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PGS.OL - Petroleum Geo Services ASA Capital Markets Day and Q4 Earnings Presentation

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PRESENTATION

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

Good morning and welcome to this presentation of PGS Q4 2017 results and our Capital Markets Day. My name is Bård Stenberg, Senior Vice President of Investor Relations and Communications in PGS.

Today's agenda is showing on the screen. And the presentations will be given by CEO, Rune Olav Pedersen; CFO, Gottfred Langseth; Executive Vice President of Sales and Services, Sverre Strandenes; Executive Vice President of Operations & Technology, Per Arild Reksnes.

We also are arranging this Capital Markets Day in cooperation with the Norwegian Association of Financial Analysts. So with us today we have 2 moderators, Anne Gjøen from Handelsbanken and Kim André Uggedal from Fearnley Securities. They will host us through the Q&A sessions.

Before we start, I would like to give some practical information. There is no fire drills planned during this event. So if the alarm is sounded, please evacuate immediately through the emergency exits at the back of the room and also here in front. This Capital Markets Day is also being webcasted. So for the audience here in Oslo, please use the microphones provided when asking questions. And also the people on the webcast are invited to ask questions and those will be managed by our moderators. I would also like to draw your attention to the cautionary statement showing on the screen and also available in today's material.

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

Rune Olav Pedersen *- Petroleum Geo-Services ASA - President & CEO*

Thank you, Bård. Good morning, everyone. I will start this show, this Capital Market presentation, by giving you some highlights from '17. I will go through a little bit of how we have positioned the company over the last 4 months and then move on to the markets to say what we expect from 2018 and onwards and finish off with guidance for the year.

So 2017, it was characterized by a very challenging market for seismic services. There is no doubt about it. It was a tough year, another tough year for PGS and for the industry. However, we were able in this market to maneuver quite successfully and get the company through. We took advantage of several regional supply constraints during especially the summer season, so we were able to get contracts at acceptable rates in the North Sea. And we were able to secure quite a few 4D jobs during the year, which has given us okay pricing compared to the industry and the challenging market in itself. But obviously, more importantly, we still have industry-leading MultiClient performance, and as you will see later today, we continue to be industry-leading in these segments.

We have very strong sales-to-investment ratios once again for 2017. We have solid sales-to-book ratios and some of our old investments in Brazil and some of our very new investments in Malaysia is paying great dividend. That has been very important and has pulled PGS through 2017.

In addition, we still have excellent operational performance. In PGS, we almost take this for granted, but it is not for granted. We work very hard and people in our operations department work very hard every day to make sure this continues. We have excellent safety records. That is a very high priority for us and for our customers, and it doesn't come for free.

We took delivery of the Ramform Hyperion, supplementing the best fleet in the industry. We now have a superior fleet to anyone else. We have 4 Titan-class vessels ahead of that fleet. And also important, and although most of you know this, we will not build any new boats in the foreseeable future. Therefore, another important element in this is that the CapEx for PGS will come down to much lower levels going forward than what we have had historically.

And last but not least, the last 4 months we have centralized, simplified, and streamlined the organization. That has had 2 main goals: one, we needed to get our cash costs down. We needed to improve our relative cost position and reduce the cash cost, and therefore we announced that we would reduce the cash cost by more than $100 million at the end of -- at the Q3 announcement. And as you will see from our guidance, we have done that and more.

The second goal of this organization, of this restructuring of the organization, has been to build a better organization, an organization more suited for today's market. So we have built a smaller, a more centralized organization, a streamlined organization, with -- and a few highlights, we've put all sales efforts into one sales unit instead of having 3 business units all addressing the market with their individual products. We put it all into one sales unit and therefore we are able to address the clients more appropriately.

We have streamlined the process for bids. That is quite important. We have centralized it, so all bids now go out of a centralized unit, and that also means that we have a much stronger centralized control over the bidding levels, the rates we are offering around the world. And we don't necessarily bid every contract to win it. If we win a contract, it's because we want it, and that is quite important and that has changed during that last -- with this reorganization.

And obviously we will continue to improve project execution. We made a project delivery organization here, which have the economic responsibility for any project, whether it be Contract or MultiClient in PGS. And we have a more effective Imaging organization, which is smaller and more directed towards assisting the MultiClient library. And together the MultiClient sales team and the Imaging organization makes up this excellent MultiClient business we have. But obviously we will focus on short-term profitability or more precisely short-term cash flow in 2018. That is the focus and therefore the focus on cost has been so strong in these last months.

And I'm happy to say that we have completed our reorganization during Q4. It has been a very exhausting exercise internally in PGS. Several hundred people have left the company, good people. We have also as part of this reorganization refocused. So we have decided to discontinue our EM activities, taken out all costs while we maintain the technology, we maintain the library, but there will be no cost on EM going forward. We will reintroduce this to the market when we see that we can make money from it.

We have also decided that we will explore possibilities of divesting the OptoSeis business. This is also a noncore activity, and we will not spend costs going forward on this. This is a good technology, but someone else can take this forward.

Finally, we have decided to sell our Cairo processing center, which is a good processing center, but it has its strength both on land processing and 2D processing and some 3D, which is not core to PGS. It's not because it's a bad center, but it is not core to PGS. Core for processing in PGS will be 3D processing, high-end processing, which we are good at, and it will be based in our central hubs rather than a place like Cairo.

So with this that's why we are choosing this tagline "Refocused and Reenergized." We have spent the last month to refocus the business, and now we're through it, and now we're reenergized and we're ready to attack the market. And we've done this without sacrificing the earning potential for PGS.

