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MUR - Murphy Oil Announces Strategic Deep Water Gulf of Mexico JV with Petrobras

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OVERVIEW:

On 10/10/18, Co. announced a new strategic JV formation with Petrobras.

CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

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PRESENTATION

Operator

Good morning, ladies and gentlemen and welcome to the Murphy Update Conference Call. (Operator Instructions)

And I would like to turn the conference over to Kelly Whitley, Vice President, Investor Relations and Communications. Please go ahead.

Kelly L. Whitley - *Murphy Oil Corporation - VP of IR & Communications*

Good morning, everyone, and thank you for joining us on our call today. With me are Roger Jenkins, President and Chief Executive Officer; David Looney, Executive Vice President and Chief Financial Officer; and Gene Coleman, Executive Vice President, Exploration and Business Development.

Before we get started, I'd like to remind you that a slide deck summarizing some of the highlights of the transaction, which we will be discussing today, has been posted to the Investor Relations section of our website, so I encourage you to review as you listen to this webcast.

Additionally, please keep in mind that some of the comments made during this call will be considered forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. As such, no assurances can be given that these events will occur or that the projections will be attained. A variety of factors exist that may cause actual results to differ. For further discussion of risk factors, see Murphy's 2017 annual report on Form 10-K on file with the SEC. Murphy takes no duty to publicly update or revise any forward-looking statements.

I will now turn the call over to Roger.

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

Thank you, Kelly. Good morning and thank you for taking the time to join us this morning for our call. We look forward to discussing in -- the new strategic JV formation announced yesterday and why we see it as a catalyst for our company. The extremely attractive bolt-on transaction was accomplished performing a JV at a very attractive price with a motivated counterparty who sought to change their U.S.-based strategy.

Petrobras is a major NOC, [one that] operated with proven global deepwater building to oversee joint venture interest in the Gulf of Mexico. We'll be increasing our ownership in oil-weighted producing assets with -- where we see having further upside, and we're achieving immediate, highly accretive metrics across the board. The joint venture will be a compromise of all of Murphy's existing producing Gulf of Mexico assets, along with those of Petrobras' existing producing assets in the Gulf as well. This does not include any of Murphy's exploration blocks. However, it does include blocks with deep exploration rights from Petrobras. The new joint venture is owned 80% by Murphy and 20% by Petrobras, with Murphy assuming operatorship. Murphy will pay $900 million in cash with appropriate closing adjustments that we will fund through a combination of cash on hand, along with the drawing on our senior credit facility. There could be up to $150 million of contingent payments in this transaction that Murphy would make should revenue thresholds at St. Malo and at Lucius unit be exceeded beginning in 2019 through 2022. In addition, if an enhanced oil recovery project is approved at St. Malo, Murphy would carry a portion of Petrobras' costs for $50 million.

Slide 4. The oil-weighted high-margin Gulf of Mexico joint venture ties directly with our previously discussed strategy. First, we were able to significantly increase our offshore portfolio with both oil-weighted production and reserves in an area where we currently operate with a long history of success. Second, we're able to use our expertise and reputation to establish a unique joint venture with NOC, allowing us to oversee all the operations. Thirdly, we are increasing our oil concentration, our oil production mix and our oil reserves with high-margin barrels. Fourth, we're leveraging our longstanding excellent reputation as a safe, reliable deepwater operator. Lastly, the joint venture is immediately accretive, generating free cash flow that leads to capital allocation optionality for our company. For example, we're able to direct a portion of the free cash flow to one of our most highly economic plays, the Eagle Ford Shale, where Murphy holds a top-tier, low-cost, high-return acreage position. This will allow us to further increase production of oil-weighted high-margin barrels, while improving free cash flow metrics. We're also allocating some of the free cash flow generated from the joint venture to pay down debt and maintain our highly regarded balance sheet.

