3Q 2018 Conference Call Transcript

Wednesday, November 14, 2018

8:00 AM MST / 10:00 AM EST

Executives

Charle Gamba – President and Chief Executive Officer
Jason Bednar – Chief Financial Officer

Operator
Good day and welcome to the Canacol Energy Third Quarter 2018 Financial Results Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star (*) key followed by zero (0). After today's presentation there will be an opportunity to ask questions. To ask a question you may press star, (*) then one (1) on your touchtone phone. To withdraw your question, please press star (*), then two (2). Please note this event is being recorded. I would now like to turn the conference over to Carolina Orozco. Please go ahead.

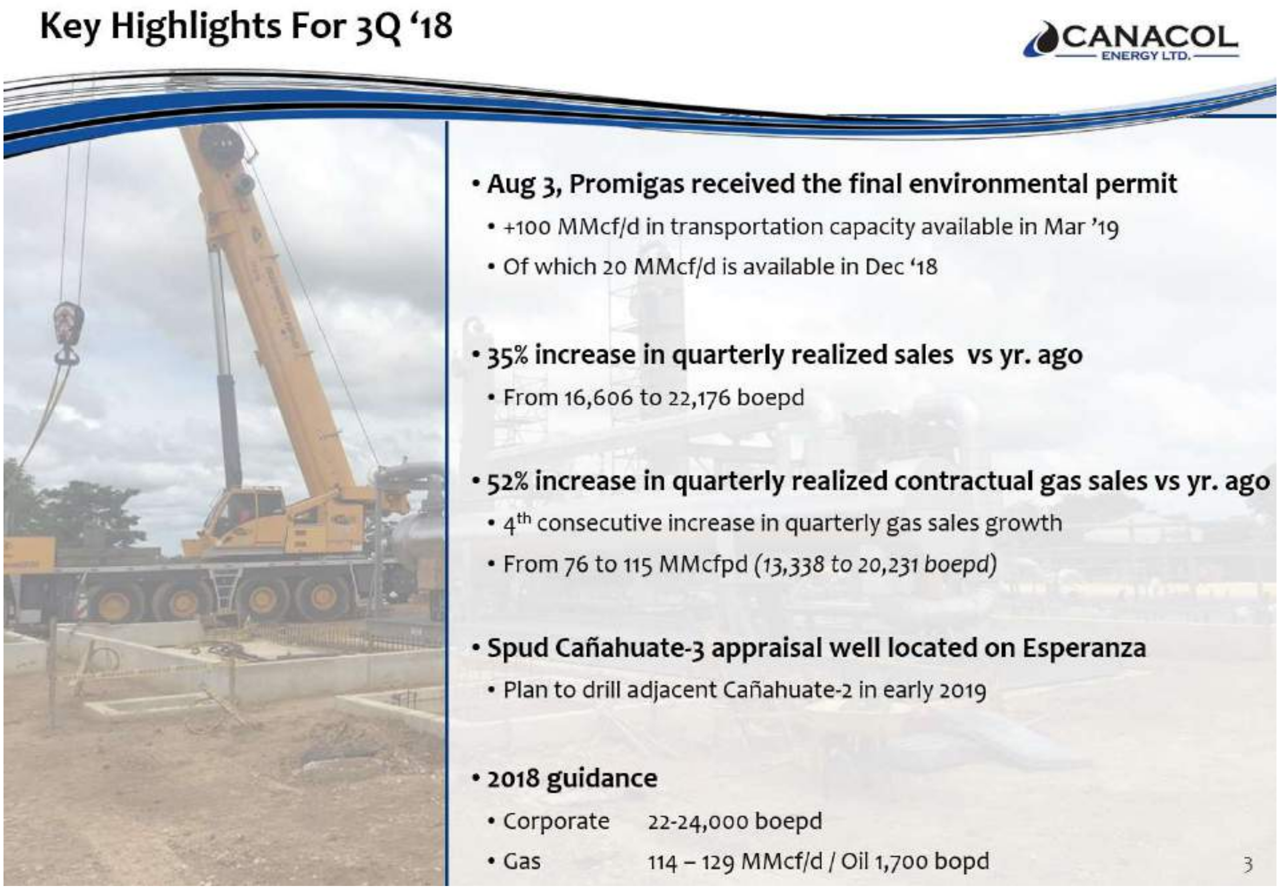
Carolina Orozco
Director of Investor Relations
Good morning and welcome to Canacol's Third Quarter 2018 Conference Call. This is Carolina Orozco, Director of Investor Relations. I am with Mr. Charle Gamba, President and Chief Executive Officer; and Mr. Jason Bednar, Chief Financial Officer.

Before we begin, it is important to mention that the comments in this call by Canacol 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 U.S. dollars.

We will begin the presentation with our President and CEO, Mr. Charle Gamba, who will cover the operational highlights for the third quarter 2018. Mr. Jason Bednar, our CFO, who will then discuss the financial highlights. Both Mr. Gamba and Mr. Bednar are joining us from Bogota. Mr. Gamba will close with the discussion of the Corporation's outlook for the remainder of the year. A Q&A session will follow Mr. Gamba's closing segment.

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

Charle Gamba
President and CEO



Thank you, Carolina, and welcome to Canacol's Third Quarter 2018 Conference Call.
During the third quarter, we made solid progress towards executing and delivering our 2018 gas sales target, all the while maintaining our focus on growing our gas business to 230 million standard cubic feet per day in 2019. These efforts will make Canacol, Colombia's largest independent producer of natural gas after Ecopetrol, state oil and gas company.

