gas-focused peers, and more than 80% lower on average than our oil-focused peers in North and South America. Our emission intensity is lower than the average for many broad equity indices, including some which constants and selects [ph] were having low carbon emissions.

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

Jason Bednar

Thanks, Charle. We continue to execute our plan to develop our natural gas business in the second quarter. Reported the following for the second quarter of 2022. \$70 million of production revenue, net of royalties and transportation, which represents a 31% increase from Q2 of '21. The increase was driven by higher sales volumes and higher realized prices. \$39 million in adjusted funds from operations, which represents a 16% increase from the same period in 2021. We also reported EBITDAX of \$55 million, which represents a 24% increase from the same period in 2021. And finally, a net loss of \$6 million when we reported a small net profit in the same period in 2021.

As I've explained on 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 second quarter, we recorded a deferred tax charge of \$12 million, the majority of which was due to deterioration in the value of the Colombian peso versus the US dollar, and without which we would have reported a healthy 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.

I'll also note that in Q1 of 2022, we saw a stronger peso, and during that quarter we booked a \$12 million deferred tax recovery, almost identical in quantum to this quarter's deferred tax expense. That's leaving the six month year-to-date balance essentially flat. Our operating netback was \$3.66 per mcf in the three months ended June 30, 2022, which is 17% higher than in the same period in 2021, also 2% higher than the prior quarter, and slightly above our guidance for \$3.60, on average, for 2022. In fact, this was the highest quarterly netback we've reported since the third quarter of 2019, prior to the COVID-19 pandemic.

Our realized gas price of \$4.73 was also the highest we've achieved since before COVID, and was at the upper end of our guidance for the year of \$4.61 to \$4.74 per mcf, thanks to stronger interruptible prices. 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 \$0.31 per mcf in Q2, down from \$0.36 cents in Q1. On our last call, I stated that during Q1 we were doing some maintenance work, hence the one-time quarter increase. We expect the remainder of the year opex to be approximately \$0.30. In percentage terms, our gas royalties were \$0.16 of gross revenue, which is in line with the average for the preceding two years.

To further highlight the strength and stability of our natural gas business, as well as the growth that we see in our business and financial results, we want to again highlight the return on capital employed, implied by our financial statements over the last 14 quarters averaging 16% over the last 12 months.

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

Charle Gamba

Thank you, Jason. Our results for the second quarter once again demonstrate high and stable operating margins, as well as a very respectable return on capital employed. While weather presents an important role in power generation and gas demand in Colombia, we're hopeful that strength in electrical demand and economic recovery after the pandemic in Colombia will support continued demand growth for our gas through the remainder of 2022 and beyond.

Our guidance for 2022 remains unchanged, and we anticipate production and cash flow to be near our high end for the guidance of 200 million standard cubic feet per day of average gas sales. We also continue to anticipate our capex spending will come in closer to the lower end of our guidance at \$170 million.

Our exploration drilling program will continue at an increased pace the second half of the year, as we drill ahead with two rigs currently at Claxon 1 and Canaflecha 2 within our core area, and we are planning to contract additional drilling rigs to drill some of our higher impact exploration wells planned for the later this year.

Cretaceous, our 200-megawatt thermal electric plant located 70 kilometers from our Jobo gas processing facility, entered commissioning this summer, and is anticipated to commence generating in September of 2022. I'd like to congratulate Celsia, our operating partner, for the successful conclusion of the construction process of Casarito [ph].

Finally, we are continuing to evaluate and clarify the bids received from the pipeline construction consortiums, and hope to be able to make a selection announcement soon, in order to progress this important Medellin pipeline project.

In summary, we are continuing to deliver financial results within our previously stated guidance, allowing us to proceed with both returning capital to shareholders, and also investing for growth, operating from a position of financial strength.

We're now ready to take any questions.

QUESTIONS AND ANSWERS

Operator

Thank you. 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.

