Chief Executive Officer's statement

A Q&A with Mr. Austin Ojunekwu Avuru

Austin Ojunekwu Avuru
Chief Executive Officer

Seplat made good progress towards its long-term strategic aims having materially grown its reserves base, delivered full year average daily production in line with guidance and exceeded peak rate objectives. Expansion plans for the gas business gathered pace and the new Oben gas processing plant will enable Seplat to increase supply to the domestic market.

In 2015, given the lower oil price environment, Seplat will take a prudent approach and seek to align spend with cash flow, allocate capital selectively and prioritise investments that offer the highest returns for our shareholders.

Q

How do you see the business has performed since IPO?

A

We have made good progress against our key objectives since the IPO in April 2014. We have:

- Grown our 2P reserves and contingent resource base
- Significantly increased production capacity at OMLs 4, 38 and 41, hitting 2014 guidance and setting a new daily output record
- Accelerated development of our gas business to increase availability of supply to the domestic market
- Acquired interests in two new blocks, taking our overall portfolio to six blocks in the Niger Delta
- Accessed the domestic and international debt markets and ensured the business is on a sound financial footing

However, 2014 was not without its challenges. We saw headwinds to growth in the form of an abrupt decline in oil price during the second half of the year and a total of 75 days downtime on the third party operated Trans Forcados System that materially averaged down our annualised production rate.

Q

What have reserves and resources grown to and what have been the main drivers?

A

Our working interest 2P reserves at 31 December 2014 stood at 281 MMboe, comprising 139 MMbbls of oil and condensate and 827 Bscf of natural gas. This represents an overall increase of +24% year-on-year. The main drivers of these additions are the recognition for the first time of reserves at the Orogho field following production start-up in the year, drilling results at Sapele Shallow and the submission of a field development plan for the Okwefe field. Impressively, in 2014 we achieved a 4x replacement ratio of produced oil and condensate volumes and an 8x replacement ratio of produced gas volumes.

Since inception the majority of our reserves growth has been driven by moving 2C resources into reserves categories as a result of detailed technical work and our development activities. Since 2010 we have converted around 149 MMboe from 2C to 2P against production of around 34 MMboe on a working interest basis. Together with volumes acquired at the OPL 283 Marginal field area we have delivered a compound annual growth rate of around 19% for 2P reserves growth over this time.

Q

To what extent have you managed to grow production during the year?

A

Our full year average working interest production in 2014 was only slightly up on the previous year at 30,823 boepd, comprising 24,252 bopd of oil and condensate and 39.4 Mmscfd of gas. However, just looking at the headline figures does not tell the whole story. We experienced a total of 75 days downtime on third party operated parts of the Trans Forcados System, 40 of which were un-budgeted. Excluding the un-budgeted days, our production would have averaged approximately 34,600 boepd over the year. Offsetting the higher than budgeted levels of downtime was more reliable gas offtake by our customers, increased oil and gas production capacity through the drilling of several new wells and the recognition of production at the Pillar assets in OPL 283. An indicator of the velocity at which we developed our core blocks in 2014 and grew production capacity is the fact that we set a new daily production record at OMls 4, 38 and 41 when oil production exceeded 76,000 bopd for the first time ever in December.

Q

Producers onshore the Niger Delta are typically subject to reconciliation losses when using third party export systems. What losses have you been subject to and are you taking steps to try and mitigate this?

A

During 2014 approximately 98.5% of liquids production from OMLs 4, 38 and 41 was transported through the Trans Forcados System (TFS). Overall reconciliation losses arising from use of the TFS were 10.6%. Whilst this is higher than we would like, we have taken steps in recent years to bring our reconciliation losses down to this level. In 2012 we were the first operator in the Niger Delta to install a lease automated custody transfer (LCAT) unit that allows for accurate metering of total liquid volumes we inject into the TFS. Prior to this we were subject to reconciliation losses averaging around 18%. The new 100,000 bopd pipeline that we completed and commissioned in 2014, linking our fields directly to the Warri refinery, is intended to mitigate sole reliance on one specific export system and allow for improved uptime and operational efficiency. Whilst we delivered modest volumes via this new pipeline in 2014, it is a focus of ours to build a long-term relationship with the Warri refinery with the aim of establishing a regular and mutually beneficial offtake arrangement. Another way that we will look to mitigate this type of risk is through diversifying and expanding our portfolio of producing blocks, with a focus on the onshore and shallow water offshore areas of the Niger Delta.

