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PGS.OL - Q1 2017 Petroleum Geo Services ASA Earnings Call (Morning)

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## PRESENTATION

**Bård Stenberg** - *Petroleum Geo-Services ASA - VP of IR & Corporate Communications*

Okay. Good morning, and welcome to this presentation of PGS Q1 2017 Results. My name is Bård Stenberg, Vice President of Investor Relations and Corporate Communications in PGS.

Today's presentation is being followed by a conference call, and participants on the conference call are invited to ask questions after the concluding remarks from management. I would also like to remind you of the conference call we have scheduled for 3 p.m. CET later today.

Before we start, I would like to give some practical information. As we are broadcasting this presentation, I would kindly ask the audience here in Oslo to use the microphones provided when asking questions. Also, for the audience here in Oslo, please notice the emergency exit located in the back of the room. If the alarm is sounded, please evacuate immediately. I'd also like to draw your attention to the cautionary statement showing on the screen also available in the press release and the presentation on today.

Today's presentation is being given by CEO Jon Erik Reinhardsen; and CFO Gottfred Langseth. So with that, it's my pleasure to give the floor to you, Jon Erik.

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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

Thank you, Bård. Even though the headline numbers for this quarter are known already, we will do as usual after a brief introduction. Gottfred will walk us through the numbers, and then we will discuss the market and the outlook afterwards.

2017 slow start as we have already released information about. On the other hand, quite significant order book increase. The first quarter reflects a challenging winter season with a low product demand and excess supply. EBITDA ended up at USD 30 million. Prefunding level at 118%. And we continue to be relatively pleased with our MultiClient business. In particular, the key ratios are still healthy and good also compared to our peers.

In the quarter, we completed the USD 35 million subsequent offering. We took delivery of Ramform Hyperion, which then reduces our CapEx needs significantly going forward. And as reported, a significant order book increase was recorded, which obviously has improved our revenue visibility for 2017 significantly.

On the numbers, again, reflecting the challenging winter, low utilization, low prices and actually also low MultiClient investments with obviously return differently in the coming quarters. Gottfred will come back to these numbers in more detail in the following minutes.

Finally, as an introduction, order book up to $340 million. Main increase sits in MultiClient, which now is $196 million, which of course, gives confidence to the prefunding needed for the coming 2 quarters, and I'll come back to that a little bit later. That is important in evaluating our ability to deliver EBITDA this year.

There's also some increase related to volume and price increase for marine contract, which I also will come back to later. Sequentially, an increase of 60%, and as you can see from the graph, 2 years since we were at this level.

When it comes to the booking, we have no more capacity to sell for Q2. There is a 10-, 15-day idle time early in the quarter for Ramform Vanguard the days before she came out of warm stack. Apart from that, there's not anything else in particular to report relative to Q1. 75% booked for -- for q2, sorry, 75% booked for Q3, 35% booked for Q4 and 15% for Q1. On average, this is up from a year ago, again underlining somewhat better visibility.

And with that and with more details to come, I will hand over to Gottfred for a walk-through of the numbers.

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**Gottfred Langseth** - *Petroleum Geo-Services ASA - CFO and EVP*

Thank you. Good morning, everyone. I will start with, as usual, the profit-and-loss summary.

Revenues were $154.8 million in the first quarter compared to $203 million in first quarter last year, reduction primarily due to lower MultiClient revenues and to, some extent, reImaging revenues, somewhat but only marginally offset by higher contract revenues in the quarter. EBITDA for the quarter of $30.1 million. Operating loss for the quarter, $83.5 million. This is impacted by a relatively high amortization rate for our MultiClient amortization rate, which I will refer to on a later slide.

We had impairment and other charges in the quarter of $10.2 million. That includes a smaller impairment of $1.4 million relating to the library and $8.8 million of other charges, which mainly related provision for onerous contracts. The latter may be -- although counterintuitive in relation to, at the same time, reporting higher average pricing in the order book. The reason is that there are some contracts in the order book with pricing lower than [true] cost, and we do this calculation based on not the cash cost of operating or executing the survey but the true cost including depreciation. When this provision reverses, it will be reversed on the same line. It will not be credited to cost of sales at any point of time in the future.

Total MultiClient revenues of $79 million, prefunding half of that, $39.7 million, which when we apply that to the investments in the quarter, $33.6 million, gives a prefunding ratio of 118%. Late sales, $39.3 million.

Marine Contract revenues $61.4 million, slightly up from what we had in Q1 last year on approximately the same effective capacity deployed for contract work. And it reflects a still challenging market with very low prices.

MultiClient revenues by region. Late sales dominated by Europe and South America for the quarter. Q1 prefunding revenues relatively low, and that is due to unusually low MultiClient investment activity in this first quarter. Projects were primarily in Mediterranean and Asia Pacific for the first quarter.

