



# CURTAILMENT ECONOMICS

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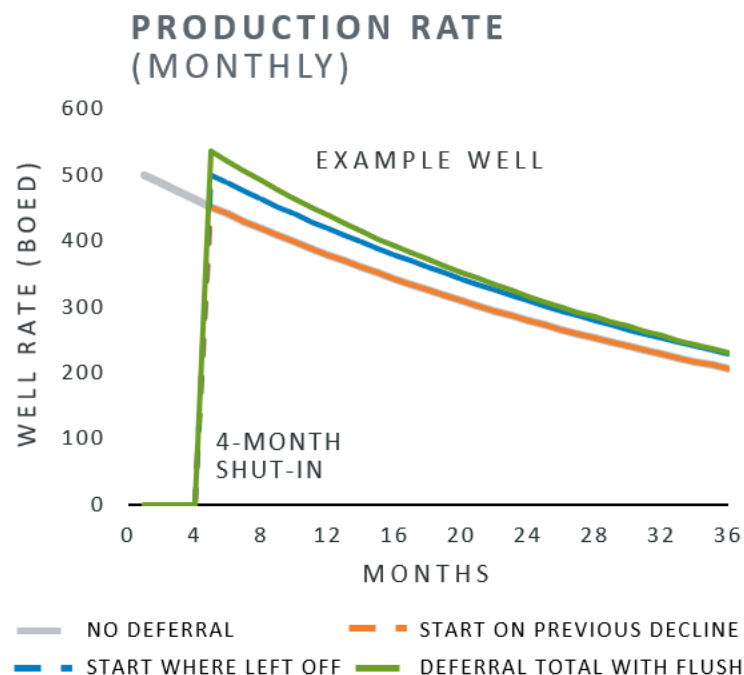
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# Agenda – *Curtailment Economics*

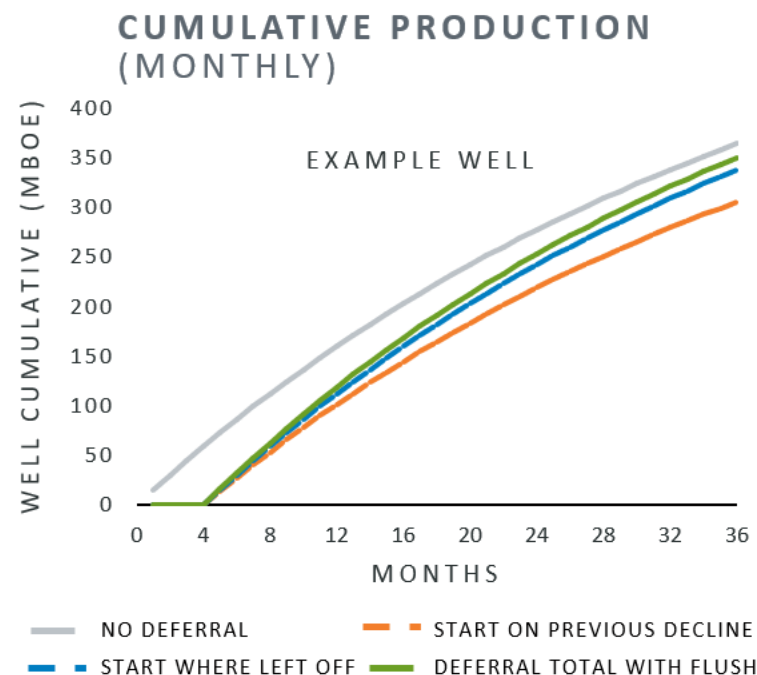
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- Why Are We Here?
  - To explain the economic rationale behind ConocoPhillips' voluntary production curtailments
- Curtailment Fundamentals
  - Production characteristics
  - Net cash flow characteristics
  - Value and sensitivity characteristics
- Summary – *why does this matter?*
- Question & Answer Session

