Q2 2020 Earnings Call

Company Participants

- BÃ¥rd Stenberg, Senior VP of IR & Communication
- Gottfred Langseth, CFO & Executive VP
- Rune Olav, President & CEO

Presentation

BÃ¥rd Stenberg

Good morning. Welcome to this Audiocast presenting PGS' Second Quarter and Preliminary First Half 2020 results.

My name is BÃ¥rd Stenberg, Senior Vice President, Investor Relations and Communications in PGS.

With us from management today are President and CEO, Rune Olav Pedersen; and CFO, Gottfred Langseth. Before we start, I would like to give some practical information. Participants on this Audiocast can submit their questions via the Audiocast platform.

I would also like to draw your attention to the cautionary statement in today's earnings release and presentation, and the risk factors disclosed in our 2019 annual report and the Q2 and preliminary first half 2020 earnings release.

So with that, it's my pleasure to give the word to Rune Olav.

Rune Olav {BIO 16158611 <GO>}

Thank you, BÃ¥rd. Good morning, everyone.

Our second quarter 2020 results and financials were, of course to a very large degree impacted by the COVID-19 pandemic and its unprecedented disruption of the oil market.

This led to immediate budget revisions by our clients, which started already in -- towards the end of Q1 and continued into Q2, which again immediately led to reduced seismic activity, and this has obviously impacted the second quarter to quite a degree.

We have seen a lot of projects being delayed, and we have seen some of the leads and the tenders we were competing for being canceled.

The COVID-19 pandemic has, of course also presented us with very large operational challenges. It has been very difficult for PGS to crew change to send our crews around the world and to conduct normal operations.

But I am very pleased to say that we have, in spite of these challenges, executed our secured acquisition and imaging programs according to plan. And this is a great testament to the very professional PGS organization, which has overcome this challenge.

I would also say that the PGS' sales teams have delivered decent results in a very challenging market. The COVID-19 pandemic and its consequences for the oil market, and therefore, the seismic market has also led us to the conclusion that we need to reduce our cost base. And during Q2, we have completely reset our cost base to a much lower level, and we have reduced CapEx to a minimum.

We are in the last weeks of this -- of the company reorganization and resetting of the new organization, and we expect to operate in the new organization from August.

We have also during the second quarter, initiated negotiations with our revolving credit facility banks and other lenders.

This, obviously to ensure sufficient liquidity going forward.

If I move to the financial summary, I will be very brief here as Gottfred, our CFO, will come back to this later.

But obviously you can see segment revenues down to $139 million, which is at a low level.

We reported EBITDA of $99 million and, obviously positive to see a positive EBIT even in such challenging markets.

So if we move to the next slide on the order book, you will all see that the order book has declined down to $155 million at the end of June.

We have fortunately or positively been awarded an additional $35 million in July, which will then obviously come in addition to the order book going forward.

This results in a vessel booking in Q3 of 14 vessel months, which means we are more or less fully booked for the fourth quarter. Now for the third quarter, there are half a month on two vessels, which are not booked.

But you can see the booking in the fourth quarter of only five vessel months, so a weaker booking in the fourth quarter. We expect the winter season this year and into next year to be quite challenging.

As I mentioned, we have reset our cost base.

We have reduced our annualized gross cash cost from $600 million going into 2020 to approximately $400 million going forward.

This is a reduction of 33%.

This is achieved by reducing vessel capacity from eight to five vessel, and therefore -- thereby also of course reducing our crews.

We have streamlined the onshore organization, reduced office-based personnel by some -- by approximately 40% versus the number we had going into the year. And there are multiple other cost initiatives, which we have talked to the market about before.

We have also reduced the 2020 CapEx to approximately $40 million, which is a reduction of 50% from the start of 2020.

So in the company, we are doing what we can to adjust our cost and CapEx to a lower activity level.

As I mentioned, we have, in Q2, initiated a process with our lenders to secure liquidity going forward.

In Q2, we did present a proposal to our lenders seeking to amend maturities and amortization across the different debt facilities. The proposal also included an amendment to the RCF, the revolving credit facility, leverage covenant for a certain period. The proposal obviously aims to preserve liquidity so that we can maintain business continuity going forward, and it aims to ensure full repayment to all lenders.

We are currently in negotiations, and we expect to complete these negotiations by the maturity date of the revolving credit facility of September 18 this year.

So to guidance. The group cash cost for 2020 is expected to be approximately USD 450 million. That excludes a restructuring cost of $35 million. MultiClient cash investments, we expect now to be in the range between $175 million and $200 million. We expect to use approximately 50% of our active 3D vessel time to MultiClient.

CapEx, as I have said, we expect to be approximately $40 million for the year.

