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PGS.OL - Q3 2016 Petroleum Geo Services ASA Earnings Call (Morning)

EVENT DATE/TIME: OCTOBER 27, 2016 / 7:00AM GMT

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PRESENTATION

Bard Stenberg - *Petroleum Geo-Services ASA - VP, Corporate Communications*

Good morning and welcome to this presentation of PGS Q3 2016 results. My name is Bard Stenberg, Vice President of IR and Corporate Communications in PGS.

Today's presentation is being also followed by a conference call, and also on the conference call you will also be invited to ask questions after the concluding remarks from management. But also you here in Oslo, if I can ask you to use the microphones provided when asking questions, so that the people on the conference call will also be able to hear your question.

Before we start I would like to give some practical information. (Conference Instructions). I would also like to draw your attention to the cautionary statement showing on the screen, also available in the Q3 earnings release and presentation published earlier today.

Today's presentation is being given by President and CEO Jon Erik Reinhardsen and CFO Gottfred Langseth. With that, I'll give the floor to you, Jon Erik.

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

Thank you, Bard, and good morning, everyone. Needless to say, we are pleased with the third quarter, we ended up with an EBITDA of $112.7 million; and with a very strong MultiClient performance, revenues of $127.5 million, prefunding at a strong 134% in a market where most players are complaining about the opportunity for securing prefunding.

Of course in the quarter, MultiClient accounted for 66% of the revenues. Mostly a MultiClient quarter, while contract was less than 25%, which is, and I'll come back to that, where we wanted to be when we started this journey focusing more on MultiClient back in 2010. We wanted to be able to stand primarily on the MultiClient foot in a downturn, but still retain the opportunity to harvest from contracts when the market is strong and the opportunity in the contracts market is better.

Liquidity reserve is $417.3 million, which is still robust. We are on track to deliver approximately $120 million in cash cost reductions for the year. This comes on top of all the even larger savings we have done earlier years.

The MultiClient performance is primarily driven obviously by a higher oil price, which lately has been $50 plus, yesterday $50 minus but today slightly plus again. There's no doubt that it is that revenue contribution to the oil companies, combined with the cost savings they have been through, that in sum gives them the ability to start investing more in the MultiClient space.

It's not only PGS, as you've seen; we've seen also a couple of other peers reporting relatively strong revenues for the quarter. So there seems to be more substance behind the numbers that are developing here industry-wide.

For the specific quarterly numbers, I just want to draw the attention to the EBITDA and how that stacks up. The cash from ops is not fully up to EBITDA, mainly driven by sales late in the quarter. Gottfred will come back to that a little bit more in detail.

Backlog, end of quarter, slightly down, $290 million; quite good order intake post the end of the quarter. The booking as of October 25 is now 70% from Q4, which is up from the 50% we have indicated earlier. 60% Q1 is quite good for us at the moment, and it looks promising for Q1 when it comes to filling up. Then we have 20% booked for Q2 and 5% booked for Q3.

20% for Q2 is lower than last year, but bear in mind that more and more the North Atlantic part of the booking for Q2 is MultiClient, and therefore it is more down to at what point do we decide to allocate that asset to a certain project for that to be booked. We follow that philosophy that we don't put it as booked before we've made a final decision; this is what we're going to do with the vessel. With that I hand over to Gottfred to take us through the financials.

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

Thank you. Starting with P&L summary first, revenues for the third quarter $224.1 million; that is in line with what we had third quarter last year. Revenues from MultiClient is stronger, primarily late sales, but that is also offset by lower revenues from marine contract and also lower revenues from our imaging activities.

EBITDA $112.7; that as well is in line with what we had Q3 last year. EBIT before impairment and other charges, negative $5.4 million. In the third quarter we had a net of $6.1 million of such impairments and other charges; $9.2 million of impairments relating to the MultiClient library; and a credit, or positive, of $3.1 million relating to reduction of our provision for onerous contracts.

So after these charges, the reported net -- operating profit, or EBIT, was negative $11.5 million.

Total MultiClient revenues, $147.5 million; prefunding $84.3 million, corresponding to 134% of the $63 million we've capitalized as cash investment in the quarters. A relatively strong prefunding per cent for the quarter. Late sales, $63.2 million for the quarter.

Contract revenues, $54.2 million; sequentially down, and lower than what we had in Q3 last year, reflecting continued low pricing, albeit with some seasonal improvement on the projects that we did in the North Atlantic region.