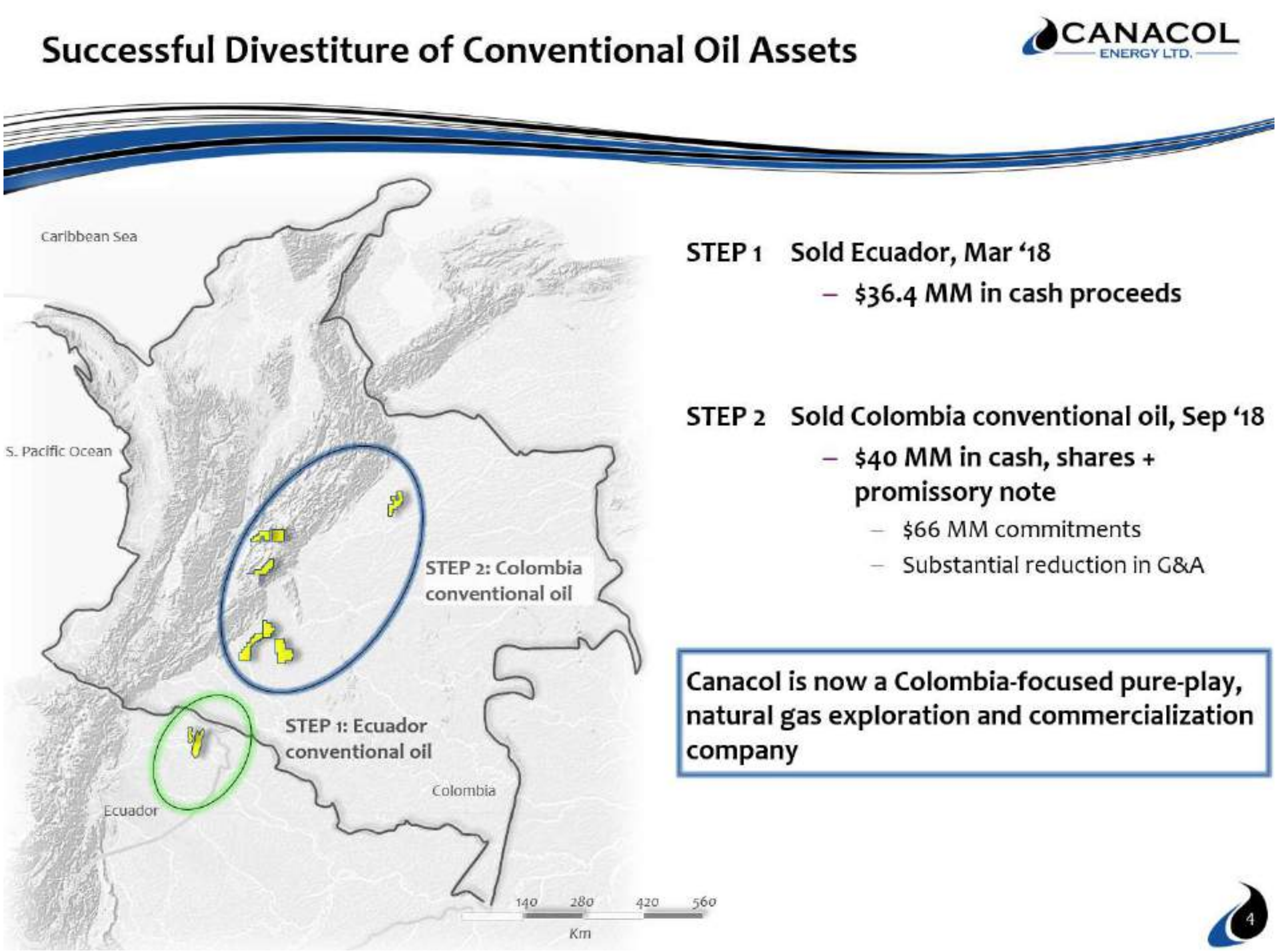
I'm pleased to report that for the third quarter of 2018, our gas and oil sales average 22,176 barrels of oil equivalent per day, a 35% increase compared to the same period in 2017. The third quarter of 2018 marked the fourth consecutive quarter of natural gas sales growth, which increased 52% from 76 million cubic standard feet per day for Q3 of 2017, to 115 million standard cubic feet per day for third quarter 2018. During the third quarter of 2018, our average oil production was 1,945 barrels per day.

During the three months ended September 30, 2018, we completed the Canahuate-3 appraisal well on our Esperanza block which took approximately four weeks to drill. We plan to drill the adjacent Canahuate-2 appraisal well in early 2019. The two wells are located in separate fall compartments on either side of the Canahuate-1 exploration discovery which we announced in May of 2017.

During the three months ended September 30, 2018, the Chirimia-1 appraisal well located on our VIM-5 block was production-tested at 15.4 million standard cubic feet per day directly into the existing flow line connecting all of the Clarinete producing wells to Jobo.

As mentioned previously in August, Promigas SA received the final environmental permit required for the expansion of their gas pipeline from Jobo to Cartagena and Barranquilla. We are currently transporting approximately 100 million standard cubic feet per day along this pipeline to Cartagena and Promigas is investing approximately $180 million in this expansion project which will add an additional 100 million standard cubic feet per day of new transportation capacity to the existing pipeline with all of the additional capacity assigned to Canacol.

Promigas anticipates that all of the additional 100 million standard cubic feet per day of capacity will be available to Canacol in March of 2019 with the first 20 million standard cubic feet per day available on December 1, 2018. This will lift Canacol's gas sales by approximately 20 million cubic standard feet per day to approximately 140 million standard cubic feet per day on December 1, 2018 and will lift Canacol's gas sales another 80 million standard cubic feet per day to approximately 220 million standard cubic feet per day in March of 2019 when the entire pipeline expansion project is scheduled to be completed.