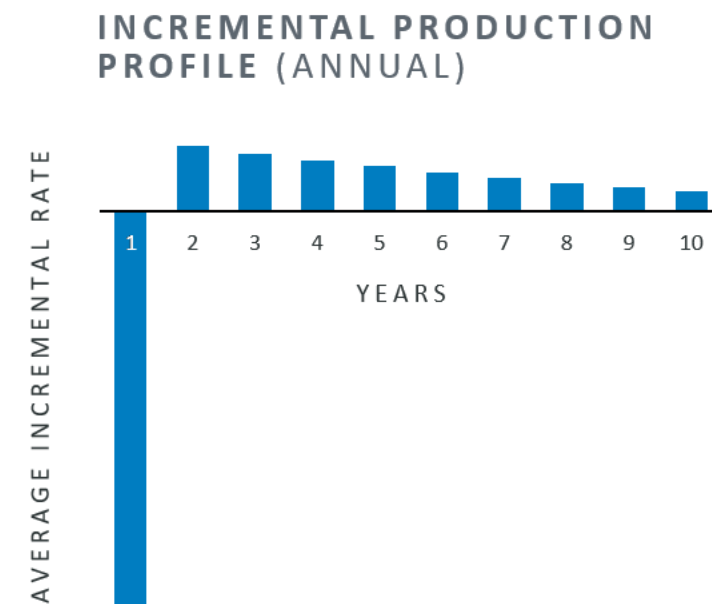
# Curtailment Production Characteristics



- After shut-in, production typically resumes at or above where it left off on the decline curve.
- If facility capacity exists, “flush production” accelerates the return of the deferred oil.
- Deferred production comes back faster in fields with higher decline rates.



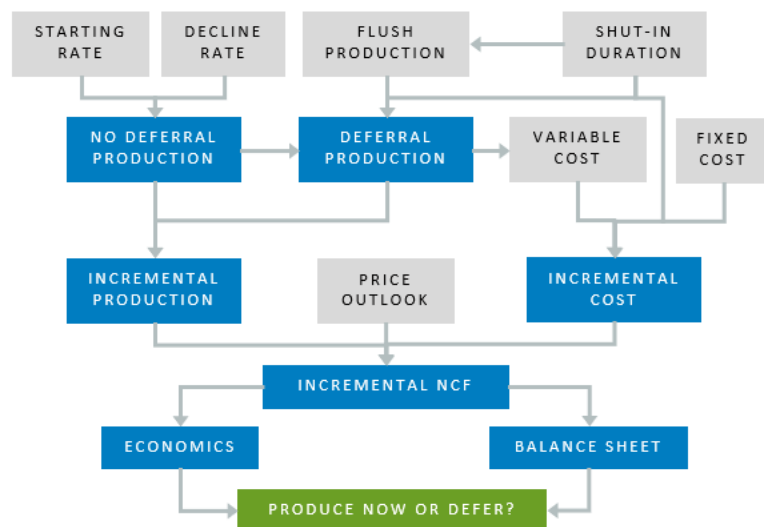
- After several years, cumulative production is close to equal for deferral and no deferral cases.
- Constraints can limit curtailed volumes, e.g. contracted sales, operating agreements, operating conditions.



- Unlike surface storage, deferred production returns over several years.
- Economic value is a balance of delayed time value of production and higher price expectations.
- The decision to defer can be considered as an option that can be exercised monthly.

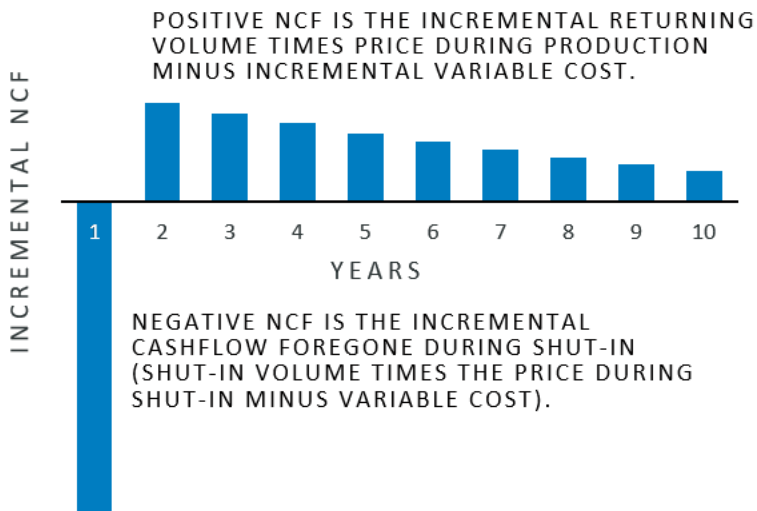
# Curtailment Net Cash Flow Characteristics

