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Conference Call Transcript

NXY - Q1 2009 Nexen Earnings Conference Call

Event Date/Time: Apr. 28. 2009 / 9:00AM ET

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CONFERENCE CALL PARTICIPANTS

Gil Yang*Citigroup - Analyst***Andrew Fairbanks***Merrill Lynch - Analyst***Martin Molyneaux***FirstEnergy Capital - Analyst***Sunil Jagwani***Catapult Capital Management - Analyst***Andrew Potter***UBS Securities - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Nexen first quarter 2009 conference call. I would now like to turn the meeting over to Mr. Kevin Reinhart, Senior Vice President and Chief Financial Officer, who is accompanied by Mr. Marvin Romanow, President and Chief Executive Officer. Please go ahead, Mr. Reinhart.

Kevin Reinhart - Nexen Inc. - SVP and CFO

Thank you and good morning. Welcome to our first quarter conference call. This is Kevin Reinhart, Chief Financial Officer, and joining me today is Marvin Romanow, President and CEO.

Certain statements I make today are forward-looking statements. Actual results may differ from expected results because of various risk factors. Please review our 10-K and 10-Q for a complete description of these risks. More information with respect to forward-looking statements and other cautionary notes maybe found in today's press release. All numbers in my comments today will be in Canadian dollars unless I specify otherwise.

My plan this morning is to touch on some of the highlights of today's press release. With this in mind, I will make a few comments on our quarterly financial results and our strong liquidity position. I will then provide an update on our Long Lake project, review our ongoing exploration success at Hobby in the Golden Eagle area of the North Sea, and touch on our exploration program elsewhere. Following this, I will open up the call to questions.

Turning to the quarter, despite low commodity prices, we have a solid quarter with cash flow of CAD\$557 million and net income of CAD\$135 million.

Oil prices declined approximately 20% compared to the previous quarter, but our cash flow remained the same. This reflects higher production volumes and a turnaround in the results of our marketing division. Production for the quarter averaged 252,000 BOE per day. That is 225,000 BOE per day after royalties. This was up 9% over the previous quarter reflecting strong run time in the UK North Sea where the contribution from Buzzard set a quarterly record.

In addition, we saw the return of much of last year's hurricane-impacted production in the Gulf of Mexico. And over the weekend we brought our Wrigley Field back online.

This is a good start to the year. As the year progresses, we will see new production volumes from Ettrick in the North Sea and Longhorn in the Gulf of Mexico, together with increasing volumes from the ongoing ramp-up of Long Lake. We are on track to meet our annual guidance subject to the start up of the new projects I just mentioned.

We continue to generate industry-leading cash net backs. Our netback for the first quarter averaged just over CAD\$30 per barrel at a time when WTI averaged \$43 per barrel US. On an earnings basis, we expect our companywide operations to break even with commodity prices around \$30 per barrel US.

Our marketing division has also started the year well, contributing CAD\$83 million in cash flow into our quarterly results. The last of the gas trading positions were exited in January and marketing's positive results in the quarter were realized from renewed focus on the optimization of our physical marketing assets.

More specifically, our crude oil group captured value by using storage positions to take advantage of contango in the oil market and by importing condensate into Western Canada to meet increasing demand for heavy oil diluent.

Our funding requirements for the first quarter totaled approximately CAD\$1.2 billion. This reflects the acquisition of an additional 15% working interest in the Long Lake project combined with capital investment and development programs that exceeded quarterly cash flows. We funded these investments with excess cash we generated in 2008 and by drawing on our credit lines.

While we are slowing down capital investment in some areas, we are accelerating projects that are economic in the current environment, such as the exciting Golden Eagle area in the UK North Sea, where we are continuing to have exploration success. In addition, we remain focused on completing our new growth projects at Long Lake, Ettrick, Longhorn and Usan, offshore Nigeria.

Our financial position continues to be excellent with over CAD\$3.3 billion of available liquidity. This comprises cash of about CAD\$2.1 billion, with the remainder in undrawn committed credit lines. We have no debt maturities until 2012, and the average term of our public debt is almost 20 years. We expect to maintain the majority of this liquidity throughout the course of this year.

Now turning to an update on our Long Lake project. During the quarter, we achieved a major milestone with the production and sale of our first premium synthetic crude from the upgrader. This demonstrates that the pots and pans at Long Lake are working successfully. We are now generating and using the syngas will give us our significant cost advantage.

We are happy with the performance of the upgrader. It has been running reliably since start up in late January except for short periods of downtime that are typical in the ramp-up phase.

The reservoir is also performing well, delivering bitumen when it gets steam. Monthly bitumen production volumes have grown steadily since December, and for the month of April, we expect to set a new bitumen production record. The pace of our ramp-up has been limited by our capacity to treat water.