Then moving to the MultiClient revenues by region; the slide summarizes or shows the quarterly development for almost three years. And it shows that despite a challenging market, our MultiClient revenues are holding up quite well compared to what we saw back in 2014.

For the third quarter the Europe region was a key driver for our sales, both the late sales and prefunding. And you'll see from the chart that it is approximately or slightly more than half of the total.

In addition, North and South America had good sales, with North America predominantly prefunding, and South America predominantly contributing to late sales.

MultiClient by vintage; book value of the library and third quarter, $682 million. That's down from the $695 million that we had at the start of the year. Moderate [net book value] for the surveys completed in the period 2011 to 2015.

Amortization rate in the quarter 58%; but on top of that, as I said, there was a $9.2 million impairment on [a really limited] number of specific surveys that were impacted by either a reduced total sales estimate or a change or push-out in time of the estimated sales. We still expect amortization expense for the full year to be approximately $300 million.

On the key operational numbers, revenues, as commented, sequentially increased from earlier in the year, [with our] net operating costs hitting the P&L sequentially flat, or slightly down.

Depreciation cost in the P&L is down from previous -- the previous two quarters. There's a slight reduction of the depreciation, gross depreciation, but the main driver for the reduction is that we used more of our capacity for MultiClient acquisition in the third quarter than the two preceding; and therefore capitalized more of that cost as library investment.

Amortization expense quite a bit up, relating obviously to the increased sales. And lastly, you see that the CapEx number, which -- on this slide $19 million is on an accrued incurred basis, $19 million, lower than earlier quarters. And the cash investment in the library sequentially up since, as I said, we spent more of the capacity to acquire MultiClient service.

On utilization, 78% active time in Q3; that's reported three weeks back already. We expect approximately for the full year, approximately 40% of our vessel active time now to be used in MultiClient [work], a notch down from what we said one quarter back, when we said 40% to 45%.

Utilization in Q4 will be lower than what we saw in Q3. We'll have higher standby time. We'll have more warm stack time, as Ramform Vanguard is now currently warm stacked, and it's highly likely to remain warm stacked throughout the quarter. And we expect steaming to be slightly higher in Q4 than Q3.

On Group cash cost, we had a sequential increase from second quarter, as we indicated last time we reported. The increase is primarily due to a larger operating fleet in the third quarter, mostly related to Sanco Swift and Ramform Tethys commencing operation during second quarter, less than a full-quarter operation and a full-quarter operation in Q3. In addition, we've had a (inaudible) campaign [with] charter capacity impacting the cost [levels].

So that is as expected and guided. We expect cost to go a bit down again in the fourth quarter.

We continue to make progress on cost reductions, and we now expect the full-year gross cash cost to be down to $675 million. That's around $25 million less than what we said three months back. The incremental cost reduction is driven by further capacity adjustments, including the warm stacking of Ramform Vanguard, and other cost initiatives.

Needless to say, cost management is one of our key priorities currently, which it has been for quite a long period already.

On the cash flow, cash flow operations $80.4 million, which is a -- quite all right; and higher than what we had in Q3 last year. That's a bit like $30 million less than our EBITDA, so there is a working capital increase in the quarter; and that relates to sales late in the quarter where anyway the cash isn't collected by quarter-end, which should obviously benefit the fourth quarter cash flow when those receivables are paid.

We have a very moderate CapEx in the quarter, and despite the slight increase in working capital, we delivered a positive cash flow before financing activities of $4.1 million.

No significant new build CapEx in the quarter. As you probably know, the substance of the remaining CapEx for the new build will be the last installment to be paid at delivery in Q1 next year and is fully financed, or fully covered by export credit financing [so does not] have any impact on our net cash position.

Liquidity position adequate, $417 million. Close to $80 million of that pending cash; the remaining to undrawn amounts on our revolving credit facility. Net interest bearing debt was flat in the quarter. There's an increase year to date which is primarily driven by the new build CapEx that we had so far, and that's primarily in the first half of the year.

Our total leverage ratio, gross indebtedness divided by adjusted EBITDA, was 3.96:1 at end third quarter, so in line with what we had a quarter back.

Not a lot of changes with respect to our debt structure. Only thing mentionable I think would be that we increased during the quarter the drawing on the RCF. It was $120 million; the drawing now $160 million. So $40 million drawing, which more or less corresponds to the increase in our cash position in the quarter. Explains why the net interest bearing debt is relatively flat.