During 2018, Canacol transformed into a Colombia-focused natural gas exploration and commercialization company via the divestment of our conventional oil assets in Ecuador and Colombia for proceeds of $76.4 million. With approximately 90% of our current and future gas sales volumes priced under long term U.S. dollar denominated take-or-pay contracts, our future cash flow is predictable and stable and completely detached from the volatility of world oil prices.

On September 28, we closed the sale of the majority of our remaining conventional oil assets in Colombia with Arrow Exploration Limited. The aggregate consideration of $40 million consisted of $15 million in cash, $20 million in common shares of barrel representing 22.6 million shares and a $5 million promissory note to be paid by Arrow within four months of closing.

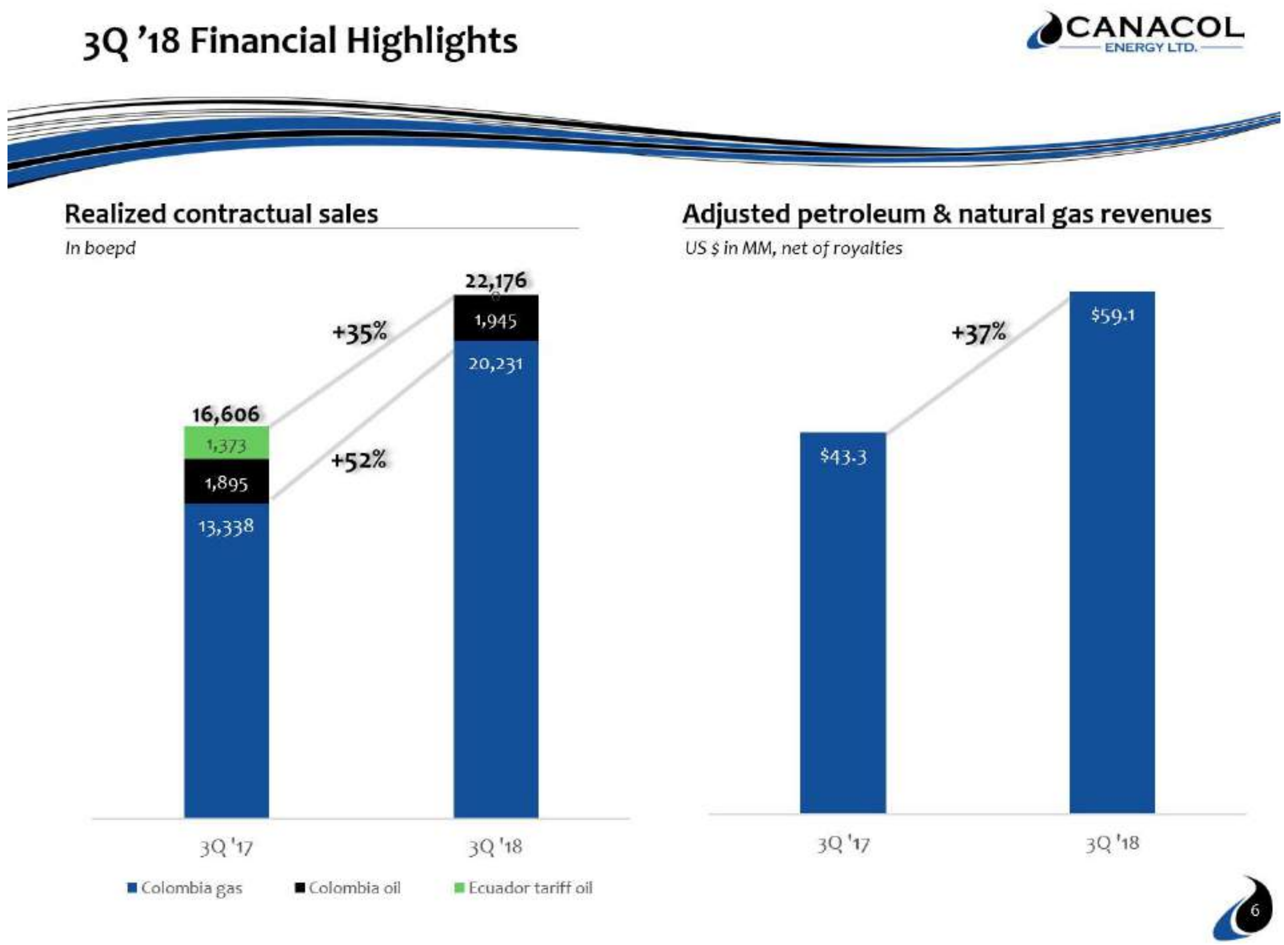
Last week, we announced the distribution of 22.6 million Arrow Exploration shares to the Corporation shareholders. These shares represent the return of capital valued at $20 million or $0.885 per Arrow share received. The effective date for the share distribution was November 6, 2018. Through the return of capital, Canacol's registered shareholders received $0.127 Arrow shares per each share of Canacol owned on the record date of October 3, 2018. Arrow's shares trade on the TSX venture exchange.

Arrow is currently drilling the Danes-1 exploration well location on the Llanos 23 block with results anticipated in late November 2018. They also plan to execute several work overs on existing wells to increase production by year-end. Canacol's shareholders who choose to keep the Arrow shares that they have received may stand to realize the potential upside associated with Arrow's current and feature exploration and production activities.

I would now like to turn the call over to Mr. Jason Bednar, Chief Financial Officer from Canacol to discuss some of the financial highlights associated with our third quarter 2018 results. When he is done, I will provide the outlook for the remainder of 2018.

