

# Canacol Energy

Guidance update

## 2020 set to be Canacol's largest drilling campaign

Canacol Energy has provided updated production for 2019–20, capex guidance for 2020 and its natural gas reserves at year-end 2019. Management expects production for 2020 to be relatively in line with realised average sales for December 2019 at c 205mmscfd and capex for the year at c US\$114m. Capex will cover 12 wells across exploration, appraisal and development activities. The investment will contribute to Canacol's reserve replacement and growth strategy and aims to expand its capacity to serve Colombia's increasing gas needs. Natural gas 2P reserves increased by 12% and now stand at c 624bcf. Management is also currently working on the execution of a gas sales agreement (GSA) for an additional gas export route towards Medellin to add 100mmscfd of sales capacity by the end of 2023. Our 2P + risked exploration NAV has increased by 13% to C\$7.16/share, reflecting the updated 2P reserve book.

Year-end	Revenue* (US\$m)	Adj EBITDAX** (US\$m)	Cash from operations (US\$m)	Net debt*** (US\$m)	Capex**** (US\$m)	Yield (%)
12/17	156.6	130.2	65.3	255.5	(106.0)	N/A
12/18	204.5	138.6	94.0	288.1	(75.5)	N/A
12/19e	230.7	191.2	168.7	271.1	(119.0)	1.2
12/20e	302.7	258.2	218.4	224.4	(114.0)	4.6

Note: \*Revenue net of transport expense and royalty. \*\*Adjusted EBITDAX is before non-recurring or non-cash charges and exploration expense. \*\*\*Cash and equivalents minus short- and long-term debt. \*\*\*\*Forecasts based on 2P production profile.

## Stable sales and cash flow generation at 205mmscfd

Canacol aims to invest c US\$114m in capex in 2020, which will be fully funded from existing cash and 2020 operating cash flow. This will support current and near-term gas sales capacity, which currently stands at 215mmscfd. The company anticipates EBITDA of c US\$265m for 2020 from an average 205mmscfd of gas sales. The updated 2P reserves result in a reserve life index (RLI) of 8.3 years based on FY20 production guidance.

## 2020 record drilling activity

Canacol's key focus in 2020 is delivering its largest ever exploration drilling programme. The drilling programme includes nine exploration wells, one appraisal well and two development wells. The campaign commenced in January 2020 with the spudding of the Nelson-14 development well, which encountered 309ft of net gas pay. This will be followed with spudding the second development well, Clarinete-5, in early March. Exploration drilling is scheduled to progress from Q220.

## Valuation: RENAV at C\$7.16/share

Our base case valuation of Canacol stands at C\$7.16/share. The company trades at an FY20e P/CF of 3.2x versus its Canadian peers on 2.1x, and its peer group of North American E&Ps with South American operations on 2.3x. We believe this premium is driven by certainty of price realisations and a strong free cash flow yield relative to peers. Key risks remain around the ability to replace reserves, somewhat mitigated by its strong track record of exploration success, and recent 12% y-o-y increase in reserves.

Oil & gas

3 March 2020

**Price** **C\$4.48**

**Market cap** **C\$801m**

C\$1.32/US\$

Net debt (US\$m) at 30 September 2019 340.4

Shares in issue 178.9m

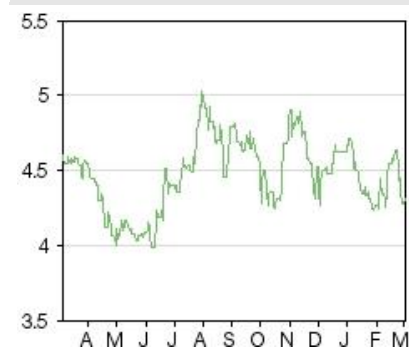
Free float 80%

Code CNE

Primary exchange TSX

Secondary exchange BVC

### Share price performance



% 1m 3m 12m

Abs 1.7 (0.5) (5.5)

Rel (local) 6.7 2.1 (8.3)

52-week high/low C\$5.03 C\$3.99

### Business description

Canacol Energy is a natural gas exploration and production company primarily focused in Colombia.

