Canacol Energy Ltd

Q3 2024 Earnings Conference Call

November 8, 2024 at 10:00 a.m. Eastern

CORPORATE PARTICIPANTS

Carolina Orozco - *Vice President of Investor Relations*

Charle Gamba - *President and Chief Executive Officer*

Jason Bednar - *Chief Financial Officer*

PRESENTATION

Moderator
Hello, and welcome to the Canacol Energy's Third Quarter 2024 Financial Results Conference Call and Webcast. 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. You may submit questions throughout the event by connecting to the webcast. On the webcast, please 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.

I would now like to hand the call to Carolina Orozco, Vice President of Investor Relations. Please go ahead.

Carolina Orozco
Good day and welcome to Canacol's Third 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'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 for our third 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, we will have a Q&A session.

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

Charle Gamba
Thanks, Carolina, and welcome everyone to Canacol's Third Quarter 2024 Conference Call. We're pleased to report that this past quarter was another record-breaking one for Canacol, with EBITDAX reaching a new high of $86 million driven by interruptible pricing, interest in operations, and the ruling in favor of the company in an arbitration process with Promigas, a gas transportation company here in Colombia, which Jason will discuss in more detail later.

Our realized natural gas prices for the quarter were $6.69 per MCF, 24% higher compared to the same period in 2023. Additionally, we generated netbacks of $5.25 per MCF, representing a 27% increase compared to the third quarter of 2023, maintaining strong operational margins of 78%.

Our strong performance continues to be supported by robust natural gas prices, which early in the year were driven by the impact of El Nino, a weather phenomenon in Colombia. While El Nino ended in May, reservoir levels have been recovering slower than anticipated, keeping electricity prices high and driving up interruptible natural gas pricing and demand.

Additionally, Colombia's gas supply is tightening due to the continued production decline of Ecopetrol's large 30 plus year old gas fields by Jana on the Caribbean coast and the Cu Ziana Coupa Hawa Complex in the interior. This supply challenge has led to increasing reliance on imported LNG to meet national gas demand. This market environment combined with our focus on cost reduction, production stabilization, and increased exposure to the interruptible gas market have been essential to maximize our response to market dynamics and achieve these results. Our commercial strategy introduced at the beginning of the year to increase our exposure to the interruptible market has been effective.

During the quarter, we averaged 169 million standard cubic feet equivalent per day of gas and oil sales, which include average realized natural gas sales of 160 million standard cubic feet per day and 9 million standard cubic feet per day equivalent of oil sales. Throughout 2024 our gas production capacity has been gradually recovering thanks to successful exploration drilling activities and our maintenance programs, which include ongoing workovers of existing wells and the installation of additional compression.

This last quarter we drilled the Chontaduro-3 appraisal well on our VIM 21 block, continuing with our strategic approach of low risk near field drilling, targeting drilling prospects close to existing infrastructure and utilizing legacy 3D seismic data. Chontaduro-3 successfully produced gas into our existing infrastructure.

We also drove the first exploration well in our new Redoblante 3D seismic program located in the northern part of the VIM5 block. The Cardomomo-1 exploration well encountered 203 feet of net port sandstone within the CDO formation with non-commercial amounts of natural gas encountered. Despite not resulting in a commercial discovery, it provided valuable data confirming that an active petroleum system exists in a largely undrilled area of the basin on our block. With over 200 feet of reservoir encountered and the presence of gas, Cardomomo results have significantly reduced reservoir and source risk for future prospects we plan to drill in this lightly explored area.

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

Jason Bednar
Thanks, Charle.

As you already mentioned, the third quarter of 2024 was another very good quarter with record EBITDAX and strong pricing and net backs from our producing operations. Also, our financial results continue to be further strengthened by our ongoing commitment to operational efficiency aimed at reducing costs and capital expenditures while maintaining strong operational and financial performance.

Our realized natural gas prices net of transportation of $6.69 per MCF during the three months ended September 30, 2024, represents a 24% increase to the $5.40 per MCF during the same period in 2023. This increase shows both the 19% increase in the average sales price of our firm long-term fixed price contracts, which reached $6.04 per MCF for the nine months ended September 30, 2024, compared to $5.09 per MCF for the same period in 2023. And secondly reflects high interruptible prices, which average approximately $9.00 per MCF during this quarter.

As Charle mentioned, this favorable pricing environment is mainly driven by tight natural gas supply in Colombia, which ratifies our contracting strategy for this year by maintaining a relatively higher exposure to the interruptible market.