Our first question today comes from Oriana Covault of Balanz. Please go ahead

Oriana Covault

Hi, good morning. This is Oriana Covault with Balanz. Thanks for taking my question, and congratulations

for the good performance over the quarter. I had three questions. If we may go one by one, that would be great. And my first one related to the [indiscernible] entering commission, and just if you could share how many mcf's per day are you expecting it to bring to your topline now that it started commissioning?

Charle Gamba

Yes, we've been, throughout the summer, we've been selling between 8 (million) to 12 million cubic feet per day to the plant during commissioning. So, the plant is not dispatching. They're simply testing the motors in sequence. When the plant enters dispatch in September, dispatch of electricity, we anticipate up to 20 million cubic feet per day will be going through that plant, assuming the utilization of approximately 50% of the capacity, the 200-megawatt capacity.

Oriana Covault

Perfect. That's very clear. And my second question, in relation to your comments on contracting another drill to the high-impact exploration, just, if you could share, how are you preparing for the drilling in Pola-1? Have you made any changes to the expected drilling date and preliminary works that need to be carried over in Pola-1?

Charle Gamba

Yes, Pola-1, we've contracted a 3,000 horsepower drilling rig. It's a fairly deep well at 18,000 feet, which requires a very large rig, which has been mobilized for the United States. We've commenced activity with respect to the construction of the civil works, the drilling platform that the rig will be located on. And we anticipate the spudding of the Pola-1 well, in November. So, this year, we're hoping to get the well initiated in the fourth quarter of this year.

Oriana Covault

Perfect. And just one last one from a higher level standpoint. We've been reading, or coming across some headlines that mention a possible revival of gas exports from Venezuela to Colombia. So, I understand it is purely speculative at this point, but if you could share any—what are your thoughts about this, and what have you heard in the country in this regard? Thank you.

Charle Gamba

Yes, there has been some discussion of importing gas from Venezuela. It's always been an option for a long time. Colombia, of course, used to export 250 million cubic feet per day of gas from Colombia to Venezuela. And there are outstanding agreements for PDVSA to return that gas at some point to Ecopetrol. However, they've never landed on the price of that gas to be returned.

But anyways, I think that the importation of gas from Venezuela represents a very interesting opportunity. We're certainly evaluating that opportunity with respect to Canacol as well. However, there's significant, there are some impediments to that scheme. The first, of course, are the US OFAC sanctions against PDVSA, which would be problematic, which would not permit export of that gas by PDVSA to Colombia. So, that's one issue that has to be overcome

And the second is a significant investment in infrastructure in Venezuela to reactivate the oil and gas fields, to be in a position to be able to export.

So, I think, in summary, it's a very interesting possibility for Canacol, and there are some significant obstacles to overcome in the near to midterm.

Oriana Covault

Got it, thanks. That's very helpful. Thanks again for taking my questions.

Operator

The next question comes from Chen Lin of Lin Asset Management.

Chen Lin

Hi. Thank you for taking my questions. Some of my questions already been answered. I would like to congratulate for this wonderful, very excellent quarter. I noticed you start buying back shares. Your company shares trading at a very depressed level after the Colombia election. So, how much room you have to buy more shares from the open market, and then do you plan for any future dividend increase? Thank you.

Jason Bednar

Yes, I can answer that. So, first thing I'd like to point out is that we have a very healthy dividends currently. At the share price it's probably 9%-ish. And, of course, that's a return to shareholders of approximately US\$28 million annually, so, it's certainly not insignificant.

As we have a very aggressive capital program heading into a Medellin pipeline, in terms of exploration wells, etc., I think our normal course issuer bid will be more opportunistic at this stage, as opposed to having a set level that we will buy for the remainder of the year.

Chen Lin

Okay, thank you. Can you tell us how much room you have for share buyback? How much—

Jason Bednar

Oh, yes, sure. Yes, sure, yes. So, it's a formula based on the free float that the TSX does every year. Our number allotted to the buyback this year was approximately 11 million shares, and we bought back between 5 (million) and 6 million in the first half of this year thus far.

