Energy Roundtable

"Leveraging Relationships to Build an Unconventional Business from a Conventional Platform"

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Leveraging relationships to build an unconventional business from a conventional platform

Thank you very much and it is indeed a pleasure to be here today. As we discussed presenting at today’s Roundtable, I questioned being up here to talk about our industry and be positioned as an expert on how we are going to meet tomorrow’s energy demand. This room is filled with subject matter experts!

What I can share with you though, and what I am excited to discuss is the Centrica Energy story. And how our vision to build a presence in the Western Canadian Sedimentary Basin evolved, how we are currently building our future by investing in natural gas and why we’ve taken a different approach to building capacity for the future.

So who is Centrica?

Centrica plc is headquartered in the United Kingdom, traded on the London Stock Exchange, and is a fully-integrated energy company, involved in every stage of the energy business – from sourcing energy to saving it.

Centrica Energy Exploration and Production, a division of Centrica, has current production of 225,000 boe per day with 66,000 of that being generated right here in Western Canada and we have an international goal of growing that number to 275,000 boe per day. We have three regional offices in Aberdeen, Scotland, Stavenger, Norway and here in Calgary.

In 1985 we produced first gas in the East Irish Sea. Over the next 25 years, our E&P business was focused on the North Sea through operations in the UK and then into Norway and the Netherlands. Assets were acquired in Trinidad and Tobago even as the business maintained its status as a top gas producer on the UK Continental Shelf.

In 2000, Centrica acquired Direct Energy which gave us our first footprint in North America. On the upstream side, we slowly built up our Direct Energy E&P business by acquiring a number of assets and small oil and gas production companies, primarily shallow gas and coal bed methane.

The drop in natural gas prices in 2009, forced Centrica and Direct Energy to take a hard look at our business. And so, in 2010, the strategy was refreshed and the decision made to build a stronger presence here in Western Canada.

Over the next two years we acquired full ownership and control of the Wildcat Hills producing assets and gas processing facility from Suncor as well as a package of liquids-rich natural gas assets at Carrot Creek, just south of Edson, from EnCana.

At that point, in early 2012, we really had no idea what the next two years would bring. As it turns out, we hadn't come close to imagining the true transformational change about to occur at our company.

Centrica is a different kind of oil and gas producer, - we aren't what you would call a typical Western Canadian energy company. We are part of a utility and an integrated energy company and as a result, we have different drivers. We have less emphasis on volume and cash flow and a greater emphasis on profitable growth and return on capital employed.

For any investment, Centrica has strict hurdle rates that require a creative and somewhat contrarian investment approach, be it oil and gas or otherwise. Growth for the sake of growth alone is not acceptable.

So what is our investment approach?

Building strong relationships with our industry partners has been a critical success factor for our Canadian operations since 2008. Our existing inventory of shallow gas and coal bed methane assets didn't lend themselves to further development, so we knew that our growth strategy would need to be focused on acquisitions in order to replenish our prospect inventory. Our team felt that the only way to achieve success would be to leverage existing relationships and ensure our peers knew that we were in the market.

We also needed an original vision to look at how and where to invest. We knew we couldn't compete with many of the large companies on unconventional plays, so we needed to customize a solution. Further, our approach to looking at acquisitions is also unique. We prefer bilateral arrangements with large companies where we have existing relationships and where the opportunity for repeat business is likely. The likes of Suncor, Shell and Encana come to mind.

And so when Suncor approached us in the Fall of 2012 to consider their remaining natural gas business in the Western Canadian Sedimentary Basin, it was like the stars had aligned and we began a bilateral negotiation that lasted eight months. We had previously completed two deals with Suncor - Wildcat Hills here in Alberta and a suite of assets in Trinidad and Tobago. We had an excellent existing relationship and with a falling gas curve here in the WCSB, Suncor had appreciated how we had previously valued their assets.

The deal Suncor approached us on was an opportunity to acquire quality assets from a large company with an evolving strategy. Their reputation provided stability to the deal and confidence that the assets were being operated in a safe and environmentally responsible manner.

The contemplated transaction would increase Centrica's production by 41,000 boe/day and add almost 1 Trillion cf of proved and probable reserves to our company. This equated to an increase of more than 150% in both our production and reserves.

And while we entered the deal for the conventional business, we were confident that we could leverage technology to enhance recovery in liquids rich natural gas in Central Alberta and unconventional liquids rich gas in northwest Alberta and northeast British Columbia.

The deal presented itself at an opportune time for Centrica. We were beginning to look at large unconventional upstream transactions in North America. The opportunity to diversify our oil and gas portfolio and buy an option on AECO gas, at a low point in the cycle, was attractive. In addition, the business case we presented showed that the cash flow generated from the conventional gas business would, over time, be able to support a long-term investment in unconventional gas.

There was one other defining feature of this transaction. It was agreed early on with Suncor there was to be one large transaction. It was imperative we were prepared to take on the entire asset, no cherry picking – the good, the bad and the ugly so to speak.

In some ways, the Suncor deal reminds me of the TV show Storage Wars. As a locker goes up for sale you can easily recognize some of the items – a dining room set, an antique armour or in our case a gas plant. And while I cannot imagine our Managing Director in the UK making the “yeeeepppp” sound, we were successful and left to discover the undeveloped treasures.

As mentioned, we knew that we were buying 41,000 boe/day and 1 tcf of 2P reserves. But slightly below the surface, and unadvertised, the deal also included some great nuggets including almost one million acres of undeveloped land, 500 mmcf/day of natural gas processing capacity and other assorted facilities, a freehold royalty payable on oil in southeast Saskatchewan and a large proprietary seismic database.

