Canacol Energy, Ltd.

Second Quarter 2023 Financial Results

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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 morning, and welcome to the Canacol Energy Second Quarter 2023 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. 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 Second Quarter 2023 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 is 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 Mr. Charle Gamba, our President and CEO, who will summarize highlights from our second quarter results. Mr. Jason Bednar, our CFO, will then discuss financial highlights. Mr. Charle Gamba will close with a discussion of the corporation's outlook for the remainder of 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 Gamba
Thanks, Carolina, and welcome, everyone, to Canacol's Second Quarter 2023 Conference Call. In the second quarter of this year, we realized natural gas sales of 185 million standard cubic feet per day just above the midpoint of our annual guidance of 160 million to 206 million standard cubic feet per day. We continue to report strong and stable financials which allow us to continue to return capital shareholders via our quarterly dividend program. Our relatively stable production and operating conditions allowed us to report a quarter with high sales prices, net backs, and operating margins, EBITDAX of $61 million, and a relatively high return on capital employed on an annual basis of 16%. Last week we announced our July sales average 197 million standard cubic feet per day, which is the highest monthly average so far this year.

On the drilling front, we announced a successful test of the Chimela oil discovery in mid-May that we had previously announced in January with an average rate of 353 barrels of oil per day from the base of Lisama. With this test data now in hand we're progressing development plans for this discovery. This is in addition to the testing of the Saxofon and Dividivi gas discoveries which was also announced in early May, and which was discussed in our last conference call.

With respect to our drilling activity for 2023, we've been primarily focused on exploration of the Cienaga de Oro prospects situated close to our Jobo gas processing facility which can be commercialized very quickly. We announced the discovery of Lulo 1 located on our 100% operated VIM-21 ENP contract which encountered 207 feet of net gas pay within the primary Cienaga de Oro sandstone reservoir and tested 17 million standard cubic feet per day.

We followed this up by drilling the Lulo 2 appraisal well which encountered 230 feet of net pay and tested 24 million standard cubic feet per day. Both Lulo wells have been tied into our facilities and are currently on production.

Last week, we announced that we had plugged an abandoned Piña Norte 1 exploration well located on our 100% VIM-21 EMP contract after encountering an overpressured zone in a very shallow reservoir. Fortunately, we were able to move very quickly to drill a twin offset well which we are now completing and preparing to bring on production next week.

With a total of three drilling rigs, we're planning to continue our drilling activity with the Mafaldine and Cereza exploration wells and the Aguas 4 [ph] development while all located on the VIM-21 EMP contract. The Mafaldine exploration well is situated approximately 1.5 kilometers to the northwest of our whole production facility, and the Cereza exploration well, which was scoped two days ago, is located approximately 500 meters to the north of [audio drops]. I anticipate we'll be providing results from our drone activity in our regular monthly updates.

Here at Canacol, we understand the crucial role of natural gas and addressing climate change in global challenges and remain committed to supporting Columbia's objective of achieving a 51% reduction in emissions by 2030. In line with this, we have published our 2022 ESG report and long-term decarbonization goals whereby we aim to achieve zero methane emissions by 2026 and reduce Scope 1 and 2 emissions by 50% in 2035 and achieve carbon neutrality by 2050.

For 2022, we reported Scope 1 and 2 GHG emission intensities that are an average 80% lower than our oil producing peers and 50% lower than our gas producing peers in North and South America. Our emissions intensity is lower than the average for many broad equity indices including some with constituents selected for having low carbon emissions. Our progress has driven us the top 10th percentile of upstream oil and gas companies in the CSA S&P assessment, and we have received an A rating from MSCI affirming Canacol's leadership in ESG. I invite all of those interested about our ESG achievements here in 2022 to read our report which is now available on our website.

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. The second quarter was another very good quarter with strong netbacks from our producing operations. Our gas operating netback was $3.94 per Mcf in the three months ended June 30, 2023, which is 8% higher than in the same period of 2022 and slightly above our guidance for $3.81 to $3.84 on average for 2023.

As was the case in the first quarter, these high netbacks can be attributed to strong pricing under our firm contracts at $5 per Mcf on average during Q2 combined with the interruptible market pricing that was significantly stronger during the quarter than we had assumed it would be for the whole year of 2023 on average. Our realized gas price of $5.13 per Mcf net of transportation was exactly the same as we reported for the first quarter, demonstrating a new stable and higher level for our realized prices.