We will have a gradual -- quite significant increase through second and into third quarter with respect to MultiClient activity, these projects are well prefunded, and this will benefit prefunding revenues in the coming quarters.

Book value of the library to $626 million end of quarter. That's a bit more than $20 million down from the start of the quarter. Amortization rate, 88%, obviously quite high, and that is down to the combination of low sales and straight-line amortization, which we apply to our library of completed surveys.

Then 2017 full year amortization expense is still expected to be in range of $350 million to $375 million, same as we said last quarter.

For the key operational numbers, I will only comment on a couple of the lines. Relating to revenues, the Imaging revenues not commented on, yet sequentially down to $13.8 million. Imaging market in the quarter relatively soft. Operating cost charged to the P&L, $124.7 million. Is higher than what we've seen over the last 3 to 4 quarters. That's not related to an increase of cost but relates to the fact that we capitalize less of the cost to the library in this first quarter.

Moving down -- far down in the table to CapEx incurred $101.6 million, $87 million out of that relates to the delivery of Ramform Hyperion, so it remains at least around or a bit over $14 million for other CapEx in the quarter, which reflects the low level left we have in our (inaudible) and expect to stay at for this year. Cash investment in MultiClient, as you can see, is at $33.6 million; in perspective of the last 4 quarters, unusually low.

To the vessel utilization, 74% active time in the first quarter, so that's a value we had in fourth quarter but still low utilization impacted by the warm-stacking of Ramform Vanguard throughout the quarter and some standby time due to the weak market.

Utilization will be higher in the second quarter. We'll apply approximately 30% of the active capacity for MultiClient. And we will operate more capacity in the second quarter than we did in the first since both Ramform Hyperion and Ramform Vanguard enters operation relatively early in the second quarter.

Moving to cost. On the quarter, cost development continuing to show a strong trend. There's a small sequential cost increase, which relates to higher utilization relative to what we have in the fourth quarter. Moving forward, the quarterly cost will increase as a result of taking Ramform Hyperion and Vanguard into operation.

Looking at the full year cost picture, not much changed from our previous presentations. Cost discipline remains key priority. We have taken down our gross cash cost by 40% or more than 40% since full year 2014. For 2017 full year, we still expect $700 million, a slight increase from what we had in '16, and that is primarily due to operating more capacity but also due to somewhat higher expected fuel prices.

Cash flow statement. Cash flow from operations, $30 million, lower than last year [target] due to lower earnings as well as less contribution from reducing working capital in the first quarter compared to a quite substantial contribution from the same in Q1 '16.

Investing activities include newbuild CapEx of $86.9 million relating to Ramform Hyperion and the delivery. And if you look at the statement itself, you see that the cash flow of the investment is $89.7 million negative as reported, which tells that in a way most of that is relating to the CapEx of the delivery of Hyperion. So adjusted for newbuild CapEx, despite the relatively low cash from operations in the quarter, adjusted for that newbuild CapEx, the cash flow [generally] balanced after CapEx. The CapEx for Hyperion was paid by -- primarily from -- by making the last -- drawing the last tranche of the export credit financing, and that drawing is included within financing activities in the cash flow statement.

Moving to the balance sheet. Liquidity reserve of $273.8 million. That's a few -- couple million higher than at the start of the year. Net interest bearing debt, $63 million higher than the start of the year primarily due to the delivery of Ramform Hyperion. Total leverage ratio at end March, 4.88. We have some headroom to covenants or requirements in (inaudible) share. It is fairly likely that we will -- the headroom will increase moving forward.

On the debt and drawing facilities, no significant changes. We have reduced our drawing on the revolving credit facility somewhat, and we have drawn the last tranche of the export credit financing in the quarter.

With that, I finish my part of the presentation. I give the word back to Jon Erik.

**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

Thank you, Gottfred. First, just a quick glimpse on the current operations. We have 2 vessels in Asia. We have started in the North with Ramform Vanguard. We have 2 more vessels under way, Ramform Sterling and Ramform Titan; Sanco Swift, Ramform Atlas in West Africa; and Ramform Tethys, Ramform Hyperion, operating in the Eastern Mediterranean.

So a few comments on the seismic markets. Needless to say, we have seen over the last weeks E&P companies reporting substantial improvements in cash flow, and we believe that impacts the market and will continue to impact the market positively.

Contract market is still challenging, but we have seen in the last weeks pockets of opportunities emerging in this market as well. In particular, the 4D production market is coming back strongly. And in addition, we have seen some short-term capacity-constrained markets that we have tried to benefit from.

Industry is now more or less fully booked for Q2 and Q3. We have some capacity left in the booking for Q3. But not -- unlike last year, it looks like it's easier to fill the books for the summer season also this year. Still, the visibility for the winter season is limited even though improved from last year.