Jason Bednar
CFO

Thank you, Charle, and thanks to everyone for joining us today.



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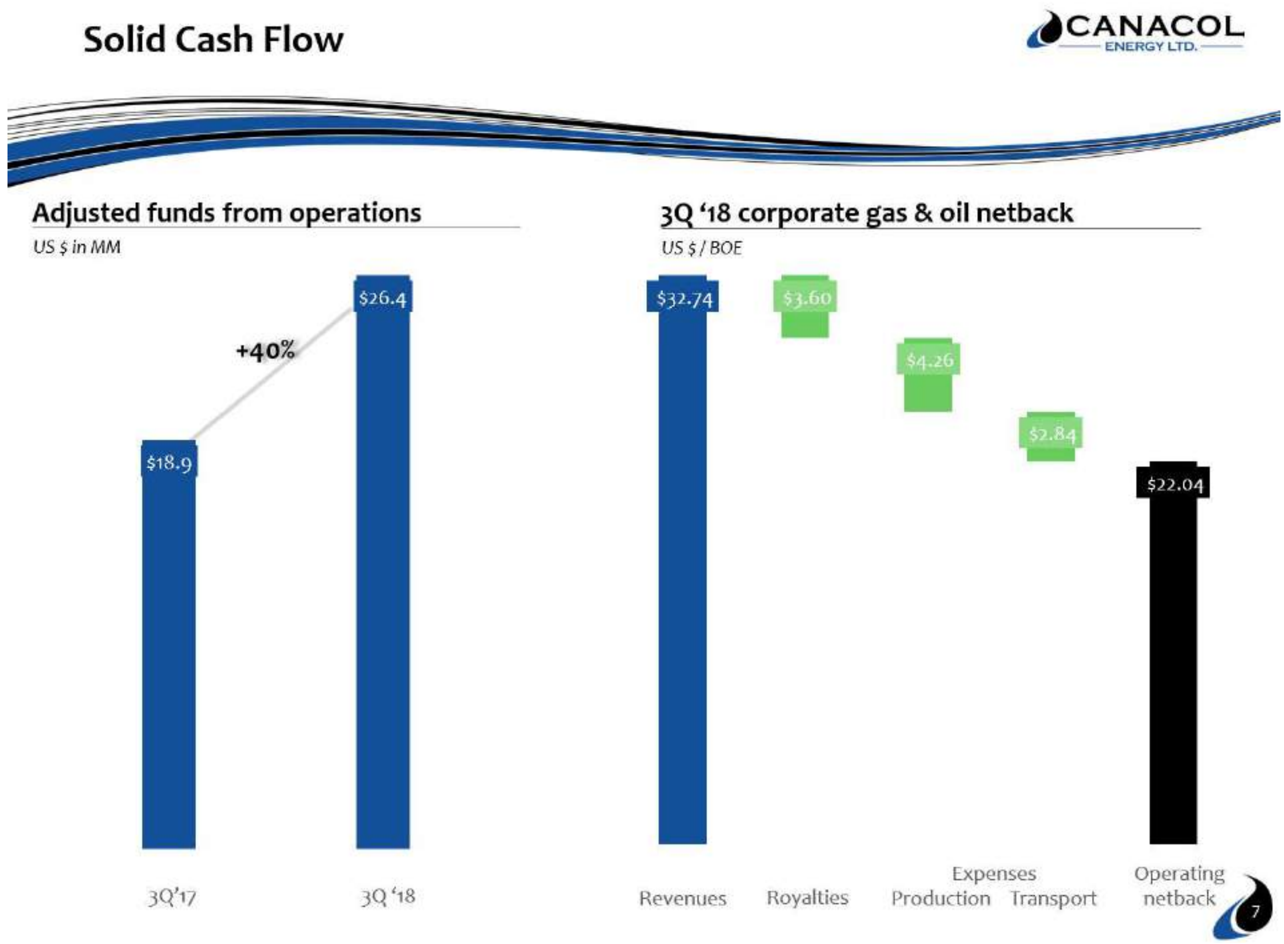
Financial highlights for the three months ended September 30, 2018 include realized contractual sales volumes increasing 35% to 22,176 boe per day, compared to 16,606 boe per day for the same period in 2017. The increase is primarily due to a 52% increase in realized contractual gas sales at Esperanza, VIM-5 and VIM 21, primarily related to the completed construction and operation of the Corporation's partially-owned Sabanas pipeline.

Although Colombian gas volumes increased year-over-year, the overall decrease in crude oil production volumes during the three and nine months ended September 2018 compared to the same periods in 2017 is primarily due to a Corporation's selling its interest in the Ecuador IPC investment on February 15, 2018.

As of September 30, 2018, the Corporation has also sold the majority of its Colombian oil assets with the exception of its interest in the Rancho Hermoso block and its unconventional oil portfolio to Arrow Exploration for a total consideration of $40 million.

Total petroleum and natural gas revenues including Ecuador were applicable for the three months ended September 30, 2018, increased 37% to $59.1 million, compared to $43.3 million for the same period in 2017.