Q

At your own operated field and associated infrastructure though, Seplat has managed to avoid any significant disruption despite the problems other operators have faced. How have you achieved this?

A

Central to Seplat's business strategy is our commitment to creating shared value for our local stakeholders. Through proactive engagement and collaboration with them we aim to create a long term contribution to the economic and social development within the communities where we operate. Beyond direct revenue and royalty payments to the government, Seplat seeks to maximise the impact of every dollar spent for the benefit of its local communities – from capacity and skills building to ensure we can hire locally to a highly inclusive local content policy which stimulates the growth of our local supply chain. We are committed to building a sustainable legacy within our communities. In this way, we believe our track record of building strong ties with the local communities through this unique approach will enable us to successfully integrate any newly acquired assets and reduce or eradicate incidences of theft and vandalism. The E&P industry has to view local stakeholders as partners in the process that requires engagement and consultation to create shared value for all.

Similarly, Seplat takes its approach to the health and safety of its employees and the protection of the surrounding environment very seriously. This is illustrated by our strong performance in HSSE management over the year – our LTIFR rates were reduced to a score of 0.4 with zero fatalities. As operator at key projects, we can implement rigorous HSSE systems and processes with an aim to surpassing best practice industry standards.

Strategic pillars

- Maximise production and cash flows from operated assets
- Move up 2C resources into 2P reserves category
- Commercialise and produce gas reserves
- Pursue a focused acquisition and farm-in strategy
- Be a highly responsible corporate citizen

Strategy
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Chief Executive Officer's statement continued

Q

How is Seplat progressing with its gas commercialisation strategy?

A

At Seplat we were quick to seize upon the attraction of gaining a foothold in Nigeria's rapidly evolving natural gas sector. Far from seeing gas as a waste by-product of oil production, or feedstock for LNG export projects, we see supplying Nigeria's domestic need as a commercial opportunity in its own right and one which we prioritise. As such we believe we are well positioned to capitalise on our early mover advantage in this area.

In 2014 we produced 39.4 MMscfd of gas (87.6 MMscfd on a gross basis), all of which was supplied to the domestic market where we have continued to see strong demand from power projects and other commercial enterprises. Going forward, we plan to further increase our gas production and processing capacity to help meet this growing demand, particularly in the gas to power sector. A major step forward in this respect is the modular build-up of processing capacity at the Oben facility to create a strategic gas hub ideally located to aggregate and supply gas to Nigeria's main demand centres. The new 150 MMscfd Oben gas processing facility will take overall gross production capacity at the Company's assets up to 300 MMscfd in 2015 and the Company intends to grow this further to at least 450 MMscfd by end 2017.

Underpinning our ambitious production capacity growth plans we have a sizeable pool of gas reserves and resources. Our working interest 2P gas reserves at end 2014 stood at 827 Bscf, with a further 854 Bscf in contingent resources or subject to classification following detailed technical work. This equates to an overall volume of 1,681 Bscf on a working interest basis and 4,020 Bscf on a gross basis that is earmarked to supply the Nigerian domestic market in the coming years.

To get all these volumes to market will of course require significant further investments, against which corresponding returns must be generated, and a stable fiscal and regulatory environment that continues to encourage and stimulate long-term investment in the sector. Importantly, we have seen gas pricing increase in recent years to commercial levels. In 2014 the domestic service obligation was priced at US$2.0/Mcf and in 2015 we have seen this step up to US$2.50/Mcf. We have also put in place new gas contracts to supply the power sector, including the Azura IPP, at pricing of US$3.0/Mscf plus and will look to place more gas into higher priced contracts where we can.

Q

How active were you with the drill bit in 2015 and what other work did you undertake at your fields in 2014?