So to the market activity. Current bid activity is low, as you can see from the curve. That could be as a result of a number of recent awards, but it could also be an early sign of a weak winter, and it's too early to call which one it is. Normally, the bids for the coming winter will start to come in now as we move into the next couple of quarters. Obviously, there is still a stable level of leads. That is what is needed to be converted to bids for that to happen. So the leads level indicate that is the outlook for '18, as we see it looking not dissimilar to what we see this year.

Seismic demand is primarily driven by, again, the license rounds, either data needed before or data committed to acquire after. But we also see now a significant increase in production seismic, especially in the North Sea, in West Africa and also in Brazil.

Over time, we still believe MultiClient market share will continue to increase on the longer trend, and therefore, the curve to the left will be less and less significant for understanding the market. In principle, the only segment of contract that we believe will be there for a long time is sort of the production seismic segment or the 4D segment. And therefore, it's important to understand that and how you play in that in order to be able to play well in their contract market.

There are still countries where MultiClient is not allowed. But as you are aware, many of you, one of the larger markets where this was not allowed, Malaysia has now opened up for MultiClient, which has the potential to increase this MultiClient client share even further.

To the curves of square kilometers compared to streamers, we maintain our view that we expect more squares to be collected in '17 compared to '16 with some downside risk not driven by need for capacity but more driven by the type of surveys being done. So we see an increase in 4D. 4D requires more capacity per square, and therefore, you get less squares done for the same capacity. So that's an important distinction. And a little bit the same when it comes to looking back at Q1. We have had, as an industry, less production Q1 this year compared to Q1 last year. And some of you remember Q1 last year had a number of very large surveys in Myanmar, among other things, where you had a lot of squares per capacity over time.

Streamer capacity will increase during the summer season due to Ramform Hyperion coming to the market and other vessels coming back from warm stack, among them, Ramform Vanguard. Still, we believe the summer season capacity will be approximately or in the range of 35% to 40% lower than the peak in '13.

We do see now that warm stack has been used quite a bit from us and others to idle capacity when the market is off. And that might be meaningful as long as there are streamers available. But it's not meaningful to buy new streamers and apply them in sort of an on-and-off warm-stack mode. That will not be rationale from a capital deployment point of view.

We still observe that the global streamer pool continues to shrink with further effects of that to come in 2018. And again, we do see an improved market balance for Q2/Q3, then with some questions about what that would look for -- like coming into Q4.

So I promised a bit more on the 4D market. You have seen that the 4D activity fell quite sharply through the low oil price environment. Surprising to us that it fell that low because we did believe that 4D was more of a regular thing. But obviously, the oil companies found good reasons to postpone a lot of these surveys. And now we see the need for those coming towards a final deadline, and they are coming to the market.

So we see a doubling of 4D surveys this year over last year, more than a doubling. And we have secured more than half of those. So 4D has always been a strong market for us due to our high-quality offering with the GeoStreamer, with the Ramforms and the productivity we cannot (inaudible).

Increasingly, these 4D surveys require now multicomponent streamers, so it is a market for a smaller set of players as it is played out today, and again, as said earlier, dominated by North Sea, West Africa and Brazil, but there are also surveys in other parts of the world.

We do expect this trend to increase further next year, so it's a little bit of a ketchup bottle effect coming through now that you have constrained these for 2, 3 years, and now they have to come to the market in order for 4D seismic to be a meaningful tool as a production tool for the oil companies. This is a market where we have a premium offering and where we get premium pricing. And that's important to understand for a couple of slides later.

Then a quick comment on the MultiClient, nothing fundamentally new on this slide. We continue to believe this is an important way for us to balance our business in a downturn and to harvest from a market that is in growth over time, we believe. The most important 2 ratios, we believe it's important to follow are the 2 below here, the revenue to book value and the revenue to investments. And on both of those 2, we perform very well relative to peers.

You also see the investment curve, which we expect then to increase, as guided, in '17 over '16. We still retain the flexibility to play in the contract market, and we believe that is important to have that capability and to be a player there as we see that market starting to improve.

So to a key slide where we have decided to offer some more detail on the next 2 quarters. And before I go into the details of this slide, I'd also like to add, we are off to a good start in the second quarter also when it comes to late sales, primarily driven by the latest U.K. license round that has come in very favorable relative to where we have data, and in particular, relative to committed uplift that we have been able to then sign contracts for.

Secondly, I mentioned earlier that we have seen a somewhat tighter Q2/Q3 market that has opened for some opportunity-driven price increases. I also mentioned an increased share of 4D, which has come our way in many ways in the sense that we have an offering there that, from the oil companies' point of view, have a higher value and, therefore, a higher day rate for the vessels.

