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NXY.TO - Q4 2011 Nexen Earnings Conference Call

EVENT DATE/TIME: FEBRUARY 16, 2012 / 02:00PM GMT

OVERVIEW:

NXY.TO reported 4Q11 earnings of CAD43m.



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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Nexen 2011 fourth-quarter and annual conference call. I would now like to turn the meeting over to Janet Craig, Nexen's Vice President of Investor Relations. Please go ahead.

Janet Craig - Nexen Inc. - VP IR

Hi and good morning and thanks, Wayne. As a reminder, some of our comments today will be forward-looking in nature. Our earnings release provides more information about these statements and our AIF describes our various risk factors. In a moment I'm going to turn the call over to Kevin Reinhart, Nexen's Interim President and CEO. Joining him is Una Power, our Interim CFO and Senior Vice President of Corporate Planning and Business Development.

Kevin will provide an overview of the Company's strategic priorities and recent progress on those priorities, and Una will provide some detailed comments on the financial results. Kevin and Una will then both be available to answer questions. If you have detailed modeling questions, my IR team would be pleased to respond to those questions after the conclusion of the call. With that I will turn it over to Kevin.

Kevin Reinhart - Nexen Inc - Interim President & CEO

Thanks, Janet, and good morning to everybody. As always we appreciate your time and interest this morning. I trust you have all had a chance to read our news release that went out earlier this morning, and you would have seen that we had a very solid fourth quarter and that we're off to a very good start for this year.



As we reported in the quarter, we met our production guidance. That was really as a result of Buzzard and Long Lake meeting expectations. On the reserve side, we substantially replaced our production and now have over 1 billion barrels of proved reserves and 2.3 billion of proved, plus probable reserves. You'll have seen that our Long Lake reserves went up slightly. This reflects the net effect of numerous changes resulting from our updated understanding and prioritizing the K-1A development area, as this is the quickest way for us to fill the upgrader.

In summary, on Long Lake we decreased the previously recognized reserves by about 25%, reflecting the poorer quality areas of the lease and the switch to the K-1A development area. That reduction was more than offset by the addition of reserves for the K-1A area. More information on these changes will be available in our AIF, which will be filed in the next week or so.

As I mentioned, we're off to a very good start this year. We set out our priorities for 2012 at our Investor Day in December. We recognize it's important for us to achieve these so that we can demonstrate to you the value of our portfolio and regain your confidence in our ability to deliver.

I am confident that we will do this, as I see the commitment of the Executive Team and all of our employees to achieving these objectives. And we've also been opportunistically adding operational talent across the Organization, and we're already seeing results.

As we laid out in those priorities, we have four, broad areas for 2012. First is safe and reliable operations. We have been advancing our plans to fill the upgrader at Long Lake. The third one is to advance our growth initiatives in various places. And finally, meeting our production guidance for the year. So, let me take a minute and make a few comments on each of these.

Safe and reliable operations are paramount. It's obviously important that our employees work in an environment where they are safe, and a culture of safety consciousness paves the way for a focus on delivering results. I'm quite pleased with the progress that we've already started to make to fill the Long Lake upgrader. Fourth-quarter production was up 7% over the third quarter, largely with the completion of the turnarounds in the third quarter and continued ramp-up of Pad 11.

More importantly is the progress we've made since Christmas. Recent rates here are running at about 35,000 barrels a day for an extended period, which is already up 10% from the fourth quarter. Pad 11 continues to ramp up with production currently at about 4,500 barrels a day, which is already above the lower end of our guidance expectation or our total expectation from this pad of 4,000 to 8,000 barrels a day.

On the other 10 pads, the teams have been focused on well optimizations, and we're seeing a strong response. And we've got more than half the wells to continue to work on yet to optimize. Pads 12 and 13 are progressing. The drilling is done. And that confirmed that we're in the good quality reservoir that we had expected to be at. We expect first steam to Pad 12 in a few months when we finish completing the wells, and then first production to follow four to six months later.

Pad 13 will follow all this with steam in the late summer and first production possible by the end of the year. We're also progressing our regulatory approvals for Pads 14 and 15 in the K-1A area, which we hope to receive shortly. This will allow us to prepare for and drill the rest of the 60 wells over the next 12 to 18 months. Also of note was that in the fourth quarter, the 31,500 barrels a day that we produced generated CAD\$22 million of cash flow, allowing us to achieve positive cash flow for the year.

This sets us up very well for the annualized cash flow that we showed in the Investor Day presentation where we expect fourth quarter, annualized cash flow would be in the CAD\$250 million to CAD\$300 million net to Nexen. We're also making good progress on our various growth initiatives. I'm sure you noticed our announcement of another discovery at Appomattox. We encountered 150 feet of net play in the Northeast fault block. Analysis is underway to determine the recoverable resource, and we expect to have an update on that shortly.

This follows our earlier success in the South fault block where we've now booked 65 million barrels of probable reserves in 2011. The operator, Shell, has an aggressive drilling program planned here with an appraisal of the westerly extent of the South fault block being tested, and then a side track into the Northwest fault to see if the oil is trapped there as well. Given the size of the initial discoveries, Shell is already working on a development plan.

At Usan, we are on track for first production in the next month or two.

We're also progressing towards closing the shale gas joint venture that we announced last December. The first closing condition, which was getting regulatory approval, we have now received that. The final condition relating to the buyer's financing is progressing, and we expect to obtain that in the second quarter.

And finally, we are on track for meeting our production guidance for the first quarter. Production to date has averaged about 193,000 barrels a day against the guidance range of 180,000 to 220,000. We experienced delays in getting the Telford well tied in due to weather, but it has just started to produce here recently. This delay has been offset somewhat by production from Block 51 in Yemen.



In Yemen there is a labor strike on the Masila block which we process our oil through. We are still producing into storage on Block 51 until the labor situation is resolved.

Buzzard is one of our keys to meeting our guidance for this year. So far we've been operating at an average of about 185,000 barrels a day. This represents an on stream factor of 85%, which is consistent with our 2012 target.