And this slide shows you the average number of streamers in 2017 per quarter in the gray bars and the average 3D streamers, the average 3D streamer count for 2018 in the blue bars. As you can see, it is fairly flat. It is fairly flat. So we will operate our fleet of 8 vessels. In this setup, we have assumed that we will operate 6 vessels in Q1 and 6 vessels in Q4, which is what we have communicated to the market. Therefore, we have fixed cost at a 6-vessel level and there is variable cost beyond that. Obviously, we won't introduce the 8 vessels, or the 7th or the 8th vessel into Q1, Q2, Q3 if there is no work for it, but we are -- the way we see the market now, fairly comfortable that that guidance of [6, 8, 8, 6] will continue.

So we have stated earlier that we believe in a flat market. I think I will rephrase. We plan for a flat market. We plan for a flat market. That is what we're saying here today and I'll get back to that. And how does this look if the market is flat? And I said that our main goal is cash flow.

This is an illustration. What you see here is our 2017 reported revenues as an illustration. And here you see our guidance on cost and CapEx, our scheduled debt repayments, scheduled interest repayments, and an estimation of tax cash costs based on what we have experienced over the last years. And as you see, a fairly healthy positive cash flow year end in a flat market with retained earnings potential for PGS. It's important to note that this does not include restructuring costs. We have taken those costs in Q4, but obviously some of the cash will come this year. So this does not include the restructuring costs.

Why is this so important? Why do we stress this? Obviously, it's very important for liquidity. That is quite obvious. And we need to make sure we have a significant and sufficient liquidity buffer going forward. As important, this puts this company in a good position to refinance our debt which falls due late '20 and early '21. And it's important to get the company in a state where we're making money, earning cash when we refinance. That's why this is so important. And we can do this in a flat market.

So is a flat market a reasonable assumption? Are we too optimistic? Are we too pessimistic? I will run you through some market slides and I will start with the very basics. What is going to happen to the demand for oil and gas going forward? We've taken this from BP World Energy Outlook 2017. If you look at almost any other similar report, it will have a similar picture, and we've looked at all which we could find.

What you see here is that there is an increasing need for oil and gas up to 2035. Although renewable take a -- have a larger growth, there is also a growth in the need for oil and gas in this period. What you don't see here is the decline rates from existing fields. All existing fields have a decline rate, which also has to be replaced. And it's clear that -- even though you project in a quite aggressive growth from U.S. shale, which I think is appropriate and I hope to God that they do it, otherwise we have no chance of meeting supply and demand, as I will show you. This is not enough. Offshore exploration needs to come back. We need to find more oil and gas. We need to bring more projects into production to meet this demand and the decline rate.

This is the discoveries in last year and all the way back to 2012. We discovered 6.7 billion barrels of oil equivalent last year, which is the lowest level we have seen since 1947. 1947. Exploration spending, drilling has been significantly down. I'll just show you. It's been very, very tough for the seismic industry. And in my opinion, oil discovery levels are at an unsustainable level. And you can see that also from the reserve replacement ratio and the reserve life ratios. And we need increased exploration activity in the world to reverse this trend. That is needed. Everyone sees this. So the question is can our clients afford to do that? Can they afford to spend more money on exploration? And the answer to that is, yes, they can.

This is an overview of some integrated oil companies. You see the list on the bottom and their cost base. You have the breakeven after CapEx down here in the blue and then you have the breakeven after CapEx and dividend in the lighter blue. And it's around $50 per barrel. Currently the oil price is $70. Our clients are making more cash almost than ever before. So, yes, they can clearly afford to increase exploration spending and they need to do so.

There is another interesting set which brings it a little bit closer to home, a little bit closer to seismic. Normally seismic spending is quite correlated to E&P offshore spending. This year that's not the case. E&P offshore spending is quite significantly down in 2017 compared to 2016, which is what this graph shows, while seismic spending is quite a bit up in 2017 compared to 2016. Seismic is early cyclical. We saw it in the downturn. I think we see it again when the tide is turning. So that's the demand side; looks fairly positive when you look forward.

Supply side, streamers have come down quite a bit. You see the seasonal flexibilities here. Schlumberger has decided to exit the seismic acquisition market. That will have an impact on vessels and what vessels are available for the market in 2018. What happens more longer term no one knows obviously, but this obviously should benefit also the supply market or the supply of seismic vessels.

So based on this, we guide group cash cost of approximately $575 million, MultiClient cash investments of approximately $250 million, and more than 50% of our fleet will be used for MultiClient, the remaining obviously for marine contracts. Capital expenditures of approximately $50 million.

So, in summary, higher oil price, improved cash flow among oil companies, and sustainable reserve replacement ratios, we believe they will benefit the seismic markets going forward. These are indications that we will see a market improvement in 2018. So why do I plan for a flat market? Well, first of all, we come out of what has been a very challenging winter season and are in a way still in it. Secondly, it is both appropriate and prudent to plan for something we are quite certain will happen. And then we can always handle the upside if it comes. That is why we plan for a flat market.

So with a centralized, simplified, and streamlined PGS organization, we believe we are well positioned to take advantage of the market to come. We're also well positioned to handle any market should it be less optimistic than what I may have given you an impression of during this presentation. Therefore, we're reenergized, refocused to capture future market opportunities.

And with that, Gottfred?

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

Good morning. I will start -- please notify me if the sound isn't okay. I will start with reviewing the Q4 and the preliminary full year 2017 numbers. And thereafter I will cover some selected Capital Markets Day finance area topics.