With that, I give the word to Gottfred.

Gottfred Langseth {BIO 5277539 <GO>}

Thank you. I will start on consolidated key financial numbers. Just a few comments on this one.

We had segment revenues of $138.7 million, in line with our pre-announcement. That's a 36% reduction from Q2 last year. Still EBITDA for the quarter relatively strong versus the revenues, $99 million and positive segment EBIT of $7 million before. I should add the impairment and other charges, and the relatively better EBITDA and EBIT performance is down to a significant cost reduction in the quarter.

Just quickly on the as reported numbers, the IFRS 15, primarily, the revenues are lower than the segment revenues in the quarter.

This is purely relating to a timing difference in when revenues are recognized.

We have had impairment charges of $78.4 million for the first half of the year. $27 million of that was in Q2. And this primarily relates to a write-down of the two cold stacked vessels, PGS Apollo and Sanco Swift.

Should add that we recorded severance and other restructuring costs of $35 million in Q2, $28 million of severance and $7 million of other restructuring costs, primarily costs relating to executing stacking of vessels.

I then move to the next slide, Q2 operational highlights. Total MultiClient revenues on a segment basis, $101.7 million. Pre-funding 102%.

This is positively impacted by a catch-up of revenues from a delayed block award ratification, which means that this relates to a survey that where some of the work was done in Q1, and all of the acquisition-related revenues recorded in Q2, which we commented when we released the Q1 numbers.

This has an approximate $15 million impact, 1-5.

Late sales in the quarter, $35.5 million. Contract revenues, $31.3 million, which is low and relates to the fact that we only used 15% of the total available vessel time for Contract acquisition.

MultiClient revenues per region, Africa and Europe, strongest contributors to our pre-funding revenues, while Europe main contributor to the late sales in the quarter.

Vessel allocation, 65% active time in Q2, so weaker utilization than many of the previous quarters.

This is partly due to higher steaming and partly due to stacked/standby time. The relatively high steaming in quarter relates to moving vessels to the North Atlantic summer season, which happens in most second quarters.

In addition, we moved the Hyperion from Southeast Asia to the Mediterranean in the second quarter. And lastly, we have steamed the two stacked vessels, Swift and Apollo from surveys in Africa to the stacking location in Norway.

The stack time then -- as well is explained by PGS Apollo and Sanco Swift being stacked relatively early in the second quarter. These two vessels are included in a way, the statistics for the second quarter. They are now cold stacked and will be excluded from, in a way the, call it, a nominal available vessels in the statistics for Q3 and subsequent quarters.

We will have five vessels in operation from early Q3 as Ramform Vanguard was -- has already been stacked now, early July.

We will adjust capacity further if that is required.

Then to cost. Q2 gross cash cost down to $110 million from less capacity in operation, temporary layoffs and a series of other initiatives. The full year gross cash cost for 2020 expected at around $450 million. And since we are slightly above $250 million year-to-date, this means that we expect to be below $100 million for each of the two remaining quarters on average, I should add.

Then to cash flow. Q2 cash flow impacted by lower earnings, primarily cash flow from operations, $67.5 million.

We received the last installment for the sale of Ramform Sterling in the quarter, $24 million.

We have, and we'll see some pressure on working capital as approximately $30 million of sales. Our granted extended payment terms to very early 2021.

And lastly, after quarter end, and this is more a subsequent event in July, we received approximately $12.5 million of Norwegian government support for the three months, March, April and May.

This particular grant is open also for the three following months, and we will apply for those, but the amounts for the three last months may well be lower than for the three first.

Balance sheet. Our net interest-bearing debt, excluding lease liabilities, $890.3 million, liquidity reserve of $234.9 million, all held in cash.

This shows the summary of our debt and drawing facilities. There are no significant changes here, except for the normal quarterly amortization on the export credit financing in Q2.

So I would just leave it with that.

There are a couple of more comments on costs.

We touched upon this already.

So on a run rate basis, with effect from third quarter, we will be down from approximately $600 million, moving into the year to $400 million going forward on an annual run rate basis. And the $200 million reduction is driven by mostly the fleet capacity reduction, $125 million approximately. Then approximately $45 million relating to our staff reductions on the offices. And then we have an impact of fuel prices and foreign exchange of approximately $10 million, and the sum of all other savings approximately $20 million.

Then CapEx. You would see from the illustration that we managed to turn CapEx down to what -- where we typically are in a weak market, from $80 million to $40 million.

This is obviously relating to having a saving as much as we can, but also facilitated by the fact that we operate less vessels and can reduce the CapEx relating to reinvestment in seismic equipment.