I think that was what I intended to cover and, Jon Erik, I will then give the podium back to you.

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

Thank you, Gottfred. We will, as usual, take a quick update on the operations.

Sanco Swift has just completed a very successful long North Sea season with streamers in the water all season long, which of course is a significant contribution to productivity and lower unit cost and speaks to the efficiency and quality of the vessel.

Ramform Tethys is on her way to the Mediterranean for work; stopped now in -- it's gone a little bit further than I thought -- in Algeciras doing some warranty work after -- so this is the latest new build, so there's work to be done paid by the yard, obviously.

Titan has been in Tenerife for a couple of weeks. We are waiting for a permit for Brazil, but we have developed [an alternative], so if that takes longer time, we will move Tethys -- Titan to another job in the interim so that the risk of sitting there waiting for weeks for Brazil is really not there.

And when it comes to Sterling, we have work to go to south in West Africa, but also there we do some maintenance work on the way down. Atlas is operating in Mauritania; Atlantic Explorer, Sanco Spirit, finishing off the season in Canada in a joint with TVS. Apollo has embarked on a campaign in New Zealand, and we stay there for some weeks.

Then finally, Sovereign has just the last couple of days started, and this is a bit of a historical event, the first MultiClient campaign in Malaysia ever. So here is a change in government regime and willingness to entertain a new business model. And as some of you know on the back of this, there is this plan of this bigger joint venture MultiClient campaign between Schlumberger, TGS and us for a larger region in Malaysia.

But that's where we are. Obviously understandable, there's some concern about vessel utilization in Q4. The booking is 70%. It's up. Most of the non-booked we are eating into now, and then as we move into the quarter you will see utilization pick up due to the opportunities we now have secured, so it will be a back-end loaded activity in the quarter. And then with quite a few good opportunities for Q1 with 60% already secured.

Also has to be said though that if the option is between work and not work in the contract regime today, the sensitivity on the financials is very limited because you operate basically on an EBITDA break-even level here. So it's not our biggest concern whether we are able to secure the last 10% or not secure the last 10% when you look at the overall number. What matters here in Q3 as in Q4 is actually the MultiClient revenues. That's what's going to make or break the quarter.

So to the market. Fundamentals, as I mentioned, benefiting from the oil price. A lot of views here. Is it really that it has to be $55 to be good, or is it good enough with $45? And there is obviously not a trigger point here. Oil companies have different portfolios in different parts of the world, and on aggregate, this becomes more like a sliding scale of the higher it is the better it is. And then I think the last quarter among at least WesternGeco, us and TDS shows that $50 is better than $40, and in general, it's more (inaudible).

Then obviously we see a lot of the oil companies, if not most that we deal with, have been through restructurings. They have laid off people. They are moving forward with their budgets. They are muted to what they have been, but they are there. And there's money to spend which reflects the revenues coming out in our numbers here.

Increase primarily in MultiClient at the moment, which is classical in a way. That is often a leading indicator to a stronger market. And we do have to expect going forward also you may see variations here quarterly, regionally, as we move forward. We are not in a strong market, but we are in an improving market.

The weakness is still reflected in contracts where we still are seeing low pricing and where the coming winter is challenging, as you have seen also from our booking. So the opportunity to push pricing in contract is not really there yet, even though looking at our third quarter, there is a big span of rates in the portfolio, quite a huge span of rates where you can capitalize on uniqueness in some surveys, while in other surveys it's more a commoditized-type offering.

Market activity, bid activity, remains at low levels. But as I always say, the curve or the curves here represent purely contract. They are in dollars, so obviously, if the unit rate is down to one-third of what it was at peak, you have to calibrate for that when you look at this in terms of a measure of activity, and more and more it's becoming MultiClient. And we think that trend will continue also into next year. So being a player in this industry without a qualified, robust MultiClient business is going to be a challenge as we see it.

Most of the demand is driven primarily by license rounds, probably 80% plus; either data you need to apply for a license round, or data you commit to do as part of being awarded a license round.

And then when we look at Q1, primarily the set of opportunities we see is Africa, but there are some other opportunities in other parts of the world as well. But the volume is primarily Africa.