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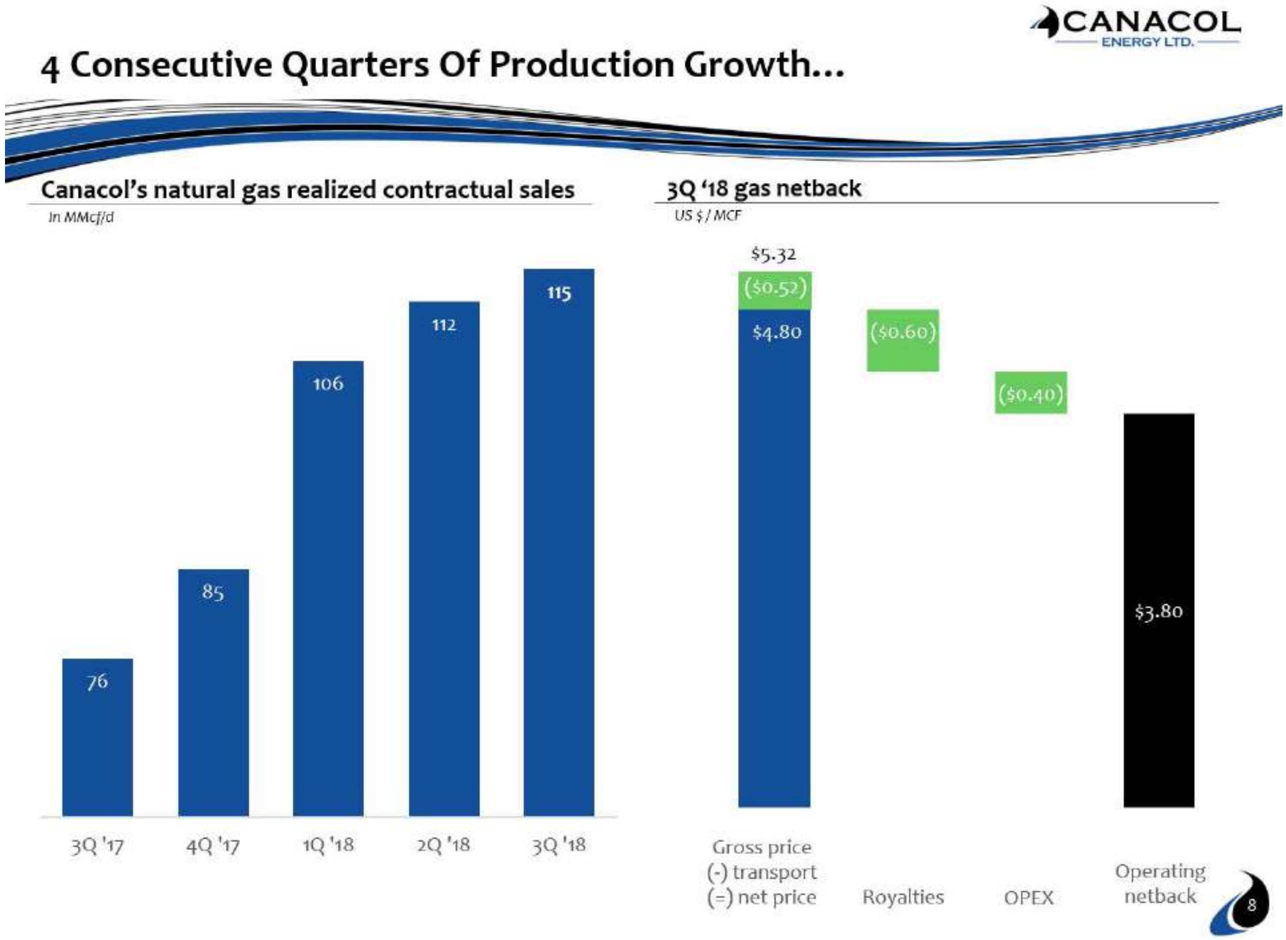
Adjusted funds from operations increased 40% to $26.4 million for the three months ended September 30, 2018, compared to $18.9 million for the same period in 2017. Adjusted funds from operations are inclusive of results from the Ecuador IPC.

Over the same period, cash from operations increased by 212% from $11.8 million to $36.8 million. In total, the Corporation registered a $22.04 per boe corporate net back for the three months ended September 30, 2018.



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The third quarter of 2018 marked the fourth consecutive quarter of natural gas production growth. Gas sales increased by 52% from 76 million cubic feet per day for Q3 2017 to 150 million cubic feet per day for Q3 2018.

As Charle asserted, we continue to work diligently towards our next goal of 230 million standard cubic feet per day of gas sales by March 2019 for which the Corporation has fully funded to achieve.

During the three months ended September 30, 2018, the natural gas averaged growth sales price was $5.32. The average sales price net of transportation, which is what the Corporation focuses on, during the same period was $4.80 per Mcf. This figure was higher than the Corporation's prior guidance of $4.75 per Mcf.

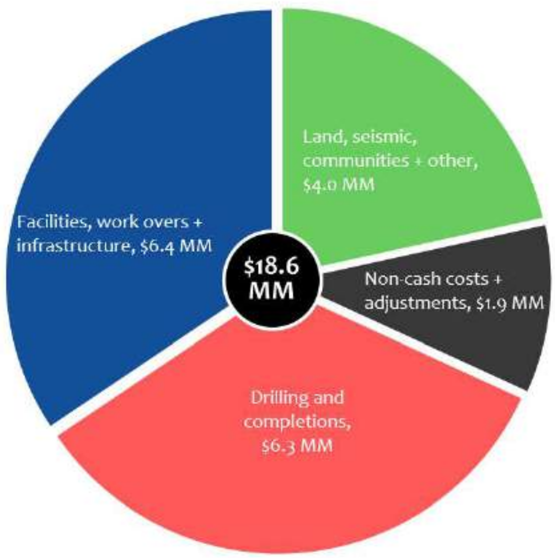
As previously discussed, the increase in transportation expenses is of no concern as it simply means that the Corporation's signed more contracts for delivery in Cartagena as opposed to the off-taker taking position of the gas at the Jobo plant gates. This of course is evidenced once again by the gas price being $4.80 net of transportation.