Then I believe I have one more slide. And this one is included to illustrate a point. It is not a revenue guiding of any sort, but the illustration shows that the revenues that we do need going forward with our new cost run rate to be a cash flow breakeven before debt repayment is around $575 million.

This breakeven should add -- would be around $40 million lower if we reduce cost further by going to -- down to operating four vessels.

I will stop there and give the word back to Rune Olav.

Rune Olav {BIO 16158611 <GO>}

Thank you. We'll start with the fleet activity now in July.

We can start in the northern hemisphere, where we see that the Ramform Atlas and the Ramform Titan are both shooting in multiple MultiClient programs in Canada as we have done over the last years.

Sticking in the northern part of the world, you can see Ramform Tethys shooting MultiClient in the Barents Sea. And moving south, you can see Ramform Hyperion, which has been reallocated or relocated, I should say, to the Mediterranean and has completed a few smaller programs, and it's just now starting on a larger program in Egypt. And Ramform Sovereign is still in Angola, where she has been for quite a while.

And then on to the bids and leads curves. I will repeat that the dark blue line represents the dollar value of all the bids we have in-house, contract bids, obviously. And then the light blue lines is the contract bids we have in-house, plus a risk-weighted average of the leads. We did see a significant decline in both these curves during Q2, that started more or less immediately towards the end of Q1 and continued through Q2, and driven by lower investments among our clients.

We have seen that projects are delayed rather than canceled.

But when they are delayed either indefinitely or to a timing where we don't know where they are, they are then taken out of the bid curve, if there were bids and taking out of the lead curve if we don't know when they will come back.

But it is clear to say that we have seen projects being delayed rather than canceled. It is positive to see that recently, and I'm talking as the reason that the last weeks, we have seen a rather significant rebound in both leads, in particular, but also you can see a small rebound in the in-house tenders.

This is mainly work for 2021 that has been delayed and now are resurfacing with more concrete dates, and also tenders for 2021 in general.

As this recent increase is mainly for 2021, and we and our industry peers have weak bookings for Q4 and Q1, we expect that the winter season of 2020, 2021 will be challenging from a utilization perspective, and we expect a slight respite early next year, and a stronger 2021 than the latter part of 2020.

And moving in then from demand to supply. What we see on the supply side is that we estimate that the average 2020 capacity will decline some 20% versus the average 2019 capacity, and most of that is obviously capacity in the second half of 2020.

We do expect industry utilization levels to deteriorate from 2019 levels, and we have seen that to some extent already across the industry. We expect industry capacity to likely be around 15 vessels during the winter season. And this is -- could be lower and it could be slightly higher, but this is in a range around 15, is where we expect active 3D vessels to be during the winter season. And then we expect a moderate capacity increase for the 2021 summer season as we expect demand to start to pick up again.

Then moving to the summary.

As I said, there has been -- we have been in a very challenging market, and we expect a very challenging market outlook. And from the vessel utilization side, we expect Q4 of 2020 to be particularly weak.

It is going to be interesting to see what kind of activity we can get out of our MultiClient library into the second half of 2020 and into 2021. There is always, of course some help in the fact that the oil price has now stabilized on a slightly or much higher level than what we saw only a few months back.

We have, during Q2, been able to execute our secured acquisition imaging programs according to plan, and that is in spite of a very challenging environment to move crews around and to keep operations going.

So very pleased with the performance of the PGS organization here.

As we said, we have reset our cost base and our -- reduced our CapEx to a minimum and ready to go forward on a much more competitive basis. We are in negotiation with our revolving credit facility banks and our other lenders to preserve liquidity. And as I said, we expect to land an agreement with these lenders within the maturity date for the upcoming RCF maturity in September.

With that, BÃ¥rd, I hand the word back to you for a Q&A session.

Questions And Answers

A - BÃ¥rd Stenberg

Thank you, Rune.

We have the first question from John Olaisen in ABG Sundal Collier. Chevron recently announced the acquisition of Noble. Will this deal lead to any transfer fees for PGS?

Also, do you expect more M&A among your clients?

If so, would that be positive or negative for PGS?

A - Rune Olav {BIO 16158611 <GO>}

Yes. Chevron announced acquisition of Noble, and the answer is yes. It will lead to some transfer fees to PGS.

We don't expect it to be a very large amount, but Noble obviously has seismic data -- PGS seismic data, which Chevron currently does not have.

And the second question was related to whether we expect more M&A activity among our clients and whether that will be positive or negative?

It is often so that when the market is disrupted in a negative way that you see M&A activity. Other than that, I don't know whether we have any expectations of a lot of M&A activity we will take what comes. That typically leads to more sales or transfer fees and sales in the beginning, but it also has the negative effect that we reduced the client base over time.