### Next events

Medellin GSA Q120

FY19 results 19 March 2020

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## 2020 work plan and guidance

Canacol Energy's main objectives for 2020 include drilling 12 wells, including nine exploration wells, representing the largest ever exploration programme executed by the company, one appraisal well and two development wells. The company estimates investing c US\$114m in capex for 2020, which will be fully funded from existing cash and 2020 cash flow. The budget also allows for a minimum of US\$7m in quarterly dividends, as well as c US\$15m in debt reduction in 2020. Management has also been working on delivering a definitive agreement for the construction of a new gas pipeline from Jobo to Medellin, which will increase its sale capacity by 100mmscfd to a total of 315mmscfd by the end of 2023.

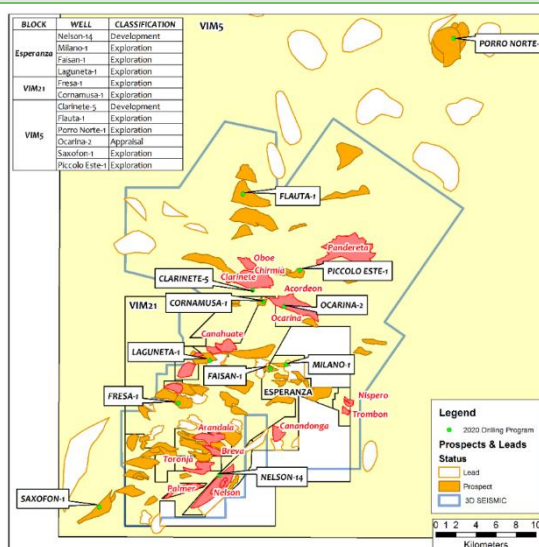
Canacol also announced its updated 2P gas reserves totalling c 624bcf at 31 December 2019, c 12% higher than its 31 December 2018 values. This increase in reserves was a result of the drilling and completion of Nelson-13 and Palmer-2 on the Esperanza natural gas block, Acordeon-1, Ocarina-1 and Clarinete-4 on the VIM-5 natural gas block, and Arandala-1 on the VIM-21 natural gas block, all in the Lower Magdalena Valley basin (by c 69bcf). Technical revisions in the Palmer, Nelson, Cañahuate and Clarinete gas fields also contributed to this increase (by c 48bcf). The new 2P reserve book results in an RLI of 8.3 years based on natural gas production guidance of 205mmscfd.

The company is also strengthening its corporate social responsibility with a series of initiatives in Colombia, through Fundación Entretejiendo, to provide natural gas to local communities that used to burn wood as a source of primary energy.

## Drilling 12 wells in 2020

The company's drilling campaign commenced in January 2020 with the spudding of the Nelson-14 development well, which will be followed around early-March with the second development well, Clarinete-5. Exploration drilling is scheduled from Q220, with the Fresa-1 well to be followed by Porro Norte-1. The locations and expected timings of the scheduled wells can be seen in Exhibits 1 and 2. The company plans to drill eight of 12 wells with the Pioneer 53 drilling rig and is currently negotiating a second drilling rig, which will commence drilling four exploration wells from May 2020. This will allow for additional wells to be drilled before the end of the year, if required.

**Exhibit 1: Canacol map with 2020 drill targets**



Source: Edison Investment Research

Nelson-14 and Clarinete-5 are both targeting the main Cienaga De Oro (CDO) reservoir with the objective of improving reservoir drainage of gas-charged sandstones located updip of each well. Nelson-14 reached a total depth of 10,150ft and encountered 309ft of net gas pay with 24% average porosity. The well has been tied into the Nelson production manifold and is already in production. Fresa-1 is located in VIM 21 and will drill a three-way fault dependent closure to assess the presence of CDO gas-charged reservoir sandstones. Porro Norte-1, in VIM 5, will drill a four-way anticline with fault dependent upside to assess the presence of gas in multiple stacked targets, including the CDO, but also the Porquero and Tubara sandstones. Both exploration wells will benefit from Canacol's continued application of its AVO methodology (using 3D and 2D seismic in Fresa-1 and Porro Norte-1, respectively), which has delivered an ongoing success rate of 83% in the company's exploration and appraisal well results.

