Canacol Energy Ltd

First Quarter 2024 Financial Results

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CORPORATE PARTICIPANTS

Carolina Orozco – *Vice President of Investor Relations*

Charle Gamba – *President & Chief Executive Officer*

Jason Bednar – *Chief Financial Officer*

PRESENTATION

Operator
Good day and welcome to the Canacol Energy First Quarter 2024 Financial Results. All participants will be in listen-only mode. To receive assistance, all of you participants may signal a conference specialist by pressing the star key followed by zero. You may submit questions throughout the event by connecting to the webcast. When in the webcast, place your question in the Ask a Question field. Questions will be addressed after the formal presentation has ended. Please note this event is being recorded.

Now, I would like to turn the program over to Carolina Orozco, the Vice President of Investor Relations.

Carolina Orozco
Good morning and welcome to Canacol's First Quarter 2024 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 our President and CEO, Mr. Charle Gamba, who will summarize highlights from our first quarter 2024 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 2024. At the end, management will be responding to written questions received through the webcast.

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 First Quarter 2024 Conference call. During the first quarter of 2024, we achieved historic record natural gas sales prices and netbacks. Canacol's gas sales prices have consistently increased quarter-over-quarter since mid-2021.

In the first quarter of 2024, we realized prices 29% higher than the same period in 2023 and 9% higher than the previous quarter. This is due mainly to tighter supply and demand conditions in Colombia coming from declining rates in the country's main producing fields exacerbated by the recent El Niño phenomenon, which has led to increased demand from thermal generators, influencing prices in the interruptible market. Additionally, we reported a record quarterly netback of $4.90 per Mcf with an EBITDA of $61 million.

Realized natural gas sales averaged 150 million standard cubic feet per day, marking an 11% decrease from the previous quarter. Our production capacity has, however, been recovering, thanks to successful drilling and workover activities during this year. As a result, our sales gas at the end of April were approximately 169 million standard cubic feet per day and our current productive capacity stands at 177 million standard cubic feet per day.

Regarding drilling activity, we have drilled two successful Ciénaga de Oro exploration wells, Pomelo-1 and Chondaturo-1, which are located close to our Jobo gas processing facilities and have been rapidly placed into permanent production. We also had success in infill drilling with the Clarinete-10 development well and the Chondaturo-2 appraisal well, the latter of which tested at a rate of 12 million standard cubic feet per day and is also being tied into permanent production.

With respect to capital expenditures, our accrued capex during the first quarter of 2024 was $36 million, 50% lower than the previous quarter and almost 25% lower than the same period in 2023 as we focus on enhancing efficiencies to reduce operational costs and capital expenditures. These improved efficiencies, we're anticipating finishing the year with capital expenditure within the lower range of our initial guidance and even below it. This underscores our commitment to maintaining financial discipline while ensuring operational performance.

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

Jason Bednar
Thanks, Charle. The first quarter of 2024 was another very good quarter with strong record pricing and netbacks from our producing operations. Our realized gas price of $6.66 per Mcf in the 3 months ended March 31, 2024, was the highest we've ever achieved in a quarter and represents a 29% increase from the same period in 2023 and a 9% increase from the 3 months ended December 31, 2023. The increase in our realized gas price is due to a 19% increase in the average sales price of our firm fixed price take or pay contracts and higher interruptible prices.

To refresh everyone's memory, most of our sales consist of 124 million standard cubic feet per day under fixed price take or pay contracts with an average price of $6.04 per Mcf as compared to the 2023 basket of $5.09 per Mcf. Driven by the strong pricing, we achieved record operating netback of $4.90 per Mcf in the first 3 months ended March 31, 2024, representing a 22% increase from the same period in 2023 and a 12% increase from Q4 2023.

Our operating expenses for the 3 months ended March 31, 2024, were $0.45 per Mcf, being $0.06 higher than the 2023 average operating costs. However, operating expenses for the first quarter of 2024 was $0.16 lower compared to the last quarter in 2023 given reduced maintenance and water treatment costs, as well as the absence of a one-time service cost associated with the compressor unit at the Jobo gas processing facility.

Gas royalties slightly increased to 18.9% of revenue driven by higher production on the VIM-5 block, which is subject to higher royalties. Despite 19% lower realized natural gas sales volumes during the first quarter of 2024 compared to the Q1 of '23, total revenues net of royalties and transportation expenses increased 5% to $77.7 million and adjusted EBITDAX increased slightly to $61 million, which was mainly attributed to higher average natural gas sales prices.