Driven by the strong pricing and by maintaining cost efficient operations, we achieved a natural gas operating netback of $5.25 per MCF during the third quarter of 2024, which is 27% higher than the same period in 2023, maintaining a strong operational margin of 78%. Despite 10% lower-realized natural gas sales volumes during the third quarter of 2024 compared to the same period in 2023, we generated total revenues net of royalties and transportation expenses of $87.9 million which is 15% higher compared to the $76.6 million for the same period in 2023.

Adjusted EBITDAX rose significantly by 38%, reaching $85.8 million for the 3-months ended September 30, 2024, compared to $62.1 million for the same period in 2023. This increase was driven primarily by higher operating net backs for natural gas, alongside a $14.2 million arbitration ruling in favor of Canacol associated with the natural gas transportation company at Columbia Promigas over disputed transportation costs. During the quarter, the arbitration tribunal ruled in our favor, ordering Promigas to reimburse Canacol for overcharge amounts plus interest totaling the $14.2 million. This settlement was recorded as Other Income for the period and on November 6th, we received the funds in full.

Adjusted funds from operations also increased by 18% to $57.9 million for the quarter from $49 million in the same quarter in 2023, mainly attributed to the increase in EBITDAX, though partially offset by higher income taxes.

The corporation also reported net-income of $10.3 million for Q3, a substantial improvement from the net loss of $0.5 million in the same period of 2023. This increase was driven by higher EBITDAX and the absence of non-recurring asset impairment recorded in Q3 2023. However, the growth was partially offset by a non-cash deferred income tax expense of $5.3 million in Q3 2024 due to FX changes compared to a deferred income tax recovery of $15.7 million in the prior year.

Our capital expenditures for the 3-months ended September 30, 2024, were $23.9 million, down from $43.8 million in Q3 2023. This reduction reflects lower operating spending on warehouse inventory and facilities and equipment aligning with the corporation's commitment to capital efficiency.

Our strategic investments and operational efficiencies have allowed us to achieve a record return on capital employed of 21% for the third quarter, a significant improvement compared to the 3% reported in the same period in 2023. This reflects our disciplined approach to prioritizing high return projects and optimizing capital allocation, ensuring that each investment contributes meaningfully to our financial performance.

At September 30, 2024, the corporation had $67.1 million in cash and cash equivalents, marking its strongest cash position since Q1 2023, along with the working capital surplus of $62.1 million, the highest recorded since Q3 2022. This robust liquidity well positions the corporation to meet both ongoing and future operational needs, providing the financial flexibility required to capitalize on strategic opportunities and support sustained growth.

On September 3, 2024, we announced the successful closure of a 24-month $75 million senior secured term loan facility with the Macquarie Group, which strengthened the corporation's financial position and offered the flexibility required to sustain growth and accelerate operational investments as needed. To date, we have drawn a total of $50 million. The facility, which carries an interest rate of SOFR plus 8% on drawn amounts, is set to mature in September 2026, and includes a 12-month grace period for principal payments.

This new facility aligns well with our existing covenants and supports Canacol's long term financial strategy. At the end of the third quarter, we were fully compliant with all financial covenants, which include the following. Firstly, a consolidated leverage ratio of 3.25x in current space and 3.5x maintenance. Our current leverage ratio is at 2.55x, well inside these covenant restrictions. The second covenant is a minimum consolidated interest coverage ratio of 2.5x, our current coverage ratio is 4.85x, which is well above the minimum required. And finally, a consolidated current ratio minimum requirement of 1.0x, and we're currently stand at 2.02x. As such, we're well inside all of our covenant restrictions.

Lastly, I'll make a few comments about income taxes. The current tax expense as found on the income statement totaled $54.6 million for the first nine months of 2024. However, we do still expect a 2024 full year amount to total approximately $30 million post the recording of an anticipated recovery/reversal in Q4.

With respect to cash taxes paid as outlined in the MD&A, we paid the final installments in prepayments of taxes relating to the 2024 year during this quarter. This $36 million of cash taxes paid in Q3 brings the nine-month total cash taxes paid to $66 million and leaves us with minimum monthly tax payments during the fourth quarter. Due to these disproportionately high payments during 2024, we do expect to end 2024 with a sizable tax receivable balance, and as such we don't expect to have any tax installments due in 2025, but for the nominal amount taken off our monthly revenue checks in favor of our tax accounts.

