Cairn Energy PLC

FY20 Financial Results

9 March 2021

Transcript

Simon Thomson:

Good morning everyone and welcome to Cairn's results presentation. I'm Simon Thomson, Chief Executive and with me are James Smith CFO, Paul Mayland COO and Eric Hathon Exploration Director. As in the usual way we have a presentation to run through with you this morning and we would be happy to take questions at the end.

Before heading into the presentation itself, a few words of overview;
The last 12 months have of course been incredibly challenging for everyone. Throughout this period our focus has been on the safety of our people and the people we work with – like everyone we are relieved to now be seeing light at the end of the tunnel. At the same time, I am happy to say that this has also been a very busy and productive period for the company.

Cairn has a proven track record of continuous evolvement and renewal in the drive for sustainability and value growth. We have been clear in our ambition to grow and diversify the company's production base, ideally in a region where we see potential to access additional assets and opportunities. The transactions that we are announcing today mark a pivotal step in the achievement of that ambition, doubling our current production and more than tripling reserves within a portfolio that provides both long-term sustainability and considerable upside potential.

Turning to the transactions themselves, a brief overview and rationale for each:
The first is the proposed acquisition of the Shell Western Desert Assets in Egypt alongside our JV partners Cheiron.
This significant portfolio brings high quality onshore assets with material development and exploration growth potential. It secures long-term, low-cost, gas-weighted production with a clear path to near-term upside. It represents an investment in a region where there is a stable and competitive fiscal regime, considerable and growing market demand, cross-border energy trading and an active M&A market. And we believe that our partnership with Cheiron, who already operate around 40k boepd in Egypt, results in a Joint Venture with deep local experience and knowledge and competitive strengths across the full breadth of the E&P value chain.

The second transaction is the agreement to divest of our entire interest in the Kraken and Catcher fields. With each asset entering natural decline this year, we believe that this is the right point to monetise and redeploy, ensuring that we retain the balance sheet flexibility to access further growth opportunities. Both fields have been great assets for Cairn and I would like to take this opportunity to thank the teams at EnQuest and Premier for their hard work and co-operation throughout the period of our ownership.

The transactions represent the culmination of a year of active portfolio management, with sales in Norway, Senegal and the North Sea preceding the acquisition onshore Egypt. In essence we have taken risked development and declining existing offshore oil production and replaced it with sustainable, gas-weighted onshore production with significant growth potential. We have also retained the financial flexibility to access additional opportunities and are actively engaged in this respect.

As you know all of this was achieved against a backdrop of continued fiscal discipline, allowing a further cash return of $250m to be made to shareholders at the start of this year.

A significant milestone was reached in late December 2020 with the unanimous, definitive Indian arbitration award in favour of Cairn of $1.2bn plus interests and costs. We have recently met with the Government of India to seek their adherence to the award and resolution of this long-standing issue. Whilst that engagement continues, absent resolution we are now deploying robust recovery options to seek to safeguard shareholders' rights to the value of the award and James will provide more detail in this respect.

It is worth restating that all of our activities and related financial planning are exclusive of India and therefore the value remains upside to the current business case.

Against the backdrop of portfolio management and capital discipline, and notwithstanding the logistical challenges raised by the pandemic, I am pleased to say that we continued to see safe and effective operations across the business. We proactively managed exploration capital commitments without jeopardising growth opportunities and as Eric will outline, we are now well-positioned to move forward across multiple jurisdictions, including wells this year with ENI in Mexico and Shell in the UK.

And we remain committed to executing our strategy responsibly and in line with the UN Sustainable Development Goals. Along with our fellow Brindex members we are committed to assisting the UK Government in reaching its Net Zero 2050 target. We recognise Climate Change as a principal risk to the business and as previously detailed we aim to reduce emissions in our operations where possible. We are also participating in early-stage Carbon Capture and Storage evaluations to ensure that we are in a position to participate in the event that the technical and economic case can be proven.

So, in summary we believe we are well-placed for further value growth from a renewed and expanded platform of exciting assets with the financial flexibility to make further portfolio additions, all against a backdrop of continued capital discipline and retained balance sheet strength. James….

James Smith:
I will briefly take you through 2020 financial performance and the outlook for this year; India; UK sale; I'll introduce the acquisition of Shell's onshore Egyptian assets before handing over to Paul.

Production last year was 21kbopd; av realised price $42.56 plus hedging gains $7.27 led to revenues of $324m. With net production costs of $19/boe, that resulted in operating cash inflows from production of $239m.
Looking forward to 2021, net production from Kraken and Catcher in the range of 16-19kbopd, with production costs targeted at $23/boe. We currently have hedging in place for around 3kbopd (but obviously we'll be reviewing future hedging plans now in the context of the planned Egypt acquisition)
Capex for 2021 $90m (excluding Egypt and Kraken and Catcher) is principally focussed on planned drilling activity in Mexico and UK, which Eric will talk about.

