

9 August 2022

The Board of Directors  
Capricorn Energy PLC  
50 Lothian Road,  
Edinburgh, EH3 9BY

Dear Members of the Board

## **Proposed All-Share Combination of Capricorn Energy PLC (the “Company” or “Capricorn”) and Tullow Oil PLC (“Tullow”) (the “Proposed Merger”)**

We write to you on behalf of Palliser Capital Master Fund Limited (together with its affiliates, “Palliser”, “we”, “us” or “our”) about the Proposed Merger and path forward for the Company. Having closely monitored the Company for well over a decade, Palliser currently holds interests in more than 5% of Capricorn<sup>(1)</sup>, making us one of the Company’s largest investors and demonstrating our conviction in the value embedded within Capricorn.

### **Introduction**

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We are grateful to the members of the Board and senior management team with whom we have exchanged views on a number of occasions since our letter of 1 July, including Company Chair Nicoletta Giadrossi, CEO Simon Thomson, CFO James Smith and Senior Independent Director Peter Kallos.

While we have listened carefully to and reflected deeply upon the perspectives that you have shared with us, we continue to strongly disagree with your view that the Proposed Merger represents an accretive step forward for the Company that equally benefits Capricorn and Tullow. Rather than the touted “merger of equals”, the Proposed Merger appears to us to be a poorly disguised nil-premium takeover of Capricorn by Tullow through which Capricorn’s substantial net cash balance, available after years of arbitration, would be applied towards repaying Tullow’s junk-rated creditors, with zero value attributed to Capricorn’s remaining high-quality and unencumbered assets. We believe this outcome falls far short of what Capricorn’s long-suffering shareholders deserve.

**The Proposed Merger materially undervalues Capricorn** and its straightforward asset base, which includes a substantial net cash position, low-risk contingent receivables and a high-quality, opportunity-rich Egyptian portfolio. Based on our own in-depth analysis and with the benefit of extensive third-party input, we strongly believe that **Capricorn can realise value of at least 330 pence per share, representing a 50% upside to the current share price and a 67% upside to the terms of the Proposed Merger.**

As you will be aware, we are not alone in our concerns – a significant quorum of other investors are equally troubled by the flawed logic of pursuing this pathway to reduced value, heightened risk and increased leverage. Therefore, and in light of the Board’s reluctance to correct course, we believe that a wider public dialogue is urgently required to ensure a full, frank and fair exchange between all market participants.

For the reasons outlined in this letter, we believe the essential – only legitimate – course of action is for you, the Capricorn Board, to **immediately withdraw your recommendation for the Proposed Merger** and **initiate a transparent and meaningful strategic review** with the best interests of Capricorn shareholders firmly in mind.

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<sup>1</sup> <https://www.londonstockexchange.com/news-article/market-news/form-8-3-capricorn-energy-plc/15576070>



## Numerous Points of Concern

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As we explain in more detail below, we have multiple concerns regarding the Proposed Merger:

- **Surrender of shareholder value:** in our view the terms fall well short of intrinsic value, attributing zero consideration to Capricorn’s non-cash assets and representing a give-away equivalent to almost two-thirds of the Company’s market capitalization;
- **Illogical exchange of risk:** Capricorn shareholders are faced with a discounted exchange of their existing exposure to a low-risk portfolio of highly predictable assets into a speculative investment in one of the worst performing and riskiest companies in the EMEA oil & gas sector;
- **Bail-out for Tullow:** the Proposed Merger constitutes a one-sided deal in favour of Tullow, allowing it to de-lever its stressed balance sheet via what we see as a backdoor rights issue, incredibly at a premium to its current share price;
- **Lacks genuine synergies:** there are no operational synergies in this combination and the promise of creating a “leading African energy company” strikes us as little more than a marketing ploy;
- **ESG dilutive:** given the substantial increase in the pro-forma oil versus gas weighting of reserves and production, the Proposed Merger represents a disappointing step backwards in Capricorn’s ESG profile; and
- **Backpedals on promised capital allocation:** Capricorn shareholders are being deprived of the promised and long-overdue return or accretive deployment of hard-fought cash recovered through the settlement of the Indian tax arbitration.

We see no reason why undervalued Capricorn shares should be used as currency for what implicitly appears to be a high-risk bet by management on the idea that Tullow’s future prospects are misunderstood by the market. In reality, Capricorn shareholders themselves can already freely and easily invest in Tullow shares directly on the open market if they wish to do so.