And we also have seen now what we believe is a longer-term trend in the seismic and increased interest for what some of our major clients say is data with a longer shelf life. So in a critical cost-saving mode, you go for a very cheap seismic survey to save cost not worrying so much about what you need the next 2, 3 years going forward. But if you really have longer-term, smarter view on what you want to do, you buy seismic data that you can use also for drilling and also for -- as a baseline for future monitors and then save 2, 3 surveys. And we see that coming back strongly, in particular, from some of our majors.

If you look at this curve, what we try to represent here is the day rates we have in our backlog. It's obviously before we do the jobs, but it's still what's signed as our contracts for the next 2 quarters. So if we compare the day rate in the backlog for contract in Q2 this year over last year, we have on average a higher day rate, 15% up.

And then if you look at the lower part of the table, you see the distribution between contract and MultiClient last year and this year. So it's ballpark the same weight between the 2 for the second quarter this year and last year. And we also reflect a little bit below which regions are driving the activity in the quarter. So contract for second quarter, as you obviously also saw on the vessel activity in Europe, West Africa, Middle East and Asia. So it's not sort of one single market that drives it all, but it's an average over these markets.

For the third quarter, the average day rate increase in the backlog is 35%, which obviously is a significant number. However, when you look at the vessel utilization below, it's a much lower percentage allocated to contract. So therefore, it weighs in a different way into the equation. The average here is around 19% increase when you weigh those 2 in for the 2 quarters.

And when you look at the activity level per contract in the third quarter, it's West Africa, Europe and Asia that sits there. And again, as I said, there is still some capacity not sold for the third quarter that may change these numbers. And we don't know yet whether that will be MultiClient or contract even though we have leads and are relatively confident for booking up that capacity.

Also worth noting and in part of understanding this that the third quarter increase is significant from Canada. So the Canada weather window sort of starts in June and will normally have most of its activity in the third quarter. We believe we will end up with one 2D and three 3D vessels in Canada in the third quarter. So significantly it's the highest level we've ever had in Canada, and it's all MultiClient.

Yes, I think I leave it with that, but it is meant as a guideline to better understand how the EBITDA will vary over the quarters, obviously, back-end loaded given the back-end-loaded nature of the MultiClient activity for the full year. And then combining this with what's earlier said about backlog for MultiClient, we are confident in terms of the prefunding we need and can achieve driven by the backlog we have secured. So when it comes to the next 2 quarters, this would roughly give you a view on what that is.

Now is this a sign of a [perm] in summer market? We don't know that. At least it shows that it's been possible to improve pricing this year, which was not possible last year. But on the other side, we expect more volatility over the year between Q2/Q3 on the one hand and Q4/Q1 on the other hand. And the reason for that is on a relative scheme, there is more activity in the North than was historically has been the case.

Often it was all vessels to the North Sea and out. Now it's not only the North Sea. It's Barents -- Russian Barents, Ireland, Canada. And then the counter to that, where was the activity in the Q4/Q1? Brazil was historically a strong taker of capacity, and Brazil is currently muted. So we have a different balance which makes it a bit more complicated to compare what's going to happen in the potential upturn this cycle versus earlier cycles in terms of how the markets balance, just to give that flavor. That's why we are a bit more cautious when it comes to the coming winter in terms of how we see that and what can come out of that.

So this year, more than half of the global capacity, we believe, will be active in the North Atlantic. And I don't think that's been the case earlier years in the history of the seismic. There might be deviation from that, but on average, I think that is the case.

So finally, to the guidance. Two changes basically or actually one change that is linked to the other, slightly lower indication of investment in MultiClient, so from earlier being $275 million, now $250 million to $275 million with the consequence that the active time planned for MultiClient is roughly 50%.

In conclusion, we believe we are competitively positioned to navigate this market environment. We have seen a significant order book increase. We have concluded a newbuild program and have a very competitive fleet to play with and much better positioned to then generate free cash flow going forward.

Liquidity is adequate. As Gottfred also mentioned, headroom in the covenant is still okay and most likely improving as we move forward. Continuous focus on cost and CapEx and with an industry-leading MultiClient performance. Needless to say, with the backlog increase, the visibility has improved for other current year.

And with that, I hand over to Bård Stenberg for questions.

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**Bård Stenberg** - *Petroleum Geo-Services ASA - VP of IR & Corporate Communications*

Thank you, Jon Erik. I think we can start with questions in the auditorium. Yes, John? Microphone.

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## QUESTIONS AND ANSWERS

**John A. Schj. Olaisen** - *ABG Sundal Collier Holding ASA, Research Division - Co-Head of Global Research*

It's John Olaisen from ABG. A couple questions regarding the slide where you show the price improvement for contract work. A few years back, you also guided reported EBIT margin on contract work. I wonder for Q2 and Q3 when you see contract rates up 15% or 35% year-on-year, respectively, what kind of EBIT margin will that convert.