To deal with this, we are implementing a number of low-cost changes to our water treating system, which include improvements to the filtration system and the addition of supplementary heat to the hot lime softeners. We have nearly completed these improvements and the modifications made so far have already resulted in increased steam generation volumes.

For the first quarter, our steam volumes averaged 66,000 barrels of water per day and they are now starting to exceed 85,000 barrels a day. The remaining modifications will be completed shortly and we expect to see another step change in our steam volumes. We anticipate this will result in the accelerated ramp-up of bitumen production.

Current bitumen production rates around 18,000 barrels per day gross. This is a 35% improvement over first quarter average bitumen production rate. We expect to reach full design rates of 72,000 barrels a day of gross bitumen production which will be upgraded to approximately 60,000 barrels a day of premium synthetic crude sometime next year.

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Earlier in the quarter we completed the acquisition of the additional 15% working interest in the Long Lake project and we have successfully integrated the upgrade of personnel that came with the acquisition. We are now the sole operator of both the resource and the upgrader.

In the North Sea, we are very excited about the success we are having at Hobby in the Golden Eagle area. This goes along with our previous discoveries at Golden Eagle and Pink. We have completed drilling the Hobby discovery well along with two sidetracks.

All three wells encountered significant high-quality oil pays with results at the high-end of our pre-drill estimates. We are planning to continue our appraisal work and expect to spud an appraisal well shortly. In addition, we plan to drill a third sidetrack.

Elsewhere in the area, we have plans this year to drill an exploration well at Lily and an appraisal well at Pink. The Golden Eagle area is expanding rapidly with the discoveries we are making here. While appraisal work is still ongoing, we expect the discoveries to date should support a standalone platform. The development of these discoveries should deliver attractive returns even at current commodity prices. The economics are further enhanced as all development capital is deductible against current cash taxes in the UK.

Elsewhere, we are about to start drilling the Antietam exploration prospect in the eastern Gulf of Mexico. This prospect is located in an area where we have already had success at Shiloh and Vicksburg.

Offshore Nigeria, we have recently spud the Owowo exploration prospect on the block adjacent to our Usan development. We expect results from these exploration wells to be available later in the year.

To conclude, I want to highlight the value proposition of investing in Nexen.

First, production growth. Our conventional production adds from Ettrick and Longhorn combined with new oil sands production from the ramp-up and increased working interest at Long Lake should more than offset natural declines and scheduled downtime at Buzzard.

Much of our production has low operating costs and low royalties. This is generating cash netbacks that are the highest in the industry and we are well-positioned to weather low commodity prices.

At Long Lake, we are now producing premium synthetic crude and we expect to have a significant cost advantage over our peers as the project ramps up. We have several identified projects to generate future production growth and value creation, such as Ettrick, Longhorn, Usan and Knotty Head, and a number of exciting discoveries in the UK North Sea.

We also have a significant shale gas division in Western Canada's Horn River basin. We are testing two shale gas wells now and plan to complete and tie in three more wells this summer. By the end of the year, we expect to have six wells on production.

In addition to these projects, we have a rich portfolio of exploration opportunities in the North Sea, the deep water Gulf of Mexico and offshore West Africa. Our globally diversified portfolio of assets gives us a choice, and we are focusing our capital on projects that are economic in the current environment, while proceeding cautiously on others.

We are well-positioned financially and our substantial liquidity provides us with confidence to unlock the value that is built into our portfolio.

This concludes my prepared comments. I will now open the call to questions.

QUESTION AND ANSWER

Operator

(Operator Instructions). Gil Yang from Citigroup.

Gil Yang - Citigroup - Analyst

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Good morning. Could you comment on the deferred, what I thought was a deferred tax credit in the quarter? What was the source of that and just explain what is going on there?

Kevin Reinhart - Nexen Inc. - SVP and CFO

The deferred tax credit largely relates to the UK reorganization transaction that we undertook last year. And as we amortize some of that gain as you recall, we booked a gain last year as a result of that reorganization. We have to recognize that gain over the future as we produce the property. So you will see that each quarter.

The other component of that, the deferred tax credit is that we had a reduction in Canadian tax rates that we were able to reflect on our expected future tax income. So it is just a reduction in the Canadian tax rate.

Gil Yang - Citigroup - Analyst

So this period was a makeup or that's not the ongoing rate of new Canadian taxes, is it?

Kevin Reinhart - Nexen Inc. - SVP and CFO

It will be a makeup, a one-time adjustment as we adjust our expected future tax obligation down to the new tax rate going forward and then in future, we will be taxed at the lower rate.