So we will then obviously need to see other people step up and take that activity.

So it is a mixed picture. It's positive in the short term, but it can be a bit challenging if there's a lot of activity in the medium term.

A - BÃ¥rd Stenberg

Next question comes from Ã˜ystein Vaagen in Fearnley Securities. The $12.5 million received in pandemic support from the Norwegian government, how is that reported?

A - Gottfred Langseth {BIO 5277539 <GO>}

Yes. I should probably have mentioned that in a way it happened after the quarter end, and it is treated under the accounting rules for government grants.

So it will be recognized in the third quarter when the grant was resolved. I cannot affirmatively say exactly whether it will then show up as a cost reduction or a revenue. I think it's fair to say that the literature points towards it being recorded as a revenue since it is a compensation addressed at giving support in a situation where there is a revenue decline.

But we will have to get back to that when we report Q3 numbers.

A - BÃ¥rd Stenberg

Then we have another question from John Olaisen in ABG Sundal Collier. When should we expect news on the suggested debt amendments?

And do you have a backup alternative if the debt holders do not accept the amendments?

A - Rune Olav {BIO 16158611 <GO>}

Well as I said, we expect to conclude the negotiations before the maturity date of the RCF -- the 2020 RCF, which is on the 18th of September this year.

So we will obviously announce any deal as soon as we have concluded it. I think the nature of these negotiations with many parties, they are difficult, and it is likely that you will not see news until towards that date, but it is obviously difficult to predict exactly when we can do that. I don't think we will today speculate in backup plans, but it is clear that the company will have to also consider backup plans without going into further details of what they may be.

A - BÃ¥rd Stenberg

We have Christian from -- Christopher MÃ¸llerlÃ¸kken in Carnegie. With regards to the tendering activity, are any other tenders for Q4 '20 work?

Or will Q4 '20 work mainly depend on level of late sales?

A - Rune Olav {BIO 16158611 <GO>}

Some of the tender activity is clearly for 2020 work as well.

So when I indicate that, that most of the, let's say, recent spike is for 2021, I mean exactly that, namely and that most of it is for 2020. It's clear that there are several tenders out there unresolved and there's out there for 2020 work as well.

So the industry will have more utilization than what we are seeing today. That is clear. It is also of course I'm sure we and others are doing what we can to move things from 2021 and into 2020 to the extent that is possible.

So we'll see how that develops.

But it is going to be challenging with respect to industry utilization towards the end of -- or in the fourth quarter of 2020, that's clear.

A - BÃ¥rd Stenberg

Then we have a question from Sahar Islam along similar lines. What is contract pricing doing?

Any color from recent negotiations would be helpful. And also which regions are seeing the more interest in the leads?

A - Rune Olav {BIO 16158611 <GO>}

I'm not going to comment on contract pricing, particularly. It's a consolidated industry and we're all fighting for work.

So I won't comment on that. Where we're seeing the most work coming out now is, obviously it's West Africa, East Africa and Asia Pacific, I would say, is where we have the bulk of tenders coming out these days.

A - BÃ¥rd Stenberg

Then we have a question from Magnus Sherman. How long has the amortization holiday you are requesting?

A - Rune Olav {BIO 16158611 <GO>}

We're not going to comment on further details in the proposal.

So any other question on that will get this answer.

A - BÃ¥rd Stenberg

Then we have a question from Monika Rajoria in Societe Generale. Any impact of the fiscal reform in Norway?

I believe that's â

A - Rune Olav {BIO 16158611 <GO>}

Well yes. That's probably the support for the fiscal reform for E&P companies operating in the Norwegian Continental shelf, which is designed to increase investments on the Norwegian Continental shelf, I believe, is what she is referring to. It is not directly relevant to PGS and seismic equipment, as is mostly a cost and not an investment.

But obviously more liquidity in the hands of our clients operating on the Norwegian Continental shelf may lead to more purchase of MultiClient data from our library, and we have obviously a very strong position in -- on the Norwegian Continental shelf.

So if anything, the impact will be indirect to a bit low.

A - BÃ¥rd Stenberg

Then We have another question from Christopher MÃ¸llerlÃ¸kken in Carnegie. With two vessels working on MultiClient offshore Canada and one vessel working on MultiClient in the Barents Sea, is it fair to assume that majority of fleet utilization will be spent on MultiClient in Q3 2020?

A - Gottfred Langseth {BIO 5277539 <GO>}

Yes. That is fair to assume it.

A - BÃ¥rd Stenberg

We actually don't have any more questions.

So we'll pause for a minute to allow people to type in any more questions. If there are any further questions?

That's all the questions for now.

So thank you all for participating.

Good-bye.