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**Gottfred Langseth** - *Petroleum Geo-Services ASA - CFO and EVP*

We are not quantifying that at the current stage.

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**John A. Schj. Olaisen** - *ABG Sundal Collier Holding ASA, Research Division - Co-Head of Global Research*

If the contract has a negative EBIT margin, then we have -- then we think provision as we did in Q1, i.e., if price is up 35%, it should be 35% from an EBIT margin, is that right to conclude. If it's limited as far as I remember, there were not any loss-making contracts in Q3 last year.

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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

But we had provision.

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**Gottfred Langseth** - *Petroleum Geo-Services ASA - CFO and EVP*

Provisions last year.

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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

We had provisions last year as well, so that's something we can say, it'd be wrong to assume that we had an average EBIT margin of 0 last year. That's incorrect. (inaudible) You'll have to derive that from the numbers we're self-disclosing [away] with the negative EBIT margins. We searched a couple of years back. It was a -- not a good measure of market strength with the varying utilization and negative rate. So can't give you a number for EBIT margin moving forward.

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**John A. Schj. Olaisen** - *ABG Sundal Collier Holding ASA, Research Division - Co-Head of Global Research*

Regarding leases in Q2, it's possible to quantify the improvement in stream or the exposure to the U.K. license round?

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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

Yes, it's hard to give you any hard numbers. We don't do that. But if I said that U.K. license round contributes more than 1/3 of what we plan for the second quarter in revenues, something like that. And then you still have a lot of questions, so we can probably go on and playing, but it's quite significant for another quarter what we get out of that round. That's why I say we're off to a good start for the quarter on late sales.

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**John A. Schj. Olaisen** - *ABG Sundal Collier Holding ASA, Research Division - Co-Head of Global Research*

A final question, back to contract. Then the contract work that you're doing in Q3 stretching into Q4? (inaudible)

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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

No, I don't think so. Or do you think so, Gottfred?

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**Gottfred Langseth** - *Petroleum Geo-Services ASA - CFO and EVP*

I also think that's fairly limited, unlimited impact. But there are some but not so that it would meaningfully impacted at the (inaudible).

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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

But with the exception of what Gottfred said that Q4/Q1 is currently with one exception, mainly MultiClient. So it's too early to kind of give any feel for rates for Q4 in terms of the contract market.

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**Sondre Dale Stormyr** - *Danske Bank Markets Equity Research - Analyst*

Sondre Stormyr from Danske Bank. Quick question on the remaining 25% not sold for Q3, given that there still seems to be 4D work tendered for and off the water, is it fair to assume that, that will drive the average up and not down in terms of pricing?

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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

I won't give you an indication because it also is a matter of where the vessels are available relative to where the demand is because when you're down to a bit of capacity on a couple of vessels, you depend on that demand being where the vessels happen to be. So -- and if you were to take that contract in other market, the margin would be limited because of the streaming, so it's kind of a bit more of a complex picture than that. So the risk -- there is risk to the downside as well as to the upside of what we show here. We just try to be very precise on what we say and what we don't say with these slides.

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**Sondre Dale Stormyr** - *Danske Bank Markets Equity Research - Analyst*

Sure. And in terms of Brazil, there's been some clear positive steps there, but I think others have been saying that there's been limited sales related to what's going to happen in second half and later this year, and obviously we're able to see since -- have you seen the same? I mean, are you expecting Brazil to be much more meaningful sales factor in the second half?

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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

We have seen Brazil improving over the last 2, 3 if not 4 quarters related to increased expectations from the oil companies that's going to be possible to do business in a different way. Operator ships and presold, these kinds of things. And now we also saw Brazil coming with more planned regular license round. It's obviously it's positive for the MultiClient business. So we think Brazil has likely turned the trough and is improving. But still, there's not a lot of work, but you may have seen reports that we have some work lined up. Actually, that was supposed to be done in the fourth quarter of last year, but it's not done yet because the time to get permit has been extended in Brazil. So a bit of the fourth and first quarter activity we still have in the back log is actually Brazil work. That's now finally coming through the permitting process.

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**Sondre Dale Stormyr** - *Danske Bank Markets Equity Research - Analyst*

And for Gottfred, on the headroom versus covenant, I mean, you're going to carry a pretty weak Q4 and a weak Q1 EBITDA-wise for some time in that (inaudible). Still you're comfortable that you're going to increase the headroom going forward and also given that covenants are starting to step down in Q3 and Q4?