We are satisfied with how we finished 2017. As Rune alluded to, the full year EBITDA ended at $374.1 million. Q4 EBITDA, $122.8 million. The final fine count of the MultiClient revenues in Q4 ended a bit higher than what we indicated when we released our update in the first week of January. So it ended at $178 million compared to the approximately $170 million that we disclosed then.

With a strong Q4, our 2017 MultiClient revenues ended up 14% compared to 2016. We had a sales-to-investment ratio of 2.5x that as well an improvement over 2016, and pre-funding level ended at 140%. The contract market was and is challenging, with significant seasonal variations and a weak Q4 this year. Slow booking, but that has improved after the turn of the year and early in the New Year.

Liquidity reserve increased in the quarter, ended at $257.3 million. And as Rune has covered relatively fully, we implemented a new organization and measures to reduce our cash costs in 2018 by more than $100 million compared to the actuals for 2017.

Looking quickly at some key financial numbers for the last -- quarterly for the last 3 years, we can observe that we have started to deliver somewhat better revenue and EBITDA numbers for the last 3 quarters. Still looking at the lower left chart here, which shows the adjusted EBIT, we are, and that's a fact, loss making. And we operate in a weak market with unsustainable financial results, particularly relating to our Marine Contract Services and Imaging.

Cash flow generation, as you can see to the bottom right, is improving, but there is a lag effect now in the fourth quarter since a fair share of the revenues, the increased revenues in the fourth quarter, will be collected early 2018.

Quickly on the P&L summary, revenues $235.9 million. That's a 50% improvement over Q4 2016. The EBITDA of $122.8 million. That's more than a doubling from Q4 a year earlier. We had a negative EBIT even excluding the charges and impairments of $24 million. And if we include the charges in the quarter and for the year, both the net EBIT and the net income at almost the bottom of this table is significantly negative.

On this slide, I have summarized then impairments and charges. I will go through them but seek to be quick. We recorded impairments on the MultiClient library of $14.2 million in the quarter bringing the full year total to $59.2 million. We had a small impairment on property and equipment in the fourth quarter, bit over $2 million. But the full year number higher, a bit over $40 million, recorded primarily in the third quarter and relating to our adjustment to the fleet, including the stacking of Ramform Vanguard and side effects of that.

We recorded a significant impairment of intangible assets in the fourth quarter of $53.6 million related to 2 things: our decision to discontinue the EM activities, so most of the intangible assets relating to that has been written down; it also relates to our decision to explore divesting our OptoSeis technology and business.

Lastly, we had other charges in the quarter, $64.7 million. Most of these have been, call it, preannounced. We recorded restructuring cost of $39.7 million. I will revert to that a little bit later. We also recorded a loss from the settlement of the ISS tax dispute in Brazil that we sent to them or informed the market about in November, $14.4 million. And then we had an adjustment, fairly large, on our provision which will move up and down on onerous contracts, customer contracts.

Moving to the Q4 '17 operational highlights, total revenues on MultiClient in the quarter, $178.2 million. Dominant share of that is pre-funding revenues of $107.7 million, which is driven by, yes, good ongoing projects and pre-funding of those but quite significant incremental sales on surveys in the processing phase in the fourth quarter.

So the pre-funding -- the revenues brings the pre-funding percent to 199%. That's almost a record, but it's actually not for PGS on the investments of $54 million. Late sales in the quarter, $70.5 million. The marine contract revenues ended at $40.5 million. We achieved slightly or somewhat higher prices in the fourth quarter, but obviously didn't have a lot of activity at same sort of capacity used for MultiClient -- sorry, for marine contract as the fourth quarter in 2016, approximately.

This slide shows the regional distributional of MultiClient revenues. In the fourth quarter, the pre-funding revenues were dominated by Asia Pacific, Europe and South America. And the late sales were more significant in West Africa, Europe, and South America.

Moving to the MultiClient library, illustrated here on sales progress and capitalized cost and book value by vintage. The total book value of the library, $512 million at year end, substantially down from $647.7 million a year earlier. We have good sales progress and moderate book value on our library, particularly obviously for the surveys completed in 2012 -- between 2012 and 2015. We had an amortization expense in 2017 of $366.8 million. This corresponds to a 69% amortization rate.

On the key operational numbers that we included lots of numbers, I commented on most of the line items. The only incremental comment I would make here is relating to our external imaging revenues, which have gradually decreased over this 2-year period show. Two primary reasons for that: very challenging market for external imaging services; and secondly, we are using more of our imaging capacity for the processing of our MultiClient library at the expense of external processing.

Vessel utilization, we had weak utilization in the fourth quarter, 46% idle time. We will have, if you follow our operating model for vessels, quite a bit idle time in Q1 and Q4 since sort of winter stacking 2 out of 8 vessels (inaudible) generally bring 25% of stack or standby time. But we ended higher than the 25% with reported 32% stacked standby time on top of some yard activity for the quarter. And the incremental loss of production there is related primarily to idle time on several vessels before starting new surveys after completing the North Atlantic season.

For the full year, we ended using 43% of our active capacity for the MultiClient versus then 57%, the other part for marine contract. So it's less MultiClient activity than we planned for a year ago.

Order book, $135 million at end December. This is clearly very low. We're not too concerned with this. The cutoff date this time was a bit unfortunate and we have progressed quite a bit on booking, firming up new acquisition projects during January. So the status on booking as of early this week is that we booked out for 2018 33 vessel months, 3D vessel months, of our fleet with 14.5 vessel months of that in Q1, 11.5 vessel months in Q2 and 7 vessel months in Q3. Still on the moderate side.