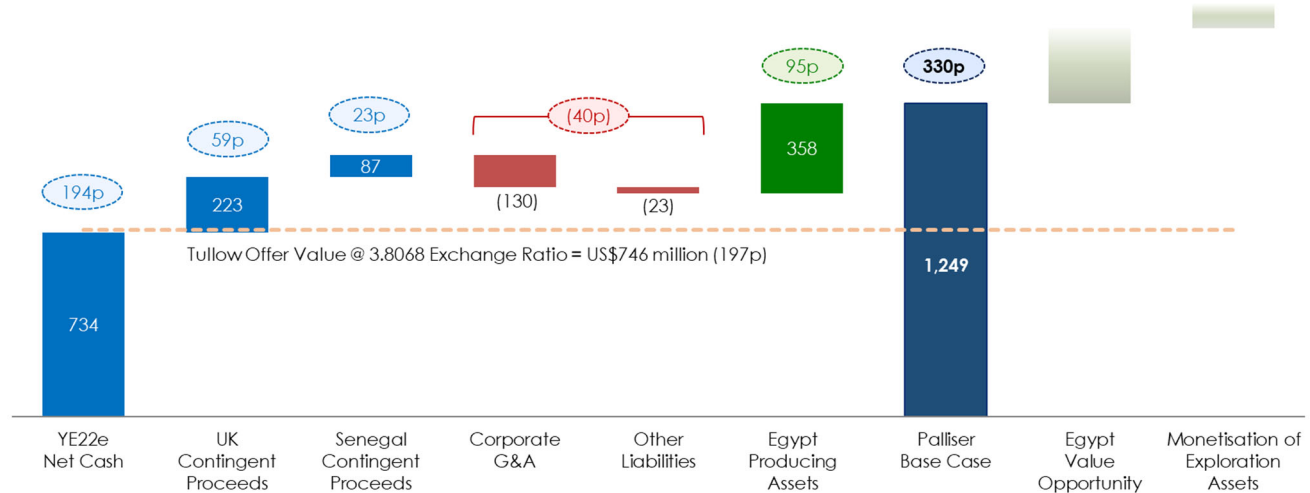
## A surrender of material Capricorn shareholder value

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The Proposed Merger consideration of 3.8068 new Tullow Shares for each Capricorn share values Capricorn at zero enterprise value and implies a price of 197 pence per share for Capricorn shareholders, reflecting a 1% discount to the undisturbed closing price on 31 May 2022 and a 10% discount to the closing Capricorn share price on 8 August 2022 – a clear reflection of the wider market’s view that the terms of the Proposed Merger are wholly unsatisfactory and that shareholders are unconvinced by any claims of value accretion.

Based on our own detailed analysis, we firmly believe that **Capricorn’s standalone value is at least 330 pence per share – representing a 50% upside to the current share price and implying that the Proposed Merger represents a value give-away of over US\$500 million, equivalent to almost two-thirds of the Company’s current market capitalisation.**

## Capricorn Net Asset Value (US\$ million)<sup>(i)</sup> – Standalone Excluding Egypt Value Optimisation Initiatives



Note: Please refer to notes on page 8 for underlying assumptions and relevant detail  
 Source: Company disclosures, Bloomberg

Given that over four-fifths of Capricorn’s net asset value is comprised of cash and near-term contingent receivables, the terms of the Proposed Merger imply that **Tullow is paying nothing for Capricorn’s Western Desert assets in Egypt**. This is despite Capricorn acquiring these assets for US\$323 million in net up-front cash consideration less than 12 months ago, at a time of materially lower commodity prices and as part of a competitive auction process.

Egypt is Africa’s largest consumer of energy and is endowed with vast hydrocarbon resources, but the country is presently undersupplied with natural gas from its low-cost domestic onshore assets and is forced to make up the difference with significantly more expensive imported volumes from abroad. Against this backdrop and with the aid of the supportive fiscal and regulatory environment that exists in the country today, we believe that Capricorn is in a unique position to deliver value from the multiple and scalable investment opportunities that exist within its highly strategic Egyptian asset base.

The market had expected to hear more about such value upside opportunities at a dedicated Capital Markets Day on Egypt which management had foreshadowed to take place in May, but this event ultimately never came to pass for reasons unknown to Capricorn shareholders.