<b>Exhibit 2: 2020 drilling schedule</b>						
	<b>Well</b>	<b>Well-type</b>	<b>Q120</b>	<b>Q220</b>	<b>Q320</b>	<b>Q420</b>
<b>Rig 1</b>	Nelson-14	Development				
	Clarinete-5	Development				
	Fresa-1	Exploration				
	Porro Norte-1	Exploration				
	Flauta-1	Exploration				
	Ocarina-2	Appraisal				
	Piccolo-1	Exploration				
	Comamusa-1	Exploration				
<b>Rig 2</b>	Milano-1	Exploration				
	Faisan-1	Exploration				
	Laguneta-1	Exploration				
	Saxofon-1	Exploration				

Source: Canacol Energy

## Three new gas exploration blocks

In December 2019, Canacol announced that it has secured a 100% working interest in three new conventional gas exploration contracts in the latest bid round in Colombia. The award of these contracts increases the company's existing position in the Lower Magdalena Valley basin where it is the leading independent producer of conventional natural gas, with the award of VIM-33, and also establishes a new core area in the Middle Magdalena Valley basin, with the award of VMM-45 and VMM-49. The new contracts increase Canacol's acreage by 29% to 1.4m net acres. The company expects exploration activity on these new blocks to begin in 2020, with a view to carrying out drilling in 2021 and 2022.

## Valuation

Our 2P valuation incorporates discounted cash flows, reflecting the monetisation of the company's existing reserve base, adjusting for overheads, net debt and decommissioning provisions to arrive at a NAV. We also look at two additional valuation scenarios that include incremental reserves over and above 2P. Here we include 'maintenance' capex (largely 3D seismic, exploration and development wells and tie-in costs) required to add reserves to sustain a production plateau. Our DCFs utilise a standardised discount rate of 12.5%, but we provide sensitivities to this key assumption later in this note. Key model inputs for our valuation scenarios can be found in [our initiation note](#).

In our 2P valuation case, we use reported year-end 2019 reserves of 624bcf, reflecting a relatively short production plateau of 205mmscfd sales prior to terminal decline, assuming minimal incremental drilling beyond planned development wells and zero value for acreage and prospective resource. We now update our estimates based on 2019–20 company guidance on production and capex. We roll forward our discount date to 2020 and estimate a net debt position for FY19 of

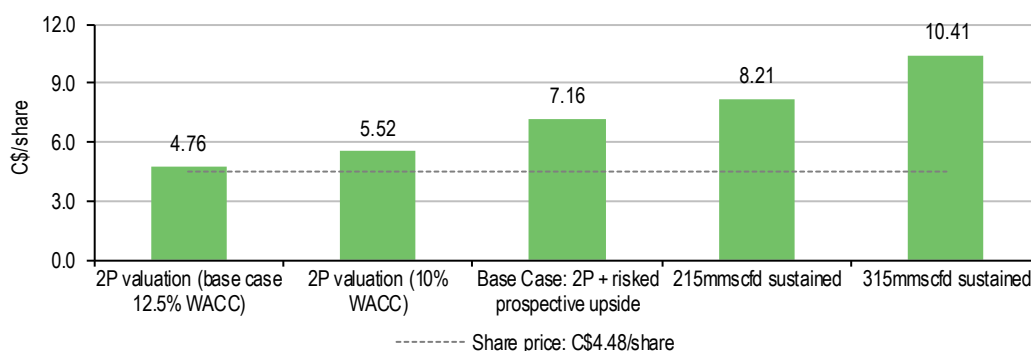
US\$271m. Our base case valuation currently stands at C\$7.16/share reflecting a 13% increase on our previous valuation, which was C\$6.35/share.

**Exhibit 3: Base case NAV breakdown**

Asset	Country	Diluted WI	CoS	Recoverable reserves		Net risked value @ 12.5%		
				Gross	Net	NPV per mcf	NPV	Risked
		%	%	bcf	bcf	US\$/mcf	US\$m	C\$/share
Net debt at end 2019							(271)	(1.84)
SG&A – NPV of 5 years							(90)	(0.61)
Decommissioning provisions							(23)	(0.16)
Cash from assumed exercise of options							60	0.41
<b>Producing assets</b>								
Esperanza	Colombia	100%	100%	276	276	1.76	487	3.30
VIM-21	Colombia	100%	100%	48	48	2.20	106	0.72
VIM-5	Colombia	100%	100%	300	300	1.44	433	2.94
<b>Core NAV</b>				<b>624</b>	<b>624</b>		<b>702</b>	<b>4.76</b>
<b>Exploration/development upside</b>								
Five-year programme (800bcf gross)	Colombia	100%	45%	800	800	0.98	353	2.39
<b>Total NAV</b>				<b>1,424</b>	<b>1,424</b>		<b>1,055</b>	<b>7.16</b>

Source: Edison Investment Research. Note: Number of shares = 178.9m + 15.6m = 194.5m (includes dilution from all share options)

The market appears to be fully valuing Canacol's 2P reserve base but undervaluing prospective resource, despite historically high exploration and appraisal (E&A) success rates, currently at 83%. We estimate a market-implied exploration success rate of just 80% based on 2.6tcf of net unrisked prospective resource (Gaffney Cline estimated Pmean). In Exhibit 4 below, it is possible to see the impact of our different valuation scenarios versus the current share price.