Gas royalties of $0.60 represented a 12.5% royalty, consistent with prior quarters and total natural gas production expenses for the third quarter was $0.40 an Mcf, down from $0.42 in Q2 with both being less than the mid $0.40 guidance provided on previous calls.

3Q '18 Capital Highlights

3Q '18 adjusted capital expenditures

US $ in MM



For the three months ended September 30, 2018:

- Jobo 3 gas plant costs
- Drilling of Cañahuate-3 and pre-drilling Cañahuate-2
- Facilities costs at Esperanza and VIM-5

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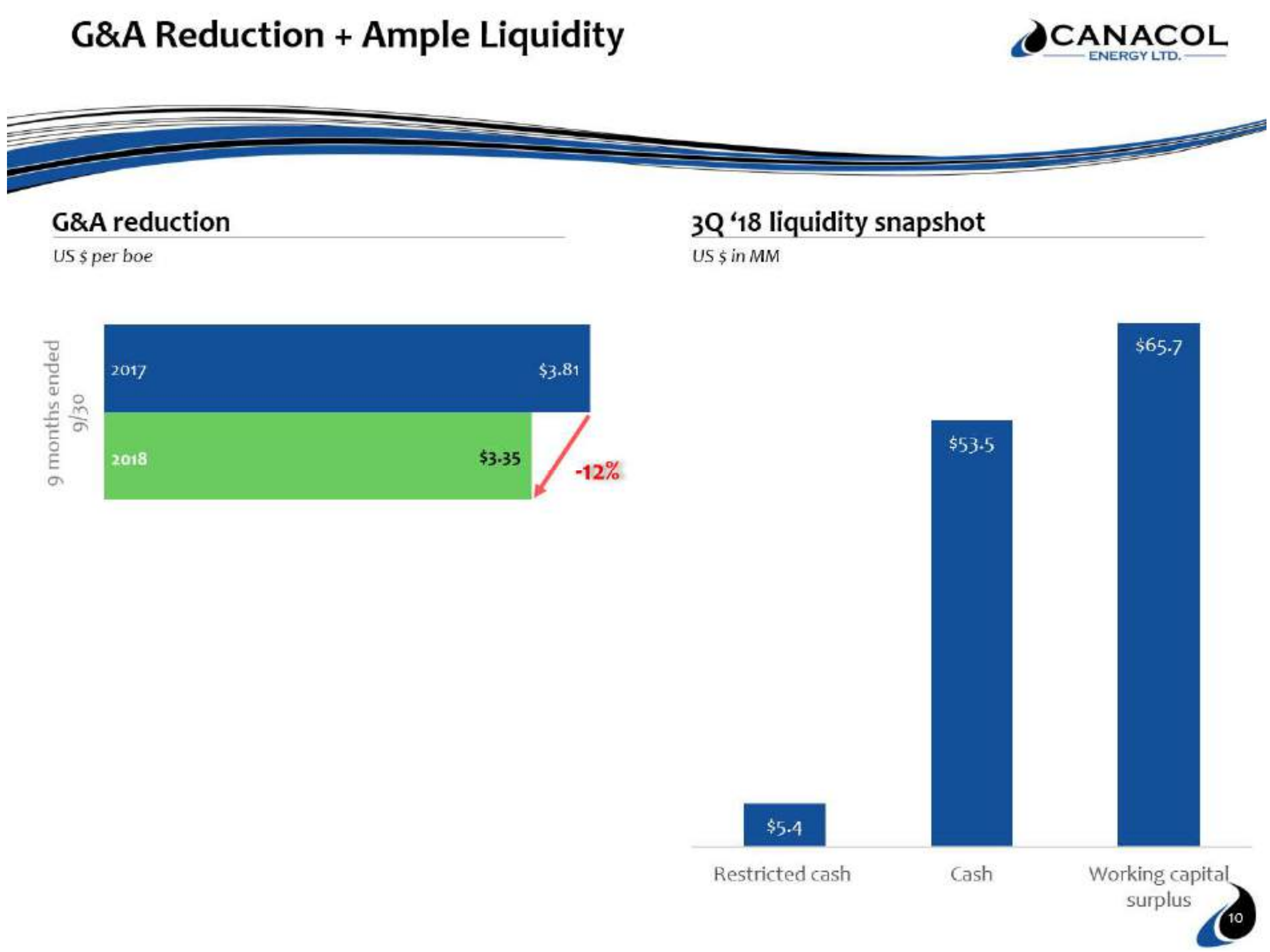
Capital expenditures in the three months ended September 30, 2018 primarily related to Jobo-3 gas plant construction cost, the drilling of Canahuate 3 and the pre-drilling of Canahuate 2 and lastly, facilities cost at Esperanza and VIM-5.

The Jobo-3 gas plant expansion will facilitate up to 330 million cubic feet a day of production, which will allow for spare capacity and future growth above the Corporation's expected production of 230 million cubic feet per day when the new Promigas pipeline is completed in March of 2019.



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G&A per boe decreased 12% in the nine months ended September 30, 2018 compared to the same period in 2017. The decrease in G&A per boe is largely a result of the increasing gas production. The G&A per boe is expected to further decrease as the Corporation's production base grows into 2019 and further into 2020.

At September 30, 2018, the Corporation had $5.4 million of restricted cash, mostly related to ANH work commitments and $53.5 million in free unencumbered cash. The Corporation ended the quarter with a very healthy working capital surplus of $65.7 million.

Perhaps some other items of note.