For the full year, we now expect 340,000 squares to be acquired by the industry, which is in the high end of the range we indicated here last quarter. It's interesting to see that in squares, we are above 2008, 2009 and 2010, which -- 2008 was a very robust year for the industry, as you remember.

So the underlying challenge for this industry is not really the activity level. It is the oversupply of capacity. And that's why it's important to monitor the capacity equation. Streamer capacity is currently down 40% from the peak in 2013. It's less down than what we saw a quarter ago, so there is a bit more capacity that has been at play. And actually, when we come to next summer, we anticipate that it will be down only 35%.

Now this matches in a way the increase in squares you see on the top here. So we're sitting at a point where the streamer pool globally available starts to be fully utilized with the vessels that are now out there, and the volumes are a reflection of what's available of capacity, in a way. So these are not true supply/demand balance pictures, but just they are proxies, and have to be considered on that basis.

Our response to this is to focus on what we can do: sales, good operations, cost, and cash flow discipline.

So a couple of words about the business. We have long had an ambition to take the number 1 position in all these segments. Contracts, we have had a number 1 position for a while, and I think any client you would ask would rate PGS as number 1 in this space.

Operations, we still have the lead positions. We still have the lowest cash cost per square, the lowest cash cost per streamer, despite all statements made by newcomers. We tow on average more cables than anybody else, and therefore our cash cost is the lowest, and we have the most modern boats with the most efficient fuel machinery.

On MultiClient, we've always looked up to TGS, tried to get up there and deliver similar numbers to them, and we're getting there very rapidly. And I'll show you a little bit on the next slide. On quite a few ratios now we are very comparable in terms of return on the book value, etc.

And we have used this downturn in these segments to really strengthen our relative position, and we've been able to push forward and do what's right for the company and not be operating in a crisis mode.

We have always seen that we have a bigger stretch in the imaging side because CGG has had a leading position that has been very strong. But increasingly now the last year, first of all, our client feedback forms have suddenly started to accelerate up and the feedback is that our technology here is now fully at par with the best in the business and in some areas even better.

We are not there yet on the volume but we are getting there much more rapidly than we had planned earlier and primarily thanks to the downturn and the ability we've had to use this downturn to relatively position ourselves better. That's why we want to come out of this downturn as the Company that has taken the lead in the marine seismic space.

In 2010 we made a decision to increase our investment in MultiClient, increase our focus on MultiClient and the driver was clearly to find a way to stabilize the performance in a highly cyclical industry. And we know that MultiClient over time has been more stable through the cycles, not as exciting at peak but much more exciting at trough. And you see on the top graph there how the MultiClient share of our revenue has gradually increased over this period

And we think it will continue to increase. We think there is more to gain, partly because countries like Malaysia and [elsewhere] MultiClient is okay, so we see more and more countries accepting that business. It is not accepted in Myanmar yet, for instance, but it will come, we think. Partly because it's beneficial for the oil companies; it's a good way of working with us, gives much more flexibility in terms of being able to pick the technology you really want versus being pushed into a bidding regime where you have to accept the lowest bidder, even though you know it's not fully as good. And it gives us the flexibility to capitalize on our technology in a much, much better way.

Our revenues now are dominated by MultiClient, 66%, and contract is less than 25%. So the sensitivity now is really how successful are we in the MultiClient business at the moment, which is good because that's the segment that is now coming first out of the trough. And most of our EBITDA now sits with the MultiClient, given how low the contract is.

There's no doubt, when we look back on our numbers, and the reason we have been able to accelerate our relative performance here is GeoStreamer data that has a much better and longer shelf life than a regular survey, there's much more you can derive out of these data; the productivity that has brought the average cost per square down, which makes it easier to make a better return; and the advanced high-quality imaging that we have on the library that gives additional sales out of the library.

These are the differentiators we have and that are much more visible in the MultiClient space than they are in a commoditized contract market at the moment.

If you look at the middle graph here, you see our revenue to book value and at the last one -- we have done the last 12 months on a comparable basis with peers and it speaks to our ability to harvest sales out of the library. And it's a strong ability. We have a very strong sales team out there and we have well-positioned library data that deliver decent returns. It's not as good as it was in the better years. The market is depressed also here, so the return is lower, but it's still decent.

At the bottom we have shown our investments and there is a downward trend lately which kind of speaks against what I've just said, that we are increasing our exposure to MultiClient, but the downward trend is primarily driven by cost reductions. So there is not a significant reduction in squares but there is a significant investment in invested capital. Of course part of that reduction is also the productivity added by the new vessels, so we get more squares done per day on a boat that doesn't cost that much more per day to run.