Looking at the reconcilitation of cashflows from last year:
Opening cash $154m, Kraken and Catcher operating CF $239m, Norway sale $105m, Senegal sale $525m
Total cash capex of $248m relating to assets divested during the year
On the continuing portfolio, cash capex was $151m ($28m on Kraken and Catcher, $123m E&A effectively paused after Q1 Mexico programme)
After admin and other costs, $570m cash at YE, of which we distributed $250m as a spec dividend in January.

On 22 December, the arbitration panel seated in the Hague under the registry of the PCA issued its long awaited ruling, which is binding on the parties under the terms of the UK-India Bilateral Investment Treaty.
It is an extensively reasoned 580 page ruling which determined on several key matters. Firstly, the arbitration panel ruled that it had jurisdiction on this matter under the terms of the Treaty and under Dutch law; having established jurisdiction, they ruled that the retrospective tax breached the standards of the Treaty, and that the means of enforcing that retrospective tax on Cairn were discriminatory and unfair.

As a result, it ordered for compensation equating to the value of assets seized, being $1.2bn, plus interest at 2.75% over Libor back dated to 2014, which currently totals nearly $500m, plus costs – putting the total value of the award today at just over $1.7bn.
There are three avenues for accessing value of award:
Engagement directly with India: constructive discussions (direct and indirect), but clearly India has not yet complied with the terms of the award.
Parallel preparations for enforcement: 160 jurisdictions under New York convention, we've already registered the award in multiple jurisdictions; we have begun the process of identifying assets against which action could be taken should it be required.

Thirdly, clearly this is an asset which has value in the eyes of third parties, either to participate directly in our claim, or as lenders secured against the proceeds….so naturally we are exploring this route as a potential way to accelerate access to the recovery of the award should that be necessary.

So just to take stock of how all this positions us against the strategic priorities for capital allocation and managing the business we set out last year:
Obviously we've been very active in managing the portfolio over the last year or so: we sold our development based assets in Norway and Senegal avoiding over $1.7bn of capex; and positioning us to redeploy capital into expanding the producing asset base (and today's announcement of the planned Egypt acquisition delivers on exactly that objective). We have also announced today the proposed sale of our UK producing assets as they enter into decline phase, again positioning us to redeploy capital to sustain the operating cashflow base and reinvest for growth.

Exploration remains core, but always focussed on value delivery. Egypt offers extensive near field potential as well as newer exploration concessions, and we have retained a number of high potential assets elsewhere which Eric will talk about, but importantly where there is flexibility in the capital programme.

We've delivered all this in a way that doesn't put strain on the balance sheet; and by which we retain the flexibility to continue to invest and expand the portfolio at an opportune point in the cycle. Following completion of the proposed UK and Egypt transactions we expect to remain in a net cash position, and therefore have significant capacity to further build the asset base.

And finally, as well as building value in the portfolio we remain focused on returning cash to shareholders. We see this as a key differentiator of the Cairn equity story over the last 15 years; we continued it in January of this year; and we aim to position ourselves to do more in the future.

So, I'll turn now to the two transactions we announced this morning:
We have entered into an agreement to sell our UK producing asset interests to Waldorf Production for base consideration of $460m plus contingent consideration structures that have the potential to be very material.
We will be retaining our UK exploration interests as well as some of the tax losses.

The details of the transaction terms are set out in our announcement this morning, but the key points are:
$460m base consideration effective date 1.1.20 subject to working capital and interim period adjustments (interim period adjustment to end December 2020 was about $144m off that headline price).

Additional consideration will be payable based on a percentage of revenues from the fields when Brent averages above $52 during the next five years (so we share the benefit of both oil price and production performance upside). At $65 Brent over the period that would pay out $125m based on our production projections.

As we said, whilst both fields have significant production life remaining, they are expected to begin to fall into decline during this year; so it is a natural time for us to consider monetising them to redeploy into growth assets given the opportunity set we are seeing the market at the moment.

Turning now to Egypt, I'll start with an overview of the transaction terms and structure.
This is a joint acquisition with Cheiron Energy, a highly experienced operator of similar production facilities in Egypt.
Net to Cairn the base consideration payable is $323m (effective date 1.1.20); plus additional consideration payable when Brent averages over $55/bbl over the next four years up to a cap of $100m over that period (if Brent were at $75 or above); and further consideration up to a maximum of $40m linked to commercial discoveries from exploration.

Funded by joint RBL and junior debt facility (as well as our existing cash resources).

Looking at the ownership structure: the producing assets are operated by Bapetco, a JV between the consortium and EGPC (which is the standard model in Egypt – and Bapetoc is one of the most substantial and long established JOCs in the country).