Slide 5. Upon closing, we'll have approximately 41,000 barrels equivalent of production, making our total production in the Gulf of Mexico 60,000 barrels equivalent per day net. More importantly, our corporate oil-weighted production increases by 6 percentage points, registering now at 60% oil. Our corporate reserves are planned to increase by 60 million barrels of equivalent to 760 million barrels equivalent. On a go-forward basis, we expect to see the assets in the Gulf of Mexico will achieve a competitive lease operating cost of $10 to $12 per BOE, again, supporting our high-margin business. We're pleased that the metrics of the joint venture only strengthen our portfolio for the long term.

Slide 6. The addition of the new assets complements our portfolio and leverages our expertise. We're also able to participate in world-class assets, such as St. Malo, while gaining operatorship of Chinook and Cascade, where we hope to streamline and improve operations.

Slide 7. In closing today, I honestly feel this is the best day for Murphy in a long while. This is just the strategic transaction we've been looking for, as it allows us to capitalize on our longstanding offshore expertise, places success in one of the key pillars of our strategy, the ability to deal with, work and understand major NOCs. We have a partner who wants to remain an owner of the assets with us and not exit, a partner who believes in our longstanding Gulf of Mexico assets and appreciates our unique operatorship ability. This deal is aligned with our long-term strategy. In the recent downturn in 2016, we made the strategic decision to not issue equity and to rein in capital spending and cause our production to decline.

Also we entered into a new unconventional play at the bottom of the cycle with very low cost and refocused our exploration program with a new team. Due to these long-term calls, we made the tough decision to temporarily lower our capital in one of our key high-returning assets, the Eagle Ford Shale. Now with this single piece of business, we can execute on our entire strategy, place more emphasis on our Eagle Ford Shale production with a portion of the new incremental cash flow from our joint venture, keeping us -- we're able to keep our new successful Kaybob Duvernay asset, fund our recent success and exploration in Samurai, while continuing with our exploration program at our planned pace. We're able to accomplish this, all while delivering and generating more cash flow on top of our previous plan. This is truly a perfect situation for us. I cannot be more pleased and excited.

I'd like to thank our new partner, Petrobras, who's working with us over the course of this negotiation. I received a congratulations call from their CEO yesterday. They're very pleased to have Murphy as their new operator. I'd like to thank our business development team led by Dan Hanchera. I'd like to also thank Gene Coleman, who leads our exploration and business development group as well as our law department, advisers, subsurface and operational teams for all the long hours and work needed to complete this transformative transaction. It feels good to see all that we've strategically wanted to accomplish for Murphy come together. It just goes to show that when you stay with something long enough that it will work out for you in the end.

And with that, I'd like to open up the line for questions this morning. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question will be from Arun Jayaram at JPMorgan.

Arun Jayaram - *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

I was wondering, Roger, if you could articulate some of the value creation opportunities from the properties that you see from, perhaps, mitigating the decline rate to improving margins or discuss maybe some of the drill bit optionality from these new properties.

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

Well, thank you, Arun, for the question. Thanks for calling in today. Actually, we're achieving a lot of value just by doing the deal. And if you were to take the 41,000 barrels at a 15% to 16% decline rate through these assets at this type of oil-weighting, you'll find a very, very accretive, value-adding for shareholders piece of business that we accomplished today. We're just getting started. We've been working on this for a long time. We've had a series of meetings and transition with Petrobras, which actually took place yesterday afternoon after the signatures. I do believe that we will be able to streamline and help some of the operating expenses at the Cascade, Chinook. We're already sharing some helicopter facilities and shore-based facilities with Petrobras now. We think that there is some possible well work to be done to -- on some mechanical failures on some wells we can work on with some low rig rates that we have today and at our cost level. We know of a couple of drill opportunities that we can do at the Cascade, Chinook field. At the Chevron-operated St. Malo project, a very, very successful, highly valuable field in the Chevron portfolio, one of the best tertiary Wilcox fields in the business, there's a possibility of an enhanced oil recovery project led by Chevron over the future that we'll be gaining a lot of information about, and we feel that could be accretive to us as well. And just putting it in with our business by adding very, very limited G&A and just change the world on our G&A per BOE, and just -- we've been working here a long time and how we can fit that in with our teams, we think, we can add some value. Also the North Hadrian, Lucius area operated by Anadarko, that's a 6-well subsea development that's going forward, we're around a 10% or 11% owner of that property now. That will be accomplished over the next couple of years. I actually believe Anadarko is in the field today accomplishing those -- that 6-well program. So those are the things that are coming in the future, Arun, there.