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**Gottfred Langseth** - *Petroleum Geo-Services ASA - CFO and EVP*

Yes, I said it was fairly likely. We can't guarantee. Even I can't exactly predict EBITDA forward, but obviously we have better visibility for the next couple of quarters, and that makes me believe it fairly likely that it will increase the headroom going forward.

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**Sondre Dale Stormyr** - *Danske Bank Markets Equity Research - Analyst*

Final one on cost. If you look into -- I mean, the cost savings you've done is relatively much activity related. If you look into 2018, are there measures you can pull to take down, say, the unit cost on the daily vessel OpEx that we should expect or (inaudible).

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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

We work with that all the time. And obviously, the big chunks of cost increase has to do with reducing activity. But we continue to work -- our ambition is to be competitive on cost. And clearly, industry leading on productivity when it comes to vessel operations, and there's still a lot of effort on that. The cost components of operating a vessel is fairly visible to all. You have the fuel, you have the crews and you have the maintenance and these elements, and that is what you can work with basically on incremental savings.

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**Bård Stenberg** - *Petroleum Geo-Services ASA - VP of IR & Corporate Communications*

Any more questions from the audience? No? If not, we'll go to the conference call. Operator, can you help us with the Q&A session for the people on the conference call?

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**Operator**

(Operator Instructions) We'll take our first question. (Operator Instructions)

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**Hin Kin Wong** - *UBS Investment Bank, Research Division - Executive Director and Analyst*

It's Amy Wong from UBS. I had a couple of questions. The first one relates to this one more -- what you're seeing from your clients right now. I mean, we had a remarkable period of stability in the oil price in the beginning of the year, and we had quite a bit of volatility in the last -- in the recent couple of weeks. So could you just give us some insight in terms of your conversations with the clients and if the nature of those conversations are changing? And then I'll follow with a more detailed question afterwards.

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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

Yes, I'll try, Amy. Still, of course, cost consciousness is a key priority for all our clients. Still -- or maybe better than last year, there are concrete plans on they need to do, and they have budgets for doing it, and they do it. So the activity level is obviously still low. But as you can see from the bookings, from the prefunding, from the activity, there are budgets out there to do exploration offshore, and that is meeting -- or that makes our vessels fulfill a certain demand out there. Dialogue is constructive. It's about looking for how we can help each other come out of a very challenging environment and still be able to deliver new prospects to develop offshore. So constructive, but constrained by the budgets that are available.

**Hin Kin Wong** - *UBS Investment Bank, Research Division - Executive Director and Analyst*

And has the volatility affected that? Or do you think the -- your clients are looking through some of the near-term volatility in terms of when they discuss with you?

**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

For the time being, we think they do. Of course, a shock downwards in oil price may change that. But for the time being, the current or latest swing switching has not impacted as we see with any dialogue. I think there is more volatility for us related to the seasonality I described just earlier here between the North Atlantic being in or not over the cycle of the year.

**Hin Kin Wong** - *UBS Investment Bank, Research Division - Executive Director and Analyst*

Right. Okay. Okay, my second question is more on the financials. Just looking at your onerous lease provisions. Can you just give us an idea, are you booking these contracts? Are they cash breakeven? Are they better than cash -- or are they cash flow positive? And then why you would actually x this out from your -- as an underlying EBIT because realistically, I mean, all the losses then does go into your underlying margins in the long term. Would you agree with that?

**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

I didn't actually understand the last part of the question, so let me start with the first one. Let me try to -- let me see if I can have some help on the last part. We're not -- we've said for a long time that contract prices have been, in a way, at or close to cash breakeven, and there have been contracts even below cash breakeven. With price improvements we've seen for next 2 quarters, that is obviously slightly improving. But I can't sort of say that we necessarily don't have any contracts with a negative cash breakeven. But most of the provision relates to anyway the noncash cost, primarily the depreciation cost. That is taken into the calculation of the loss on the onerous contract.

(inaudible)

**Hin Kin Wong** - *UBS Investment Bank, Research Division - Executive Director and Analyst*

(inaudible) Actually, you answered my question, actually.

**Operator**

We'll take our next question.

**Jorgen Andreas Lande** - *Clarksons Platou Securities AS, Research Division - Analyst*

Jorgen calling from Clarksons Platou. Several question have been answered. But you are slightly trimming your allocation towards MultiClient for rest of year. Can you elaborate on this move also in terms -- I mean, in the context of profitability?

**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

Thank you for handing that to me, Gottfred. It is a small adjustment from approximately 55% to approximately 50%, and it's just how we currently see capacity being booked for the remainder of the year. There are some operational drivers for this, in particular now in Q2 and Q3. And partly the Canada market, as I mentioned, is primarily a Q3 market. Partly some of the North Sea markets have restrictions -- seasonal restrictions due to fisheries that drives sort of more contract to be done early in Q2/Q3 rather than MultiClient in terms of where we would have liked to operated. There are things like that, that changes our operating plan. And then, of course, it's what we believe are the opportunities that's into Q4 impacting that. It has an impact, as you allude to primarily on EBITDA, though, given that there is a more favorable EBITDA contribution from MultiClient rather than from contract in the current environment. That's what there is to say from that.