This is the way we will report our booking going forward. The reason for changing away from the percentages is that we will be flexible on how much of the capacity we operate. And this will give information on how many vessels we have secured work for and you all know what kind of model we are seeking to achieve throughout the year.

As an example, Q1, 14.5 vessel months; that's almost 5 vessels out of the 6 that we have available for operation in the quarter. So it's 80% booked for Q1. And in reality for Q1, the remaining 20% is -- it is so that we would be in practice 100% sold had it not been for gaps created by permitting issues in the first quarter, which is a problem that we see in many of the countries that we operate in this part of the season.

We're okay with the current dynamics and we are reasonably confident that we will be able to book and operate 8 vessels on acceptable terms from early Q2. None of the statistics, none of the planned expected North Sea projects are yet included in the booking. The reason for that is that we haven't finally decided which to do and the pre-funding is not yet committed. Also we see a positive trend on leads and bid activity. And as a change from last year, we see meaningfully more discussion or leads relating to the second half of 2018 and Q4, which were more or less completely absent a year back.

Moving on to cost, this is the quarterly cost development. We ended with $170 million gross cash cost. In fourth quarter that's -- I will have to move this one otherwise this will continue to happen -- down from Q3. Reasons for the reduction is the stacking of Ramform Vanguard as well as the reduction to 6 vessels with 2 vessels warm stacked in Q4. Offsetting this to some extent, we had higher project variable cost in the quarter. When we move into 2018, there would be another step change down in cost levels already in Q1.

A couple of comments on the cash flow. Cash from operations, $84.3 million, which is okay but clearly quite a bit lower than the EBITDA for the quarter, and this is, as you may have caught already, related to a revenue-driven increase in working capital, which will benefit our cash flow in the coming period. The other comment is that in investing activity in the cash flow statement there is in a way that -- on the net basis $57.6 million we got released relating to the settlement of ISS disputes in Brazil.

Balance sheet, liquidity reserve of $257.3 million. That's somewhat down from a year back, but up from what we had in the third quarter. Total leverage ratio, 3.65:1 at end of year, which is significantly down from what we had in Q3. And we have a substantial headroom compared to the requirement in the revolving credit facility, which at the same time is 4.75:1.

That sent me to the end of Q4 and preliminary full year 2017 numbers, and I will move into a few topics which are -- we regularly cover on these events, primarily cost. A bit on cash flow outlook for 2018, CapEx, MultiClient investments, and the more challenging topics such as IFRS 15, tax, and foreign exchange at the end.

Starting with the cost illustration. On this slide, we seek to illustrate the main drivers bringing our gross cash cost from $690 million in 2017 to $575 million in 2018. And the primary elements are, from the left here, staff reduction. Then the adjustments to our fleet, which includes in a way the flexible model as well as the stacking of Ramform Vanguard, somewhat offset by a full year operation of Ramform Hyperion. Should be said that in the bars here the salary cost reduction relating to our offshore operations is in the fleet adjustment bar and not in the staff reduction bar. So it could probably have been done both ways. Next, the close or scale down of our EM and OptoSeis operations.

Offsetting the decreases from the measures we implement, we have an increase there in, I think it's yellow, relating to the fact that our fuel cost would increase in 2018. And as it looks, we will have less favorable foreign exchange rates than we had last year. So that is in a way creating a little bit of resistance in our attempt to get even further down on our cost. Our tight cost control remains a key priority and we are highly committed, it's fair to say, to delivering on our cost ambition.

And a quick look at restructuring costs. We had an initial estimate of $40 million to $50 million. We made a provision now in Q4 of $39.7 million. $33.9 million of that is relating to severance, staff reductions, and $5.8 million relating to onerous lease contracts, primarily office spaces for office space that we have vacated and where it's not likely that we will take that into use again in foreseeable future.

We paid out of this $39.7 million, $3 million paid in the fourth quarter and most of the remaining will be paid throughout 2018 with a declining profile. And that's as precise as it gets. We do not expect any material restructuring costs to be booked in the first quarter of 2018. We think that there may be a little bit but with moderate incremental costs to be expensed, our total restructuring cost for this reorganization is likely to end in the lower end of the initial estimate.

Then we would have covered this quite a bit already, so this maybe spoon feeding you a little bit. But we provide a simplified illustration of cash flow for 2018, and we use 2017 actual revenues as a starting point, and then some sensitivity around them. This is not meant as a guiding on revenues. I understand that. Some will just read it as an indication of revenues, but that is not the intention. It is also not intended as an exact guiding on cash flow, obviously.

So our financial target, and our key financial target is to be cash flow positive after debt service next year. The table there just lists our expectations for various cash elements going out of the company, cost CapEx installments and interest expense and cash tax. These can be seen as our best estimate, to put it that way. We may miss by a few million but that is what we expect as of today. And with flat revenues, and that is an assumption for illustration purposes, we will deliver a meaningful positive cash flow for next year. And as illustrated with up and down cases, we can absorb quite a bit of negative variation from this without it becoming problematic for the company.

Just quickly, this illustration does not take into effect in a way the moderating effect you typically get from working capital changes if revenues drop or on the other side increase where you typically will have a countering swing in working capital. And as Rune clearly stated, it also doesn't include the remaining cash payments of restructuring costs.

This is our debt and facilities as of year end. There are no material changes there, so I will not say much more than the drawing on the revolving facility at year end is $190 million, so that's $210 million undrawn. So it's reduced somewhat during the fourth quarter.