## MODEL INFLUENCE DIAGRAM



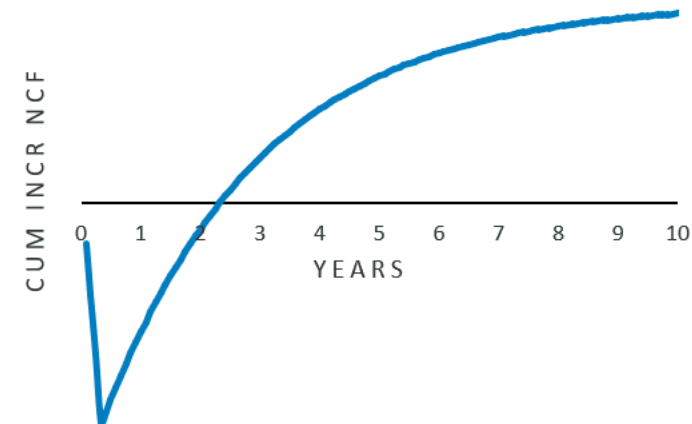
- A simple NCF model can be constructed to consider economic and balance sheet implications of deferral.
- The economic analysis considers the difference in NCF with and without curtailment.

## INCREMENTAL NCF



- NCF characteristics are the same as other investment decisions and can be considered using standard economic decision criteria.

## CUMULATIVE INCREMENTAL NCF

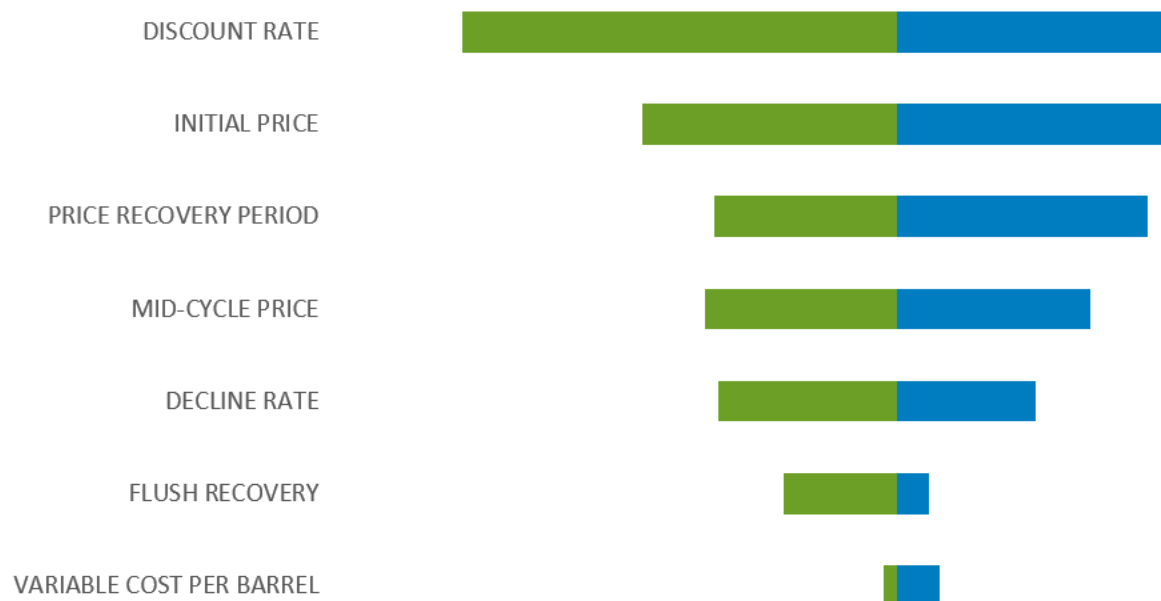


- Cumulative incremental NCF shows the implications for the balance sheet of the cashflow forgone during curtailment.
- The minimum cumulative NCF can be considered as an investment.