### An illogical exchange of low-risk assets for speculative paper

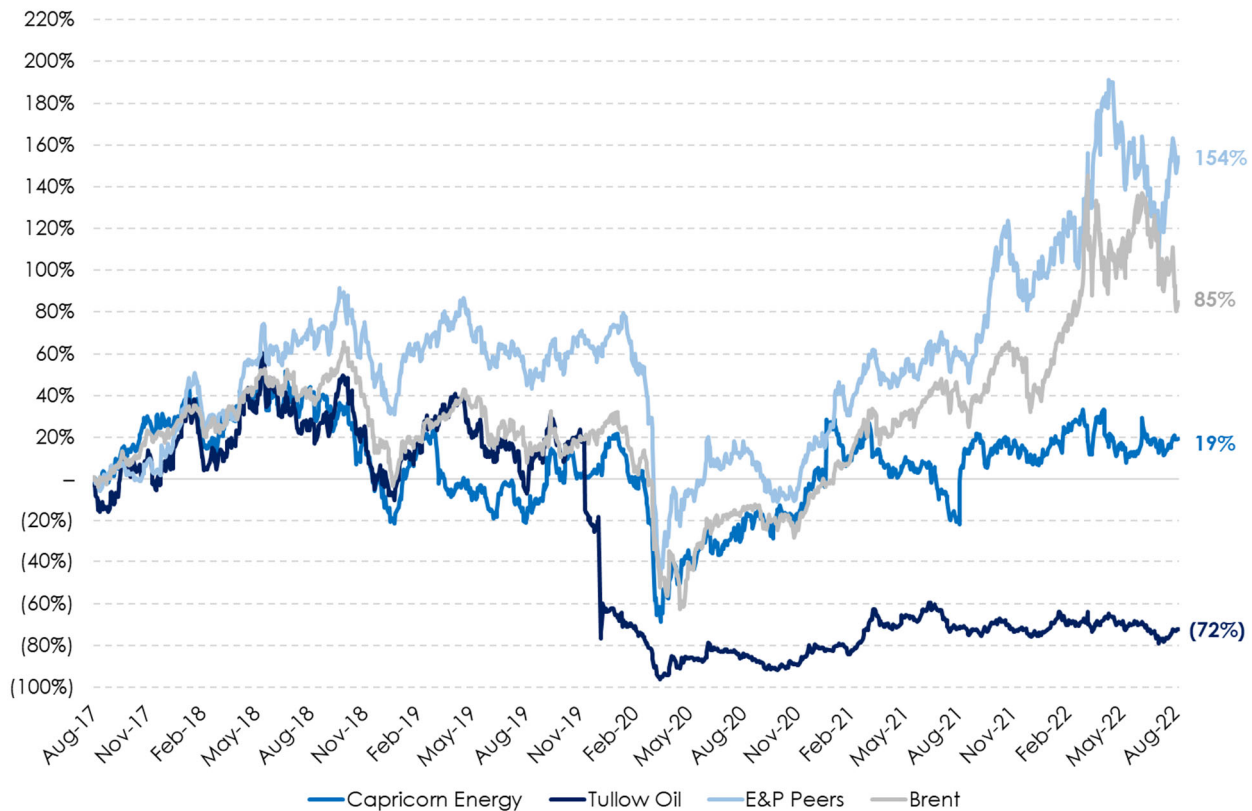
Capricorn’s net asset value is highly transparent and straightforward to assess: net cash is unencumbered, contingent proceeds are considerably de-risked and the Egyptian portfolio comprises proven legacy assets underpinned by low-cost, fixed price gas production with incremental optionality from oil sales.

In exchange, the Board’s recommendation is for a deal with a company with an extended track record of missed targets and broken promises. Tullow’s assets are in higher risk jurisdictions, involve significant development uncertainty and are longer-dated – the market cannot be expected to attribute Capricorn’s equivalent valuation framework to Tullow’s blue-sky forecasts.

# Palliser

From a Total Shareholder Return (“TSR”) <sup>(2)</sup> perspective, Tullow has been amongst the worst performing investments in the EMEA oil & gas sector over the past five years, with TSR of –72% versus Capricorn at +19%, Brent at +85% and an E&P Peers Average<sup>(3)</sup> of +154%.

## Total Shareholder Return – Last 5 Years (US\$ Terms)



Source: Bloomberg

Critically, Tullow is a company that only last year was still warning its shareholders of a significant risk that it may not survive as a going concern, following chronic underperformance of its flagship deepwater fields in Ghana, the abrupt departure of its senior management team and a subsequent fire sale of assets to avoid insolvency.