With similar adjusted EBITDAX of $61 million for the Q1 compared to the same Q1 in 2023, adjusted funds from operations increased 29% to $42.2 million for the first 3 months compared to $32.7 million for the same period in 2023. This increase is mainly attributed to a reduction in current tax expense of approximately $9 million resulting from the corporate restructuring previously disclosed. I'd also like to reiterate that despite recording $17.2 million of current income tax expense for Q1, the corporation still expects 2024 annual current tax expense to total approximately $35 million.

The corporation realized a net income of $3.7 million for the 3 months ended March 31, 2024, compared to a net income of $16.9 million for the same period in 2023. The decrease in net income for Q1 is driven by a non-cash deferred income tax expense of $0.5 million as compared to a deferred income tax recovery of $17.4 million in 2023. The 2023 recovery was FX related whereas the Q1 2024 FX was essentially flat throughout the quarter.

Net capital expenditures for the 3 months ended March 31, 2024, was $35.9 million compared to $47.1 million in Q1 of 2023 and compared to $72.2 million for Q4 of 2023. As Charle previously mentioned, the corporation has been focused on operational efficiencies with the objective of reducing costs and maintaining strong financial results.

With respect to our low case guidance capex budget of $138 million, I'd like to state that our current working model anticipates total capex of approximately $120 million for that same capital program reflecting a reduction of $18 million.

During this call, I'd like to address the short-term liquidity concerns that have surfaced in the markets. First of all, I want to emphasize that we are actively managing our liquidity position with prudence and foresight. Any speculation suggesting that we may not meet our next bond coupon payment is completely false and we reaffirm that we are well-positioned to meet all of our future financial obligations.

As of March 31, 2024, our cash position was $25 million. Subsequently, on April 26, 2024, we announced the sale of over 60 million common shares of Arrow Exploration at a price of 0.185 pence [ph 9:35] per share for a total of $13.3 million net of fees. As of April 30, 2024, the corporation had a cash balance of approximately $30 million not including these Arrow share sale proceeds as the trade settled on May 3rd, so effectively an April 30th cash balance of $43 million.

While speaking about April, I'm also pleased to state that April's EBITDA, buoyed by high interruptible prices, was approximately $26 million, which of course is $6 million higher than the average of January to March of roughly $20 million EBITDA each month. Of course, April revenues aren't received on April 30th, thus these additional amounts are not included in the $43 million cash balance I just discussed, once again affirming ample liquidity for bond coupon payments and future obligations.

To comment solely on the Arrow share sale, the holding of shares in a publicly traded oil company was obviously a non-core asset for us; $55 million of the $60 million share position we held was acquired in October 2021 upon their secondary aim listing at a cost basis of approximately $4.8 million US, including associated warrants we later exercised. That position netted a fully tax-sheltered gain of approximately $7.5 million, once again in US dollars.

With respect to Canacol of November 2028 note, since February 2027 revolving credit facility, we are in compliance with all of our debt covenants. Our net debt to EBITDA leverage ratio was 2.9x and interest coverage ratio was 4.65x at March 31, 2024. To refresh everyone's memory, our bond leverage covenant is at 3.25x in current space and the revolver is at 3.5x maintenance covenant. Our interest coverage covenant is a minimum of 2.5x. As such, we're well inside those covenant restrictions. Further, and a point I have not previously discussed, the bond indenture allows for certain additional credit facility baskets which effectively raises the leverage ratio allowed under that covenant.

Given the cash balances and leverage ratios I just went through, I'd like to respond to rumors in the markets. I can unequivocally state Canacol has not hired a financial advisor, nor have we ever spoken to one at any time during 2024 and we have not ever contemplated a restructuring.

I will now turn the presentation back to Charle.

Charle Gamba
Thanks, Jason. In 2023, our [ph 12:25] exploration drilling activities met with limited success due to several factors. Primarily, our entire exploration portfolio was built upon opportunities identified from legacy 3D seismic data acquired approximately a decade ago with the most promising prospects having already been drilled years prior and yielding discoveries such as Nelson and Clarinete, Aguas Vivas and Pandereta.

This led to a diminished pool of large and/or low risk drilling targets in the recent years with the last substantial discovery, Aguas Vivas, made in 2021. Additionally, the failure to reach the target of the high impact in the Tier 1 exploration well on our SSJN7 contract due to mechanical issues contributed to setbacks experienced in 2023.