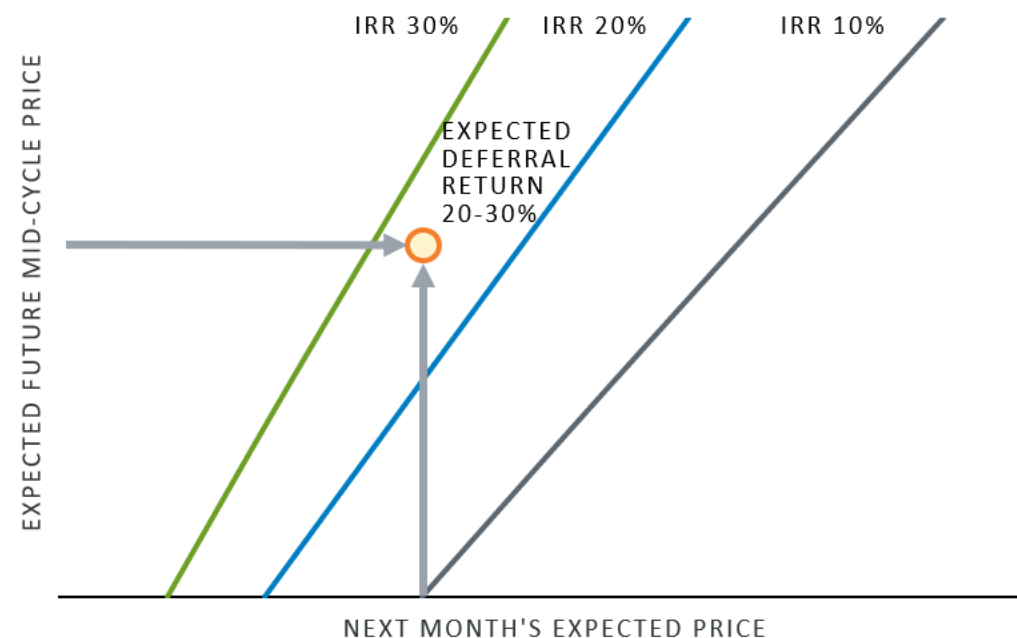
# Curtailment Value and Sensitivity Characteristics

## EXAMPLE NPV SENSITIVITY



- Value is very sensitive to hurdle/discount rate – financially stronger companies can add more value through deferral.
- Most value can be created in both longer and steeper contangos, if you have the balance sheet to persist.
- Fields with higher decline rates and capacity for flush production have higher value from production deferral.

## MONTHLY DECISION FRAMEWORK ILLUSTRATION



- Simple approximation covering 80% of variance.
- Enter with expected mid-cycle price and expected next month price. Interpolate for expected return.
- In practice in ConocoPhillips, customized models exist for all assets with deferral potential (including constraints, type curves, flush capacity, variable cost, etc.)
- Monthly call made to defer or produce at each asset.

# Summary – *Why Does This Matter?*

- Companies with strong balance sheets and low incremental cost of capital are uniquely positioned to add value for shareholders in current circumstances by deferring production.
- ConocoPhillips is choosing to curtail production at prices significantly above variable cost because it adds value for shareholders.
  - e.g. ~1/3<sup>rd</sup> of production curtailed for the month of June.
  - Continuing to produce at what we believe are temporarily very low prices is not rational economics.
- Proper economic analysis requires generating monthly NCFs and explicitly modelling the contractual and infrastructure constraints, fixed vs variable costs, type curves and flush capacity of different assets.
- We are evaluating every asset on a month-by-month basis to consider the option of producing or deferring.
  - Deferral value is maximized when there is deep, long contango.
- Investors should understand why managements are choosing to curtail, or not.

# Q&A