Chen Lin

Okay, great. Thank you. Good to know you have more room. And can you just expand a little bit? I know it was asked previously, the high-impact well. A lot of shareholder really waiting for that. What approximate, when you get the rig to come in and approximate what time the shareholder will know that it's a success or not.

Charle Gamba

Yes, thanks, Chen. As I mentioned on the previous question, the rig is being mobilized, 3,000 horsepower. The civil works are being constructed, and we hope to spud the well in November. That would put results into January of next year.

Chen Lin

Okay, great. Thank you. Again, congratulations for the excellent quarter.

Charle Gamba

Thank you, Chen.

Operator

Again, if you have a question, please press star then one. At this time, I would like to turn to Carolina Orozco to address some questions from the webcast.

Carolina Orozco

Thank you. The first question that we have is from Lucas Royo from Compass Group. Lucas is asking, it is a possibility that there will be no more exploration contracts signed. How many years do you estimate

that you could operate without problems?

Charle Gamba

Thank you, Lucas. We hold interest in 11 exploration and production contracts, six in the lower Magdalena Valley, which is our core operating area, five in the middle Magdalena Valley, which is our new high-impact gas exploration area. On those 11 contracts, we have identified about 190 drilling locations, exploration drilling locations, containing, on a gross, un-risked basis, 18 TCF of prospective gas resource.

We have sufficient inventory to drill on those 11 blocks for at least 10 years. So, we have a very deep portfolio of opportunities for gas on those 11 contracts, which could see us continuing to drill exploration wells, and translate those resources to 17 trillion cubic feet of gross prospective unrealized resource of gas into new reserves for commercial sales.

Carolina Orozco

The next question comes from Brody Batorres [ph] [indiscernible]. The Minister of Mines and Energy just said that the new government in Colombia would not sign any new exploration contracts for gas, and if the gas reserves goes down, we will import gas from Venezuela. What do you think, and how can this impact the Canacol business in Colombia?

Charle Gamba

I think I just answered that question, I believe.

Carolina Orozco

Thank you, Charle. The next one is Carlos Carasas [ph] [indiscernible] SAD. Hello. Have you estimated the impact of a hypothetical improvement of the Colombian tax reform? The government expected to change the royalty [indiscernible] P&L and exports? What do you expect?

Jason Bednar

Yes, we're still analyzing the impact of the yet approved reform.

Carolina Orozco

Thanks, Jason. The next question is from Julio Vengar [ph]. What is the average maturity of the actual take-or-pay contracts that you currently have?

Charle Gamba

It's 7.3 years is the answer.

Carolina Orozco

Okay, thank you. The next question is from Maddie Pabam [ph] from First New York Capital. The BOOM contract that you're about to sign has taken more time than expected. Can you talk about some of the issues around the delay, and how soon do you think you will sign?

Charle Gamba

No issues. No issues. We're currently drafting the final form of the agreement with the party that has been selected. And we anticipate that's back and forth drafting of the agreements, of course. We expect that we will be signing those agreements within the next month.

Carolina Orozco

Thank you, Charle. And, operator, I think we've had someone else in the queue to ask a question. Can you please let him in?

Operator

Of course.

Charle Gamba

There's one from Rodrigo Torres that you should address, Caroline.

Carolina Orozco

Yes, it's coming through, but can we please take Schroeders first, and then we will address that in [indiscernible].

Operator

The next question comes from Till Moewes of Schroders. Please go ahead.

Till Moewes

Hello. Thanks for taking my question. Congratulations on the results. My question is about Ecopetrol. They, over the last weeks, made announcement about deep water finds of gas. And it seems that, potentially, they could be significant, as Ecopetrol even said that they could allow the company to become exporters of gas, which I think indicates a potentially game-changing nature of this.

So, I was wondering, what is your take on these announcements, and how would they impact the domestic market, according to your very first initial take? Thank you.