Of the consortium, Cheiron is the designed contractor operator party for the production and development leases; Cairn will operate the three newer exploration concessions acquired by Shell in recent years.

This slide sets out the investment potential and scope for growth that we see in the portfolio.
Significantly more detail on production and cost expectations will be provided in a mineral expert report in the shareholder circular to be published in the coming weeks – but we wanted to set out the high-level picture today.

As you will have seen, the acquisition will add net WI 2P reserves of 113mmboe, but also around 50mmboe of net WI 2C resources and gross unrisked exploration potential of over 800mmboe predominantly in Cairn operated acreage….so it's a resource base that can support both near term growth and long term sustainability of production.

We will aim to significantly ramp up the level of drilling activity following completion of the acquisition, taking production from around 35kboepd net WI to Cairn for 2021 up to 50kboepd or more over the next couple of years. This would effectively be returning production to levels that had been sustained over a significant period before the last couple of years which have seen diminished activity.

You can also see on this chart, that we hope to be able to materially reduce opex over the same period through operating efficiencies and contractor overhead reductions – further enhancing cashflows from the assets. And on that note, I'll hand over to Paul to talk more about the asset base.

Paul Mayland:
Good morning everyone. I would like to provide you with some further details on the quality of the assets that we are jointly acquiring with Cheiron from Shell in Egypt. The combination of these assets has already produced almost a billion barrels, has gross 2P remaining reserves of over 300 mmboe as of the effective date of the transaction (which is 1st January 2020) and includes the largest gas field in the western desert.

There are 4 main concessions as part of this package which include the Obaiyed and Badr El Din (BED), where Shell hold the full Contractor WI and NEAG and AESW, where there are additional JV partners in the IOC share. A joint Cairn and Cheiron team including myself, visited all the key sites in the fourth quarter of last year. These are assets that have continued to operate safely and efficiently through this global pandemic.

The pie charts illustrate the 2P WI Reserves and 2C Contingent Resources net to Cairn as of 31st December 2020 i.e. adjusted for 2020 production. As normal, these have been independently estimated by a third party and will be contained in our circular to shareholders. Obaiyed and BED contribute most significantly to the overall reserves and production. At anticipated 2021 production rates, the Reserves Life Index (RLI) is approximately 8.5 years which extends to around 12 years including Contingent Resources. This compares with 5 years for our current North Sea assets calculated on our mid-case production guidance for Kraken and Catcher for 2021.

The assets are managed through a Joint Operating Company, Badr Petroleum company or Bapetco which is a 50/50 JV between EGPC, the NOC of Egypt, and Shell; Shell's interest will obviously be replaced by Cheiron and Cairn on completion.

Cheiron will be deemed the Operator within the Contractor parties but Cairn will have rights to certain operational positions. This JOC actually operates all of the concessions including those with other IOC JV partners, which are shown on this slide for the 4 key concessions. We believe that we are well placed to bring together and leverage the skills-sets of the two companies including Cheiron's existing western desert production experience and our prior legacy development experience from the onshore desert in Rajasthan, India. Current opex is around $6/bbbl and we would anticipate reducing that with time. Again this compares with our North Sea opex which has now risen above $20/bbl as production starts to decline.

The Shell WI production is shown in the next chart and during 2020 averaged 83 kboepd. This has exhibited a relatively low decline of ~ 10%/annum due to a curtailed capital programme limiting the number of new wells in particular, that were drilled. This was obviously a consequence of the significant fall in oil price during 2020 from the second quarter onwards and highlights the capital flexibility in an established onshore asset base.

The percentage displayed on the chart for each year references the split by hydrocarbon type; with approximately 2/3rds gas and 1/3rd oil, condensate and NGLs. Going forward, in the right investment climate, we will work with the JVs with the aim to grow production back to historical WI levels of approximately 100 kboepd or 50 kboepd net to Cairn.

There are two main processing facilities, which have recently undergone life extension work and there are ongoing process enhancements in relation to produced water handling and gas treatment.

The majority of Shell's entitlement oil and condensate is currently exported, while the gas is sold domestically to EGPC via the Western Desert gas complex. The acquisition includes ownership in the main transportation infrastructure to deliver hydrocarbons to the point of sale including third party gas via the Obayied facilities.
Oil from the BED and Obayied facilities is delivered to the Hamra oil receiving terminal on the Mediterranean coast. This western desert grade has historically sold at prices close to Brent.

The western desert is of course a well-established oilfield sector with a competitive playing field for service companies. This allows rigs and services to be contracted and executing new activities on a fast cycle time. We will aim to work together with Cheiron, who already operate in this area to deliver synergies and reduce costs whilst maintaining safety and efficiency.

I'll finish on the forward plan. Following completion, we aim to maintain the excellent HSSE performance that has been delivered historically in partnership with EGPC. We will look to maintain and leverage the infrastructure to aid development and production of further resources.