### A one-sided deal that benefits Tullow alone through a de-leveraging of its stressed balance sheet

We regard the Proposed Merger as a transaction structured exclusively for the benefit of Tullow and its creditors. Tullow is highly indebted, has no distributable reserves, has a portfolio of riskier, longer-dated assets and is facing acute funding challenges, including a need to refinance high yield debt carrying an onerous 10.25% coupon.

The terms of the Proposed Merger would allow Tullow to raise significant funds by almost doubling its share count via the issue of new equity at an effective premium to its share price – a truly incredible outcome given its poor track record and lack of financial health. We find it highly improbable that Tullow could raise

<sup>2</sup> Cumulative daily TSR calculated over preceding 5-year period as of 8 August 2022 including net dividends reinvested.

<sup>3</sup> E&P Peers: Aker BP, Lundin Energy, Var Energi, Harbour Energy, Kosmos Energy, Energean, DNO, Africa Oil, Serica Energy, EnQuest, Genel Energy, Gulf Keystone Petroleum and Seplat Energy.



over US\$700 million<sup>(4)</sup> through an equivalent rights issue without offering investors a sizeable discount to its current share price.

By providing access to Capricorn's cash on a deeply discounted basis, the Proposed Merger would represent a lifeline for Tullow, potentially allowing it to (i) satisfy its creditors with a meaningful repayment of its outstanding junk rated high-yield debt; (ii) deliver on ambitious investment targets in Ghana; (iii) address scepticism from rumoured farm-in partners on its capacity to fund future capex for its stranded oil project in Kenya; and (iv) finally resume paying dividends to its shareholders.

Inexcusably, Capricorn shareholders are faced with the prospect of giving up their cash to shoulder the burden of servicing this highly speculative turnaround story, so it is unsurprising to us that a number of equity research analysts at market-leading investment banks have similarly denounced the one-sided nature of this transaction.

### **A lack of wider strategic rationale or operational synergies and a backward step for ESG**

From a business and operational perspective, the Capricorn and Tullow oil and gas interests are, aside from coincidentally being located on the same large continent, disparate with no coherent logic or obvious operational synergies in combining onshore Egypt and deepwater West African assets. Management's vague promise of creating a "leading African energy company" strikes us as naïve and subsequent attempts to justify this vision to us have been unconvincing to say the least.

We also question whether claimed cost synergies, which are used to endorse the deal, should in fact be characterised as synergies at all. These potential savings do not relate to the operating asset organisations across the combined group, but instead to reductions within board, corporate and group-level administrative functions.

With Tullow having already been forced to implement significant cost reductions over the last two years and given the Proposed Merger is expected to result in a material downsizing of Capricorn's head office and the removal of its listing, we wonder whether the vast majority of claimed cost synergies will come from an effective liquidation of Capricorn's bloated administrative function, particularly noting that Capricorn's recurring administrative expenses last year were US\$43 million as compared to total expected synergies of US\$50 million. If so, this would be yet another indication that this "merger of equals" is in fact a disguised nil-premium takeover of Capricorn.

Crucially, the Proposed Merger is also a backwards step for Capricorn from an environmental, social and corporate governance (ESG) standpoint. Whilst the parties claim that the combined group will have a strong commitment to ESG standards, in our view, the reality is that the deal will pull Capricorn adrift from its current positive ESG trajectory – substantially increasing its oil versus gas-weighting given that the pro-forma portfolio by 2P reserves is 75% liquids-weighted versus 66% gas-weighted for Capricorn standalone.

### **An excuse to backpedal on the promised accretive deployment or return of long-awaited cash reserves**

The bigger picture is both confusing and troubling to us, not least because the Proposed Merger is sharply out of step with recent pronouncements by management on the Company's future.

For example, in the latest Annual Report, it was stated that "*Capricorn will use its balance sheet strength to pursue value accretive acquisition opportunities*" and that following the acquisition of the Egyptian assets from Shell, management saw "*numerous other opportunities to acquire high-quality upstream assets from legacy operators*". We and other shareholders understood this to mean that the Company would be targeting

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<sup>4</sup> Capricorn's estimated net cash balance on 31 December 2022 is US\$734 million based on Bloomberg consensus



more high-quality disposal candidates from the Majors. Separately, in our recent bilateral discussions, you indicated to us several times that following an extensive search over the last 18 months, the Proposed Merger “*is the most attractive transaction available*” to Capricorn.