Our target over the next year into 2013 is to move that up substantially to top performance of some 90%. And we have various initiatives underway today to allow this to happen. Clearly we've made a lot of progress since our last reported Investor Day in December. I will now turn it over to Una for some comments on the financial results.

Una Power - Nexen Inc. - Interim CFO & SVP Corporate Planning & Business Development

Thanks, Kevin, and good morning, everyone. For the fourth quarter, production was strong at 208,000 BOEs per day. This is a 12% increase over the third quarter and is within our guidance of 200,000 to 230,000 BOE per day. Kevin talked about many of the reasons, so I will be brief. I'm pleased to say that Buzzard had its best quarter of the year, averaging 186,000 BOEs per day, reflecting the completion of cooler repairs and successful start-up of the fourth platform.

At Long Lake, we also made good progress with production increasing 7% over last quarter, following the completion of turnaround and the strong ramp-up of Pad 11. In the UK we completed the Blackbird tie-back to Etrick, achieving production rates consistent with our expectations. Partially offsetting these increases were natural declines, a scheduled turnaround and hydrogen plant issue at Syncrude, and expiry of the Masila contract in Yemen.

Cash flow for the quarter was CAD\$585 million. This is a 13% increase over the third quarter, reflecting strong crude oil prices and solid production rates. Our after-tax cash net-back continues to be industry-leading, averaging CAD\$43 per BOE in the quarter, compared to CAD\$39 per BOE in Q3. We expect these strong net-backs to increase further in 2012 with the addition of high net-back production as the Usan project ramps up. This should allow us to deliver 15% year-over-year growth in 2012 cash flow on a price-neutral basis.

Quarterly earnings of CAD\$43 million were less than expected as a result of some one-time charges in the quarter. In our Oil Sands business, we expensed previously-capitalized costs relating to the development of our leases at Kinosis. These costs relate to preliminary engineering and design work for a large, integrated project that included a 72,000 barrel per day SAGD project and associated upgrader.

Our strategy has now changed to a bitumen-led strategy initially focused on smaller SAGD projects. As a result we have expensed these costs and have reclassified our reserves from PSC to bitumen. We also impaired some gas assets in Canada and the Gulf of Mexico due to low prices. The assets in Canada were mature, conventional gas properties, as well as CBM properties. We did not have any impairments on shale gas properties in Canada.

Turning to our financial capacity. During 2011, we used proceeds from non-core, asset sales to reduce our net debt by another 13%. Over the last two years, we have reduced net debt by 36%. During 2012, we expect that our capital program will be funded by cash flow, assuming current prices. We also expect to receive about CAD\$600 million of proceeds when we close our shale gas JV in the second quarter. Proceeds consist of the upfront cash payment and partners' reimbursements of our costs since the effective date of the transaction, which was July 1.

With our portfolio heavily weighted to crude, in particular Brent oil, and strong operating performance, we believe we are well-positioned to deliver strong cash margins and cash flow in 2012. That concludes my comments. I'll pass it back to Kevin now.

Kevin Reinhart - Nexen Inc - Interim President & CEO

Thanks, Una. Before I close, just a couple other comments. First of all I want to thank the employees. They have shown great resilience over the past several months and they have committed to achieving our 2012 priorities. The momentum is visible. We look forward to this being translated into delivering results.

I would like to leave you with a couple of key messages. First and foremost is that we are making progress on our strategic priorities that we've laid out to you. I think we've made clear the milestones we are driving to achieve this year. Secondly, successful execution on our strategic priorities means that we will see results, such as increased cash flow and margin expansion that Una talked about, and making strides towards rebuilding your confidence that we can deliver the value that exists in our portfolio. So on that note, I'll turn it back to Janet.

Janet Craig - Nexen Inc. - VP IR



Thanks, Kevin. And that concludes our prepared remarks. We will now move to the question and answer portion of the call. I will turn the call back over to Wayne to get the questions started.

QUESTION AND ANSWER

Operator

Thank you. We will now take questions from the telephone lines. (Operator Instructions) The first question is from Menno Hulshof from TD Securities.

Menno Hulshof - TD Securities - Analyst

Thanks, and good morning. I've got a few questions. I'll start out with the Gulf of Mexico. I was just wondering if you could maybe talk us through the geological similarities and differences when it comes to the Northeast fault block versus the South. And then, any high-level thoughts on the size of that discovery relative to the initial discovery?

Kevin Reinhart - Nexen Inc - Interim President & CEO

Sure. Thanks, Menno. The Appomattox structure is a very steep, domed structure that has faulted into three compartments. So we tested and had the initial success in the southern part there, and as you would have seen from our press release, we recognized 65 million barrels of probable reserves. So that starts to give you an indication of what we believe is the size, at least to the confidence factor of a probable reserves booking, indicates the size on that side.

The next then was to go into the northeast section and test it, and that's where we have found that the oil is also trapped on that side of the fault. Right now we're going through the process of calculating what we believe the recoverable resource is at that point, and we expect to have that number here over the next little bit. So it would be premature to put any other information out there.

The next plan here is to test the westerly extent of the South fault block so that we can start progressing on a development scenario, and then from that test on the west, we will do a side-track to reach up into the Northwest fault block to see if the oil that was once in that structure has managed to seal and trap itself up there as well.

Menno Hulshof - TD Securities - Analyst

And then when you talk about the 100,000 barrel per day, stand-alone facility, would that incorporate all three fault blocks, or is that a potential to grow over time?

Kevin Reinhart - Nexen Inc - Interim President & CEO

The development that's being considered today is to find the optimal size of production facilities, not necessarily the maximum size. And what I mean by that is, building something large is incredibly complex to execute and very difficult to manage. And so, the approach here would be to determine an optimal size of development; and at this point in time, it looks like the Southern fault alone will support an optimal development.