Charle Gamba

Thanks for the question. They've announced two announcements. One is a discovery, Uchuva-1 well in the Tayrona contract, which is located off the Coherer [ph] coast in Northeast Colombia. That well was drilled in approximately 840 meters of water, which is a deep water, not associated gas discovery. It follows the Orca-1 discovery in the Tayrona contract made by Petrobras in 2014. So, it's the second gas discovery in deep water in Tayrona. While it is very positive, with respect to detecting the presence of gas, the failure to develop Orca, which was discovered in 2014, probably indicates commercial issues associated with developing, on a full-field basis, non-associated gas discoveries in that water depth.

So, while the Uchuva-1 discovery is positive, with respect to the presence of gas, there are still uncertainties with respect to the commercial viability of developing both the Uchuva-1 discovery, as well as the Orca-1 discovery, which was made in 2014, eight years ago.

The second announcement that Ecopetrol made was with respect to the Gorgon-2 sidetrack, which was an appraisal well of the Gorgon-1 discovery made in the Gulf of Uraba by Anadarko in 2018. The Gorgon-1 well, which was drilled in 2018, encountered gas, and the Gorgon-2 sidetrack well, which was announced earlier this week, confirmed the presence of gas in another part of that discovery. However, the Gorgon discovery is located in 4,200 meters of water, which would make it the deepest, the ultra-deep, non-associated gas discovery in the world, with considerable issues concerning commercializing discovery in those water depths.

So, in conclusion, there has continued to be the successful detection of gas in the Caribbean coast of Colombia, both in moderately deep waters at Uchuva and Orca, and ultra-deep waters in Gorgon. However, there are significant issues related to the commercial development of those fields, given the water depths for these non-associated gas fields. If they were to be developed, you would be looking at timelines between eight to ten years, and multibillion dollar development projects.

Till Moewes

I think that's very interesting, very clear. Another question is on the Medellin pipeline project. I was just

wondering, what is the state of permissions and licensing there? Is there anything that could cross your plans when it comes to environmental regulation, community consultations, or so on, where the new administration might take a more critical stance on? Thank you.

Jason Bednar

With respect to the environmental licensing, so the project, late last year, was sanctioned by the Colombian government as a project of strategic national importance to the country. So, it has a special designation, which will aid in the environmental permitting process. We are preparing to submit. We have received the DAA from the environmental ministry, which essentially is an approval of the pipeline routes. Amongst the options that we presented, they have approved the preferred route that we wish to take. And now we are preparing to submit the environmental permit, the detailed environmental permit, late September, early October this year.

So, we anticipate that that license should come out in Q2 of next year, which will allow for the commencement of the construction of the pipeline in order to be ready by December 1, 2024.

Operator

The next question is from Oriana Covault of Balanz. Please go ahead.

Oriana Covault

Hi, thanks. No, I had just a follow-up, but it was already addressed. Thank you.

Operator

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

Carolina Orozco

Thank you. We have another question from Reese Orgeen [ph] from William Blair. What is the average price of your contracted volumes?

Jason Bednar

As we released our guidance in December, the average price for 2022 of our take-or-pay volumes is \$4.74 per mcf, net of any related transportation charges, well head price.

Operator

Again, if you have a question, please press star then one.

Carolina Orozco

We have another question from Marical Bound [ph] from First New York Capital. The BOOM contract that you're about to sign—no, that that one has already been taken. Excuse me. Let's give it two seconds to see if we get any more questions from the webcast or in the queue.

Charle Gamba

Yes, I see a question here, Carolina—

Carolina Orozco

Later, we can go with Joseph Shafter.

Charle Gamba

I see a question here, Carolina, from Rodrigo Torres from Valora Analitik. Have you seen that question?

Carolina Orozco

Yes, I'm going to read it again. I think we read it before, but I'm going to read it again, Charle. So, we got a question from Rodrigo Torres from Valora Analitik. He is asking, the Minister of Mines and Energy just said that the new government of Colombia would not sign any new exploration contracts for gas, and if the gas reserves go down, we will import gas from Venezuela. What do you think, and how can this affect Canacol's business in Colombia?