Arun Jayaram - *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

Yes, Roger. We were calculating a little bit more than $1.1 billion in free cash flow over the next couple of years given, call it, $40 million, $50 million of CapEx. Does that seem right to you as you model out the assets?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

Very right.

Arun Jayaram - *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

Okay. And final question is just on P&A liabilities. Any other liabilities that we need to think about for the properties and how to think about that?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

This is a standard Gulf of Mexico ARO situation. The NPV of that is around $250 million. One of the key fields in the play, St. Malo, will not be abandoned to -- past 2040. So the NAV, I also feel that's conservative and that's the NPV of the ARO that we have accurate information on from the data room with our partner, and that's what we will use on our economics.

Operator

Next question will be from Paul Sankey at Mizuho.

Paul Benedict Sankey - *Mizuho Securities USA LLC, Research Division - MD of Americas Research*

Roger, can -- could you just take a little bit of a step back in terms of what you've done here? I guess, the big idea is that you get some synergies from combining operations. Petrobras gets cash and you get the extra production. Could you just talk a little bit about what the overriding major concept is? And could you continue into how you came up with valuation?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

Well, that's been no secret. I've talked about many times, Paul, as you know, about buying free cash flow-accretive operations in the Gulf of Mexico when people desire to make strategic change. This is a situation exactly like that. We've been working on it for a very long time, formed a very unique relationship with Petrobras to accomplish that with the idea of putting more of the -- some of the cash flow to immediately jump-start our Eagle Ford Shale where we'd like to get more capital. So the idea for us is to build 100,000-barrel-a-day-plus, oil-weighted highly tax-efficient, U.S. business between the Eagle Ford and the Gulf over the next 2 to 3 years. And this will easily accomplish that based on the current projections. And that's the overall strategy is getting back home with the tax situation that we have after going through all the repatriation. We are a long-term operator in the Gulf. We started the Gulf business and the founders of our company, and we have that in our heritage and our expertise. We feel we add a lot of value. And it's a lot of deals we have to go through and a very long-term negotiation here to get this accomplished but that's been the goal for a while and finally get it going today, and that's strategically what we want to accomplish. On the valuation, we were able to take a very close look at the fields. There's not a large number of fields here, the large value's in St. Malo, a very successful project. It's operated by Chevron with name-brand partners, like Statoil, Exxon, E&I and now us and a very nameplate brand to review there. And spent a lot of time with the reserves and came up with the appropriate 2P evaluation of the decline of the assets, put that into the NPV at any kind of strip price or any kind of price deck and it's very, very accretive for us. We also, I think, very unique about this project, it's a heavily proven to P2 ratio of around 60 million proven to 86 million P2 on our incremental basis. And of the P1 are proven 58 of the 60 is PDP today. So this is a lower-risk profile, outstanding piece of business for us. Again, working with NOCs, wanting to make a strategic change, here we are as operator and a very good operator that we are and a long history, all this come together for us today. And that's the story, Paul.

Paul Benedict Sankey - *Mizuho Securities USA LLC, Research Division - MD of Americas Research*

Good. And just a follow-up would be, can you keep doing this? You said that it was an ambition that you've talked about a lot in the past. Is this a terminal point for you? What do you think this further work here to be done in the Gulf of Mexico to extend your position?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

I believe we will continue on, and we'll certainly be trying. I can tell you that.

Operator

Next question will be from John Herrlin at Societe Generale.