I can't comment on whether that's the 100,000 barrels a day or not. We're still in the process of working through what size of production facility that would be. But the intent would be to start with that development; and then as we continue to explore and appraise the rest, the structure in the northeast and the northwest, and perhaps even the south could support more, we would look at putting in another facility of a similar-type size; and we can continue to replicate those until we have enough production facilities to support what the reservoir is capable of delivering. So it's more of a hub-type strategy that we would be building rather than one massive platform.

Menno Hulshof - TD Securities - Analyst



Perfect. Thanks a lot, Kevin. That's it for me.

Operator

The next question is from George Toriola from UBS. Please go ahead.

George Toriola - UBS - Analyst

Thanks and good morning, guys. My question relates to the comments you made earlier, Kevin, about reliable operations. And I guess in your role as the leader of that organization, what levers do you have to ensure that you have reliable operations? And I guess if you could also speak to how you look at the Company, and what are the key areas of strength you see as an organization and what are the areas of weaknesses that potentially you can improve on?

Kevin Reinhart - Nexen Inc - Interim President & CEO

Thanks, George. When it comes to reliability, this happens at the grass roots level. This is the individuals that are out in the field that are making the difference. These initiatives have been underway for quite a period of time, and particularly on our two assets at Buzzard and Long Lake. Those are obviously the two, most important.

We started an operational excellence initiative at the Buzzard field late last summer. And that has a whole bunch of components to it. And we're well underway. It's how we look at communication so that we have better planning and coordination amongst the various groups, whether it's maintenance or production or reservoir engineering. It's better communication so that we're prepared for when we do plan maintenance, it's much better coordinated.

Doing preventative maintenance rather than repairs can make a huge difference. And so, the focus on doing maintenance to avoid problems in the future is so important. And we have an initiative underway to work through the backlog of maintenance that is built up. It wasn't critical maintenance, but it's in the realm of preventative maintenance, and it will pay off dramatically as we go forward.

So our target is to move that reliability up quite substantially here. As I say, take it from a target this year of 85% to over 90% within a year. And I see lots of energy in doing that. Long Lake, same sort of exercise is underway with respect to the upgrader and with respect to the steam and the SAGD-type facilities. So these are initiatives that the teams are coming forward with. And as a leadership team, I view this as, it's our responsibility to enable this to happen and make it possible and make it a priority for the teams to be doing this.

On the second half of your question here, George, with respect to what do I see as a strength of the organization, a lot of these we've talked about in the past. We have a very high quality portfolio of assets. Our assets are at the front end of the maturity curve, not the back end. So we're still seeing a lot of upside potential as opposed to trying to squeeze the last couple barrels out at this point in time.

So there is lots of opportunity for reservoir management, lots of opportunity for reliability and how we operate these fields. And I see the capacity in the organization to tackle these things, and the progress that we've made at Long Lake already this year in six weeks, the excitement that gets created by seeing results, as you go through and start to do well optimizations, is pretty infectious, not just for the team, but for the whole organization. And so I just see the opportunity within our portfolio and the energy of the people to extract that value as being our greatest strength at this point in time.

George Toriola - UBS - Analyst

Thanks for that, Kevin. Just one more question. This goes to Buzzard. Buzzard tends to be fairly newsy, just in the press in general, because whatever the Forties Pipeline tends to do has a bearing on Buzzard. Is there a way you think of communicating Buzzard to the Street, because we see the Forties, whether it's the loading or whatever, and it starts to really raise questions around what Buzzard is doing.

Kevin Reinhart - Nexen Inc - Interim President & CEO



We get a lot of phone calls on what goes on, because of the media reporting with respect to Buzzard, because it is a big item. But the reality is that we've provided the guidance in terms of we expect an 85% reliability out of this field. So if you turn that into some simple math, that means that that platform, over the course of the year, is not going to be operating for a month and a half to two months.

And so what you hear in the press about it being down, either the Forties System being down or the Buzzard field being down for a day or two, we shouldn't be surprised by that. That's the 15% of down time that is just natural with any facility of this magnitude, whether it's Buzzard or any of the other fields. So it's not going to be productive for us to certainly try to report against every up and down in the field, and I would caution the investors as well to not look at every day's headline report to figure out what's going on at Buzzard. I would come back to looking at our quarterly guidance to see how we're progressing against that 85% reliability factor.

George Toriola - UBS - Analyst

Thank you very much, Kevin.

Operator

Thank you. The next question is from Brian Dutton from Credit Suisse. Please go ahead.

Brian Dutton - Credit Suisse - Analyst

Good morning, Kevin. Could you give us some insight, please, into the process, the strategy, and the reasons behind why you selected the partner you did for your shale JV?

Kevin Reinhart - Nexen Inc - Interim President & CEO

Yes. We went through an exercise last summer, and we set up a couple criteria that we wanted to achieve. We know that there's some challenges with respect to North American gas supply, and therefore prices. And so one of the key focus items for us in the partner selection process was to find somebody that had an interest that we could align with in terms of accessing the global market. So we wanted to have a partner who understood that.

We wanted to have a partner who had some technical capabilities with the resource, and we found that with INPEX. They produce, I believe, somewhere around 400,000 barrels a day, around the world today, and they are actively engaged with two LNG projects in southeast Asia and Australia. And they're a financially-strong partner. Japan is following the challenges that they had a little less than a year ago. Japan is very motivated to secure energy supply.

So we met virtually all of the objectives that we were looking for in a partner, which was to make sure that our interests, both theirs and ours, would be very much aligned in terms of resource development. Otherwise, when you enter into this, if you're selling an asset, it's very different than when you're joining into a partnership. So it was very important that we were aligned and comfortable with their technical capabilities before we signed up on that. And so we're quite pleased to have both INPEX and JGC as our partners here.

Brian Dutton - Credit Suisse - Analyst

Thank you.

Operator

The next question is from Phil Skolnick from Canaccord Genuity. Please go ahead.

Phil Skolnick - Canaccord Genuity - Analyst

Thanks, good morning. A few questions. First, how far in the ramp-up cycle do you think you are on Pad 11? That is, does it seem that you are going to possibly be above the midpoint of that 4,000 to 8,000 barrel-a-day target that you have for it?