**Exhibit 4: Edison valuation scenarios versus share price (base case at 12.5% WACC)**


Source: Edison Investment Research. Note: Priced at 25 February 2020.

## Discount rate sensitivity

We have used a generic discount rate of 12.5% in our valuation. This is in line with that used for funded, cash-generative E&Ps with operations in emerging markets, resulting in a valuation of C\$7.16/share. At a 10% discount rate, it would increase to C\$7.92/share. We provide a sensitivity to this key input below.

**Exhibit 5: 2P and risked exploration NAV sensitivity (C\$/share) to WACC**

	8.0%	10.0%	12.5%	15.0%
<b>2P NAV</b>	6.24	5.52	4.76	4.13
<b>Risked NAV (800bcf risked @ 45%)</b>	8.64	7.92	7.16	6.52

Source: Edison Investment Research

## Relative valuation

Canacol currently trades at a premium to our NPV<sub>12.5</sub> valuation of the company's 2P reserve base, reflecting its ability to continue to replace production and grow its reserve base. Relative to Canacol's peer group, the free cash flow yield in FY20 (based on 205mmscfd plateau production and after maintenance capex) is high at 9.3%, supporting shareholder cash returns. However, it is lower than our previous published estimates of 20.3% due to an increase in our capex assumption for 2020, which now stands at \$114m as per company guidance. Canacol trades at a P/CF multiple of 3.2x in FY20e, compared to its Canadian E&P peers on 2.1x and its North American E&P peers with South American operations on 2.3x. North American E&P peers with South American operations include Frontera Energy, Gran Tierra, Parex Resources, PetroTal and Geopark.

We feel this is justified given the company's historical exploration and appraisal success rates, as well as installed infrastructure capable of supporting plateau production well beyond that implied by current reserves. Other supporting factors include limited exposure to commodity price volatility, low levels of debt and high netbacks, which could help justify a lower cost of capital than our assumed 12.5%. We provide a sensitivity to this driver in Exhibit 5.