John Powell Herrlin - *Societe Generale Cross Asset Research - Head of Oil & Gas Equity Research and Equity Analyst*

The genesis of this transaction, is it started at data room and then became something more selective? Is that fair?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

No. This was a 2 or 3 years of traveling to Rio and establishing relationships with Petrobras, as you know, are in Brazil and an incredibly, highly prolific exploration area with Exxon. We see the DROs in Brazil is still something but mainly looking for the best deals we can do. We have talked to them in prior times about their assets, became a come together, if you will, about -- they'd changed their desire and wanted to remain in the United States in a different way with a smaller office footprint with an operator. They're very -- became very interested and built a great rapport with our company. They're very interested in our longstanding safety reputation, operational reputation. And our NOC reputation globally is very, very strong. They seem to really appreciate that and wanted to work with us. And we formed a relationship all the way at the very top of the organization between me and Ivan, their CEO, at Gene's level with all the heads of the upstream. And just have formed a very, very formative, incredible relationship with our new partner, one that we respect and there's respect for us. And through all that, we were able to have a long-term negotiation that worked out for both parties, their strategic move, their cash coming in. I know you cover Petrobras. And here we are to operate and streamline, and that's how it went.

John Powell Herrlin - *Societe Generale Cross Asset Research - Head of Oil & Gas Equity Research and Equity Analyst*

Okay. Great. Next one for me. In terms of subsequent [E&D] activity, you'll hit the wells first that you mentioned and then do new drills? I mean, is it reasonable to assume that you may start new drills next year?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

No. We're going to have to look at that harder. We have some of our own success to deal with too today that we're in the middle of and drilling head on, as we speak. And we -- we're going to take some time to get -- [fit] the size that we are going to be taking in some personnel from there and -- with our team and looking at a drilling opportunity that exists at Cascade, Chinook, also have a partner there in Total that's experienced there who we'll have to work with, hopefully, positively. And then there's some well work that we'll start analyzing mechanical situations that we hope we can rectify with lower rig rates that we are able to achieve, the way we procure and do things here. And it probably will be -- there -- at this particular time in our budget, we did not have new activity for them. But their rates of production there are very high for '19 as well. So we're just studying that. We have an -- we have game plan, and it could supersede and come into some of our budget and replace. But it's pretty early days for that right now, John.

John Powell Herrlin - *Societe Generale Cross Asset Research - Head of Oil & Gas Equity Research and Equity Analyst*

Sure. How many workers are you inheriting?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

We prefer not to say, a few key strategic. And they are making their announcement today, and I really don't want to get into all that. But we're -- our G&A change here is very, very minor. And our goals of continuing to lower cost in our company will override the additional G&A, and this is a game changer on G&A per BOE for Murphy Oil today.

John Powell Herrlin - *Societe Generale Cross Asset Research - Head of Oil & Gas Equity Research and Equity Analyst*

Okay. Last one for me. In terms of spare processing capacity at Cascade and Chinook, how much is available?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

All we need. No problem at all in that.

John Powell Herrlin - *Societe Generale Cross Asset Research - Head of Oil & Gas Equity Research and Equity Analyst*

I couldn't hear that.

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

All we need, John. It's not an issue.

John Powell Herrlin - *Societe Generale Cross Asset Research - Head of Oil & Gas Equity Research and Equity Analyst*

Okay. Well, I just wanting volumetrically, that's all.

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

No, no. No, I don't see that. Gene, do you have any known issues on that? No? Okay. No, John, not at this time.

Operator

Next question will be from Pavel Molchanov at Raymond James.

Pavel S. Molchanov - *Raymond James & Associates, Inc., Research Division - Energy Analyst*

Just to clarify. On the plug-in abandonment liabilities, you mentioned $250 million. Is that right? And is that going to be allocated proportionately 80-20 with the JV ownership?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

No. That's our share, as we used in our economics evaluation.