Kevin Reinhart - Nexen Inc - Interim President & CEO

Yes, it's a bit of a mug's game trying to predict exactly where this will all turn out, but I would say we're quite pleased with where we're at, given the time that's passed. When we initially started steaming that pad, we didn't get consistent steam going into the ground. Now that we've been getting consistent steam in there for about a year, we've seen a tremendous response, which is what we had expected from this quality of resource that we targeted here.

So we're not seeing any signs of this thing slowing down. But I'm not prepared to say at this point in time whether we're going peak out at the midpoint or we're going move upwards of that, but I would just say right now, we're optimistic by where it's going to go, but we need a little bit more time here, another six to nine months, I think, before we're going to know where this thing goes.

Phil Skolnick - Canaccord Genuity - Analyst

Okay. Could you be maybe a little more specific on the types of optimizations that you're doing at the other pad that you talked about?

Kevin Reinhart - Nexen Inc - Interim President & CEO

Sure. There's a couple items that we're focused on here. One is the fluid withdrawals. So it's the rate of injection relative to the withdrawals that we start to tinker around with. You certainly don't want to be in a situation where you're trying to suck the fluids out, because you can bring all kinds of other stuff in with that. So that exercise is underway.

And similarly, it's the injection pressures for the steam that we're putting in. Obviously the more steam, the more heat, the more bitumen. But the counter balance to that is, if the water fluids are too hot, and coming back into your producer, or it comes back in the form of steam, you could do a lot of damage to your liner in the well bore. So we obviously start rather cautiously so that we don't overshoot on where we should be.

So during this period of time, we've been pretty cautious as to how intense to inject, how aggressive to withdraw. And with some stability in these wells over the last little while, we're starting to move that up a little bit to see how much more ground we can make here. So the teams really are focused on just turning the dial up a tiny bit every day and seeing what's the right way to go. And we're seeing tremendous response from where we were last fall.

Phil Skolnick - Canaccord Genuity - Analyst

Okay, thanks. And finally, what stage is the Board at in finding a new CEO, and are they also looking for a COO?

Kevin Reinhart - Nexen Inc - Interim President & CEO

Yes, the Board has a search committee with respect to the CEO. They have engaged a search firm, and they're going through the process right now of defining what they would like in a CEO relative to what they believe Nexen needs at this point in time. And the Board is committed to following due process here to identify and secure the best possible candidate, and they're not driven by any particular time line here. So this is about following a proper process.

Phil Skolnick - Canaccord Genuity - Analyst

Then also on a Chief Operating Officer, are they looking for that as well or just the CEO?

Kevin Reinhart - Nexen Inc - Interim President & CEO

I think you start with a CEO, then the CEO builds his or her team, and I believe that's a decision of the future CEO, not a decision that needs to be taken at this point in time.

Phil Skolnick - Canaccord Genuity - Analyst



Okay, great, thanks.

Operator

Thank you. The next question is from Greg Pardy from RBC Capital Markets.

Greg Pardy - RBC Capital Markets - Analyst

Good morning. So just a couple of quick ones. Kevin. On the Gulf of Mexico production numbers, they just looked a little bit soft in the fourth quarter, and I'm wondering whether there was anything operational or whether it was just, to some extent, natural declines? And then maybe just on Buzzard, I know you've got Golden Eagle and so forth coming on, and I think it's 2014. When do you expect Buzzard to go into structural decline?

Kevin Reinhart - Nexen Inc - Interim President & CEO

Thanks, Greg. The fourth quarter was a little weak in the US, and there were really two drivers to that. One is the Wrigley field was shut in because of the host platform that we put the production through was down for maintenance, and that will be down for a more extended period of time, so that will continue on into the first quarter here.

Our Gunnison field was also down for some maintenance. We expect to have that back sooner than the Wrigley field. So I would say at this point in time with the Wrigley field being down, awaiting on the repairs of that host platform, I would expect the US to trend towards the lower end of their guidance.

Greg Pardy - RBC Capital Markets - Analyst

Okay.

Kevin Reinhart - Nexen Inc - Interim President & CEO

In terms of the Buzzard field, and when we're going to see that start to turn down, we're still drilling development wells in the Buzzard field, and we're drilling those wells, which tend to be on the outer flanks, so we're still testing the aerial extent of this field. And as you saw this year, we added some more proved reserves, part due to recovery factor, but also in part due to just more oil in place as we drill on these outer flanks.

And so while we're expecting based on our profile right now, that this could be sometime in 2014, I think there's still a real possibility that with the activity that we have going on, that we have an opportunity to extend that a little bit.

Greg Pardy - RBC Capital Markets - Analyst

Okay, thanks Kevin. And then Wrigley, net to your interest, production-wise what is that? And then what's the oil/gas split on that.

Kevin Reinhart - Nexen Inc - Interim President & CEO

I don't have those numbers at my fingertips here.

Greg Pardy - RBC Capital Markets - Analyst

Okay, I'll follow up.

Kevin Reinhart - Nexen Inc - Interim President & CEO



Yes, I think it's best if we do that.

Greg Pardy - RBC Capital Markets - Analyst

Thanks very much.

Operator

Thank you. The next question is from Rob Bellinski from the Morningstar. Please go ahead.

Rob Bellinski - Morningstar - Analyst

Good morning, everybody. I just had a quick question on the reserve updates. There was a footnote that says that you no longer have sufficient certainty as to when you will be able to build additional upgrading facilities at Kinosis. I was just wondering if you could give some additional detail as to what drove that uncertainty and what you're looking for in the future to make that decision.

Kevin Reinhart - Nexen Inc - Interim President & CEO

If you recall, our bitumen strategy, or our development strategy for our Oil Sands was to build replications of what we did at Long Lake, so basically to do 72,000 barrel-a-day, SAGD facilities and run that through an upgrader. The economics of upgrading have changed since we first sanctioned the Long Lake project. And so the value of upgrading today is not as attractive as it was at one point in time, but these are long-term projects.