Gil Yang - Citigroup - Analyst

Could you give us some idea of what is the amortization of that gain in '08? How much was the makeup and what should the forward tax rate be?

Marvin Romanow - Nexen Inc. - Pres. and CEO

Maybe just tried to put this issue in a slightly different perspective. I mean when we did the tax rate organization in the UK, we had close to a CAD\$650 million tax benefit which we took in the current year. The accounting for that, though that's factored into the net income over the life of the assets. So the balancing out there occurs in deferred taxes.

Gil Yang - Citigroup - Analyst

And what should be the ongoing tax rate that we use in modeling?

Kevin Reinhart - Nexen Inc. - SVP and CFO

That depends on production mix and a whole bunch of factors -- price, but at this point in time I would say it's somewhere in the high 20's 27-28% range.

Marvin Romanow - Nexen Inc. - Pres. and CEO

Keep in mind this is the tax rate that is associated with our net income which has this deferred taxes going through it. On a cash basis, we are fully cash taxable in the UK and that's at a 50% tax rate. Tax rates in the United States are in the low 30s and similarly in Canada.

So when you look at what do you use for an economic assessment, it would be those kinds of variables.

Gil Yang - Citigroup - Analyst

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Okay and did you have any mark to market gains in the quarter?

Marvin Romanow - Nexen Inc. - Pres. and CEO

The marketing returns of CAD\$83 million came primarily from storing oil and selling it through the opportunity to get the gains on the Contango part of the curve. We also had good returns from our condensate railing business where we rail condensate from the United States into Canada.

And I think the important thing to remember about these pieces of business is that when you put a barrel of oil in the tank and you mark forward to the positive sloping contango curve, that's virtually a riskless transaction.

Gil Yang - Citigroup - Analyst

Right. But there were no mark-to-market gains on derivatives in the period?

Kevin Reinhart - Nexen Inc. - SVP and CFO

There would be some market gains on inventory positions and some on financial contracts, but a large portion of the gains that Marvin talked about related to crude oil and the contango and blending. On the blending side, most of that is realized on the contango, on the oil storage.

Marvin Romanow - Nexen Inc. - Pres. and CEO

Hi. This is Marvin Romanow and Kevin Reinhart and we just lost power here for a second and lost our telephone line. So we are back.

The last question we were addressing was the question of mark-to-market gains in our marketing business.

And our marketing business today is not active in proprietary trading. So what we have is financial positions that support our physical positions.

On the oil side when we put a barrel of oil in inventory, we will forward sell it, take advantage of the contango curve and it will match the physical barrel against the financial barrel.

Now we still do have the issue that we will always have in our business, where financial contracts have to be mark-to-market on a quarterly basis and physical volumes are taken into earnings when the crude or the natural gas is sold.

But this month's or this quarter's marketing income reflects true economic gains in our business. It does not reflect any significant timing differences.

Operator

Andrew Fairbanks of Merrill Lynch.

Andrew Fairbanks - Merrill Lynch - Analyst

Good morning. I was wondering if you would be willing to divulge any technical details in your Horn River wells from the quarter?

Marvin Romanow - Nexen Inc. - Pres. and CEO

We have drilled a total of six wells, six horizontal wells and some of these go back a few years. Some of them go back to the winter program and we have completed two of them.

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We expect to complete, sorry -- we completed three of them. We expect to complete the remaining three this summer. Shortly we will have a total of three wells producing and the last three wells that were -- the last three wells that will be completed later will be on stream sometimes in the fall just to the schedule of our facility construction.

What we are typically seeing for outcome of results, if you look at average production over the first 30 days is, we are seeing anywhere between 0.5 million and 1 million cubic feet a day per frac that we are able to get from a well.

So some of our wells have three fracs, some of our wells have four fracs, but we are continuing to increase the concentration of the number of fracs that we can stick into a well. So we expect to be somewhere on the order of producing 20 million to 30 million cubic feet a day from our entire inventory of wells by the fall.

Andrew Fairbanks - Merrill Lynch - Analyst

That's excellent and can you remind us what your takeaway capacity is out of that basin?

Marvin Romanow - Nexen Inc. - Pres. and CEO

Our takeaway capacity is well above that. So I don't have it right in front of me, but I think we are somewhere between 70 million and 90 million cubic feet a day of takeaway capacity.

Andrew Fairbanks - Merrill Lynch - Analyst

That's great. Thank you.

Operator

Martin Molyneaux from FirstEnergy Capital.

Martin Molyneaux - FirstEnergy Capital - Analyst

Good morning, gentlemen. You mentioned in the press release Ettrick is on the next few months. Can you give us a bit more detail of what is left to be done and can we kind of fine tune the timing expectations of it?