The other important observation is then the ratio here and this ratio is not very comparable across the industry, we agree to that, but at least if you see our number, it's pretty flat. So what we are able to spend relative to what we invest is relatively flat, and even showing an uptick over the last period. This is the only Company in the industry that has an uptick over the last couple of years on that ratio.

Yes, you cannot compare the number itself but you can compare the trending of those numbers and we are the only ones that are actually showing an uptick in that number over the last two, three years. So again, very respectable performance on the MultiClient side, if we have to say it ourselves.

Then, finally, to the guidance. As we said initially, the gross cash cost coming down further with another $25 million from what we said in the last quarter.

MultiClient coming down somewhat, another $25 million on the investment side, and also another $10 million on the CapEx side. So we are disciplined on the cash side, trying to preserve the cash as our most valuable resource.

Finally, in conclusion, competitively positioned to navigate the current market environment. We are trying to take the benefit of the weak market to gain relative strength. Our performance in MultiClient is now up there as industry leading. Cash flow has improved. We have an adequate liquidity position with flexibility to address the debt maturities in time. They're still two years out.

Our substantial cost reductions continue. The fleet is industry leading with lowest cash cost per streamer per square, which is the production unit you actually sell. And we have significantly improved our imaging performance and technology over the last years. Of course what we do now is really reap the benefit of our increased MultiClient focus.

And with that I hand over to Bard Stenberg to lead us in the questions.

QUESTIONS AND ANSWERS

Bard Stenberg - *Petroleum Geo-Services ASA - VP, Corporate Communications*

Thank you, Jon Erik. I guess we can start with questions from the audience here in Oslo.

Frederik Lunde - *Carnegie Investment Bank AB - Analyst*

Frederik Lunde, Carnegie. I'm just curious. You're obviously highlighting all the time that your main revenue and profit generated (inaudible) but you also have a lot of invested capital in the vessels and indeed buying two barges last year. I'm just curious. Have you changed your thinking on the underlying structure of the business going forward or is it more a reflection of where you are in the cycle?

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

It's more a reflection of where we are in the cycle but we have changed our philosophy over the last year. If you look back to our presentation, we've come to a point where we've said there are six more vessels we want to own over time, the four Triton classes and the two S classes. And the rest we will retain flexibility in terms of chartering in over shorter or longer periods. So there is a philosophy here in terms of becoming a bit more capital-light on the vessel side over time.

We still have, of course the older stacked vessels. There's not a lot of book value left with them but they are not as old as need to be retired. We think they have another cycle in them that we can take out but, yes, there is some change there.

But the philosophy, when it comes to more MultiClient is, as I said initially, driven by we want to be able to stand on the MultiClient foot in a downturn, still have that in a good turn but retain the opportunity to maximize the profits from the contract market when the market is better.

Frederik Lunde - *Carnegie Investment Bank AB - Analyst*

And is there any news on the final new build in terms of delivery time? Are you looking to push it out?

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

No, we are looking for a Q1 delivery because the plan for next year, post-Q1, is to have nine vessels in operation: the newer Ramform Hyperion and Ramform Vanguard, which is now warm stacked, plus the seven we operate today.

Frederik Lunde - *Carnegie Investment Bank AB - Analyst*

Thanks.

Bard Stenberg - *Petroleum Geo-Services ASA - VP, Corporate Communications*

Any other questions from the audience in Oslo?

Sondre Stormyr - *Danske Markets - Analyst*

Sondre Stormyr, Danske Markets. Shearwater GeoServices arrived here a couple of weeks ago. When and how do you expect to see them in the market and in terms of the competitive situation, what is changing for you over the next 12 months?

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

They are in the market. They both have been in the market through this, Dolphin Geophysical, for a long time. They have been out marketing. Not a lot of bid participation that we have seen, to be honest, but clearly they have been promoting this to a number of clients. Probably more of a challenge to [other markets] because they are predominantly in the contract segment, which is the weak segment today.

Since we allocate quite a bit to MultiClient, and probably even more to MultiClient next year, I'm not too concerned about the added capacity here, nor am I too concerned about the cost structure that's been referred to. We still have the lowest cash cost per streamer and we are down to EBITDA-zero business. So whether your financing is more or less expensive for a while, it doesn't really change the game in an EBITDA-zero business. Their main challenge will be to survive or get more capital, or whatever it is.