Since 2022, we have invested approximately $70 million in the acquisition of three new large seismic programs, one located in our SSJN7 block, another in the northern part of the VIM-5 block and the last one at the west side of our VIM-5 block, which opens a whole new portfolio of exploration prospects.

During the first half of 2024, we've been prioritizing smaller, low-risk exploration opportunities in the vicinity of our Jobo facilities identified from the legacy 3D seismic data with a 100% exploration success rate with the discoveries of Pomelo and Chondaturo. Furthermore, in midsummer, we are planning to drill the high impact Cardomom-1 exploration well, the first exploration well to be drilled off the new 3D seismic acquired in the northern part of our VIM-5 exploration contract in 2023. Success in this prospect could have substantial impact in reserves additions and potentially unlock a new producing area for Canacol.

In summary, for the remainder of 2024, the corporation is focused on the following objectives. In line with maintaining and growing Canacol's reserves and production in its core gas assets in the Lower Magdalena Valley, the corporation is executing comprehensive development exploration programs. The corporation's aim is to optimize its production and increase reserves by drilling up to five development wells and four exploration wells, install new compression and processing facilities and work over operations on producing wells in the corporation's key gas yields [ph 14:41]. The corporation to date has completed the drilling of two successful exploration wells, Pomelo-1 and Chondaturo-1 and two successful development wells, Clarinete-10 and Chontaduro-2. The Chontaduro-2 well was recently completed and tested at a rate of 12 million standard cubic feet per day and is currently producing into the Jobo gas treatment facility.

Through these above-mentioned activities, the corporation managed to stabilize its gas sales at an average rate of 150 million standard cubic feet during Q1 of 2024 and lifted gas sales to approximately 169 million standard cubic feet by the end of April of 2024. As I mentioned earlier, our current gas production potential stands at approximately 177 million standard cubic feet per day.

On the exploration front, the corporation expects to drill the high-impact and potential material Cardomom-1 exploration well in midsummer of 2024. Cardomom-1 will be the first exploration well drilled off its newly acquired [indiscernible 15:40] 3D seismic survey acquired on the northern part of the VIM-5 E&P contract in 2023, where the corporation has identified 15 new gas prospects in the Ciénaga de Oro sandstone reservoir, the same reservoir that produces 15 kilometers to the south in the majority of the corporation's gas fields. The Cardomom prospect exhibits well-defined ABO, which is a direct indicator of gas within the prospect, identical to that exhibited by all of the corporation's major gas discoveries such as Nelson, Clarinete, Pandereta and Aguas Vivas fields.

Secondly, maintaining a low cost of capital, cash, liquidity and balance sheet flexibility to invest for the long-term. In a year of expected highly supportive gas market dynamics, the corporation is tactically prioritizing investments in the Lower Magdalena Valley and has therefore decided to postpone the drilling of the Pola-1 exploration well located in the middle of Magdalena Valley to 2025. On April 26, 2024, the corporation sold its non-core investment in Arrow for gross proceeds of $13.8 million to add additional equity [ph 16:46].

Thirdly, Bolivia achieved the government's approval of a fourth E&P contract that covers an existing gas field reactivation to begin development operations with a view to adding reserves and production and commencing gas sales in 2025.

Lastly, continue with the corporation's commitment to its environmental, social and government strategy. I'm pleased to announce the release of our 2023 ESG Integrated Report in the coming weeks, highlighting our dedication to corporate responsibility and sustainable operations. Canacol's inclusion in the S&P Global Sustainability yearbook 2024 reflects our excellence in sustainable practices, particularly in corporate governments within the oil and gas upstream and integrated segment.

The report will comply with the United Nations Global Compact's communication on progress requirement, utilizing GRS standards and SAS indicators for the oil and gas sector. We'll also integrate metrics from the IPIECA and will align with TCFD recommendations, the UN Agenda 2030 and the S&P's Global CSA. Canacol emphasizes the importance of integrating ESG strategies into our business model to meet shareholder and stakeholder expectations, striving for continuous improvement in ESG performance.

Finally, with respect to Ecopetrol's unfortunate statements concerning Canacol in the first quarter conference call held on May 8th, I would like to formally state that we have had no discussions whatsoever with Ecopetrol concerning a corporate transaction or any other transaction. Furthermore, we have had no discussions with any other company or any other banks regarding any corporate transaction or any other transactions whatsoever. Ecopetrol's public statements do, however, reflect the strategic importance and value of Canacol's role as the largest independent gas producer in Colombia, as well as the critical shortage of gas reserves in this country. It's not unexpected that there is a great deal of interest in our gas reserves in Colombia, which are second only to those of Ecopetrol and were recently evaluated by our third-party auditors as having a 2P NPV10 after-tax value of US$1.8 billion.