We remain encouraged by the persistence of robust pricing for interruptible gas sales. Recall that the majority of our guidance is based on sales under fixed price take-or-pay contracts with an average price of $5.09 per Mcf for 2023.

Opex was $0.35 per Mcf in Q2 up from $0.25 in the first quarter as we had previously indicated that we would likely return to doing more maintenance spending in the second quarter. This brought the first half of 2023 opex to $0.30 which is slightly less than our internal budgets of $0.32 for 2023 on average. In percentage terms, our gas royalties were roughly in line with prior quarters at 16.5% of revenue. Return on capital employed was 16% for the second quarter on an annualized basis and 12% on a trailing 12-month basis.

We reported $75 million of revenue net of royalties and transportation which represents a 6% increase from Q2 of 2022. This increase was driven by an 8% increase in realized prices slightly offset by 2% decrease in sales volumes, combined with slightly higher royalties. Then, $34 million in adjusted funds from operations represents a 14% decrease from the same period in 2022. This $5.4 million decrease in adjusted funds flow from operations is solely attributable to a 9% increase in current taxes relative to the same quarter in 2022.

We also reported EBITDAX of $61 million which represents a 10% increase from the same period of '22, and finally, we have reported net income of $40 million with the change from a net loss in the same quarter of 2022 being due to a deferred tax recovery this year when we had deferred tax charges in Q2 of last year.

As you hopefully recall, in Q4 2022 we initiated a corporate reorganization in order to better optimize our business alongside of which we also increased our deferred tax asset by $202 million. The most important steps of that reorg as it relates to our ability to make use of our tax assets were completed by the end of the second quarter. As a result, our expectation is that relatively high current tax expense in the first two quarters of 2023 will not continue going forward, so I expect significantly less current tax expense going forward than we have reported for the first two quarters of 2023.

EBITDAX of $61 million in the second quarter was just a few hundred thousand dollars short of a new record we set in the first quarter, so I will again highlight the long-term trend of steadily growing EBITDAX over the last eight years. We do anticipate this trend continuing and are optimistic with regards to the pricing and demand outlook for the second half of 2023, and as such, our high case 2023 EBITDAX guidance of $263 million remains unchanged.

Before, I hand the call back to Charle, I'll make some comments on capital spending to date and the outlook for the remainder of the year as well as debt levels. Our cash capital expenditures of $99 million for the first six months represents approximately 60% of our unchanged high case capital budget guidance of $163 million for 2023. The $99 million of first half capex does include $17.5 million of warehouse inventory at June 30th as required under IFRS including a wellhead and casing materials for Pola and other upcoming wells. If we adjusted for these amounts as traditional inventory items, the capex levels for the first half of 2023 would be exactly 50% of the annual $163 million budget. As such, I do anticipate that we can continue significant drilling activity despite anticipated lower spending in the second half of 2023.

During the second quarter, we drew an additional $70 million on our revolving credit facility such that we've now drawn $145 million in total on this $200 million facility as of June 30th. As a reminder, the main reason for the additional draw during the quarter was to pay a $65 million one-off cash tax bill incurred, as part of the corporate restructuring that we had discussed earlier and in detail on prior calls. Our net debt to EBITDA leverage ratio was 2.7 times on a trailing 12-month basis at June 30th with the increase from prior quarters caused mainly by the restructuring tax payments.

How this ratio evolves going forward will depend on a host of factors including gas demand as a key driver of revenue and hence also EBITDA levels. With our one-off cash tax payment now behind us, my expectation continues to be that our leverage ratio will decrease to approximately 2.4 times or 2.5 times at year-end. To refresh everyone's memory, our bond covenant is at 3.25 times, and the revolver is at 3.5 times. As such, we're well inside those covenant restrictions.

That concludes my comments. I'll now hand it back to Charle.

Charle Gamba
Thanks, Jason. Our results for the quarter once again demonstrate high and stable operating margins as well as a very respectable return of capital employed. As Jason just outlined, our guidance and plan for 2023 remains unchanged and we're continuing to progress a steady exploration drilling program targeting exploration prospects located close to Jobo that can be commercialized very quickly. We're doing this in order to build productive capacity to meet the anticipated high demand for natural gas associated with the upcoming El Nino phenomenon.

We forecast realized contractual gas sales for 2023 which include downtime, our anticipated to range between one $160 million to $206 million standard cubic feet per day. Our gas sales average $185 million standard cubic feet per day for the first half of this year, and we're $197 million standard cubic feet per day during July.