Sondre Stormyr - *Danske Markets - Analyst*

And then on, to look further on the financing side in terms of covenants for next year and the potential discussions with the banks around waivers. Can you give some color on the type of security, additional security you can offer the banks to avoid [extra] ways to manage the covenants or get around them in a 2017 scenario? Because you don't have, probably, pulled all the strings when it comes to the collateral you have in your fleet and maybe you have additional stuff to offer the banks. Can you give some comments on that?

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

I will comment on that but I will not follow the analysis in the direction of debts that you're seeking. We amended the covenants with the bank group as late as four, five months back to get a profile of the covenants that we believe we should be able to live with. And there are some mechanisms in that relating to that, which gives us some further maneuverability.

So I think, in a way, a discussion around the topics you raised is likely premature in way. We prefer to operate with a final thing, profile, which is generally based on a corporate level debt and it's not in our current planning to change that.

Sondre Stormyr - *Danske Markets - Analyst*

Okay, thank you.

Bard Stenberg - *Petroleum Geo-Services ASA - VP, Corporate Communications*

Okay. If there is no further questions here in Oslo at this stage, operator, can you help us with questions from the people on the conference call?

Operator

Yes, sir. (Operator Instructions).

John Olaisen - *ABG Sundal Collier - Analyst*

John Olaisen, ABG Sundal Collier. A couple of questions. First, in Q3 your MultiClient sales were pretty strong in Europe. I just wonder, were there any single, large buyer of chunks of data in Q3?

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

There are some, not only one, but some larger purchases that is a mix of old and with data in the mix, which, of course, has had a positive impact on the data set.

John Olaisen - *ABG Sundal Collier - Analyst*

Is it possible to say to which extent, in percentage terms, how much of the sales were generated from a couple of big sales?

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

The numbers would still have been very nice, compared to earlier quarters, without those sales, to put it that way. But I'm not going to go further in detail in terms of what it is.

John Olaisen - *ABG Sundal Collier - Analyst*

Did you have to discount data significantly to secure these chunk sales?

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

It's pretty normal when you do bigger sales that you give some discount, for two reasons. The one is the volume. For the other reason, it's a mix of new and old data. The old data would normally be something you had in there to sweeten the package. But you know, John, a dollar is a dollar. And we tend to like the dollars, so we are very happy with that.

John Olaisen - *ABG Sundal Collier - Analyst*

Yes. No, I understand that. My second question is regarding the 2017 outlook. Are tenders out yet for the North Sea summer season, 2017?

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

I'm not aware of how many; it's probably a couple of tenders out already. But for the North Sea season, most of the North Sea work now is MultiClient. So the usual -- when I started here, the pattern was you got tenders and here's the timing for it. Now they're early now, now they're late. It's a pattern that's not very, it's not there for the last couple of years because it's limited now to less than a handful of bodies, basically, that is now in the [camp] of tendering.

John Olaisen - *ABG Sundal Collier - Analyst*

But if not the North Sea then -- because you're still employing about half of your fleet for contracts, contract outlooks. They're still pretty important. I just wonder, normally the first time that we see any uptick in contract rates would be in the second quarter, because that's the peak season. And I just wonder, are there any signs of improvements of contract rates for next year or is it too early? Is there zero visibility?

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

I think that's too early but you are right, it's particularly Q2, Q3 that represents the window when you can start to move prices in an upcycle. Not necessarily because there's a lot of contract work in the north, but there's a much higher utilization because of the North Atlantic market, so you tighten the whole picture. We are as curious as you are for that and are testing that, obviously, all the time in terms of what is possible to do.

John Olaisen - *ABG Sundal Collier - Analyst*

But it's too early to tell or to give an indication, is that what you're saying?

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

Yes. It is now, but bear in mind, when you look back at this summer, we have had day rates, anything from $130 to over $200 a day. So even now there is a big span of rates in the business, depending on what type of job it is, and how you can differentiate on a job. So -- and the question is, can we get rid of the low ones and move the top ones further up? And that's what we try all the time, obviously.