## Exhibit 6: Peer group valuation table

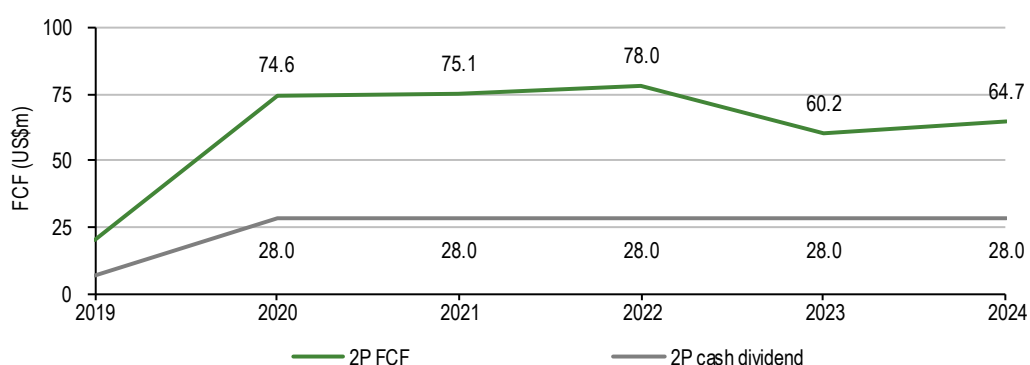
Company	Market Cap (\$m)	EV (\$m)	EV/EBITDA FY19e	EV/EBITDA FY20e	FCF Yield FY19e	FCF Yield FY20e	P/CF FY19e	P/CF FY20e	ND/EBITDA FY19e	ND/EBITDA FY20e	Div yield FY20e	Prod FY20e	Prod growth FY20e	EV/kboed FY20e
<b>Edison forecast</b>	<b>607</b>	<b>878</b>	<b>5.21</b>	<b>3.74</b>	<b>2.5%</b>	<b>9.3%</b>	<b>4.37</b>	<b>3.22</b>	<b>1.61</b>	<b>0.96</b>	<b>4.6%</b>	<b>36.0</b>	<b>44.1%</b>	<b>24.4</b>
<b>Canada</b>	<b>607</b>	<b>878</b>	<b>5.21</b>	<b>3.74</b>	<b>2.5%</b>	<b>9.3%</b>	<b>4.37</b>	<b>3.22</b>	<b>1.61</b>	<b>0.96</b>	<b>4.6%</b>	<b>36.0</b>	<b>44.1%</b>	<b>24.4</b>
Canacol Energy	607	878	5.21	3.74	2.5%	9.3%	4.37	3.22	1.61	0.96	4.6%	36.0	44.1%	24.4
<b>Canacol peer group</b>	<b>855</b>	<b>1,001</b>	<b>2.98</b>	<b>1.98</b>	<b>3.6%</b>	<b>10.6%</b>	<b>3.15</b>	<b>2.30</b>	<b>0.02</b>	<b>0.12</b>	<b>4.8%</b>	<b>42.9</b>	<b>46.5%</b>	<b>61.6</b>
<b>South American operations</b>	<b>855</b>	<b>1,001</b>	<b>2.98</b>	<b>1.98</b>	<b>3.6%</b>	<b>10.6%</b>	<b>3.15</b>	<b>2.30</b>	<b>0.02</b>	<b>0.12</b>	<b>4.8%</b>	<b>42.9</b>	<b>46.5%</b>	<b>61.6</b>
Frontera Energy Corp	591	743	1.26	1.32	20.9%	18.6%	1.16	1.25	(0.16)	(0.16)	10.6%	62.5	-6.2%	32.6
Geopark Ltd	1,073	1,440	3.78	3.20	15.3%	4.6%	3.96	3.82	0.87	0.73	0.9%	48.3	20.6%	81.6
Gran Tierra Energy Inc	325	907	1.86	1.78	-30.8%	16.9%	1.17	1.20	0.92	0.88	0.0%	34.8	4.5%	71.3
Parex Resources Inc	2,096	1,747	2.61	2.58	13.3%	12.3%	3.86	3.67	(0.69)	(0.68)	0.0%	56.5	6.9%	84.8
PetroTal Corp	190	170	5.37	1.01	-0.4%	0.3%	5.61	1.56	(0.83)	(0.16)	12.4%	12.3	206.9%	37.8
<b>Canada</b>	<b>1,690</b>	<b>2,841</b>	<b>4.18</b>	<b>3.93</b>	<b>11.2%</b>	<b>1.3%</b>	<b>2.18</b>	<b>2.14</b>	<b>2.20</b>	<b>2.10</b>	<b>3.3%</b>	<b>98.1</b>	<b>3.6%</b>	<b>53.4</b>
<b>Junior E&amp;P &lt;30kboed</b>	<b>135</b>	<b>284</b>	<b>3.69</b>	<b>3.59</b>	<b>16.2%</b>	<b>-5.9%</b>	<b>1.91</b>	<b>1.81</b>	<b>2.04</b>	<b>2.07</b>	<b>3.3%</b>	<b>17.1</b>	<b>3.4%</b>	<b>43.6</b>
Altura Energy Inc	23	26	2.23	2.37	6.7%	-20.0%	2.15	2.39	0.15	0.16	0.0%	2.0	10.1%	36.5
Bonterra Energy Corp	69	283	4.42	4.95	43.0%	14.6%	0.96	1.02	3.61	4.04	4.3%	12.5	1.2%	62.2