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**Jorgen Andreas Lande** - *Clarksons Platou Securities AS, Research Division - Analyst*

Yes, okay. And secondly, just on the prefunding level -- prefunding rate level that you achieved in Q1 was 118%. Was it correctly understood if you expect a higher rate level for second and third quarter?

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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

We have not communicated anything on rate level for the MultiClient work. The rates we referred to with this graph is day rates for contract as they sit in the backlog for signed contracts. For MultiClient, we still guide 100% prefunding for the full year. And we use words like good prefunding for Q2/Q3 as indicated in the backlog with an increase of roughly $100 million compared to last year.

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**Jorgen Andreas Lande** - *Clarksons Platou Securities AS, Research Division - Analyst*

Yes. You just state on Slide 9 that you expect gradual increase of well prefunded MultiClient projects.

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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

It's a gradual increase of projects that are well-funded. That's the way that it's meant to read and not an increase in the funding.

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**Jorgen Andreas Lande** - *Clarksons Platou Securities AS, Research Division - Analyst*

Okay. Finally, back on the -- the line was a bit busy in the morning, but can you -- back to contract rates, and can you indicate if you expect to be EBITDA positive for the contract rates you have in your backlog for second and third quarter?

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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

No, we will not indicate anything like that. But I mean, you can from the spreadsheets derive where you think the EBITDA contribution has or has not been from contract earlier. And then you can add the prices basically to see where it would be. But we will not give any indications for that. I mean, 35% obviously is hard to see an EBITDA negative environment if the prices is $35 million. But I leave that to your spreadsheet to kind of do those calculations.

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**Operator**

(Operator Instructions) And we'll now take our next question.

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**Phillip Anthony Lindsay** - *Crédit Suisse AG, Research Division - Research Analyst*

It's Phil Lindsay from Credit Suisse. Two questions please, which are sort of related, really. Interesting in what you're seeing in the broader seismic market in terms of how the competitors are behaving, just how the environment is evolving and actually whether you see any opportunities for inorganic growth in terms of MultiClient libraries? And then the second question, as I said, which is related to some reactivations. Is it too early for you and others to be thinking about reactivations? And how do you view the threat of these in the coming 12 to 18 months? And also, if you have any views on reactivation costs and lead times, that would be useful as well.

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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

For the most of us, reactivation beyond the activity level we have today would require investments in new streamers, which would be $50 million, $60 million per 3D vessel. And I think any sort of rational economic analysis in the current market would make that quite a meaningless investment unless you believe in a very sharp and rapid improvement in the market. But that is kind of what we have to look for to have a view whether that could come a big addition to the fleet. We think the streamer pool available will continue to shrink. So even some investment in this might just be to maintain the current capacity level. Now we do see, as I mentioned, some capacity with us with WesternGeco coming in and out that has streamers available. But it's because streamers are available. It's not because you would take an investment to make more streamers available to play the vessels like that because you then carry a lot of costs in the idle quarters, if you like. So I think there is downward pressure on the available capacity going into '18 restricted by the available streamers. And through the first part of the question on -- and we will not make investment in streamers for added capacity for the next couple of years, I'm pretty confident. When it comes to competition, I think there is -- a main focus is to keep the boats going and securing backlog, and that's fair enough. That's what it is.

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**Operator**

Our next question.

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**Christopher Møllerløkken** - *Sparebank 1 Markets AS, Research Division - Research Analyst*

This Christopher Møllerløkken from Sparebank 1 Markets. Going back to Slide 25, the graph there showing the day rate increase. When it comes to the 2016 numbers, just to understand it correctly, is that based on what you expected going into these 2 quarters? Or is it based on what you realized those 2 quarters historically?

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**Gottfred Langseth** - *Petroleum Geo-Services ASA - CFO and EVP*

It's based on what we realized, the actual.

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**Christopher Møllerløkken** - *Sparebank 1 Markets AS, Research Division - Research Analyst*

Okay. In terms of the price improvements then, you do expect for this year, have you seen any cost increase for the projects you are planning in second and third quarter this year versus last year?

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**Gottfred Langseth** - *Petroleum Geo-Services ASA - CFO and EVP*

If you consider the projects on the contract side, nothing mentionable. We'll have more activity in -- sorry, in Canada this sort of summer, and that is costlier, but that's now MultiClient projects. So for those surveys included in these bars, in a way, it should be very comparable.