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

Charle Gamba
Thanks, Jason. In September, we revised our 2024 capital program to further enhance our drilling activities through the remainder of this year. The updated plan adds four additional wells for a total of 11 wells, with an estimated capital expenditure of $138 million, which is the original low-end capex estimate for the year. This revised program includes five exploration wells and six development and appraisal wells. We're able to increase our drilling activity and maintain our original capex for 2024, largely due to the cost-efficient initiatives enabling the corporation to maximize operational output while maintaining disciplined capital management.

To date Canacol has drilled seven wells, which includes six successful wells, those being Clarinete A10, Pomelo-1, Chontaduro-1, 2, and 3, and recently Nispero-2. For the remainder of 2024, we plan to drill three exploration wells, those being Natilla-2, Kite-1, and Pibe-1 along with one appraisal well.

The Natilla-2 exploration well is a high impact prospect located on our SSJN 7 E&P contract and is targeting sandstones of the CDO formation with additional potential in the overlying Porquero formation. We spud the well on November 2nd with an estimated two-month timeline for drilling and evaluation. Success in Natilla could be particularly exciting given that it's a sizeable prospect with the potential to add substantial reserves, as well as unlock a new gas producing area for the company. Additionally, it will help derisk nine similar prospects we have identified in the recently acquired Mayupa 3D seismic area.

We are also drilling the Kite-1 and Pibe-1 exploration wells, which are near field prospects positioned on a productive structural trend extending from our Palmer gas field to the south through to our recently discovered Pomelo and Chontaduro gas fields to the north. Both wells are targeting the same Cienaga de Oro sandstorm reservoir targets.

We spudded Kite yesterday with results anticipated by late November and Pibe-1 should spud later in

November with results anticipated in mid-December. If successful, both wells will be placed immediately on production, and flow into our Jobo facility for sales.

Finally, throughout the remainder of the year, we will be drilling one additional appraisal well, which if successful, will also be placed on production immediately.

The corporation also this quarter secured approval of our fourth E&P contract in Bolivia, Tita, that includes an existing gas field reactivation. The next steps will be to sign all four contracts and begin development operations at Tita with a view to adding reserves and production commencing gas sales in 2025.

As Columbia's largest independent natural gas producers, with approximately 16% of market share, we are confident in the strong foundations we built here and the resilience that has carried us through our recent challenges. Our high operational efficiency and profitability with annual operational margins consistently above 75% have kept us agile and well prepared to capture new opportunities. We're also pleased to lead in low emissions, with an intensity that is 75% lower than our oil-focused peers and 45% lower than our gas-focused peers, aligning growth with a commitment to environmental responsibility.

As we look forward, we see great potential for exploration here in Colombia, with over 20 TCF of un-risked prospective resource on our existing acreage, all located close to existing transportation and production infrastructure. We're confident about the path forward as we continue developing our plans for next year, which we look forward to sharing in January of 2025. Our focus remains on derisking our exploration portfolio, particularly in the lower and middle Magdalena basins of Colombia. This will help strengthen Canacol's position in Colombia's dynamic gas market. Additionally, our recent strategic entry into Bolivia opens up further opportunities to expand our regional presence creating strong foundations for sustainable growth.

Thank you all for your attention, and we're now ready to take questions.

QUESTIONS AND ANSWERS

Moderator
We will now 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 by management. The questions will be read, and management will answer. Please stand by while we assemble our roster.

Carolina Orozco
Thank you. We will begin with the first question from Augusto Uribe from Macquarie Asset Management. "Can you please give us some question on the firm gas contract terms for 2025 being negotiated into year end? Do you still foresee a contracted volume of 70% for next year?"

Charle Gamba
Yes. Thank you. Yes, approximately 20 million cubic feet per day of our existing firm contracts will be falling off at the end of this month, November 30th. Gas demand remains very strong projected into next year, and we're currently negotiating potential new firm contracts at this point in time. But at this moment, we have not made a decision with respect to executing additional firm contracts. Our thinking is to keep as much volume as we can available to the interruptible market where we expect pricing to be robust next year. Thank you.

Carolina Orozco
Thanks, Charle. The next question comes from Petr Grishchenko, from DoubleLine. “You mentioned another successful well that will start adding production in a few weeks. Was this previously reported or this was a new development discovery?”

Charle Gamba
Yes. That's referring to the Nispero-2 well, which is an appraisal well of our Nispero discovery that we made in 2019. We completed the drilling of that well fairly recently and are currently completing the well in order to bring it on to production which we anticipate to occur next week.