Cardinal Energy Ltd	183	367	4.05	3.88	19.6%	11.9%	2.02	2.03	2.09	2.00	8.6%	20.7	1.5%	48.6
Crew Energy Inc	43	311	3.76	4.88	-49.6%	-6.3%	0.69	0.93	3.24	4.20	0.0%	21.7	-4.9%	39.3
Delphi Energy Corp	9	137	2.59	3.64	175.5%	-71.8%	0.23	0.60	2.41	3.38	0.0%	7.9	-6.1%	47.6
Pine Cliff Energy Ltd	28	68	8.56	5.44	-8.0%	-14.6%	5.48	3.97	4.91	3.12	0.0%	19.0	-0.5%	9.9
Storm Resources Ltd	116	199	3.77	2.94	-30.4%	-3.9%	2.63	1.97	1.35	1.06	0.0%	24.8	23.1%	22.0
Surge Energy Inc	238	561	3.94	4.19	16.3%	13.9%	1.79	2.01	2.31	2.46	10.3%	21.0	-0.9%	73.0
TORC Oil & Gas Ltd	624	853	3.76	3.94	12.1%	7.1%	2.74	2.89	1.08	1.14	8.0%	28.3	0.0%	82.5
TransGlobe Energy Corp	88	108	1.42	1.30	23.8%	21.0%	1.50	1.28	0.01	0.01	4.9%	16.3	2.7%	18.1
Yangarra Resources Ltd	59	207	2.08	2.01	-31.1%	-16.8%	0.85	0.78	1.31	1.27	0.0%	14.1	11.3%	40.3
<b>Intermediate E&amp;P &gt;30kboed</b>	<b>660</b>	<b>1,288</b>	<b>4.38</b>	<b>4.05</b>	<b>8.1%</b>	<b>3.1%</b>	<b>2.14</b>	<b>2.14</b>	<b>2.47</b>	<b>2.28</b>	<b>2.3%</b>	<b>64.8</b>	<b>6.0%</b>	<b>52.7</b>
Advantage Oil & Gas Ltd	314	521	4.08	3.73	-7.5%	-6.5%	2.74	2.58	1.58	1.45	0.0%	46.6	5.4%	30.7
Athabasca Oil Corp	146	401	3.16	3.85	58.3%	-11.7%	1.21	1.73	2.30	2.79	0.0%	37.3	2.9%	29.5
Baytex Energy Corp	567	2,027	2.87	3.50	42.2%	19.8%	0.84	1.08	2.12	2.58	0.0%	95.6	-2.1%	58.1
Bonavista Energy Corp	82	706	8.35	4.75	-33.2%	15.4%	0.66	0.69	7.40	4.21	0.0%	63.4	0.1%	30.5
Canacol Energy Ltd	607	938	5.69	3.78	3.2%	9.3%	4.68	3.83	1.74	1.16	4.8%	36.2	42.4%	71.1
Enerplus Corp	1,021	1,412	2.75	2.71	4.6%	5.3%	2.04	2.13	0.75	0.74	2.0%	98.6	-2.4%	39.2
Frontera Energy Corp	591	743	1.26	1.32	20.9%	18.6%	1.16	1.25	(0.16)	(0.16)	10.6%	62.5	-6.2%	32.6
Kelt Exploration Ltd	461	739	4.21	3.36	-20.2%	3.8%	3.31	2.66	1.18	0.95	0.0%	39.3	30.6%	51.5
MEG Energy Corp	1,472	4,033	5.36	6.44	27.6%	21.7%	2.70	3.22	3.42	4.10	0.0%	95.7	2.8%	115.5
NuVista Energy Ltd	357	880	3.30	2.83	-7.3%	-3.3%	1.76	1.58	1.65	1.41	0.0%	58.4	14.8%	41.3
Painted Pony Energy Ltd	61	691	9.41	9.14	-7.9%	-29.3%	1.08	1.58	8.59	8.34	0.0%	47.4	-3.8%	40.0
Paramount Resources Ltd	467	1,028	4.13	3.93	-15.8%	-31.6%	2.11	1.88	2.32	2.21	0.0%	86.7	5.2%	32.5