John Olaisen - *ABG Sundal Collier - Analyst*

Sure. But the average seems to be pretty bad, so we hope for some improvement. But my final question. This new company that just entered the scene Shearwater, which is rising from the leftovers from Dolphin. Have you noticed them in the market yet? And do you think this is different with the new name, Shearwater, compared to the vessels being part of Rieber Shipping? This is my final question, sorry.

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

No, the vessels are the same. So we have competed with these vessels earlier. That ended up in a bankruptcy. The name is new. I don't think that helps a lot. But there is competition out there, there's going to continue to be competition out there. And the only place we have seen them is this bid in India for [NDC], where they ended up, it was actually the old Dolphin that bid, as the lowest bidder. And I think we were number three or something like that in pricing. So then we have to see what's going to come here.

John Olaisen - *ABG Sundal Collier - Analyst*

Okay. Thank you.

Monika Rajoria - *Societe Generale - Analyst*

Monika Rajoria, Societe General. I have two questions, please. First is on the contract margins. Would you be able to give us some kind of flavor as in how they were this quarter, given that the pricing still remains quite weak?

And the second one is on the restricted cash. I saw a lot of movement in the long-term restricted cash. I was wondering if there was something over there. Thank you.

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

Yes, on the contract market, you probably picked it up a bit on the previous question. The commodities part of the contract market is cash flow break-even-type rates. So it's clearly negative on the EBIT side. That's where the competition sits, and that's what it's about.

And then there are opportunities here and there, where you can differentiate on your technology. Particularly for us is the 4D space, where a multi-component streamer seems to be the preferred avenue for the oil companies; that does a lot of this for you.

And then, Gottfred, on the long term?

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

Yes, there shouldn't have been a lot of movement in restricted cash in this quarter, but year to date, there is an increase. And that increase relates, in the first part of the year, to some strengthening of the Brazilian real, which -- where we have a deposit relating to some legal disputes.

But the most important reason for the increase is that relating to the export credit financing in Japan, there is a certain percentage of the loan amount that is put on a debt service account. And since we got delivery the delivery of Ramform Tethys in the first quarter, and also paid for the launching installment for Hyperion in the second quarter, and paid for that with export credit financing, at the same time as we made a drawing on the financing, [we are] amount depositing -- deposited it on this debt service account. So that is the reason for the increase.

Monika Rajoria - *Societe Generale - Analyst*

Thank you. And my final question would be on the covenants on this past few years. Are you under negotiations with the banks for a renegotiation on the RCF covenant? Thank you.

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

No, we renegotiated the covenants for the RCF effective June this year. So we're creating more headroom for the period ahead. And we're still, as you will see from the reporting numbers, we're quite a bit lower on the leverage ratio than what the covenant requires.

Monika Rajoria - *Societe Generale - Analyst*

Okay, great. Thank you.

Christopher Mollerlokken - *SpareBank 1 Markets - Analyst*

Christopher Mollerlokken, SpareBank 1 Markets. First of all, congratulations with the clear beat on MultiClient sales in Q3. When -- Jon Erik, this is a question for you. When you speak with your clients, what are the indications they give for their budgets in 2017?

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

Obviously, this varies and most of them have not finished their budgets yet. But there's no doubt that there is a lot of ambition among many of our larger companies to remain present in the offshore; the focus on offshore, even deepwater for some of them. But it is a, what do you call it, a more varied picture between the various players.

Personally, at the moment, I think we might well see a flat activity level next year, to me. And E&P spending coming down 10%, 15% next year probably represents a slight -- 10% would probably be an upside, just by the gravity of CapEx projects coming off, and nothing new being added on the other side. You will see a decline curve on spending, irrespective of what you do about it. Because every year, you spin off a few projects, and if you have like an average seven years of E&P spending in your portfolio, one-seventh will come down just by gravity.

And similarly, on the exploration rates for rigs, the rig rates are basically coming down 40%, 50%. Even at flat activity level, you have a significant reduction in spending. So the question is, where is that break-even point where the activity level is flat or start to come up? So you might see activity level coming up even if E&P spending comes down 10%. And that's the important thing.

And we get that feeling when we talk to clients that, that's actually how it looks at the moment, that they have ambitions, they ask for budgets, they have budgets. But more and more since the world is turning MultiClient, they are less specific in terms of what they have budgets for. Because there's like a pool of money to be spent on MultiClients, and we'll be driven by opportunities as they emerge during the year.