So significant are the Proposed Merger’s shortcomings, that these comments lead us to the view that there is, in fact, no deal worth pursuing. Instead, shareholders’ interests would be far better served by simply returning the Company’s surplus net cash balance to Capricorn shareholders, who have by now been waiting long enough to realise the full value from the sale of Cairn India. This would be in line with commitments made by the CEO to investors at a fireside discussion earlier this year, when in relation to Capricorn’s recently repatriated cash balance, he proclaimed that the Company will “*either return it or do something else with it*”. Suffice to say, Capricorn shareholders certainly did not imagine that this “something else” might be to give the cash away to Tullow at a significant discount.

Frankly speaking, against the backdrop of such clear and recent statements of intent, and given the otherwise inexplicable push for this deal, we are left questioning whether the close relationships between the Tullow and Capricorn executive teams, management fatigue and/or other factors unrelated to enhancing shareholder value may have also played a part in the genesis of the Proposed Merger.

## Next Steps

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All matters considered, we simply fail to understand the Board’s recommendation to vote in favour of the Proposed Merger and it is easy to see why Capricorn shareholders feel let down and misled.

Given the level of shareholder dissent against the Proposed Merger, it strikes us as highly improbable that you will garner sufficient votes for this transaction to be approved. We also do not believe this deal can realistically be improved by Tullow because it is restricted from meaningfully increasing its stock consideration without an unpalatable level of dilution for its shareholders, and unable to afford a cash component, which would also remove the underlying strategic rationale of the deal for Tullow in the first place.

In the circumstances, we believe that the best way forward is for you, the members of the Capricorn Board, to **immediately withdraw your recommendation for the Proposed Merger** and instead to **initiate a transparent and meaningful strategic review** that is thoroughly benchmarked, on a risk-adjusted basis, versus the true yardstick against which any alternative path should be assessed, which is the considerable shareholder value which could be realised in the near-term from a monetisation of Capricorn’s Egyptian assets and the return of residual net cash to shareholders.

**Every day that the Board fails to take action serves only to exacerbate the level of value destruction that Capricorn shareholders are faced with** through unnecessary deal-related expenses and missed alternative investment opportunities.

We have dedicated significant resources to our analysis and we appreciate the Board’s time in considering our views. Capricorn is at a critical moment and the stakes are high for shareholders. We believe that the Board should waste no time in promptly demonstrating its willingness and openness to exploring alternative pathways to maximising shareholder value.

For and on behalf of  
**Palliser Capital (UK) Ltd**

By: James Smith, Chief Investment Officer





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### Notes

<sup>i</sup> Oil price assumption derived from Brent forward curve as of 8 August 2022; GBP/USD exchange rate of 1.20; 10% discount rate assumption applied; Capricorn share count of c.315 million shares as per latest RNS disclosure.

YE2022e Net Cash: Based on Bloomberg consensus estimate as of 8 August 2022.

UK Contingent Proceeds: Earn-out consideration related to completed sale of Catcher and Kraken assets to Waldorf Petroleum; production estimates based on input from leading oil & gas research consultancy.

Senegal Contingent Proceeds: Earn-out consideration related to completed sale of Sangomar asset to Woodside; assumes first oil achieved in 2023 as per Woodside public guidance.

Corporate G&A: Capricorn 2021A recurring departmental expenses & corporate projects (US\$43.4 million) capitalised at ~3x multiple.

Other Liabilities: Reflects Capricorn's reported UK decommissioning provisions (US\$2.2 million) plus undiscounted remaining exploration commitments in Egypt; assumes 7 wells remaining at estimated US\$5.8 million cost per well (implied from North Um Baraka exploration well completed in 2021).

Egypt Producing Assets: Palliser's asset-level cash flow model for Capricorn's Western Desert concessions is based on broker consensus production and cost profiles; reflects value for 2P reserves only; includes oil price-related contingent payments due from Capricorn to Shell as part of the original acquisition.

Egypt Value Opportunity: Reflects upside available to Capricorn from successful de-risking of contingent (2C) resources, modernisation of fiscal terms and other value creation opportunities in Egypt.

Monetisation of CNE Exploration Assets: Reflects potential to monetise Capricorn's global portfolio of exploration licenses in the UK, Israel, Mexico, Suriname and Mauritania.