Parex Resources Inc	2,096	1,747	2.61	2.58	13.3%	12.3%	3.86	3.67	(0.69)	(0.68)	0.0%	56.5	6.9%	84.8
Peyto Exploration & Development Corp	311	1,171	4.24	4.49	30.9%	10.8%	1.26	1.31	3.13	3.31	9.6%	81.3	0.3%	39.5
Whitecap Resources Inc	1,344	2,280	4.33	4.33	12.6%	11.3%	2.71	2.84	1.79	1.79	7.8%	66.6	-6.1%	93.8
<b>Large E&amp;P &gt;100kboed</b>	<b>7,119</b>	<b>11,413</b>	<b>4.57</b>	<b>4.23</b>	<b>9.8%</b>	<b>10.0%</b>	<b>2.74</b>	<b>2.75</b>	<b>1.78</b>	<b>1.72</b>	<b>5.7%</b>	<b>329.6</b>	<b>-1.9%</b>	<b>73.0</b>
ARC Resources Ltd	1,741	2,446	7.07	4.42	-1.9%	5.7%	3.61	3.12	2.01	1.25	9.2%	147.2	5.8%	45.5
Canadian Natural Resources Ltd	33,416	51,241	5.56	5.52	9.7%	12.2%	4.38	4.60	1.73	1.72	4.0%	1,092.0	-1.0%	128.6
Crescent Point Energy Corp	1,558	4,319	3.76	4.08	25.7%	11.7%	1.19	1.42	2.53	2.75	1.0%	132.9	-17.9%	89.0
Seven Generations Energy Ltd	1,554	3,118	2.75	3.01	6.1%	6.7%	1.56	1.68	1.37	1.50	0.0%	188.3	-7.2%	45.4
Tourmaline Oil Corp	2,421	3,782	3.81	3.64	7.4%	12.9%	2.72	2.54	1.20	1.15	3.9%	316.4	8.5%	32.8
Vermilion Energy Inc	2,026	3,568	4.48	4.70	11.7%	10.5%	2.99	3.16	1.86	1.94	16.0%	101.1	0.5%	96.7
<b>US</b>	<b>6,872</b>	<b>11,727</b>	<b>5.31</b>	<b>4.02</b>	<b>-1.4%</b>	<b>6.6%</b>	<b>2.62</b>	<b>2.34</b>	<b>2.63</b>	<b>2.01</b>	<b>1.5%</b>	<b>310.4</b>	<b>13.8%</b>	<b>89.6</b>
<b>Intermediate/Large E&amp;P &gt;30kboed</b>	<b>6,872</b>	<b>11,727</b>	<b>5.31</b>	<b>4.02</b>	<b>-1.4%</b>	<b>6.6%</b>	<b>2.62</b>	<b>2.34</b>	<b>2.63</b>	<b>2.01</b>	<b>1.5%</b>	<b>310.4</b>	<b>13.8%</b>	<b>89.6</b>
<b>RoW</b>	<b>14,774</b>	<b>16,012</b>	<b>4.44</b>	<b>4.01</b>	<b>2.7%</b>	<b>2.3%</b>	<b>5.29</b>	<b>4.61</b>	<b>0.89</b>	<b>0.78</b>	<b>5.3%</b>	<b>365.7</b>	<b>28.7%</b>	<b>137.6</b>
<b>Intermediate/Large E&amp;P &gt;30kboed</b>	<b>14,774</b>	<b>16,012</b>	<b>4.44</b>	<b>4.01</b>	<b>2.7%</b>	<b>2.3%</b>	<b>5.29</b>	<b>4.61</b>	<b>0.89</b>	<b>0.78</b>	<b>5.3%</b>	<b>365.7</b>	<b>28.7%</b>	<b>137.6</b>
<b>Grand Total</b>	<b>5,592</b>	<b>8,375</b>	<b>4.66</b>	<b>3.87</b>	<b>4.0%</b>	<b>4.4%</b>	<b>2.84</b>	<b>2.56</b>	<b>2.10</b>	<b>1.77</b>	<b>2.8%</b>	<b>223.8</b>	<b>14.1%</b>	<b>80.3</b>