Beyond 2021, we will look to direct new capital to the best infill, satellite and process enhancement projects to arrest declines and grow the production base. Concurrently, we will baseline, verify and develop a GHG emissions reduction plan to build on the work already done by the current Operator. This initial focus is likely to be electrification to reduce diesel consumption and reducing routine flaring, consistent with Cairn's commitment to the World Bank's global gas flaring reduction initiative. We will also examine further initiatives tied to the host government's Nationally Determined Contributions to the Paris agreement.

But it would be wrong to just focus on the short term; these assets have the potential to produce out beyond this decade and can both survive in a low-price environment and thrive in a higher price environment.

Finally, we will establish a presence in country and look to work with our new JV partners and prepare for Operated exploration activities. And at this point, I'll hand over to Eric to tell you more.

Eric Hathon:
Thank you, Paul. Good morning everyone.
Turning to slide 20, Exploration at Cairn is entering an exciting new phase. Our entry into the Western Desert provides us with numerous targets across multiple basins, from near field exploration to deeper

wildcats, all in a province with a historical discovery rate above 50%. Importantly as James said, Cairn will operate exploration in three large concessions with lots of potential. More on that shortly.

As Simon said, In the UK we are beginning our drilling campaign with Shell and in Mexico we are following up on our success at the Saasken discovery with more exploration drilling. We continue to mature the other targets in our portfolio in Suriname, Cote d'Ivoire and Israel and remain on the hunt for select opportunities which fit our Advantaged Barrels criteria; high value and/or low-cost resource, with optimised development time, sufficient scale and good fiscal terms.

Turning to slide 21 we'll first focus on Egypt. The Shell acquisition presents a host of opportunities for exploration in a proven super basin which frankly just keeps on giving. As you see on the slide, there are myriad leads and prospects identified by Shell with material potential. We are working this inventory in detail now. Given the maturity of the infrastructure in the Western Desert even modest discoveries have a high chance of being commercialised.

Turning to slide 22, the Western Desert provides a host of often stacked targets, from Palaeozoic sands over 250 million years old right through to Eocene carbonates less than 50 million years old. The entire prospective section is up to 5 kilometres thick. While much of the success has been focused in the Tertiary and Cretaceous-aged sections, recent activity is opening up deeper plays in the Jurassic and Palaeozoic sections. There are even unconventional-style opportunities operators are starting to investigate. Of course, our partner Cheiron bring a deep knowledge of the basin.

Now on slide 23, I am particularly pleased with the acreage Cairn will be operating. We are 50:50 partners with Cheiron in the West El Fayum, Southeast Horus and South Abu Sennan concessions, which together cover almost 9,000 square kilometres. These were awarded to Shell in 2020 and are still in their first exploration phases. There is significant activity ahead, including two new 3D acquisitions and nine commitment wells. We have had a team working these concessions for some time now and are in a good place to start the exploration campaigns, aided by our partner who is active in the area. The pie chart shows the scale of the opportunity in these three concessions. There is significant growth potential. Of course, these are more frontier exploration blocks which have seen some activity in the past, so it will take new ideas, better seismic and a broad vision of what's possible to maximise the value.

Turning to Slide 24, in addition to our new acquisition, we remain focused on the rest of our programme. In the UK we will be spudding our first well in the Jurassic Fulmar sand play with our partner Shell in just a few months' time, targeting over 30 million barrels gross within 15 kilometres of the Shell-operated Nelson platform. With success this could be on production in three years as a subsea tieback. Follow on next year will come from the Cairn-operated Diadem well, just south of Nelson. Again, a relatively quick subsea tieback with success. And with encouragement we have other similar prospects to target.

Turning to Mexico where we will resume our exploration campaign in Block 10 with the Sayulita-1 well targeting amplitudes analogous to the Saasken discovery, which completed just over a year ago. We may also appraise the Saasken discovery later in the year. There are multiple such amplitude-supported targets in blocks 9 and 10 which can form a hub concept for development.

Turning to Suriname on slide 26 success continues to march east toward our block. Following on four discoveries in a row in Block 58, Petronas and Exxon announced a discovery in December on block 52, just to the west of our block as the map shows. We have identified numerous targets at multiple levels, including several of a similar style to the discoveries, and we are planning a 3D acquisition programme in the future.

In summary, we are accelerating our exploration programme after a sensible pause in 2020. We have new, operated acreage to mature in our exciting Western Desert acquisition, we have exploration drilling in the UK and Mexico, and we continue to mature the rest of our portfolio to drill decisions in the near future with very modest capital expenditures. Lots to do in Exploration.

Now back to you Simon.