This is a simple illustration relating to our maintenance covenant. The revolving credit facility was, as you are aware, a year back extended from '18 to 2020 maturity. And at the same time the maintenance covenant profile was amended, and it's the top line in this chart, that is what we are required to comply with. And lower line, blue one, is our actual total leverage ratio during 2017, and it shows that we have had a strong reduction in the leverage ratio, and we have a substantial headroom. And it is clear that we expect to be in compliance with the maintenance covenants going forward.

This is an illustration of the maturity profile of our debt. For the first 2 years, as you can see in the graph, the debt repayments relate to the annual installments on amortizing debt as well as in 2018 the final maturity of the 2018 notes, $26 million of those. We are in position to cover these debt repayments by our operating cash flow. Beyond that, or from here after 2019, it is almost 3 years until we get to the substantial maturities, late 2020 and early 2021.

And in a way Rune stole my thunder a little bit here and that's fair enough, as you are the CEO. This is a 2-step logic you know why we need to demonstrate that we can deliver a positive cash flow. And if we deliver on that, we believe that we should be well positioned to refinance the 2020 maturities well in advance of their due dates.

CapEx and depreciation trends. Graph on the top shows our maintenance CapEx, graph at the bottom shows our newbuild CapEx which ended in 2017, and we expect obviously none in 2018. Full year 2017, we had $154 million CapEx, almost $90 million of that related to the newbuilds. For 2018, we'll reduce the maintenance CapEx somewhat to $50 million approximately and that's primarily related to seismic and processing equipment, but also some of that related to maintenance investments on our fleet.

This slide shows the trends of MultiClient investment and pre-funding, which both are solid. In 2017, we had MultiClient cash investments of $213 million and 140% pre-funding on that. And I think the graph illustrates here on the top that we have a strong pre-funding record. And we have historically tended to be in or at the high end of our targeted range for pre-funding or sometimes quite a bit above. This is due to the combination of well-funded project at inception of the project and our ability to achieve incremental sales of the surveys throughout the project execution. MultiClient investments next year, $250 million; more than 50% of capacity to be used for MultiClient, and we then overweight in second and third quarter, the two summer quarters.

Okay, I will take a deep breath on this one. So this is a difficult topic for the industry. I would almost say frustrating, but it is so that IFRS 15 revenue recognition takes effect 1st January, 2018, so it's already in effect a month back.

This slide is very wordy. So I don't -- in a way those interested will have time to read it. I will try to get through it without losing the thought flow. This new standard is likely to result in a change of the way seismic companies report revenues on pre-funding related to MultiClient projects, so projects in progress. That is the simple takeaway. And what I comment on the remaining is only relating to that, pre-funding revenues. The other services and revenues are not impacted, so that's marine contract and late sales for MultiClient and similar.

The companies in the seismic industry have for more than a year worked fairly hard to achieve an accounting for pre-funding revenues which is similar to the one that we use today, which is on a percentage of completion basis. And we've also worked to achieve a consistent practice, or similar conclusions.

To the disappointment for all of us, we have not been able to conclude that. We've worked with secondary solutions which, based on milestones or interim deliveries, achieve some of the same. That as well is not concluded. It is therefore in a way we will turn into the first quarter 2018, and we will report under this standard when we report the Q1 numbers. It is therefore likely -- there's a high likelihood that we will have to change how we account all of the companies for external -- or pre-funding revenues.

How it ends up I don't know as of today. We obviously -- it's realistic that we end up with a deferral until completion of the finally processed data, which may be around a year or maybe sometimes later, and sometimes more after the completion of the acquisition of a survey. Obviously, this would provide a quite terrible sort of matching with the company's use of resources and project progress and so on, and would also make it difficult for those of you who're analysts to estimate. Anyway now there's reasonable chance of estimating what the vessels are doing and guessing on the pre-funding on surveys, while that would be much more difficult in the completed contract method of accounting.

We believe that the percentage of completion method is a superior method in the way that the revenue recognition coincides with project progress, resources used, primarily vessels, and also value creation. And it is also the basis for how we establish payment plans with our prefunders normally, because that's tied to when resources are used.

If this ends up concluding that pre-funding revenues will have to be materially deferred towards completion of the final data, we will, for internal reporting purposes and performance management, continue using percentage of completion; that's the only thing that works. For the external financial reporting, we will obviously do as IFRS 15 tells us, but we will provide percentage of completion information either as a supplement or as a part of the financial reporting with appropriate reconciliations, of course.

That one was long. One more thing to say only and that is this change will not have any negative impact on the measurement or calculations of covenants in our loan agreements. So that is not an issue here.

Okay, with IFRS 15 done, tax should be easy and I'll make this pretty short. We are continuing to operate some of our vessels in the Norwegian tonnage tax regime, all of the Titan-class Ramforms. The other vessels we took out or exited from the tonnage tax regime with effect from 2016. Our cash taxes are illustrated on the graph to the left. Have varied between sort of $10 million in the low end and $35 million in the high end over the last 6 years, in the low end for the last couple of years as you will see. These are taxes that primarily are withholding taxes in the countries where we operate and where we put resources in and pay for services or vessels, or local taxation in countries where we do not have anything to offset that with. So it can be revenue based taxes and similar. So we believe this will fluctuate, but this is an illustration of where we should generally be, considering the fact that we are in a weak market. In an improving market, this will gradually increase of course.

