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Agenda – Curtailment Economics

- 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
- 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.
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.

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

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**

- **Discount Rate**
- **Initial Price**
- **Price Recovery Period**
- **Mid-Cycle Price**
- **Decline Rate**
- **Flush Recovery**
- **Variable Cost Per Barrel**

- 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. ~1/3rd 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.