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**Christopher Møllerløkken** - *Sparebank 1 Markets AS, Research Division - Research Analyst*

And final question, just digging into this. Based on this capacity that you plan to allocate to contract this year versus last year, have you seen any change of the mix, meaning, are you using more high-capacity vessels in contract this year versus last year? I understand all your vessels are high capacity, but are you more using the Titan-class vessels this year versus last year, et cetera?





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**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

I mean, we obviously have one more Titan-class vessel available in the mix. But if you look at those that are not S or Titan-class, we're down to Vanguard and Sanco Swift.

**Gottfred Langseth** - *Petroleum Geo-Services ASA - CFO and EVP*

And Apollo.

**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

And Apollo. So Apollo is operating in Asia, mostly contract. Vanguard is used extensively for 4D. It's a very, very well-suited vessel for 4D but also MultiClient. Currently, doing MultiClient and Swift is a bit of the same contract currently. Mostly MultiClient in the summer season after that. So those lower-capacity vessels, that's how they are used compared to the more modern vessels, if you like. Yes.

**Operator**

We'll take our next question.

**Morten Nystrøm** - *Nordea Markets, Research Division - Senior Analyst of Oil Services and Sector Coordinator*

It's Morten from Nordea. Just a couple of questions from me. You say that 30% of your capacity will be allocated towards MultiClient in Q2. Could you also give a, let's say, a range on the dollar level? And also on that, when should we expect Hyperion and Vanguard to actually start being in operations?

**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

Vanguard, mid-April. Hyperion, early May. Cautious on the dollar-for-dollar for multiclient investment. It will be higher than in the first quarter since we use more capacity. And on top of that, if you read our quarterly earnings release carefully, we'll point to 1 explanation for the low investment in Q1 being low processing -- or imaging investment and low 2D activity -- or no 2D activity. Both of those would increase in the second quarter. So there should be obviously -- not a massive increase but a meaningful increase.

**Morten Nystrøm** - *Nordea Markets, Research Division - Senior Analyst of Oil Services and Sector Coordinator*

Okay. And also, then a question about Q4, which I guess is the main question now. Firstly, when do you expect to have more visibility regarding Q4? And if you also could talk about a little bit about your strategy in terms of how we see yourself booking capacity. Is it key now to, let's say, secure contracts so you don't end up in the same situation as you did in Q4 2016? Or do you think the market is at a such level that you're able to sit and wait for a while and see how your competitors book their capacity?

**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

We do not intend to disclose our bid tactics for the next quarters, obviously. But of course, we would like to avoid the situation we had last 4 quarter, was mainly caused by a couple of jobs moved out of the quarter that actually were secured at an earlier point in time. But I think you will have to see what happens as we move forward on that.

**Morten Nystrøm** - *Nordea Markets, Research Division - Senior Analyst of Oil Services and Sector Coordinator*

But if you could say something about when do you expect to have more visibility? Is it -- do we need to go postsummer? Or could we see things happening in June already?

**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

I think I have to just leave you with the updates we come with, whether it's in the rest of the presentation at some point where we always disclose this to the market when there are updates that are different from earlier and follow that. Obviously, it's from now and the next 5 months that the bookings will happen for Q4 and then subsequently for Q1. But to give a more refined time line for that is not something I can offer you today.

**Operator**

We'll take our last question.

**Monika Rajoria** - *Societe Generale Cross Asset Research - Equity Analyst*

I'm Monika from Societe Generale. I have one question on the realized pricing, contract pricing. Would you be also willing to indicate how much lower are these levels from the peak levels of 2013?

**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

I don't think I will go into this now.

**Monika Rajoria** - *Societe Generale Cross Asset Research - Equity Analyst*

All right. My second question would be the Gulf of Mexico. I was wondering if that region also is meaningful in your activities? Or has there been a shift in the thinking of PGS regarding this region?

**Jon Erik Reinhardsen** - *Petroleum Geo-Services ASA - CEO and President*

I think it's less meaningful than for our similar-sized peers. But still, we have some presence in terms of 3D library in the U.S. Gulf of Mexico, where we had some revenues, in particular, from the Crystal surveys that we have reprocessed and had good traction on. We participate in a 2D package in the Mexican side, but that's smaller investment and a smaller exposure.

**Bård Stenberg** - *Petroleum Geo-Services ASA - VP of IR & Corporate Communications*

Operator, I think we'll conclude the presentation there, and we have spent one hour. So thank you all for coming to listen to us. And also, thank you all on the conference call for dialing in. I also remind you about the conference call we have scheduled for 3 p.m. CET later today, so it's another opportunity to ask more questions. So thank you.

**Operator**

Thank you. Ladies and gentlemen, that will conclude today's conference call. Thank you for your participation. You may now disconnect.

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