We'll now respond to some questions sent via the platform.

Carolina Orozco
Operator, can you please give instructions to receive questions while we process any questions that we're receiving?

QUESTIONS AND ANSWERS

Operator
Absolutely, thank you. We will begin the question-and-answer session. You may submit questions by connecting to the webcast and then placing your question in the Ask a Question field. The questions will be read, and management will answer.

Carolina, please go ahead.

Carolina Orozco
We have one question from David Lee [ph] from Alliance Global Investors. Could you please speak to current trends in gas price realizations in April?

Charle Gamba
Yes. With respect to April, we saw very high interruptible gas pricing due to very severe El Niño effect, which is a very dry weather phenomenon. We were selling gas into the interruptible market at $17 an Mcf, up to 40 million cubic feet per day, all through thermal generators who were covering the shortfall of electricity in the market. So, April was a very strong month, very dry month, very low levels of hydroelectric— electrical generation and very high thermal generation.

Carolina Orozco
We have another question from Julio Del Gal [ph]. What is the current participation of contracted gas sales and what is the projection towards year-end?

Jason Bednar
I can answer that, I guess. If I understand the question properly and I did touch on in the script. So, we have our current take or pay baskets that runs until December 1, 2024, which is the start of a new contracting year annually in Colombia. The current basket is 124 million cubic feet a day at an average price of $6.04. I did also mention that compares— it's up 19% compared to, the price is, compared to 2023. Looking forward, of that 124 million cubic feet a day, only 12 million cubic feet a day drops off for next year thus leaving the price relatively unchanged.

Carolina Orozco
Please give us a couple of minutes. We are processing questions received.

We have a question from Alejandra Andrade from JPMorgan. With El Niño easing, are you seeing gas prices easing as well?

Charle Gamba
Yes. With El Niño starting to ease, there have been higher levels of rainfall, and the hydroelectric reservoirs are starting to fill. So, we've seen a decrease in gas demand, particularly in the coast, as well as pricing. So, it seems that we are coming out of the El Niño period now for the next two months and we'll regress to sort of normal type conditions here in Colombia.

Carolina Orozco
We have a question from Albert Chang from Santander. What is modeled for Cardomom-1 contribution to output?

Charle Gamba
Cardomom is a typical Ciénaga de Oro target. It's a little deeper than our producing fields, about 1,000 feet deeper. So, we expect that the well, if successful, will IP at a rate between 12 million and 15 million cubic feet per day. Given success at Cardomom-1, there are three or four follow-up locations to drill in that field to develop it as well.

Carolina Orozco
Next question is from Diego Espinosa from [indiscernible 23:42]. What is the current average duration of your take or pay contract, just to understand how contracted prices could be in the second half of 2024

when El Niño fades away?

Jason Bednar
Yes. The weighted average life of our take or pay contracts is 4.5 years. Once again, that's 124 million cubic feet a day. So, it's roughly 75% of our total sales.

Carolina Orozco
We have one question from David Mirzai from SP Angel. How do you think about your capital structure and capital allocation strategy ahead of taking on a higher risk exploration led strategy versus last year's infrastructure led strategy?

Charle Gamba
I don't view the strategy as higher risk. The exploration has— our exploration activities over the past 10 years have always been very consistent. As you know, we've enjoyed a very high rate of success, 82% chance of success and this year's program is no different. We've already scored two for two on our first two exploration locks [ph 25:14] and the remaining exploration wells we drilled this year, we'll have a fairly high chance of success as well. So, I don't view— we've not shifted to anything higher risk.

Last year, we spent quite a bit of money in infill drilling in the existing fields. So, I think the strategy remains the same, particularly with respect to exploration. Fairly conventional exploration risk that has historically generated very high chances of success.

Carolina Orozco
The next question comes from Daniel Guardiola from [indiscernible 25:49]. What is the expected capex associated with drilling the high-impact well Cardomom-1 exploration?

Charle Gamba
I'm sorry. Could you repeat that question?

Carolina Orozco
Yes, of course. What is the expected capex associated with the drilling of the high-impact well Cardomom-1 exploration well?

Charle Gamba
It's a typical, vertical exploration well. So, it's about 1,000 feet deeper than our typical wells. So, with respect to the civil works, we have to build the road into the location and a platform and the drilling of the well. We're out looking around $6 million as opposed to $4.5 million to $5 million for a typical exploration well.