And so we will continue to assess this each year as we go forward. About a year ago, we announced that we were changing our strategy from some of the learnings that we had coming out of Long Lake. Those learnings were that we should make sure we have bitumen available for the upgrader before the upgrader comes on stream. So the complexity of constructing both the SAGD and the upgrading at the same time and then starting them up concurrently can be very, very complex as we learned from Long Lake.

So we switched to a bitumen-led strategy, which meant that we would start up bitumen production, and given the economics of just producing raw bitumen and selling dilbit, we would just do that strategy and then build an upgrader at some point in the future. We continued to recognize the reserves on Kinosis on the assumption that we would upgrade them at some point in time. That's why we showed them as synthetic.

With the change in strategy to carve out some of the K-1A area and dedicate that back to Long Lake so we can fill the upgrader sooner, that caused to us say, we're not real sure exactly when we will be upgrading at Kinosis. And under the reserves booking rules, we need to have a reasonably strong degree of confidence that we will build the facilities to achieve that upgrading in order to show them as PSC. So without that at this point in time, without visibility on exactly when we'll do that upgrader, we made the reclassification to bitumen.

So in terms of the decision going forward, it's purely an economic decision. We will start with the bitumen, and we'll sell it, because there is good profit in doing that. And when the upgrading economics change around, we have the option and the capacity to put an upgrader in the field and take advantage of the upgrading differentials that we could get.

Rob Bellinski - Morningstar - Analyst

Thanks.

Operator

Thank you. The next question is from Mike Dunn from FirstEnergy. Please go ahead.



Mike Dunn - FirstEnergy - Analyst

Good morning, everyone. Kevin, I'm just wondering if you can maybe provide a bit more color on Knotty Head? Maybe more specifically, what has caused the delays? Is it simply a disagreement over who would get what percentage of a unitization and maybe just explain why we haven't seen more progress on that front? Thanks.

Kevin Reinhart - Nexen Inc - Interim President & CEO

Sure, Mike. Knotty Head is obviously something that we've had on the books for some period of time. What complicates Knotty Head here a little bit I guess is two factors. One is the reservoir. And we're dealing at some pretty deep structures here that are sub-30,000 feet. So the pressures and the temperatures are pretty extreme at that level.

There is production elsewhere in the Gulf, at Tahiti and so on, that isn't too far away, so this is producible. But you want to make sure that you understand the reservoir very well before you start a development scenario. So we're working through that aspect. At the same time, there's four of us on our Knotty Head block. So four partners. And so trying to align four partners around a reservoir, understanding what we're prepared to commit to for a development, in and of itself can be, bring its own complexities.

But the one complexity we don't have to deal with there is negotiating who gets what. That's already set with the working interest. But then when you bring in a fifth partner on another block, and then you bring in the complexity, not only of their reservoir understanding and trying to align it with the other four, but you're also trying to figure out now who is going to get how much of the pie, it just brings in another whole dimension.

So we are working through this to bring all of these interests together to plot what's the best path forward here for the development of our Knotty Head field and whether that includes the block to the north of us or not, is part of that deliberation. So while we're a little bit frustrated with the time that it's taking to progress this, I think the caution and the pace that we're going at will pay off rather than trying to rush this one through and getting the development scenario wrong or perhaps getting the equity split with another partner wrong. Getting that wrong can cost us a lot of value as well.

Mike Dunn - FirstEnergy - Analyst

Okay, thanks, Kevin. Just as a follow-up, could you comment on whether or not your Knotty Head interests might be farmed out or sold? Is that something that's out of the question or currently being considered?

Kevin Reinhart - Nexen Inc - Interim President & CEO

It's like any other asset, when we go to make further investment in, we'll look at what's the best way to realize value from that future investment, and that can range anywhere from saying we're all in to develop this, or we may decide that in our perspective, there's greater value in exiting that asset. So we need to go through and complete all the work that I just described before we can take a view on what we think the value of that asset is. And at that point in time, we'll make a decision whether to hold or sell.

Mike Dunn - FirstEnergy - Analyst

Okay, thanks, Kevin.

Operator

Thank you. The next question is from Mark Polak from Scotia Bank.

Mark Polak - Scotia Bank - Analyst



Good morning. Just a couple questions on Yemen. I think you mentioned some production there early this year offsetting the Telford delay. I just want to confirm, I think you mentioned into storage so there's production volumes but no sales for the quarter? Also just curious for an update. I know you're looking at options for Block 51 there.

Kevin Reinhart - Nexen Inc - Interim President & CEO

So Block 51 runs through the Masila facility because it's just to the, I believe, the west of Masila; and so we operate at that as somewhat of a joint operation. We have about seven days of storage on Block 51. So we flow our production every day through Masila, but then when we get interruptions, like we have right now with the strike going on, we continue to produce into storage. But as I said, we've only got five to seven days of storage available.

So we're right at the point now where that storage is full, and so we're going to be moving to shutting in the Block 51 production, because we've got no place to store the oil at this point in time. We know that the government is working expeditiously to deal with the labor strike on the Masila block, but in the meantime we're shut down.

In terms of sales for the quarter, as I described, we only have seven days of storage. So for the rest of the quarter, certainly year to date, we have sold all of that production. It's only these seven days that are not sold right now, and then whatever days we might be shut in for, going forward.

Mark Polak - Scotia Bank - Analyst

Great, thanks. Any update on options for how we should be thinking about Block 51 in our estimates for the rest of this year? I know it wasn't included in guidance. What are your thoughts on that block?

Kevin Reinhart - Nexen Inc - Interim President & CEO

Yes, we are going through the process of looking at our options, now that we know the outcome on the Masila block. So I would be cautious on including too much in the estimate going forward. As we said, it's only about 5,000 barrels a day that comes out of this field, so it's not particularly material to our overall numbers. And it doesn't drive a high cash flow that comes out of the production we do produce there. So I would be just really cautious of including too much with respect to Block 51 going forward, and if we do continue on, it's just not going to be a material upside.