Simon Thomson:
Thank you Eric. So, in conclusion we have taken a pivotal step in our strategic ambition to grow and diversify Cairn's production base to provide a sustainable platform for differentiated growth over the next decade and beyond as we seek to responsibly produce hydrocarbons in support of the UN Sustainable Development Goals.
Our retained balance sheet strength and financial flexibility affords us the ability to consider additional opportunities and we continue to provide exposure to significant exploration upside from an actively managed portfolio.

Ongoing capital discipline ensures that investment opportunities are continually ranked against the potential for further returns. As I previously stated, the portfolio is managed and financed excluding the value of the Indian arbitration where, notwithstanding ongoing dialogue with the Government of India, we are actively deploying robust recovery options to safeguard shareholders' rights to the value of the award.

We look forward to updating you on our progress in the coming months. Thank you, I will now hand back to the Operator for questions.

Nathan Piper:

Thank you. Morning, everyone. Thanks for the call and the backdrop on the deals. I wonder if I could ask why you're swapping high margin oil exposure for low margin gas rated production, and why don't you keep them both? I mean, I recognise it's short cycle and I see the opportunity there to start reinvesting there as Shell stopped. Will this become clearer with future deals you've got planned, and are you effectively trying to build the company so that you can pay a regular dividend?

And just one last one. Is it also a suggestion that there's a lack of attractive deals in the UK North Sea? It seems a bit of a surprise with these tax losses and also, given you've got exploration coming up, potentially more tax losses and utilising them to the existing production. I guess, can you pull a deal together? Because there's nothing wrong with having oil and gas in the deal.

Simon Thomson:

No, there isn't, you're right, but it's not about swapping so much, as about renewing and regenerating. As we said, these assets are at the point of entering natural decline. So for us, and I think we've been very open about this, as we said, looking to grow and to diversify the production base. We want to do that from a platform that's sustainable and has upside growth potential. So, from our perspective, it's perfectly natural to dispose of assets at what we believe is the right point of the cycle, and to reinvest in a region where we see considerable growth potential.

You're right that this is a pivotal step, as I said, but it's not the only step, and we believe that there's more that we can do in terms of adding to the portfolio. You'll have to leave that with us to come back to you. But in the meantime, this in itself is a material transaction, and actually, with the fiscal terms in Egypt. It's gas weighted, but there's also liquids production. I would say these are pretty attractive from a fiscal perspective as well. I'll maybe let James answer on the tax losses point.

James Smith:

Just to sort of reiterate your point on the first question, the UK sale was not undertaken in order to enable us to redeploy that capital into Egypt. As you saw, based on our year-end cash position, post dividend, we were well-placed to fund the Egypt acquisition anyway. The UK transaction was, in our minds, the right portfolio move and the right economic decision based on the deal terms in its own right. And obviously, as you alluded to, it positions us to do more in terms of building the portfolio, if we see attractive opportunities to do that.

On the specific point about tax losses in the UK, lots of asset buyers in the UK have plenty of their own tax losses. In fact, most do. And so just in structuring terms and in terms of the commercial reality of it, if they're not of value to the purchaser, then we may as well retain them. Clearly, they will have some value in the event of exploration success in the UK. They have some theoretical value if we were to look at further deals in the UK. We certainly don't rule that out. And so it made sense for us to retain part of those losses. Part of them will transfer to the purchaser.

Nathan Piper:

Okay. Thank you. One just quick follow up, please. You're obviously shifting a different type of political risk in UK North Sea versus Egypt. I wonder if you'd give a bit more colour on the payment history within these assets. I mean, I know we're just beginning to catch up on quite significant arrears we've had in the past with certain players. So, maybe a bit of colour there. And I guess I was alluding to whether you're planning to set the company up to pay a regular dividend, other than the specials that you've done over the years.

Simon Thomson:

Well, let me deal with the dividend point first of all, and then James can deal with payments. As you know, we are very focused on returns, providing returns to shareholders, and that's always a balance against disciplined reinvestment of capital in the business. Today, we're not of a scale where a regular dividend is appropriate, looking at the kind of reinvestment cycle we've got. Obviously, we have India ahead of us in terms of further potential for returns. And obviously, if we get to a scale that we believe gives us the flexibility to contemplate a more regular form of dividend, then that's something we'll look at. And I hope that our track record speaks for itself in terms of the focus on routes to returns to shareholders. James.

James Smith:

On the payments point for hydrocarbon sales to the state in Egypt, obviously that has been a key focus for international investors in Egypt for some time. To your question, I would say it was very much more than beginning to catch up on that situation in Egypt. I mean, there has been a very significant improvement in restructuring in recent years to normalise that, and we see a massively improved position on that front.

During the course of looking at this transaction, we saw the receivables position grow a little bit, as you might have expected, following the shock of Q2 of last year, but then equally, we saw it improve significantly on these assets through the latter part of last year. So, it's being actively managed, and I would say that the track record is pretty strong. Clearly, we'll be coming in with a story of reinvigorating investment in these assets, which we expect to be welcomed by the government.