Marvin Romanow - Nexen Inc. - Pres. and CEO

Sure. The floater has sailed away from Singapore. It is currently at the docks in the UK. It is going through a final round of commissioning and checks to equipment. We expect it to sail onsite sometimes in May. Hookup to be completed in the next 30 to 45 days after that and we expect first production some place right around the middle of the year.

Martin Molyneaux - FirstEnergy Capital - Analyst

Excellent. Okay. And also on the press release, you talk about no change in the capital expenditure program for this year, yet you mentioned that there are some reallocations.

Can you give us some details on where capital is being taken away from and what capital is being put towards?

Marvin Romanow - Nexen Inc. - Pres. and CEO

Yes, the primary shift in our capital expenditure program is -- we've deferred some of our exploration in the UK in favor of appraising our Hobby discovery. The other pieces of the program are fairly well intact. We have a slightly smaller shale gas program that we originally

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envisioned but we still expect to have some very good results from our shale gas program as I mentioned in responses to one of the earlier questions.

Martin Molyneaux - FirstEnergy Capital - Analyst

Yes. Great. Last question, I was caught a little bit light in terms of the capitalized interest in the first quarter. Can we expect most of the interest to be expensed in Q2 and going forward?

Marvin Romanow - Nexen Inc. - Pres. and CEO

Yes, the capitalized interest component has to do with when we finalize and get Long Lake wrapped up. So someplace on the order of getting close to half our production from wells will stop capitalizing that interest and maybe even a little earlier than that.

Martin Molyneaux - FirstEnergy Capital - Analyst

Great. Thank you very much.

Kevin Reinhart - Nexen Inc. - SVP and CFO

Martin, it's Kevin. On the operating costs, we continue to capitalize those until we get to a reasonable steady-state with the upgrader. The capitalized interest we stop, once construction is done. So we have during the quarter stopped capitalizing interest at Long Lake, even though we haven't yet achieved what we'd call commercial operations for purposes of operating costs capitalization.

Martin Molyneaux - FirstEnergy Capital - Analyst

Excellent. Thank you.

Operator

(Operator Instructions). Sunil Jagwani from Capital.

Sunil Jagwani - Catapult Capital Management - Analyst

I just had a quick question on Usan. Can you remind us how much from Usan has been booked in your year-end '08 reserves on a P1 basis? And I guess P2 as well.

Marvin Romanow - Nexen Inc. - Pres. and CEO

It's in the vicinity of 25 million to 28 million barrels at the end of last year. On a P1 basis.

Sunil Jagwani - Catapult Capital Management - Analyst

And how much on P2 if you can recall?

Marvin Romanow - Nexen Inc. - Pres. and CEO

I believe it is somewhere in the vicinity of 80 million barrels.

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Sunil Jagwani - Catapult Capital Management - Analyst

Okay. Perfect. Thank you.

Operator

Andrew Potter from UBS Securities.

Andrew Potter - UBS Securities - Analyst

Just looking for a little bit more color on Hobby and Golden Eagle. Just wondering if you could elaborate on what would the cycle time be to see development of this asset? And I know you are not giving out reserve estimates at this point, but how much critical mass we need to see to build a fixed platform from all of these discoveries or some color along those lines would be appreciated.

Marvin Romanow - Nexen Inc. - Pres. and CEO

If you go back to our discovery at Golden Eagle, there we had previously disclosed that we had discovered in the order of 25 million to 50 million barrels. And at that level we were able to support a floater and move forward with the development.

Because of the success we had been having in the area, we decided to defer just the development of Golden Eagle and continue to explore in the area to see what additional reserves we could identify. So we have successfully done that. We still have a few additional prospects to drill -- primarily a prospect called Lily, but also the appraisal of Pink.

So we are clearly now at the point where we believe we've discovered enough that we should be able to support a fixed platform. Our game plans here are to continue to drill the site tracks from discovery well and we will drill a northern and southerly appraisal wells and we will do that in sequence.

We've disclosed the results from the drill stem tests. We started doing early feed work to determine exactly the kind of facility we would have and the nature of it. So that work will continue as we continue to explore here.

I think a good analogy would be in terms of the cycle time of what it takes to develop this. A good analogy would be Buzzard. It was a fixed platform and a substantial accumulation and that was 3 to 4 years from sanctioning to first production.

Andrew Potter - UBS Securities - Analyst

That's great. Thanks.

Operator

Thank you. And there are no further questions registered at this time, gentlemen.

Marvin Romanow - Nexen Inc. - Pres. and CEO

Okay, well thank you very much for joining for our first quarter conference call and have a great afternoon.

Operator

Thank you. The conference call has concluded. You may disconnect your telephone lines at this time. We thank you very much for your participation.

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