A

During the year we had up to seven rigs in operation at any one time, completing 23 new wells and workovers at OMLs 4, 38 and 41. This comprised 12 development wells, four appraisal wells, five workovers, one water injector and one water producer. This makes us one of the most active drillers anywhere in the Niger Delta. Over the course of the year we drilled a mix of oil and gas wells to deliver our production objectives for both streams. We also installed smart well completions on the Okporhuru field, reducing the need for additional drainage wells in the future and two wells on Sapele Shallow gave us important data with which to plan the development of the heavier oil there. We brought the Orogho field onstream, adding around 3,200 bopd gross production, and also completed the Amukpe - Ovhor gas lift project adding around 3,500 bopd gross production initially which we are targeting to increase up to 5,000 bopd gross.

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The Oben associated gas compression project, designed to eliminate flare gas and process gas to sales quality, was 75% mechanically complete at year end and entailed the installation of three 10 MMscfd compressor units. The installation of two additional crude oil storage tanks at the Amukpe field was around 90% complete at year end meaning the additional storage will become available to us over the course of 2015. Further to this, we have of course installed the new Oben gas processing facility as previously discussed.

Q

Did Seplat undertake any exploration activity in 2014?

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In 2014 we drilled one exploration well on the Ogegere prospect in OML 38. Although it was a marginal discovery by itself, what it has done is open up new play potential at a deeper level to existing reservoirs on OMLs 4, 38 and 41. In particular we believe there could be potential at deeper levels below current well penetrations in the nearby Orogho and Okporhuru fields and a portfolio review following the Ogegere well result has indicated credible prospects for inclusion into the short to medium-term drilling sequence. We are also in the process of evaluating the exploration potential at our newly acquired blocks OML 55 and OML 53.

Q

One of the strategic reasons for raising money at the IPO was to accelerate growth through acquisitions. Can you update us on new venture developments?

A

Since our IPO we have actively continued to pursue a number of selective acquisition opportunities, some successfully so, others not, but that is the process we go through and we remain true to our technically driven and value disciplined approach. We prioritise acquisition opportunities that offer near-term production, cash flow and reserve replacement potential. Whilst we have been active in the onshore parts of the Niger Delta to date, we have ambitions to grow the portfolio into the offshore shallow water areas too, where we see our production and field development expertise can also be leveraged to great effect.

We recently completed the acquisition on a 40% working interest in OML 53 and effective 22.5% working interest in OML 55 onshore the Niger Delta from Chevron Nigeria Limited. The OML 53 transaction fits neatly with our strategy of securing, commercialising and monetising natural gas in the Niger Delta with a view to supplying the rapidly growing and evolving domestic market. In addition to the large scale discovered, but undeveloped, gas and condensate resources there are near-term opportunities to increase and optimise oil production significantly above current levels of around 2,000 bopd gross. The OML 55 acquisition offers us an opportunity to redevelop existing oil fields, much in the same way we have done elsewhere, taking advantage of significant infrastructure already in place and aiming to maximise economic oil recovery from the reservoirs. Additionally there is a significant gas resource that we will also assess options to commercialise in the future. Both blocks have been relatively lightly explored and we will seek to implement modern technologies and our understanding of the subsurface to identify further E&A drilling upside opportunities.

We continue to pursue a number of other acquisition and farm-in opportunities and inorganic growth will continue to remain a central component of our growth strategy.

Q

How has the new lower oil price environment impacted on your plans for 2015?

A

Following the abrupt decline in oil prices during the second half of 2014 and continued weakness in 2015 year-to-date, Seplat will prioritise the allocation of capital to production and development opportunities that offer the most robust economic returns. The Company anticipates modest exploration and appraisal expenditure under current conditions, and aims to align spend with cash flow. Seplat is the designated operator at its key projects, and as such is able to influence the magnitude and timing of expenditures. The Company constantly reviews its cost structures, and will take every opportunity to apply downward pressure to its overall cost base. By also investing in its natural gas business and growing gas production the Company is able to partially offset its exposure to oil price volatility, benefitting from a revenue stream derived from gas prices that are not linked to the oil price.