Operator:

We'll now take our next question. It comes from James Thompson of JP Morgan.

James Thompson:

Morning and congratulations on the deal. First couple of questions on Egypt. I mean, obviously it's going to take a few months now to get all the approvals in place and actually get onto the licences. When I look at your production profiles going out through to over the next three or four years, you've obviously got a very significant ramp up in 2022. I just wondered how achievable that is, given you may not be operating the licenses until the back end of 2021. First question.

And then, in terms of the gas/oil mix, it looks like on the reserve split, the licence is the one which is probably most, I suppose, go-gettable from a production growth standpoint. Does that mean this is going to become a more gas weighted portfolio over the next couple of years? So that's my question, thanks.

Paul Mayland:

Thanks James. I guess the beauty of these assets is, it's in a very well-established area. And it's got quite a long budget cycle process, which is quite helpful in terms of setting out your overall capital program. But you can obviously adjust it fairly quickly. And that can be in the case of 2020, they obviously laid down quite a few rigs and services and reduced the activity. And the contrary to that is obviously in the right investment environment, you can ramp it back up. So, I think we're relatively comfortable that providing we see completion in a reasonable time period, then we can start to obviously shape the activity levels in 2022. And we've already identified what I would describe as quick wins.

In terms of the gas oil mix, both in terms of the last question and this one, is clearly in a higher oil price environment, you would probably target more of those opportunities. And likewise, obviously in a lower oil price environment, you may target more of the gas opportunity. So, I think it offers that flexibility as well in terms of where you direct your capital in terms of thinking about the returns.

James Thompson:

And so, for the capital program, have you got a rough estimate of what the CAPEX is going to be to get the assets back to £50,000 a day net return?

Paul Mayland:

I think with last year we saw a capital program that was under a hundred million dollars gross. I think you're probably looking at growing that, potentially up to, 80 to a hundred million net to Cairn, to double that for the consortium.

James Smith:

And that's what you see on slide 12 of the presentation this morning, the high-level numbers around that. You'll see, as I mentioned, a lot more detail in the circular when we publish that to shareholders. But I think the key point here is that that significant delivery of growth, potentially 40% to 50% of production growth we anticipate will be self-funded. So, can be funded out of operating cashflow within Egypt over the next couple of years. And then clearly when we get there, that puts us in a much stronger free cashflow position.

James Thompson:

Okay, thanks. And James, while you're there, just in terms of the India consideration. You're now talking about 1.7 billion, 500 million in interest, that is higher than when you last talked about the post consideration from India. So, what's driving that change? And then in terms of the processes you made out, clearly you're not going to be drawn on particular timeframes or anything like that perhaps, but just in terms of the enforcement measures that you are pursuing, or at least name the groundwork for, at what point you start becoming more active in those processes?

James Smith:

So, on the interest amount, I don't think we've previously quantified it. But, well I said, 2.75 annually. It's actually 1.375 over libor, calculated semi-annually. And as I said, backdated to 2014. So that's obviously, over seven years that is the quantum. And it continues to grow. So, in terms of the timing, as you'd expect, we're not going to be drawn on giving specific guidance. I think all we can say is that we have been taking all the necessary preparatory steps to make sure that we're ready, based on the enforcement front. And that we've progressed discussions around monetizing and risk sharing for this in the event that we don't reach a timely accommodation with India directly.

Operator:

Our next question comes from Rachel Fletcher of Morgan Stanley.

Rachel Fletcher:

Morning. I wonder a little bit about your net zero target. I'm not sure if this is something you've officially talked about before. I just wanted to know, is this stroke one and two? Or because now you have a more gas focused portfolio and you also mentioned VCUs, does it also include scope three? And then in terms of bringing down your emissions, what other steps do you plan on taking to do this? Thanks.

Paul Mayland:

Good morning, Rachel. Thanks for that question. We are at this stage primarily focused on scope one and scope two. Recognising we're only in the upstream part of the business. In terms of net zero, I guess we've made a commitment for some time aligned with our fellow BRINDEX members about supporting, the UK Government's aspiration to reach net zero by 2040. One of the reasons for being in the NEXUS consortium is working not just with other E&P players, but also industrial players to really understand the scope of that challenge. And where CCUS may play a role particularly in the UK, and whether we can contribute in some towards that.

In terms of the general emissions reduction. The number one step obviously is energy efficiency. So, looking for ways, particularly in our operations operated, or non-operated through all of the phases, exploration, appraisal, and production as to how we can use energy better. And then where we have emissions, so for example, in the case of the portfolio that we'll hopefully be acquiring in Egypt, where we can actually make a difference there and reduce them. So, you've seen that we stated that we do need to do our own baseline survey verification plan and identification of targets, where we believe we can potentially reduce things and improve the overall emissions from those fields that have obviously been producing for several decades.