We have substantial tax carry-forward losses or tax assets in Norway and many other countries, which will benefit us going forward. And we have a full valuation allowance against these and there are no deferred tax assets recognized in the balance sheet.

We are exposed to foreign currency risk primarily on our cost base. We report in U.S. dollars. Some of our cost is in Norwegian kroner and pounds and some other currencies, but kroner and pounds are most important. Most of our costs are in dollars, so that doesn't impact anything here. We have been enjoying a beneficial currency exchange rates for a couple of years. Weak krone, weak pound against the dollar. Some reversal over

2017, some more changes now during January, and the sensitivity for our cost base measurements is so that a 10% change of the krone versus the dollar with effect for a full year would be in the range of $15 million to $20 million. And for the pound, same sort of 10% change against the dollar, the effect is around 1/3 of that, between $5 million and $8 million.

This is my last slide and we are on time, and I will be short on this one. To sum up, we are delivering solid MultiClient performance with high cash generation. We've implemented the substantial reductions of our cost and our capital expenditure. We're well positioned to deliver positive cash flow after debt service for 2018 and delivery of our 2018 financial targets should position us to refinance well in advance of our 2020 maturities.

I think I will stop there, and I think we are then ready for the Q&A session, and someone else may want to take the lead. Bård, Anne?

QUESTIONS AND ANSWERS

Anne Gjøen - *Handelsbanken Capital Markets AB, Research Division - Head of Equity Research*

Yes. Yes, we have today 2 Q&A sessions. The first one is approximately 15 minutes and it's one coming up later. Normally it's many that want to ask questions of PGS, so I kindly ask you to limit your questions to 2 in this first session. But we will ask a couple of questions first. So I hand it over to Kim Andre.

Kim André Uggedal - *Fearnley Securities AS, Research Division - Equity Analyst*

Thank you. Okay, if we start with the fourth quarter results and a surprisingly strong pre-funding ratio, if you like. If you look at MultiClient revenues, it seems that close to $40 million comes from Southeast Asia, and you indicate that it's primarily related to pre-funding. We understand that you have bought into a survey in Malaysia together with Schlumberger. Looking at the vessel activity in that region for fourth quarter, I assume there is $5 maybe $10 of investments in that region this quarter. So is there any kind of cash payment to Schlumberger on this survey in fourth quarter or is that just deferred? Or if you can talk us through the accounting of that survey in particular and that region.

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

Yes. I didn't hear what you indicated or guessed on the investments. There are no one-off investments in the quarter. We are now in the fourth phase of the so-called -- can I say that, Sabah project, and that is a phase that is acquired by WesternGeco. We have acquired the 2 first phases, whereas WesternGeco acquired 3; started in late summer or something like that and now the fourth is ongoing. And this is a joint venture setup. There's a variable participation between the parties in the different phases. So the phases that we participate and we pay our pro rata share of their ongoing agreed cost on that agreed basis. And we receive the same share of annual revenues generated by the survey. So it's not anything more peculiar than that, and I don't recollect how much we invested in that survey in Q4, but it could probably be between $5 million and $10 million or below $5 million in the fourth quarter, something like that.

Rune Olav Pedersen - *Petroleum Geo-Services ASA - President & CEO*

And obviously sales from these surveys, if I can put it, these 4 surveys in Malaysia which you see which were strong, are obviously not only sales from an ongoing acquisition project. These are sales from surveys we have done way back but we're processing and not done yet, and therefore it's recorded as a pre-funding rather than late sales. But that's just because processing is not completed.

Kim André Uggedal - *Fearnley Securities AS, Research Division - Equity Analyst*

So you had the same ownership in all surveys from kind of the start of these projects?

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

No. Then you didn't listen. I said that the ownership varies between the phases.

Rune Olav Pedersen - *Petroleum Geo-Services ASA - President & CEO*

Yes.

Kim André Uggedal - *Fearnley Securities AS, Research Division - Equity Analyst*

And there's no deferred payments coming in first quarter?

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

No, there are no deferred payments. We send -- the participants get their monthly bill and we will pay -- PGS always pay on time.

Kim André Uggedal - *Fearnley Securities AS, Research Division - Equity Analyst*

If we can move to Page 37 and just looking at your guidance and you also have a chart indicating that you are slightly a cash flow positive for 2018. In the chart at -- or the table at Page 37, you indicate if you assume revenues down 5%, you have a cash flow of $20 million. That excludes the $30 million remaining of cash payments on severance settlements, right. So you are actually negative cash flow if you assume a 5% drop. So I just would like to get -- you assume a flat market or plan for a flat market, so that would indicate flat prices, flat more or less late sales. You have a lower operating asset base in number of vessels this year. You have a 37% decline in backlog from 1 year ago and you have a MultiClient library which is valued at your books at $135 million or so, lower than 1 year ago. So can you just get this to the flat revenue line for '18? How is that -- if you can build that bridge for us?

Rune Olav Pedersen - *Petroleum Geo-Services ASA - President & CEO*

Sure. We can do that. Yes, you can assume flat late sales, flat revenues on pre-funding, and as I showed in slide something in the beginning there, there is a very limited impact on the vessels. So basically we have the same vessel capacity operating this year as we did last year. In addition to that, last year we had quite a bit of idle time on the vessels we had available. So you see similar vessel capacity, quite a bit of idle time last year, which we believe we can take out or do better this year. We had also a few projects which were not good projects. We took contracts which were not good. So even achieving the same rates but just performing better on a few of those projects would increase -- so that creates a little bit of buffer for the flat revenue line.