On top of these nuggets we also found ourselves in the middle of a couple of active plays at Hanlon Robb chasing the Wilrich and at Gilby chasing the Glauconite. It also included a couple of very nice unconventional starter kits on the Montney play in the Peace River Arch area. However, it also included a significant abandonment liability that we assumed on a white map basis. But that’s the uniqueness about this type of investment - you accept the trade-offs believing the upside will outweigh the downside.

The contents of our “storage locker” led to transformational changes within our business. We grew to 660 employees with operations in five regions across Western Canada. And our daily production now tops 66,000 boe a day. Overnight we became a top 10 gas producer in the Western Canadian Sedimentary Basin and a material, profitable growth business within Centrica Energy.

Since the deal closed a year ago, we have focused on continuing to be a low-cost natural gas producer – an especially critical element that will keep us in this game while prices are lower. In this first full year, we’ve struggled a bit with production costs on our new assets. But by optimizing production and focusing on a few key areas, we have managed to keep cash costs in line at $2.50 per mcf.

That being said, we haven’t turned our back on new opportunities and looking at new properties. This spring we completed a $43 million deal for natural gas assets with Shell Canada adding to our already strong position in the Wildcat Hills area northwest of Calgary.

Nor have we shied away from organic investments. By the end of this year, we will have invested $210 million to drill and develop opportunities within our own infrastructure with a specific focus on Gilby, Carrot Creek, Hanlon Robb and Spirit River in west-central Alberta. This program is the largest, most aggressive program Centrica has undertaken during its 14 year history in the WCSB.

Throughout my remarks though, I have left out a significant element as it really deserves its own special section – finding the right partner and again developing strong business relationships.

An aggressive growth strategy for North America was a key priority for Centrica. But our ability to take this transformational leap was really only made possible because we found a partner that wanted the same. And we found that in Qatar Petroleum International, or QPI.

In December of 2011, QPI signed a Memorandum of Understanding (MOU) with Centrica to look for upstream partnership opportunities. Being able to leverage the existing relationship between the Centica plc and QPI and present them with their first production opportunity in North America, was a game-changer.

And while we all know we operate in a global business, this really came to light for us during the initial meetings with QPI in Doha. It turned out that a former Suncor employee was now working in Qatar with QPI. He knew Suncor was evolving their strategy and, as a result, why they were looking to divest. In what could have been a very hard sell about investing in the WCSB all of a sudden became very legitimate and real. And thus began our partnership.

In the end, the Qataris were interested and attracted to the deal for the same reasons that we were – a long-term investment in quality assets that would benefit from long-term thinking. Plus for QPI, they secured the added bonus of investing in a politically and fiscally stable province and country.

CQ Energy Canada Partnership's $1 billion acquisition of Suncor's assets was set up through a 60:40 joint venture, with Centrica assuming the role of operator. We are QPI's first and currently only partner here in North America and one of only three production deals they currently participate in outside of Qatar. We have welcomed the approach and perspective that they have brought to our business and appreciate having such a strong, enthusiastic and engaging partner.

Just two weeks ago, on October 1, we closed a second deal with QPI to strengthen our strategic relationship. Through the agreement, QPI acquired 40 per cent of our wholly owned Canadian natural gas business for 200 million dollars Canadian. This highlighted QPI's strong commitment to our existing partnership and their eagerness to forge new opportunities together. As a result, all of our North American assets now reside with our CQ Energy Canada Resources Partnership.

So much of what we do in this business is motivated by aggressive capital investment and based on quarter-to-quarter results. But how would your decisions change if that wasn't the primary driver?

As I mentioned before, Centrica Energy is a different kind of energy company due to our integrated business structure and shareholders that demand profitable growth. Couple that with a partner who wants us to think on a 20 year timeline and the possibilities change.

So, is there room in this Basin for people like us?

We definitely believe there is!

At Centrica, we want to be a company that people desire to work with. Reputation is important to us as a company and as individuals. We conduct ourselves with integrity and respect and seek to do repeat business with our key partners. Working together, we are confident that we will not only grow but proudly deliver a safe, sustainable natural gas business.

To that end, we have begun the conversation about growing our business organically by exploiting our own scalable and material liquids rich natural gas opportunities. We will look to invest another $250 million, primarily organic, in 2015 and have identified key priority investment areas that we feel will provide the long-term value additions that we seek.

First and foremost, we will continue to seek and develop unconventional gas opportunities in the Peace River Arch. Currently we are in the midst of introducing Centrica to and enhancing their learning about unconventional resource development. They are looking to Canada for our expertise and wisdom to inform their own UK operations.

Secondly, we want to continue to grow liquids rich natural gas opportunities in Central Alberta. We have a good starter kit of assets but additional growth is an imperative.

Thirdly and finally, we will seek to acquire additional natural gas assets within our core areas and close to our existing infrastructure.

At the same time, we also need to take the time to review our portfolio in terms of core and non-core assets, evaluate potential divestments and retrench for future growth. While growth is an imperative, it may be necessary to go slowly for a while as we align our objectives and seek a portfolio that can deliver on our promise of profitable growth.

So what's next?

In Canada we move forward with great optimism.

Our partnerships allow us to think well into the future, given our balance sheet capability and strong cash-flows. Volatility can be our friend if we are bold enough to seize opportunities.

We firmly believe in the future of natural gas and the use of technology to improve recovery from the liquids rich unconventional reservoirs and perhaps some of our large, high quality conventional reservoirs.

And through this all, we will empower our team to leverage relationships, take bold steps forward and have faith in their abilities to discover the nuggets. When next great storage locker presents itself, we want to be ready.

Thank you for your time and attention and I look forward to opening up the floor to questions and continuing the conversation.