Operator:

Our next question comes from James Hosie of Barclays, please go ahead.

James Hosie:

Hi, good morning. Just a couple of questions from me, on first the Egyptian assets. Can you outline just what determined the gas pipe that you've received there is at spec? So, in terms of benchmark. And then secondly, if you can provide detailed carbon footprint of these assets, for example, scope monitor emissions for BOE and how that compares with the UK portfolio you're divesting?

James Smith:

You'll see, again more detail on the gas pricing. But I think for the purposes of your modeling, you can think of it as basically fixed $2.60 or at least average across the portfolio. At the extreme ends there is some Brent linkage, but thinking about it as basically fixed gas price is probably the simplest way.

Paul Mayland:

On the emissions is obviously we've got to recognise that ... Well, not just for these assets, but assets and generally they'll obviously a function of the maturity or how new they are. So, your assets that have been built and constructed in the last few years are obviously going to be probably more energy efficient and therefore lower emissions than assets that were potentially built one or two decades ago. That in no way excuses us from not looking for significant improvements. So, the actual emissions from the Egypt assets are about 1.2 to 1.4 million tons per year, which equates ... It's about average for Africa on your IOGP benchmarking of an intensity of about 30 kilograms per CO2, 30 kilograms CO2 per barrel of oil equivalent, which is obviously higher than our North Sea assets. But obviously, the main reason there is cracking and catcher assets that were constructed in the last five years.

James Hosie:

Okay. Thanks for that. Just one more on the North Sea asset sale. Why did you not consider proposing a further special dividend given that you've already mentioned that you do have the resources in Egypt to deal without selling those assets?

Simon Thomson:

Of course, we continue to look at everything we're doing against ... set against the prospect of further returns to shareholders. And obviously as you know, very recently we made a considerable return. But we do see the opportunity to add to the portfolio. As we said over recent months, we think now is a good time to be adding with some of the disposal programs that are in place. So, as I said, this is a pivotal step, but it's not the only step that we are contemplating. So, we think there's more that we can do.

Operator:

Our next question comes from Chris Wheaton of Stifel. Please go ahead.

Chris Wheaton:

Thank you. Good morning. A few questions from me if I may. Could you just go back to the CapEx slide for Egypt. I think it's slide 12, just to understand there. Is that kind of 90 to 100 million is CapEx left to care, that kind of steady state number that you would expect to hold production around 50,000 a day net to you?

James Smith:

I would say this in the early years there's certainly some catch-up against a couple of years, at least of significantly diminished activity from the current owner. So, there's a certain amount of catch-up to accelerate production, which has declined over the last couple of years, as I said, from a net basis of 35 to 50 for us. So, I would say the steady state CapEx is lower than that. But as I said, you'll see in I hope, a short number of weeks full life of field production and cost projections by licensing our mineral expert report. At least, for the drilling opportunities that have been identified already.

Chris Wheaton:

Okay. My next question was going to be about how much you're going to have to spend on both converting the 2C into 2P. But, also going after the exploration, because ramping up production to 55,000 a day really starts to cut into your reserves production ratio. And that suggests to me that you're going to have to spend. You'll be running on an expiration treadmill quite significantly. I'm trying to work out what this steady state pre-cash flow is for this business. Coming out on your 2024 number, about 100 million a year. But that's going to be less than that if you have to spend money on the teasing and the exploration in order to give you that runway on that longevity on the assets. So, could you help me understand. Does that 100 million number seem right? And if not, then how much of an additional CapEx is going to have to be spent on exploration on the top of what you've identified in slide 12, looks to be just operational campaigns, rather than exploration as well?

Paul Mayland:

In the near term anyway, this is a portfolio pretty rich in opportunities in and around the fields, which is obviously being classified, as you've seen the circular, both in terms of reserves and contingent resources. And obviously, we will move to invest and convert the reserves into production, predominantly maybe not exclusively, but predominantly in the first couple of years. There are some discoveries that have also been made with several wells already drilled. Some of those are producing, but the area isn't fully developed. And then we'll probably look at those in the sort of ... could see in the sort of 2024, 2025 category. So, I think that's where we'll be directing the capital probably in the next period of time. And in addition, Eric can just touch on, there's obviously these three new expiration blocks, which we're quite excited about, which have got commitment wells associated with them.

Eric Hathon:

So those three blocks certainly, but then also the blocks to the North, which we only briefly touched on. North Ambarica and North Maturo where there are a couple of wells to be drilled this year for exploration. But one of the attractions here is the wells, these are two to $5 million wells, depending on the depth and the complexity to drill, which is quite a bit different from even in shallow offshore. So, you get a lot of bang for your buck for exploration. And then again, with the amount of infrastructure, as I said, you can bring even modest discoveries online commercially, which is what drives up the success rate. So, you're right, there will be significant activity. But if I have to have exploration activity, this is the place to have it.