Source: Edison Investment Research. Note: Priced at 25 February 2020.

## Financials

Canacol announced that it will invest an estimated c US\$114m in capex in 2020, which will be fully funded from existing cash and 2020 cash flow. It expects EBITDA of c US\$265m for the year (vs our estimate of US\$258m). The budget also allows for a minimum of US\$7m in quarterly dividends, as well as c US\$15m in debt reduction in 2020. The company also expects a decrease in net debt/EBITDA in the coming years, guiding to 1.1x net debt/EBITDA for year-end 2020, compared to 2.3x in September 2019. We believe excess cash is likely to be directed at expanding Canacol's footprint through the drill bit, considering the extensive acreage the company owns around its producing facilities. The excess cash could also offer significant capacity for returns to shareholders, either via dividend payments or a share buyback programme.

**Exhibit 7: Free cash flow forecasts**



Source: Edison Investment Research

Exhibit 7 shows free cash flow (FCF) generation under our 2P development scenario, together with shareholder returns taking into account the announced dividend and assuming it remains constant in the foreseeable future. We can see that with a yearly cash dividend of US\$28m, Canacol's base case scenario is sustainable until at least 2025, even in our 2P scenario.

**Exhibit 8: Financial summary**

	US\$m	2017	2018	2019e	2020e	2021e
Year-end December		IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>						
Revenue*		156.6	204.5	230.7	302.7	310.3
Cost of sales (opex)		(25.0)	(28.9)	(15.9)	(20.3)	(21.4)
Gross profit		131.6	175.6	214.8	282.4	288.9
General & admin		(26.5)	(28.2)	(23.6)	(24.2)	(24.8)
Share based payments		(11.6)	(8.5)	(8.7)	(8.9)	(9.1)
Exploration expense		(27.1)	(13.7)	(14.0)	(14.4)	(14.7)
EBITDA		130.2	138.6	191.2	258.2	264.1
Depreciation		(35.8)	(44.2)	(50.8)	(73.2)	(73.2)
Operating Profit (before amort. and except.)		(90.0)	41.9	117.7	161.8	167.1
Intangible amortisation		-	-	-	-	-
Exceptionals		-	-	-	-	-
Other		-	-	-	-	-
EBIT		(90.0)	41.9	117.7	161.8	167.1
Net interest		(26.3)	(34.5)	(28.9)	(28.8)	(26.9)
Profit Before Tax (norm)		(116.4)	7.3	88.8	133.0	140.2
Profit Before Tax (FRS 3)		(116.4)	7.3	88.8	133.0	140.2
Tax		(32.4)	(29.2)	(23.3)	(40.8)	(45.3)
Profit After Tax (norm)		(148.8)	(21.8)	65.5	92.2	94.9
Profit After Tax (FRS 3)		(148.8)	(21.8)	65.5	92.2	94.9
Average Number of Shares Outstanding (m)		175.2	177.2	178.9	178.9	178.9
EPS - normalised (c)		(84.95)	(12.32)	36.63	51.55	53.06
EPS - normalised fully diluted (c)		(84.95)	(12.32)	36.63	51.55	53.06
EPS - (IFRS) (US\$)		(0.85)	(0.12)	0.37	0.52	0.53
Dividend per share (c)		-	-	-	-	-
Gross margin (%)		84.01	85.87	93.10	93.28	93.11
EBITDA margin (%)		84.01	85.87	93.10	93.28	93.11
Operating margin (before GW and except.) (%)		(57.49)	20.48	51.03	53.44	53.86
<b>BALANCE SHEET</b>						
Non-current assets		499.8	580.3	634.5	661.0	689.9
Intangible assets		43.9	39.6	85.5	143.2	202.2
Tangible assets		383.4	480.4	488.7	457.5	427.4
Investments		72.5	60.3	60.3	60.3	60.3
Current assets		196.7	124.7	141.7	173.3	220.4
Stocks		0.6	0.3	0.3	0.3	0.3
Debtors		50.4	68.2	68.2	68.2	68.2
Cash		39.1	51.6	68.6	100.2	147.3
Other/ restricted cash		106.6	4.6	4.6	4.6	4.6
Current liabilities		(86.3)	(69.3)	(69.3)	(69.3)	(69.3)
Creditors		(86.3)	(69.3)	(69.3)	(69.3)	(69.3)
Short-term borrowings		-	-	-	-	-
Long-term liabilities		(371.0)	(430.3)	(430.3)	(415.3)	(415.3)
Long-term borrowings		(294.6)	(339.7)	(339.7)	(324.7)	(324.7)
Other long-term liabilities (inc. decomm.)		(76.4)	(90.6)	(90.6)	(90.6)	(90.6)
Net assets		239.1	205.4	276.6	349.7	425.8
<b>CASH FLOW</b>						
Operating cash flow		65.3	94.0	168.7	218.4	220.3
Capex inc acquisitions**		(106.0)	(75.5)	(119.0)	(114.0)	(116.9)
Financing expenses		(21.2)	(36.0)	(29.7)	(29.8)	(28.4)
Equity issued		(1.9)	(3.7)	4.0	-	-
Dividends		-	-	(7.0)	(28.0)	(28.0)
Net cash flow		(63.8)	(21.2)	17.0	46.6	47.1
Opening net debt/(cash)		184.4	255.5	288.1	271.1	224.4
HP finance leases initiated		-	-	-	-	-
Other		(7.4)	(11.4)	0.0	-	-
Closing net debt/(cash)		255.5	288.1	271.1	224.4	177.4

Source: Edison Investment Research, Canacol Energy accounts. Note: \*Edison revenue forecast net of royalties and transport expenses; Canacol reports revenues net of royalties before transport expenses. \*\*215mmscfd and 315mmscfd plateau scenarios include materially higher capex.

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