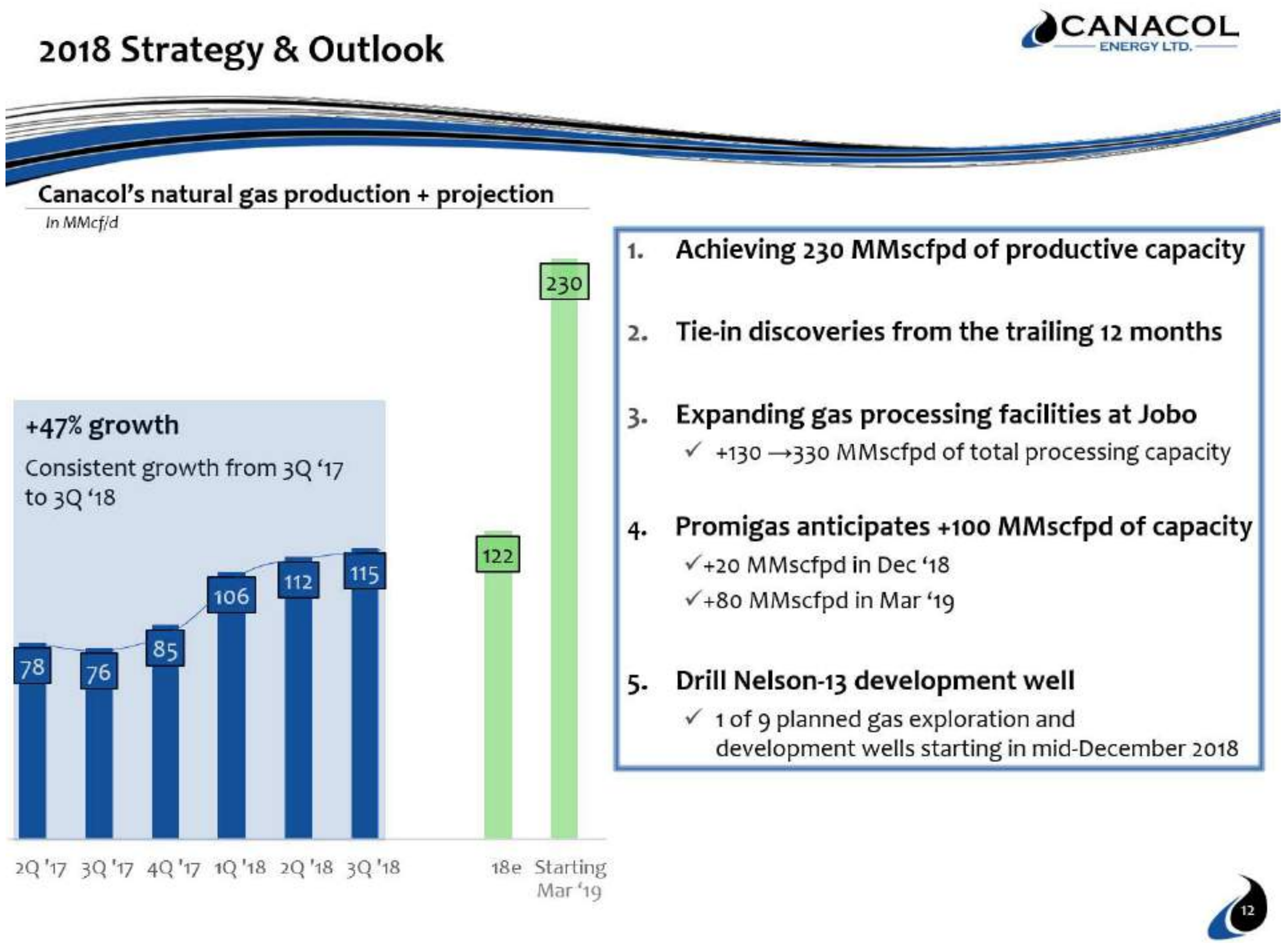
During Q1 2018, the Corporation sold its remaining shares of InterOil for proceeds of $1.9 million resulting in an overall realized cash gain of $3.8 million on the Corporation's original $3.2 million investments.

During Q2 of 2018, the Corporation sold its investment in a power generation company for proceeds of $12.4 million. These proceeds have been received on a monthly basis and will continue to be received until July 2019.

As mentioned earlier, the sale of the majority of our Colombian conventional oil assets closed in late September. We then received approximately $50 million in cash, a $5 million promissory note maturing in four months and $20 million in Arrow common shares. This totaled approximately $22.6 million Arrow shares. This amount was recently distributed to our shareholders via a return of capital.

At this point, I'll hand it back to Charle to close with strategy and outlook for the remainder of 2018. Thanks, everyone.

Charle
Thank you, Jason.