Mark Polak - Scotia Bank - Analyst

Great, thank you.

Operator

The next question is from Andrew Potter from CIBC.

Andrew Potter - CIBC - Analyst

Just a question on Long Lake. What is the current SOR on Pad 11 that goes with that 4,500 barrels a day? And just a question on Usan. It sounds like it's coming on soon, but what should we expect when it first comes on in terms of initial volumes? And what would be a reasonable expectation for it, length of time, to get up to full production?

Kevin Reinhart - Nexen Inc - Interim President & CEO

Yes, those are still the uncertainties that we can't resolve yet, Andrew, with respect to Usan. We're driving towards first production here in the next little while. But we're still trying to figure out how many wells you bring on, how quickly you bring the wells on, and a lot of that is going to be determined by what the first well does and what the second well does and how things work once we start with real production flowing through the system. So it's still a little premature to start making predictions to try to narrow that guidance range of whatever 14 to 28 that we provided for the year. It's still a little premature to start to narrow that.



Andrew Potter - CIBC - Analyst

Sure.

Kevin Reinhart - Nexen Inc - Interim President & CEO

With respect to Pad 11, our SOR there is in around the 3 to 3.5 SOR with 4,500 barrels of oil per day.

Andrew Potter - CIBC - Analyst

And the current Long Lake overall SOR on the 35,000 barrels a day?

Kevin Reinhart - Nexen Inc - Interim President & CEO

It would be running at about 4 to 4.8; and I think you've seen the charts, that the tail on that, because of the last few wells that are producing in there are taking a fair bit of steam, but giving up very little oil, and so that 4.8 gets driven up from a lower number pretty quickly with those last 1,000 or 2,000 or 3,000 barrels a day of oil.

Those are the wells that we'll shut in when we have a use for the steam elsewhere, but at this point in time, because we have excess steam relative to what the wells can take, it still makes economic sense, even at a high SOR, to continue to steam those wells to get the oil flowing out of there. But that tail is what we cut off pretty quickly once we have all the other wells. That will give us a much lower SOR. So we expect to see a fairly quick drop in that SOR once we get some of these other wells drilled.

Andrew Potter - CIBC - Analyst

That's perfect, thanks.

Operator

Thank you. The next question is from Joe Citarella from Goldman Sachs. Please go ahead.

Joe Citarella - Goldman Sachs - Analyst

Thanks. Kevin, focusing back on the strategic review process discussed in December, it was clear that improving execution at Long Lake was what Management and the Board saw as the key way to close the perceived value gap. But can you speak a bit more to whether the way forward then is as simple as executing successfully on the current plans or are there other strategies you're contemplating to maximize value? I guess what I'm getting at is, do you continue to view Long Lake execution as the overwhelming swing factor here or are there any other key areas of the portfolio or the Company as a whole for that matter that Management and the Board will take another hard look at and consider ways to better monetize going forward? Thank you.

Kevin Reinhart - Nexen Inc - Interim President & CEO

That's a good question, Joe. Operating an oil and gas company takes many moving parts, and it's not one or two things that drive your success, and it's not (just) what you do today that's going to guarantee your success tomorrow. So the clear priorities, and we saw this happen last year, but the disappointments that we had last year were with respect to the Long Lake ramp-up and Buzzard reliability. So clearly those are two focus areas for us moving forward.

But all of the other priorities that we laid out at Investor Day, and we keep repeating, every one of those is important to the success of the organization. In terms of strategy, our strategy continues to evolve every day, and circumstances change, and we will, and we have, always continued to challenge the things that we're doing. And pace of shale gas development is clearly one of those in light of where our gas prices are. The decision that we make today is very different than the decision we might have made 12 months ago.



That doesn't mean that it's not a very attractive asset. It just means that you should take a different strategy in the short term here. And so we continue to have dialogue with the Board and continue to look at opportunities as to how to evolve our strategies to continue to progress the organization and continue to demonstrate the value of our assets. But the flip side of that is undertaking an activity for the sake of activity is something that, it's just not the right thing to do as an organization, and we're going to continue to resist the temptation just to create some excitement out there because we've done something. That isn't in the best, long-term interests of the organization.

Joe Citarella - Goldman Sachs - Analyst

Thank you, Kevin. Appreciate your thoughts.

Operator

Thank you. The next question is from Kam Sandhar from Peters & Company.

Kam Sandhar - Peters & Co. - Analyst

I have a couple questions. First of all, I'm just wondering if you can give us an update on Poland, where you're at and what the plan is for this year there? Secondly, just as a follow-up to Greg's question on Buzzard, just wondering if you could highlight a couple of potential tie-back opportunities that you're seeing? I think you've talked about them in the past. I'm just wondering if there's anything here in the short term that you guys are planning to drill.

Kevin Reinhart - Nexen Inc - Interim President & CEO

Sure, Kam. At Poland, we're still in the very early stages here. We have completed the first well and taken a fair degree of core, and that is going through its analysis at this point in time while we continue to drill. I think we have another four to six wells planned for this year in Poland. But this is a vast resource, and one well doesn't give you enough information to draw any conclusions.

But getting that information from the first well is going to be pretty important for us to understand what type of structures that we're looking at. So I would expect that it is going to take us just a little while yet before we get through that analysis and build up enough information where we're confident to start to communicate what we believe we have there. So I think we're still very early stages, and I wouldn't be waiting by the computer to watch for a press release on that real quickly here.

Kam Sandhar - Peters & Co. - Analyst

Are those verticals or horizontals you're planning?

Kevin Reinhart - Nexen Inc - Interim President & CEO

These are horizontals.

Kam Sandhar - Peters & Co. - Analyst

Okay.