So there is less clarity, in many ways, when you sit down with the larger companies, about I'm going to do something here, here, and there. Yes, we know some of that, but there is a bigger pool of money that is not disclosed in terms of area, specific stuff. But, of course, it's important to grab when we're out there, and stay close to the customers and get what they have available.

Christopher Mollerlokken - *SpareBank 1 Markets - Analyst*

MultiClient is known to be hard to forecast, but history has shown that, typically, fourth quarter tends to be the strongest quarter in a year. Now, with you guys reporting a very strong third quarter, and also the rest of the industry showing a growth year over year in MultiClient sales in Q3, do you see a risk that it could be a bit early this year? Or would you assume that fourth quarter will, as usual, be a strong year-end?

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

It's obviously too early to say, as it is every fourth quarter this time in the quarter. I tend to come back to the story where Sverre, our head of MultiClient, closed, was it $40 million or $50 million between the starter and the main course on New Year's Eve. And that's an illustration of how dramatic this can be at the end of the year. And those leads we will not know of today, obviously.

But there are clearly dialog with clients that have year-end money, and that have stated they have year-end money. And then, it remains to be seen where we land. That's too early to say.

Christopher Mollerlokken - *SpareBank 1 Markets - Analyst*

With the MC utilization in 2016 at 40%, would you indicate that, that will be a fair proxy for 2017 as well?

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

On MultiClient?

Christopher Mollerlokken - *SpareBank 1 Markets - Analyst*

Yes.

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

Is that what you mean? It's likely to come up next year. And it's with a trend overall. We have ended up a bit on the low side from what we planned, as you remember, from this guiding on this year.

Christopher Mollerlokken - *SpareBank 1 Markets - Analyst*

And final question: you indicated off-hire to increase in fourth quarter versus third quarter, would fourth quarter last year be a fair proxy?

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

I don't even recall what we had fourth quarter last year, so let's go back to that. There is possibility to book more than the 70% we have now, to put it that way. But, of course, the first week we have run some idle time and we cannot get that back.

So we will end up somewhere probably about the 70% booking that we have today; more than that, I cannot offer of refinement today. But again, the sensitivity here on the last 10% is not a big number for the overall, given these are, basically, contract opportunities we are playing with.

Christopher Mollerlokken - *SpareBank 1 Markets - Analyst*

Many thanks.

Gregory Brown - *Credit Suisse - Analyst*

Gregory Brown, Credit Suisse. It's a question on Mexico, if I may. We've seen one of your competitors secure a 3D acquisition contract in the region and I was hoping you'd be able to give us an update on your strategic approach to the basin as we head into the deepwater license round, and how you see the opportunity evolving over time. Do you think Mexico will be more of a MultiClient market, like we see in the North Sea? Or will it eventually be more of an acquisition-type market? Thank you.

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

As you may know, we have taken a relatively cautious approach to Mexico, given the uncertainty. For us, that has been prudent, given where we are as a company, and what means we have available to invest.

So we have not been able to do huge 3D bets in Mexico. We don't think the regulatory clarity is sufficient for that, on our book. We have taken a 2D bet, where we share the bet with two other players to mitigate the risk.

We did not win the 3D contract work recently for PEMEX, for many good reasons. Basically, we thought it was a tough-priced job, compared to what we were prepared to entertain. But we have a view that we would like to do more in Mexico, given the right circumstances are there.

There are clients talking about need for more data, willing to maybe do group [suits] or contracts. But I think over time, most of the volume might probably be MultiClient, given that's the start that has emerged in Mexico. And you have got huge 3D MultiClient data available now, predominantly by the Schlumberger investment that's been done. And then, there is a market in Mexico, as well, in terms of reprocessing existing data. That also is kind of a MultiClient play in the market.

Gregory Brown - *Credit Suisse - Analyst*

That's very helpful. Thank you very much.

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

But we will be there when the opportunity's right and it fits with our ambition and willingness to take risk.

Gregory Brown - *Credit Suisse - Analyst*

Thank you.

Operator

There are no further questions on the phone.

Bard Stenberg - *Petroleum Geo-Services ASA - VP, Corporate Communications*

Okay. And any further questions from the audience in Oslo? If not, that concludes this presentation of the Q3 2016 results. I would also like to remind you of the conference call we have this afternoon, at 3:00 PM CET.

Thank you, all, for coming; and thank you, all, for following us on the conference call. Have a nice day.

Operator

Ladies and gentlemen, you may now disconnect.