Pavel S. Molchanov - *Raymond James & Associates, Inc., Research Division - Energy Analyst*

Okay. Got it. You're 80%. And Petrobras, obviously, has assets outside of the United States and outside Brazil in some of the other places where they have been interested in divesting their international exposure. I'm curious whether this JV might lead to Murphy entering some of the other geographies, again, not Brazil, specifically, where Petrobras has had a footprint.

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

We have made a real strategic thing -- change over the last few years to really work in the Gulf of Mexico, Mexico, Brazil, Malaysia, Vietnam and Australia and that's all. And we're -- as long as we're in our key operating areas, we look at various things that are accretive and make money and add value for our shareholders and add free cash flow and allow us to improve our NAV but not looking to go outside of those operating areas at this time.

Operator

Next question will be from Brian Singer at Goldman Sachs.

Brian Arthur Singer - *Goldman Sachs Group Inc., Research Division - MD & Senior Equity Research Analyst*

Roger, can you talk about -- more about the use of the free cash flow, whether it's from the acquired assets here or from higher oil prices? How do you think about the right level of activity to add in the Eagle Ford versus to offset the cash associated with the acquisition or build cash for future opportunities like this?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

We are -- our plan is to take around half of the free cash flow at this time from the assets and immediately jump-start our Eagle Ford Shale and move from around a 1-rig scenario to a 3-rig scenario in 2019 and 2020 and possibly even higher in 2021. We're probably looking at a $63, $64 kind of a price for next year. I mean, we have to look at raising from our $53 we had last year. I think the rest of our company, from our long-range planned capital will be very similar. Our exploration capital is looking to be very similar. And all of this is focused on our LLS-weighted Gulf of Mexico, our U.S. Gulf of Mexico prices, building an accretive, highly successful U.S. oil-weighted business with our tax efficiencies and low tax rates in the United States and all of the capital we can and be focused on Eagle Ford Shale and not other parts of -- and keeping the rest of our long-range plan intact as well as the capital we need for success at Samurai, which we did not have a year ago. And we also will be taking those -- that cash to repay our revolver and looking to that. At this time, we would like to enhance the free cash flow above our dividend that was disclosed in our LRP and build free cash. And we have an opportunity, hopefully, to greatly improve free cash flow yield. I will point out that the first 2 quarters of the year, only 4 companies have positive free cash flow yield of our 16 peers, and we're one of them already. So this is not a big -- everybody making free cash flow parade out there. So we're doing it now, and we're going to increase it. And our game plan is to excel in that due to our oil-weighted, high U.S.-priced tax advantage business.

Brian Arthur Singer - *Goldman Sachs Group Inc., Research Division - MD & Senior Equity Research Analyst*

Great. And my follow-up is on the Eagle Ford. Can you talk about where you plan to drill within your Eagle Ford position with those 2 incremental rigs and whether you expect the well results to be at, better or worse relative to the wells you've been drilling with that 1 rig over the last year?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

Well, we've hit our targets, they have been doing well there. And we're going to be drilling across our play in both Karnes, Tilden, Catarina, more focused earlier on Lower Eagle Ford. And we have 2 big pads drilling in Karnes today. Karnes is a place we'd like to go to first but our other areas are working well. And we have a detailed plan of drilling, high well count last year, doubling what we're doing now. And it's going to be across that play in our usual fashion.

Operator

(Operator Instructions) And your next question will be from Leo Mariani at Nat Alliance.

Leo Paul Mariani - *National Alliance Securities, LLC, Research Division - Research Analyst*

Wanted to see if there was an update on some of the existing Gulf of Mexico activity. I know you guys were sidetracking Samurai and also drilling that King Cake prospect. What can you tell us about that?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

We're executing a plan we have on our quarter. We're getting all that on our quarterly call. We -- if you are asking if we have downtime for the hurricane in Samurai, very slight. We'd never disconnect. And we're drilling ahead now. And we, like some operators, shut in some production on the Eastern part of the Gulf and going back offshore to return that today and see what issues we have, if any, and not a major concern about any of that at this time.