Kevin Reinhart - Nexen Inc - Interim President & CEO

On Buzzard, the tie-backs, we still have lots of opportunity for, as I mentioned earlier, for field extension, if you will, within the Buzzard platform, in the Buzzard area. And so we continue to focus on that as a priority. Clearly the entire partnership with respect to Buzzard is quite keen on extending that plateau period from within the field. Down the road, there may be an opportunity to tie in other production.



One of the original plans was to tie in the Golden Eagle field. When we first had our discovery there, we thought that would be a tie-back to the Buzzard field and fill in as we hit declines. As we found Golden Eagle was much bigger than what we had initially anticipated, and therefore it justified stand-alone facilities, so I would look at Golden Eagle as somewhat of an offset for Buzzard. It's just that it's even bigger than we expected and therefore stand-alone as opposed to through the Buzzard facility.

We had a Polecat discovery, which is not too far away from the area; and we're going through an assessment right now as to whether it makes sense to tie that back to the field. Our business development people continue to look around the area to see if there's an opportunity to find other production in the area. So we're only five years into this field. And this is going to go on for another 20, 30 years of production life. So how we utilize that excess capacity in the future, there's a lot of opportunity here yet.

On the Buzzard field, just back to what I said earlier, we're going to continue to drill in the northern panel. That's where we've added reserves this year, and we see that as an opportunity to continue to extend the field and the oil in place, and therefore our reserves here.

Kam Sandhar - *Peters & Co. - Analyst*

Great. Thanks.

Operator

Thank you. The next question is from Harry Mateer from Barclays Capital.

Harry Mateer - *Barclays Capital - Analyst*

Hi, guys. Kevin, first question on the JV. The time has slipped a little bit to the second quarter. Can you just give us any more color on the status of the buyer's financing? Who are they seeking from? Is it banks? Or public markets? And has there been anything specific to delay that process?

Kevin Reinhart - *Nexen Inc - Interim President & CEO*

Yes, this is the financing. The partner that we're dealing with here is a well-financed company, and what they have is access to some government funding to support energy security within the country. And so there's a government agency that supports that type of financing similar to Canada has Export Development Corporation to help finance Canadian exports.

So in Japan, in order for that entity to commit to the financing, it has to go through their parliamentary process as part of their normal budgetary funds. That budget is just going through their parliamentary system right now and is not expected to be approved until at least the end of March, likely into the April time frame. Then it takes a little time to move from budget to enact it into law which allow that funding to happen. So we're not particularly concerned that this is an economic issue as to whether they're going to get the financing or not. This is a government processing issue that's going to take a little bit of time here.

Harry Mateer - *Barclays Capital - Analyst*

So would it be fair to say May or June is what we should expect?

Kevin Reinhart - *Nexen Inc - Interim President & CEO*

You know, I think it's going to be in that time frame, sometime in the second quarter, probably into the middle part of that, but it's a minority government, parliamentary process, and we see how budgets evolve around the world and how quickly they get passed, and sometimes how much they get debated. So it's hard to predict exactly how this will unfold over there.

Harry Mateer - *Barclays Capital - Analyst*

Okay. Can you restate your intended use of proceeds from the JV?



Kevin Reinhart - Nexen Inc - Interim President & CEO

Yes. We have a lot of opportunities. We have our budget that we put out there. We can finance that at current prices. So we'll continue to monitor where commodity prices go and what kind of investment opportunities we have. We have a lot of cash on the balance sheet today, and we've been pretty transparent with respect to our commitment to the rating agencies. And so we're continuing down a path of looking at bolstering up our balance sheet here and whether that's to put it in a short-term capacity, which would be cash on the balance sheet or put it into a more permanent reduction of capacity, which is buying back debt, is a decision that we'll make when we get the cash in the bank, and we decide which way we're comfortable going at that point in time.

Harry Mateer - Barclays Capital - Analyst

But either way you choose, is it fair to say, you are still committed to remaining investment grade?

Kevin Reinhart - Nexen Inc - Interim President & CEO

We're committed to protecting all of our stakeholders here, because we appreciate how important all of the capital providers are to the success of our organization. So we are respectful of the debt capital markets. But at the end of the day we have to make a decision that's in the best interest of all stakeholders here; and at this point in time, we believe that we have a great opportunity in order to protect that investment grade rating, but it does depend on the decisions that we take in future, and we'll wait and see how those decisions unfold.

Harry Mateer - Barclays Capital - Analyst

Thank you.

Janet Craig - Nexen Inc. - VP IR

Thanks, Harry. And Wayne, we have time for two more callers.

Operator

Thank you. The next question is from Jason Gilbert from Goldman Sachs. Please go ahead.

Jason Gilbert - Goldman Sachs - Analyst

Good morning, guys. Harry asked a few of the questions I was going to hit you with, but one remaining one is, I was just wondering, can you talk about production plans for the Horn River and take-away plans over time? It seems like any development in the Horn River has to be part of larger LNG strategy over time. Just wanted to get your thoughts there.

Kevin Reinhart - Nexen Inc - Interim President & CEO

Sure, Jason. I don't think it's any particular secret that trying to get gas off the west coast of Canada is the right strategy for going forward. But this is an industry issue, not just a Nexen issue. It's a North American pricing dynamic that isn't unique to what we're doing. So we're looking at how do we see LNG, take-away capacity evolving in North America. And then as part of that, what we're going to consider is whether we need to be a direct investor in that LNG or whether we can sit back and be a beneficiary of somebody else doing the LNG.

So in other words, if there's enough gas removed from North America from LNG, then the price within North America rises, and we may not have to put up the capital in order to do that. On the other hand, it may be in our economic best interest in order to be a direct investor in LNG, and so we have a pretty intense effort underway, a



gas monetization strategy, looking at all of those options and trying to secure an option with respect to LNG capacity off the west coast. So that we don't have to rely on somebody else to do it, let's at least capture the option; and we'll figure out how LNG evolves here over the next several years and what role we're going to play in that.

Jason Gilbert - Goldman Sachs - Analyst

Thanks. Just back to one of the things that you were just talking about on the debt repayment plan. Just refresh my memory, you committed to Moody's to reduce net debt or gross debt by CAD\$1.5 billion at the end of 2010?