Charle Gamba

Perfect. Thanks. I think with respect to Venezuela, which I've already discussed, it's certainly an interesting opportunity for Canacol. It's a very large potential source of gas to commercialize here in Colombia. In addition to the two issues I mentioned previously, which were with respect to the sanctions against PDVSA, and the amount of investment in infrastructure in Venezuela which would have to be done to achieve this, there's also some uncertainty with respect to the price that that gas will be sold at within Colombia. So, there's a lot of issues with respect to that pricing of that gas potentially being higher than a domestic Colombian gas.

And, of course, I'd like to reiterate that Canacol, as I mentioned previously, has an exploration inventory here in Colombia of over 17 trillion cubic feet of gross un-risked prospective resource that we can drill through here. So, thank you.

Operator

The next question comes from Josef Schachter of SEI.

Josef Schachter

Good morning, Charle and Jason. The question I had for Jason on maybe royalty deductibility, you mentioned that you're still looking into it. And congratulations on starting to have volumes moving to [indiscernible]. That was another one, and I'm glad that's moving forward.

The last question I had was related to your production of oil. It's up 170%. Were these shutting wells that were uneconomic in the past? Are you spending any money there? What's the outlook for your Colombian oil side? And, of course, the revenues are pretty good. What do you see happening there going forward.

Charle Gamba

Hi, Josef. Yes, that oil production comes from our Rancho Hermoso oilfield located in the Llanos Basin. We operate that field, and our partners there are Ecopetrol. So, that field's been producing since 2008 for us. It's a very, very mature field. And as you state, the fact of the matter is, you're quite correct. With the increase in oil price, we've been able to reactivate wells that were shut-in due to negative economics at lower oil price. That simply reflects turning on new wells. We have not spent any capital whatsoever in Rancho Hermoso for the past eight years, and we have no intention of investing any capital in oil-related projects in Rancho Hermoso, or anywhere else at this moment.

Josef Schachter

So, going forward, we should just have depletion, take that number down, or is that number able to stay stable for a little while?

Charle Gamba

It's a mature field. It's been producing, Josef, since 2002. So, it's a very old field, very mature, and declines are very, very low. So, very stable production, very low declines. We're at the tail end of production from that field, which is going to be very long and very flat, in general, but very sensitive, extremely sensitive to oil price.

Josef Schachter

Super. Thank you very much, and congratulations again on the good quarter.

Charle Gamba

Thanks, Josef.

Operator

Again, if you have a question, please press star then one.

The next question comes from Till Moewes of Schroders. Please go ahead.

Till, your line is open.

Till Moewes

Thanks for taking my follow-up questions. It's about take-or-pay contracts. You earlier mentioned that the average maturity is 7.3 years. And I was just wondering, as contracts expire, do you plan on renewing them? Or the new scenario where the Minister of Mines is openly positioning again exploration licenses, would it make sense to increase your spot market exposure as prices could go up in such a scenario? Thank you.

Charle Gamba

Jason, can you take that one?

Jason Bednar

Yes, sure. So, historically, our sales profile has been approximately 80% in take-or-pay contracts. We've been in the gas business with the last 20% being interruptible. This last quarter was the strongest interruptible prices that we've seen in approximately 2.5 years, but that's more internally-driven with respect to supply and demand inside Colombia, as Colombia produces approximately a BCF a day, and uses approximately a BCF a day.

Obviously, mature gas fields are in decline, and are, theoretically, at least, our price picks up as demand continues to go up 3% a year, as estimated by UPME. We've been in the gas business since 2012, so approximately a decade, and most of our clients have had renewing contracts during that term.

So, if you look at any one of the contracts in our portfolio, which are approximately 20 contracts in that portfolio, they routinely roll over at the end of that expiry, and we'd expect that to continue moving forward.

Till Moewes

Thank you.

CONCLUSION

Operator

Again, if you have a question, please press star then one.

Seeing no more questions in the queue, this concludes the question and answer session, as well as the conference.

Thank you for your attendance and participation. You may now disconnect.