Carolina Orozco
We have one question from Diego Espinoza from BTG Pactual. At what price have you been renewing your contracts during this year?

Jason Bednar
As I mentioned, the contract year for long-term contracts is December 1st. So typically, the contract renewals are in the fall and not during this time. So, I'm unaware of any contracts that have been renegotiated or extended heading into next year as it's a little bit early.

Carolina Orozco

We have one question from Darja Lema from Bloomberg Intelligence. Your funding position appears to be solid in 2Q. Will you be looking at postponing some of the exploration program in the next year to improve your cash position in 3Q?

Charle Gamba
Our funding position is solid for the rest of the year, basically and we're going to continue with our exploration programs in the Lower Mag Valley. So, we're going to go ahead and drill. We're currently preparing the rig to mobilize the Cardomom-1 location, which we anticipate spudding in July, followed by another high-impact well in the fourth quarter.

We did, as I announced— as I mentioned a little earlier, we did defer the drilling of the Pola-1 exploration well, which we were planning to drill sooner rather than later in the Middle Magdalena Valley. We're deferring that till next year so that we deploy our capital this year into the Lower Mag Valley where we can commercialize our reserves very quickly into the existing market. So, no, we're continuing with our exploration programs against a very solid, financial background.

Carolina Orozco
We have a question from Diego Espinosa from [indiscernible 29:19]. From where do you expect the growth in research will come during 2024 considering the important decrease in capex for 2024?

Charle Gamba
We expect the four exploration wells we're drilling this year. The smaller ones we drilled, Pomelo and Chondaturo are decent reserve adds. We're looking at 5 to 10 BCF each on those and the two large ones, Cardomom and the second one we're going to be drilling in the latter half of the year are 60 BCF targets. So, we expect a return, off the new seismic, for those two big exploration wells that are going to be drilled after new 3D seismic we acquired. We expect the return to fairly robust. The reserve replacement ratio is well above a 100%.

Carolina Orozco
We have a question from Carloalberto Fraccaro from MainFirst. Would import of gas from Venezuela put downward pressure on prices in Colombia? Any idea on potential impacts?

Charle Gamba
Yes. The concept of importing gas from Venezuela is a fairly complicated one, but I suppose aside from the issues of timing, in that it will certainly not be happening anytime soon, certainly, a five-year plus type of outlook in terms of timing, it all depends what that the price of the gas is, I suppose. I don't know that there have been any formal discussions with anyone concerning the price of that exported Venezuelan gas. I don't imagine PDVSA will be giving the gas away into the Colombian market, I would think, but it's a very difficult question to answer. However, you're looking— the outlook for any potential Venezuelan gas to enter the Colombian market is in the five-year plus time frame.

Carolina Orozco
Next question is from Alex Marrucho from Lord Abbett. Regarding new take or pay contracts, what is your expectation of prices for such?

Charle Gamba
This year— well, going from 2023 to 2024, the average increase in our take or pay contracts was approximately 20%. We're now moving into— moving out of El Niño, but we are, however, moving forward into a very tight supply scenario. Ecopetrol's fields continue to decline in terms of production. There are

very few other operators adding significant reserves of any sort. So, we expect supply to be increasingly tight going into 2025, which should drive pricing in a very positive way for us.

The only other potential source of gas entering Colombia would be LNG from SPEC. So, I expect that the ceiling for gas prices next year would be parity with SPEC. Landed gas in the $10 to $12 range would be sort of the absolute ceiling, but we do expect the tightness to increase in terms of supply and that to have a positive effect on our negotiating of new contracts going into next year. So, I would expect a 10% to 15% increase in terms of outlook.

Carolina Orozco
Next question is from Juan Cruz from Morgan Stanley. Given the reduction in capex and the average production of 150 million feet [ph 33:23] per day in first quarter 2024, how confident are you that you will reach production guidance for the year?

Jason Bednar
Okay. So, a couple of things in that. As I mentioned the reduction in capex is for the exact same drilling program that was originally envisioned. So, there's no change aside from efficiencies. Q1 was indeed 150 million cubic feet a day, but as Charle stated, our current productive capacity is 177 million cubic feet a day. As such, our guidance remains unchanged.

Carolina Orozco
Give us a couple of minutes as we process any further questions.

CONCLUSION

Carolina Orozco
With this last question, we now conclude the First Quarter 2024 Conference Call. Thanks, everyone, for joining us this quarter and we hope you join us again in the second quarter conference call.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect. Have a good day.