Kevin Reinhart - Nexen Inc - Interim President & CEO

Really the commitment that we're looking for is that there are several measures that all of the rating agencies follows, and Moody's has theirs, as do the others. One of the key focus areas for them is to get our total debt to production under the method that they calculate, so it's not just your debt on the balance sheet, it includes a couple other items. But total debt to production into that 20,000 barrels per day range, not necessarily a precise number, but it really comes down to how much confidence they have in our assets and our growth plans over the next period of time.

So, roughly in and around that 20,000 barrels a day. When we put that press release out a little less than a year ago, that implied about a CAD\$1.5 billion decrease or buyback of debt. So it's not the CAD\$1.5 billion that's important. It's more driven around the 20,000 barrels a day combined with the level of confidence that they have with respect to what's happening at Long Lake, Buzzard reliability, Usan start-up and ramp-up, and all of the other activities that we have going on.

So we will engage with all three rating agencies here over the next month or two as they go through their annual review. We'll continue to have dialogue with them to ensure that they understand the quality of the operations and where we're headed here. And then we'll figure out what kind of pressures we have on our balance sheet and whether and how we respond to those particular pressures.

Jason Gilbert - Goldman Sachs - Analyst

Thanks. As you plan the road ahead, is that 20,000 barrel production, is that a metric you guys intend to keep on your radar screen as you make plans?

Kevin Reinhart - Nexen Inc - Interim President & CEO

Everybody has a different criteria for measuring your financial capacity. We tend to look at two factors that we believe are important to our financial strength. And those two factors are debt to cash flow (and liquidity). We look at net debt to cash flow, and we're in a very comfortable 1.5 times. And we believe that we're going to be able to stay in that kind of range here for a period of time. That's kind of middle of the pack for our peers. So we're very comfortable at those levels.

The second component of our financing strategy is really driven around access to liquidity. And when we're so exposed to one commodity, which is oil, our cash flow is going to go up and down with the oil price. We have a capital program that's got some big lumps in it that's hard to turn on and turn off. So what we need to do in order to be able to finance through some volatility in the commodity price environment is we need to carry lots of liquidity.

So if you look at our balance sheet today, we have over CAD\$4 billion, probably CAD\$4.5 billion of standby committed long-term liquidity; and so, that's how I measure the financial strength of our Company. And whether the rating agencies or debt investors view the financial strength in a different capacity, that's totally up to you as to how you look at it. But how we manage the Company is to those other metrics.

As I said earlier, it's important that we have access to the capital markets on an efficient basis, so we can't ignore all those other measures, but we're not totally consumed by them and driven to appease every one of those other measures.

Jason Gilbert - Goldman Sachs - Analyst

Great. Thank you, Kevin, for the explanation.

Janet Craig - Nexen Inc. - VP IR



Thanks, Jason. And we have I believe one last caller.

Operator

Thank you. The last question is from John Herrlin from Societe de Generale. Please go ahead.

John Herrlin - Societe de Generale - Analyst

Three quick ones. You took 84 million barrels off the books I assume for Long Lake as a negative revision. Do you think you have haircut it enough there? That's number one.

Kevin Reinhart - Nexen Inc - Interim President & CEO

Sure. We went through a fairly intense exercise of reviewing our reserves there in light of the better understanding that we had of the reservoir there. So we went through and tore that apart this year. We always have our reserves evaluated by an external evaluator. And in this case we turn over all the data that we have with respect to the reservoir and production. We turn all that data over to a third party and they go away and they come up with their estimate. That's totally independent of our estimate.

And then at the end of the day, we work until we get within 10%. So we're highly confident that that 84 million that we took for Long Lake is very representative of what the reservoir is capable of delivering going forward.

John Herrlin - Societe de Generale - Analyst

Great. Next one from me, Kevin, is Kakuna. You're going to target depth (TD) at this quarter, what's your dry hole exposure and are you encouraged by the stratigraphy that you are seeing?

Kevin Reinhart - Nexen Inc - Interim President & CEO

Yes, it's too early to comment on the stratigraphy. We're still drilling on here. It'll probably be the end of the quarter before we hit TD, and so it's premature to comment on any of that. Our dry hole cost here is higher than what we had originally anticipated. This is a very thick, salt structure that we were drilling through. And so we had some drilling challenges just moving through the salt bed.

So we're starting to push up into the CAD\$250 million to CAD\$300 million gross cost for the well. And we have a share of that, part of which is carried, so we have less than 50% exposure on that number. I don't know the number offhand. But I believe our paying interest is below 50%.

John Herrlin - Societe de Generale - Analyst

Okay. That's works. Last one for me is the Shetland well. What's the time to TD and how much will that cost?

Kevin Reinhart - Nexen Inc - Interim President & CEO

Yes, we expect to start drilling. This is the North Uist well. We expect to start drilling sometime before the end of March. We should be at TD about three months after that. And the well costs over here, I don't know that number offhand, John. We can get back to you on that number.

John Herrlin - Societe de Generale - Analyst

Okay, that's great. Thank you, Kevin.



Janet Craig - Nexen Inc. - VP IR

Thanks, John.

Kevin Reinhart - Nexen Inc - Interim President & CEO

All right. I really want to thank everybody for your participation this morning. A lot of good questions have come out here, so I'm quite pleased with the level of engagement that we've been able to have here. And I can tell you that there is a real excitement in the organization because we're starting to see some results in some of these things, with an Appomattox discovery, and particularly the response that we're seeing out of the Long Lake optimizations and Pad 11 coming along.

There is a high degree of excitement in the organization right now. And I think as I mentioned earlier, that becomes very infectious. And the organization is committed to achieving the commitments that we laid out to you last year. So I look forward to carrying on in the next quarter and chatting again soon. So thanks, everybody.

Operator

Thank you. That concludes today's conference call. Please disconnect your lines at this time, and we thank you for your participation.

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