But the main thing is we believe that we have the same earnings capacity in terms of vessels. We believe we're going to have the same late sales, and we believe we're going to have the same pre-funding in flat. And obviously, it may shift around a little bit what is late sale, what is pre-funding and things like that. The order book is weak. I don't think it's a good indication of where we see '18 going. I mean as a one-off point, it's one of the points you can look at, obviously. And in this case, I think it is weak compared to where we see the position. In other quarters, they may be strong compared to where we see the position. It's a little bit of when we land the contracts. If you can see, all our leads from 10% chance of success all the way up to 100%, which is like a big basket. When it tips over the secured line, it goes into the order book, but doesn't say anything about the comfort in the company of securing the work just to kind of address that a little bit. So that's why we believe that a flat market equates approximately to flat, but this is not a guidance. We say a flat market, it may be a little bit up or down.

Anne Gjøen - *Handelsbanken Capital Markets AB, Research Division - Head of Equity Research*

And then I have one question related to 4D. You and WesternGeco have or should have the highest market share weighting for the 4D market. Previously you indicated 25 4D projects in 2018. Now it looks to be a bit lower than that, 22 or so. It was a substantial increase from '17. Now it's not that substantial increase because it was more in '17. But still for you, is it much upside potential already this year due to the WesternGeco exit? That means how much tendering is it out in this market now for -- remaining for this year?

Rune Olav Pedersen - *Petroleum Geo-Services ASA - President & CEO*

There is quite a bit of 4D tenders out currently. And obviously we have just -- the announcement from Schlumberger just arrived, so it's -- I don't think -- it's too early for us to say that, yes, we see tangible proof that we are winning more following this. But it's clear, as you say, that this market has been mainly reserved for multi-component streamers, which have mainly been WesternGeco and PGS, and therefore we have had the lion's share of that 4D market. We had it in '17 as well and we expect to have it in '18. And it's clear that we find it quite interesting that they claim that they will not bid any 4D jobs. So, yes, this is an interesting opportunity for PGS I would say.

Anne Gjøen - *Handelsbanken Capital Markets AB, Research Division - Head of Equity Research*

Then Olaisen.

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

It's John Olaisen from ABG Sundal Collier. Two questions, if I may. First on the contract rates and the outlook, you're saying that you're going from expect to plan; you used to say expect a flat market and now you say you plan for a flat market, implying that you are a bit more optimistic now. Could you give us some indication of the prices that you have in your current backlog and what's your view on outlook for the summer? Any hope for price increase at all? So that was question 1.

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

Yes, we're going to be cautious obviously to talk about prices, but it's -- what we have in Q1, which we have secured, prices are slightly up to up from same period last year. And I think it's reasonable to expect a seasonable swing in prices as we saw last year also this year, but other than that I think I will leave it at that for prices.

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

So just to specify, you said what you have booked so far for '18 is up or slightly up year-on-year, also compared to the fairly strong rates you achieved in December last year?

Rune Olav Pedersen - *Petroleum Geo-Services ASA - President & CEO*

This is on...

Rune Olav Pedersen - *Petroleum Geo-Services ASA - President & CEO*

Quarter-to-quarter.

Rune Olav Pedersen - *Petroleum Geo-Services ASA - President & CEO*

-- for the same period (multiple speakers).

Rune Olav Pedersen - *Petroleum Geo-Services ASA - President & CEO*

Yes, same period-to-period, Yes. The comment is on Q1 what we have in our...

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

In Q1. And how about the backlog you have for Q2 and Q3, the prices for the summer?

Rune Olav Pedersen - *Petroleum Geo-Services ASA - President & CEO*

No, I don't think I'll comment further on that.

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

Okay. And secondly you said that there will be no newbuilds for the foreseeable future in PGS, but how about the WesternGeco boats? They are now out in the market. Is there any chance that those vessels could end up in PGS? Is that something you will say definitely no way to or do you see some opportunities that that could happen?

Rune Olav Pedersen - *Petroleum Geo-Services ASA - President & CEO*

I think I'll be limited in commenting on that as well. We don't need more vessel. As you know, we have several stacked vessels. Well, I mean, this is an industry opportunity which everyone has to consider. And other than that, I don't think I'll comment more.

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

But do you rule it out?

Rune Olav Pedersen - *Petroleum Geo-Services ASA - President & CEO*

No, I think I will repeat what I said.

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

Would you be happy if (inaudible) bought -- the Chinese bought the whole fleet of WesternGeco?

Rune Olav Pedersen - *Petroleum Geo-Services ASA - President & CEO*

We'll take what comes.

Anne Gjøen - *Handelsbanken Capital Markets AB, Research Division - Head of Equity Research*

Could we now take next question from Morten Nystrøm?

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

This is Morten from Nordea. If you look at your '18, I would say that contract revenues can't be many worse than you did in 2017 and late sales given where all sits likely at least at the same level. So the main uncertainty is the pre-funding level and also your visibility on investments. And if you look back the last 2 years, you have actually ended up slightly below your initial targets on MultiClient investments. So my question is regarding the $250 million you have planned for MultiClient investments. What is the visibility on these investments? What is a pre-funding level compared to the high level you had in 2017?

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

In a way, it is so that I think on which projects to do, our visibility is at par with what we had last year, and that's clearly surveys. And you will see that from the booking, in a way, we aren't there at the stage where we have decided to do in a way all of these surveys. So there is a risk that if we don't get surveys that delivers the financials that we are satisfied with is that we end up lower. We hope to be able to maybe to end up higher, but that in a way we have to deliver that through the year. And that is in many way a sensitivity to -- if you seek to estimate what the EBITDA number for PGS will end up next year. It is less so for the cash flow in a way, assuming we're able to achieve acceptable contract work to offset the change. So not sure it's possible to say much more...