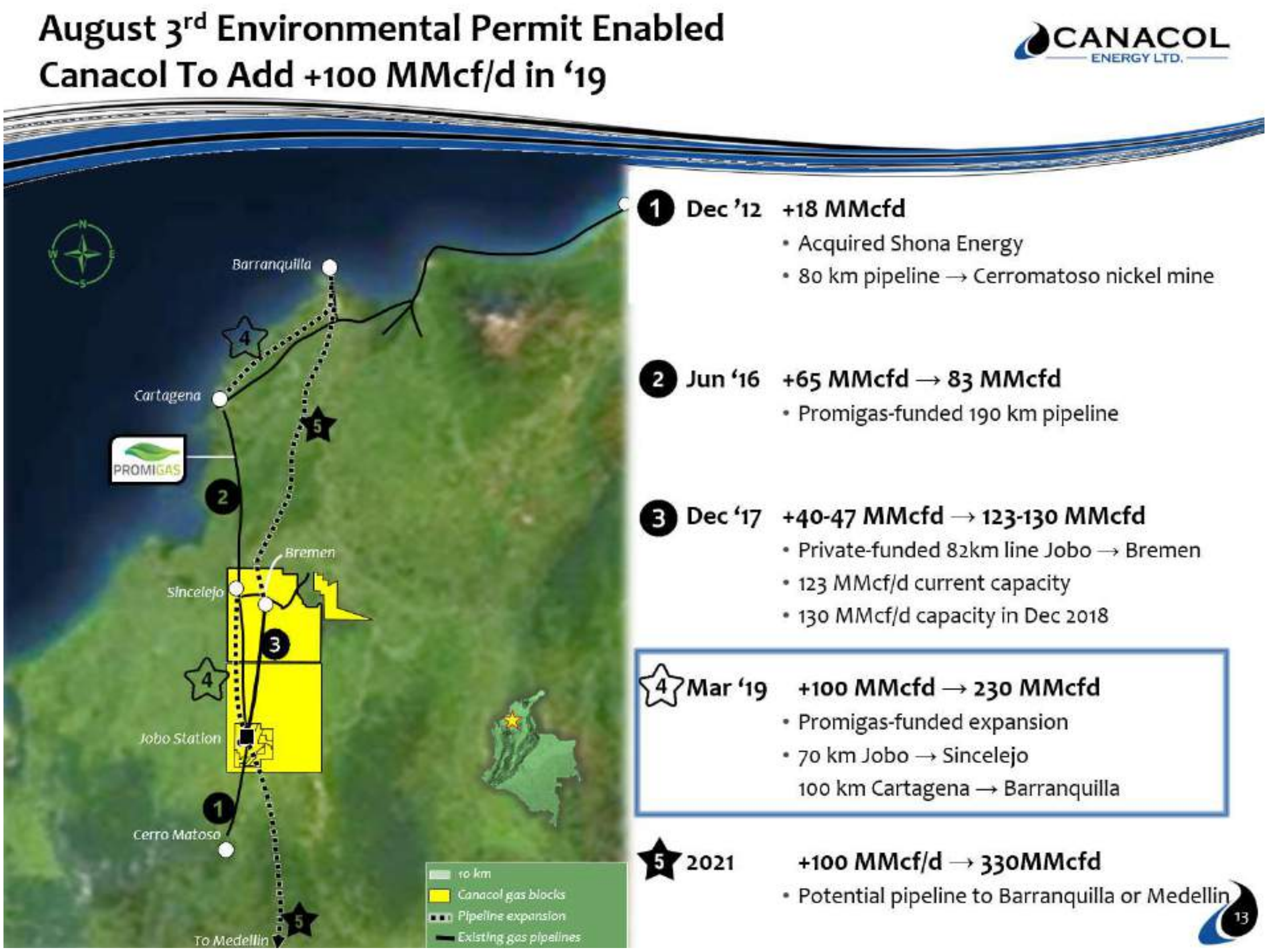


For the remainder of 2018, we remain focused on achieving 230 million standard cubic feet per day of productive capacity due to the expansion of the gas processing facilities at Jobo and the tying in of the Pandereta-1, 2, 3, Canahuate 1 and Canahuate 3 production wells. We completed the debottlenecking of Pandereta to Jobo flow line in October of 2018 and are currently completing the Pandereta to Jobo flow line to tie the Pandereta-1, 2 and 3 wells into the processing facility. The expansion of the Jobo gas processing facility is progressing as planned and will add another 130 million standard cubic feet per day of capacity to the facility to bring total process in capacity to 330 million standard cubic feet per day.

Promigas anticipates that all of the additional 100 million standard cubic feet per day of capacity will be available in March of 2019 with the first 20 million standard cubic feet per day available on December 1, 2018. This will lift our gas sales by approximately 20 million standard cubic feet per day to approximately 140 million standard cubic feet per day on December 1, 2018 and will lift our gas sales another 80 million standard cubic feet per day to approximately 220 million standard cubic feet per day when the entire pipeline expansion project is scheduled to be completed in March of 2019.

As previously announced, forecast realized contractual gas and oil sales which include contractual gas down time for 2018, our anticipated average between 22,000 and 24,000 of barrels per day of oil equivalent which includes 114 million to 129 million standard cubic feet per day of gas respectively and approximately 1,700 barrels of oil per day of annualized oil production. Our production guidance remains in line with our original base case guidance which assumed the Promigas pipeline delay into early 2019. The Corporation has contracted a drilling rig and will spud the first of the plan nine well gas exploration and development drilling program in the mid-December of 2018 with a Nelson-13 development well.

Since our moving to gas in December of 2012, our exploration drilling programs have resulted in over 465 billion cubic feet of new 2P reserves from 12 successful exploration wells, which represents an industry-leading commercial exploration success rate of 80% to the highest of any oil and gas operator in Colombia. These volumes represent a 40% compound annual growth return in natural gas 2P reserves since inception. With gas production reserves success, Canacol's senior management team has been successful at turning these achievements into dollars. Based on current project estimates when Canacol successfully sells and addition of 100 million standard cubic feet per day in 2019, our pipeline partner, Promigas and Canacol would have delivered over 440 kilometers of pipeline, an increased production by 14 times since our gas platform acquisition in 2012.



With the anticipated completion of the Promigas pipeline expansion, we are targeting realized contractual sales volumes of up to 230 million standard cubic feet per day in 2019. These volumes represent an 89% year-over-year growth in sales versus the midpoint of our 2018 natural gas sales guidance. We've demonstrated consistency in delivering production growth over the trailing four quarters and expect this trend to continue throughout the rest of the year and into 2019 when we will be supplying approximately one quarter of Colombia's natural gas demand.

Carolina Orozco
Thank you for participating in Canacol's third quarter conference call. Please join us again in March for our 2018 year end conference call. Have a great day.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.