Chris Wheaton:

Okay. Thank you. One last question please, following up on some of the earlier questions on ESG. What do you see as the carbon mitigation strategy for these assets, given that you've got disparate well stock, geographically widely dispersed well stock. I presume, lots of which is running off natural gas at the moment, and I'm guessing it would be expensive to electrify. I'm just interested in your thoughts about that and that sort of five to 10 years basis.

Paul Mayland:

Actually, it's a little bit different from that, but you're on the right theme. There's basically about 100 diesel generators across the facilities. And obviously, the focus of them in the near term will be conversion to gas. So, I think that will make a difference. The second step which we'll need to look at in terms of the overall process, as I mentioned, is a reduction of continuous routine flaring ...

Reduction of continuous routine flaring, which contributes about 14 to 15% of the overall emissions. So, we'll be looking at that. And then, longer term, there's some studies that the current operators are done that we'll need to look into further, which is really to do with use of CO2, either sequestration or potentially miscible flooding in some of the oil fields. But I'd say that a longer cycle project.

Operator:

Our next question comes from Mark Wilson of Jefferies. Please go ahead.

Mark Wilson:

Hi, good morning. I might pass firstly regarding the Egypt asset and try to visualise the activity that's required there in a physical sense. Just how many rigs were running across those licences in the years 2017 to 2018, versus now and so how many rigs you would look to get back to in order to increase the production. So just how many drilling rigs in the past versus what we'd expect to get back in the future.

Paul Mayland:

The specifics of every year might be beyond my memory, but certainly I can give you a flavor of what has operated in the past. So, they've probably been at a peak in the past of around seven rigs operating and they've probably been a low, particularly last year of around two. I would imagine the sort of program that we're outlining is probably somewhere in between that range. So probably more around about the four mark and we could envisage potentially drilling 40 to 50 wells per year rather than 20, which occurred last year. But a lot of that is also down to working out an optimal contracting and execution strategy over a number of years. So, it may not be necessarily as peaky as up and down, you'd rather have it obviously stable and driving continuous improvement. So that's sort of what we'll be looking at.

Mark Wilson:

Anyway, same question for James. Just some details on the UK disposal event, you mentioned the £144 million working capital adjustment. So we either take that off that the year ended at £320 or off the headline figure the first of January. Is that correct?

And then the second part of that disposal, just to clear up, are there any preemption requirements for partners on either deal actually, in Egypt or in the UK, and are you completely interested in decommissioning requirements across both cracking and catcher? Thank you.

James Smith:

That's the right way to think about the interim period adjustments. So effectively the effective date of the deal was 1st of January 2020. In practice, we will retain the cash flows, therefore they're recognised on our balance sheet at the year end and they will be deducted from the purchase price. So, either of the rates you described comes out with the same performer answer.

There's not preemption and it is a clean exit, yes. So, we have no residual exposure to liabilities relating to the assets. The only residual exposure we have is on the upside obviously relating to all price and production, as I mentioned.

Paul Mayland:

Just to clarify, there are obviously the preemption rights in Egypt, but you're correct as James alluded, there's no preemption in the North Sea.

Mark Wilson:

Okay. All right, thank you. If you can just spin through the contingent upside on the Adriatic. It seemed quiet material actually. You mentioned over a hundred million in revenue.

James Smith:

Yes, that's right. So basically, it's quite an extensive announcement this morning on the UK transaction, because it will be a Class One transaction and therefore subject to a shareholder vote. So, there's a lot of detail on the transaction terms in that announcement. And you'll see midway through that, the exact mechanism for the earn-out. But basically over the next five years, including this year, it's a percentage of revenues that are generated by the oil price being over $52 uncapped. And so what I mentioned was our estimate of Brent being at 65 over that period with the production profiles we expect from those assets generating a further $125 million of consideration.

Operator:

We'll now take our next question. It comes from Peel Hunt. Please go ahead.

Peel Hunt:

Just a quick one on the UK. So, I was wondering if Jaws and DIADEM don't work, would that trigger your complete exit from the UK oil industry in effect?

Eric Hathon:

Well, no. I wouldn't rule out an area that has such good fiscal terms, strong hydrocarbon delivery and a long history. I mean, we look at each thing as it comes and if good opportunities pop up in the North Sea we'll pursue them. But for right now we'll just remain focused on the program we have as well as some of our other licenses, particularly in the East Orkney Basin where we're also maturing.

Operator:

This concludes our question and answer session. I would now like to hand the call back to Simon Thomson for any additional or closing remarks.

Simon Thomson:

Thank you everybody for listening in. I appreciate the questions. Obviously, if you've got any follow-ups, please do let us know and in the meantime, we look forward to reporting to you on further progress. Thanks very much for your time.