Rune Olav Pedersen - *Petroleum Geo-Services ASA - President & CEO*

I guess we have somewhat more MultiClient projects going into this year in Q1 and what we're doing now and what we did in a similar period last year. So in a way we're spending a bit more as we speak than we did last year. So I guess that would be a flavor to it, but other than that, I think that's correct. And we have deliberately not guided on pre-funding percentage. So you'll just have to accept that we will continue to operate within our guidance of between $80 million and $120 million. And I can point you to the fact that we have over-performed quite a bit on that over the last years, which mainly is because of late sales in a way. Not late sales but sales which is late sale, similar sales in the processing phase which we discussed regarding Malaysia.

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

If I just could follow-up on the number of vessels you're planning for the North Sea and if you also could touch slightly on the Canada 2018 season.

Rune Olav Pedersen - *Petroleum Geo-Services ASA - President & CEO*

Yes. No, I won't tell you how many vessels we plan to do and how many vessels we plan to have in the North Sea or in Canada. But I can tell you, yes, we will have an active and good program in Canada also this year, and we plan to have more than 1 vessel in the North Sea as well.

Teodor Sveen-Nilsen - *Swedbank Norge AS, Research Division - Former Financial Analyst*

Teodor Nilsen, SpareBank 1 Markets. First on backlog, you already highlighted that the backlog was pretty weak by end 2017. But what is the number right now? Is it up to 10%, 30% or 50%? Any indication?

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

No, I don't think I will indicate. You'll have to do with the booking as of now.

Teodor Sveen-Nilsen - *Swedbank Norge AS, Research Division - Former Financial Analyst*

And then on accounting under the new standard on the revenue recognition, which of course is very important for earnings but not important for cash flow at all. Looking at the quarters with a high portion of pre-funding revenue, I guess it could be pretty challenging to estimate earnings. Could you actually see this in order to have pre-funding revenues down 50% compared to the previous accounting standard?

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

This is only about timing. This is in a way if you just assume that every project takes a year or 2 from mid-acquisition to completing the data. You just push -- and you get survey booked as anyway one revenue voucher on a specific day in some quarter. So you just push 2017 pre-funding revenues to 2018 and 2018 revenues to 2019, which makes budgeting fantastically easy and we don't do that, unfortunately. So and it won't help me. But that is more likely to be lumpy and the main concern is that in a way we -- most of our revenues are generated from the vessels and what their vessels are doing, either as pre-funding revenues or contract revenues, or from the sales from the library. That's where we -- in a way what delivers revenues every quarter. And with this new standard, if the pre-funding part of revenues is not to be booked until you process the data and deliver it, you would have very significant swings in how much the ongoing vessel activity delivers. In a way we could put all vessels to contract and collect the pre-funding revenues for the acquisition last year with overreported revenues compared to the revenue generating capability and vice-versa.

So we haven't concluded this yet and we have not given it up, but it's an uphill struggle. I think those who follow other industries which see a bit of the same problem. We have not been able as an industry any way, we're a tiny, tiny industry in the global economy, and the standard-setters in IFRS has not given us a lot of priority, to put it that way. I fear that we will have to end up deferring the revenue recognition. We will, as many companies in different segments have started doing over the last couple of years, we will report the numbers on the new standard and then we'll report the numbers as we feel they best represent value creation and progress.

And then we will all be able to look at both and you decide for yourselves which you think most meaningfully reflects in a way performance. And we'll make things a bit more complicated. What I can promise is I will do whatever I can to make sure that -- and I talk a lot to my peer group on this -- to do it in a similar way so that in a way we don't create more confusion than absolutely necessary. So we will most likely end up with 2 sets of numbers. You have the completed contract PGS numbers and you have the percentage of completion PGS numbers. And then it's down to the user of the report what in a way is, in addition to the cash flow and all of these other things, more meaningfully sort of portrays the performance.

Teodor Sveen-Nilsen - *Swedbank Norge AS, Research Division - Former Financial Analyst*

I think most people understand that this is just a timing issue and that the total revenue and total cash flow will not change, but could you just give a sensitivity for third quarter, which is a quarter where traditionally have a lot of vessel activity. How much of the pre-funding revenue could potentially be pushed out?

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

I'm unable to say that. If you assume that we are able to complete the data in 12 months, then you would push out the pre-funding revenues delivered in the third -- produced pre-funding progress in that third quarter and you would book the pre-funding produced a year before in the same quarter. So it will be lumpy and difficult to say what the net effect is.

Kim André Uggedal - *Fearnley Securities AS, Research Division - Equity Analyst*

Should we do 1 question before we go for a short break from the web? From Sahar Islam from UBS. Would you consider buying existing assets from player like Schlumberger exiting the market if the price is right? I guess you've already answered that. If the oil price remains as strong as it has been recently, would your spending plans, CapEx investments, increase? Or is the guidance you have given a hard ceiling even if the market is better than it is now?

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

In a way, this is our plan and we will not increase our cost of CapEx due to observing oil price. Obviously if we start to deliver better cash flows and have opportunities for incremental projects or other things, we may adjust the base plan, but this is the plan until we see that we are able to generate enough of positive cash flow to consider doing something else.

Kim André Uggedal - *Fearnley Securities AS, Research Division - Equity Analyst*

And then we move for a short break: 10, 15 minutes.

(Break)