Carolina Orozco
Thank you, Charle. We have another question from Kevan Salisbury from Ninety One. “Can you please give a little context around dimension working capital surplus? Why has this developed now? Do you expect it to unwind and over what period of time?”

Jason Bednar
Thanks, Carolina. The strong working capital balance this quarter is essentially related to the very strong EBITDAX quarter and free funds from operations as compared to a very small capex number of $23 million. So, $85 million in EBITDA, $23 million in capex. Once again, that $85 million in EBITDA does include the $14 million of the Promigas settlements, so that also helped.

Looking forward, no, I don't expect it to unwind given the robust EBITDA projections, the tight gas market, etc. Even though the Q4 capex will be higher, I don't expect the working capital position to unwind.

Carolina Orozco
Thank you, Jason. Next question is from Alejandra Andrade, from JPMorgan. “When should the company start investing in Bolivia? Timing and amounts first, thanks.”

Charle Gamba
Yes. We expect with the execution of the contracts this year, by the end of this year, we expect to begin investing primarily within the Tita contract, which is an existing gas field that's been shut in since the year 2000. And we expect investment of relatively minor investment next year of up to around $12 million, aimed primarily at the workover of existing wells, the testing of those wells, and the construction of some gathering infrastructure in order to commence production and sale from those wells.

Carolina Orozco
Thank you, Charle. We have another question from Alejandra Andrade from J.P. Morgan. She said, “Under taxes is the withholding level close to 7% of top line?’

Jason Bednar
We broke out withholding taxes separate from income taxes in our MD&A. I assume that's what she's referring to. So, what's labeled there is withholding taxes has to do with intercompany transactions and withholding amongst those different jurisdictions. Not to be confused with we do get 4% of our revenue check is withheld and paid monthly to the DN in favor of our tax account, but what's labeled as withholding taxes relating to intercompany transactions has no set relation to revenues.

Carolina Orozco
Thanks, Jason. We have a question from Sergio, from UBS Asset Management. “Do you expect to reach a reserve replacement ratio in excess of 100% for full year 2024?’

Charle Gamba
Yes, the 11 wells that we're going to be drilling this year, exploration and development of appraisal wells, along with the workovers we have done and the installation of compression, we're targeting a reserve replacement ratio of approximately 120% with this year's program.

Carolina Orozco
Thanks, Charle. The next question comes from Stephane Cheleen. “What are the conclusions or observations following Cardomomo-1 results?”

Charle Gamba
Cardomomo-1 was the first exploration well we drilled off the newly acquired Redoblante 3 seismic program that we collected last year on the VIM-5 block. Cardomomo-1, although disappointing in that it's not encountered commercial quantities of gas, did encounter a much thicker section of porous sandstones within the target reservoir, the Cienaga de Oro, just over 200 feet, which is very positive for the rest of the prospects we've identified in that block and some of the sandstones did indeed contain gas. However, it seems that there was an issue with the fault seal, along one of the faults defined in the Cardamomo prospects.

So, we're currently evaluating the offsetting prospects. We've identified 11 other prospects on that new 3D. We're currently reevaluating the fault seal analysis, which appears to be the main cause of failure to Cardamomo on those other 11 prospects in order to prepare for drilling 1 or 2 of those prospects next year.

Carolina Orozco
Thank you, Charle. We will now take an additional moment to review any remaining questions. Please stay with us and we'll resume shortly again.

We have one last question today from Hisham Alwani from Macallan Capital. “Can you please give us a rule of thumb of the relationship between peso devaluation and additional tax insured? Can you give guidance for reserves based on current exploration?”

Jason Bednar
The second reserve question Charle has already answered. With respect to peso devaluation, every 1% move in the peso would be good for plus or minus $4.5 million. So, essentially, since our tax pools are recorded in pesos, if the peso devalues by 1%, you'll see an additional $4.5 million of deferred tax expense, not current tax.

Carolina Orozco
Thank you. Jason. We actually received another question from Augusto Uribe. “Can you please give us more precise timing for the $12 million capex in Bolivia? First half or second half, 2025?”

Charle Gamba
It would be second half of 2025 would be the planned timing for that capital expenditure.

CONCLUSION

Carolina Orozco
Thank you, Charle. This was the last question that we received. So, that concludes our call for today.

Thank you all for joining us and for your questions. We appreciate your time and interest, and we look forward to connecting with you again on our next call. Have a great day.

Moderator
The conference is now concluded. You may now disconnect your lines.