Leo Paul Mariani - *National Alliance Securities, LLC, Research Division - Research Analyst*

Okay. Helpful. And I guess, you certainly talked about incremental use of free cash flow, roughly half going to the Eagle Ford. Wanted to kind of focus maybe on the other half. I know you said a little bit of that for debt repayment. But where would you see the other free cash flow growing? Is that just to kind of build cash on the balance sheet? Or might you return some of that to shareholders with a bump on the dividend or buybacks or anything like that?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

All of those things will be on the table for us. We have a very incredible dividend yield today and after yesterday, really good yield. So we are doing well on that front. And we believe that greatly improving the free cash flow that we have is the way to do. And typical, we have some bonds down the road that we would like to lower our debt levels as those towers become available. We'd like to do accretive things, if possible but always with an eye on returning to shareholders and building free cash flow that would lead to all the optionality that's discussed by all of our peers today. So all of the above for us. And we want to just get this going and build up this free cash better than we had last year and go from there. But all the above, from that buffet line, will be available to Murphy.

Leo Paul Mariani - *National Alliance Securities, LLC, Research Division - Research Analyst*

Okay. That's great. And I guess, just lastly, you're certainly talking about rather extensive production line, particularly at the St. Malo fields. Was hoping maybe you could touch on the other 2 sort of large fields that you guys brought in as well. You talked about a 15% to 16% sort of annual decline rate on the new properties. And it sounds like St. Malo is probably a lot lower than that just based on the fact that it's going to last until 2040. So what can you tell us about decline rates on the other 2 key assets here?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

They're all -- St. Malo, on a 2P level, is around 15%. And the higher one on a 2P basis would be Chinook at 20%. Lucius, with its new development going forward, is probably at a 16%. So they're all sort of similar. And I think, pretty damn good, for Gulf of Mexico offshore decline. And real happy about it and feel real good about this production. Oil production declines in the Gulf of Mexico is quite common. Shale does too, by the way. And we have our business growing. In our long-range plan last year, we had our Gulf business growing with a Dalmatian pump project that we're executing on, a rig program at Medusa, a rig program at Front Runner, a very highly economic well to drill at Kodiak at the end of the year. So we have a growing business there, slight decline in business, building a really solid 55 2-year per day solid Gulf of Mexico, highly economic business coming for us.

Leo Paul Mariani - *National Alliance Securities, LLC, Research Division - Research Analyst*

Okay. That's helpful. I guess, just, obviously, you guys are talking about, like you said, relatively low decline rates in the Gulf. Just kind of looking at the reserves, you guys, incremental sort of 60 million 1P. I think you said 86 million, 2P. Obviously, that -- those numbers would sort of imply, maybe, slightly steeper declines. Do you think this is just a case of conservative engineering on those reserves? How do we sort of square that up?

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

We -- we're in a very, very positive situation. As this negotiation played out, the performance of the fields was better. Cascade, Chinook had a very highly positive well result during the negotiation. A well at Chinook, very, very positive, a very high rate well was put online there. And these reserves have not been updated for that. And I believe there's some upside for that because the wells are outperforming the rates that we originally worked on. And I feel very, very good about that kind of all of the P question, if that's what you're after.

Operator

And at this time, we have no other question registered, so I would like to turn the call back over to Mr. Jenkins. Please go ahead, sir.

Roger W. Jenkins - *Murphy Oil Corporation - CEO, President & Director*

Thanks, everyone, for calling in today on the interest on our JV. We're very, very proud of it and very excited to work with Petrobras and the announcements we made today. Thank you for calling in. Should you have additional questions, please contact Kelly and Emily on our IR team here in Houston. And we appreciate it, and thank you, and see you soon.

Operator

Ladies and gentlemen, this does indeed conclude your conference call for today. Once again, thank you for attending. And at this time, we do ask that you please disconnect your lines. Enjoy the rest of your day.