

Q2 2021 Earnings Call

Company Participants

- Bard Stenberg, President Investor Relations and Communications
- Gottfred Langseth, Executive Vice President and Chief Financial Officer
- Rune O. Pedersen, President and Chief Executive Officer

Presentation

Bard Stenberg {BIO 19147078 <GO>}

Good morning, and welcome to this audiocast presenting PGS Second Quarter and Preliminary First Half 2021 Results. My name is Bard Stenberg, Vice President, Investor Relations and Communications in PGS. With us from management today are President and CEO, Rune Olav Pedersen; and CFO, Gottfred Langseth.

Before we start, I would like to give some practical information. Participants on this audiocast can submit their questions via the audiocast platform. I would also like to draw your attention to the cautionary statement in today's earnings release and presentation and the risk factors disclosed in our 2020 annual report and the Q2 2021 earnings release.

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

Rune O. Pedersen {BIO 16158611 <GO>}

Thank you, Bard. And in PGS, we have delivered a solid second quarter, considering the challenging market conditions we have been experiencing. We continue to leverage our integrated business models -- means the model, where we operate vessels, and we have an in-house imaging business, and we operate both in the marine contract and the MultiClient market. We believe this positions us well in what we now are considering a recovering market.

In the quarter, we experienced strong MultiClient sales from mature regions in particular. In fact, we were the largest MultiClient player by revenues for the fifth quarter in a row. We experienced late sales of \$65.5 million, and we had good client commitment for new projects, leading to strong pre-funding. We are now seeing increasing demand for new acquisition surveys and, I would say, in particular for new contract surveys. This is supported by a positive order book development and, as you will see, increasing bids and leads. We continue to expect higher 2021 segment revenues versus 2020.

And before I move on, I would just like to pause a little bit and comment that PGS is celebrating 30 years in 2021. In 1991, a few visionary people got together to fund a 3D

seismic company in a world which had not seen a lot, if any, 3D seismic. They got funding and they merged the two companies, Geoteam and Precision Seismic, and created Petroleum Geo Services. I won't comment much more on this, except to say that it has been 30 eventful years. And in PGS, we believe the next 30 will also be quite eventful.

So back to the quarter and the financial summary, and I will be brief as Gottfred will go through these numbers in more detail. On the revenue side, I will just comment that, what we saw our largest -- our lowest revenues post COVID-19 in the third quarter 2020, exactly as we predicted when we presented these numbers. After third quarter, we have seen a gradual increase for the seismic market. Vessel booking stands at 17 vessel months in the third quarter; and in the fourth quarter, eight vessel months; in the first quarter 2022, three vessel months. And I am also glad to say that our order book has now increased four quarters in a row.

So with that, I give the word for -- to Gottfred to go through the financials.

Gottfred Langseth {BIO 5277539 <GO>}

Thank you. On the key financial numbers, segment revenues and other income, \$151.8 million, in the quarter, that's a 9% increase from Q2 last year; segment EBITDA, \$84.4 million; segment EBIT, negative \$4.2 million, both EBITDA and EBIT down compared to Q2 2020. And this is down to a primarily a mix change with more contract and less MultiClient and the fact that Q2 last year still benefited from pre-COVID contract pricing. Revenues and other income on the IFRS basis or as reported, \$185.9 million in the second quarter, \$351 million year-to-date. This is higher than the segment numbers quite significantly. This is down to timing and due to completing several surveys, some of them relatively large during first and second quarter this year.

Lastly, on this slide I will highlight, which is also stated there in the footnotes to the table, that our net financial items in Q2 includes a non-cash gain on revaluation of the separate derivative financial instrument deriving from the convertible bond. In addition, also in net financial items, I wanted to mention that the gross interest expense that we are recording on a quarterly basis, of course, includes a significant non-cash component, primarily deferred debt issuance cost and imputed the interest from the debt rescheduling exercise. And to quantify, more details are in the release, in the second quarter, the gross interest expense amount was \$25.3 million, whereas compared to actual cash interest of \$20.1 million. So a difference of approximately \$5 million.

Then the Q2 operational highlights. Contract revenues of \$51.5 million, that's up from \$31 million in Q2, last year. We used more of our acquisition capacity for contracts. 69% of the active time was used for contract now in the second quarter. The total segment MultiClient revenues, \$94.1 million, pre-funding level of 111% and late sales of \$65.5 million.

Then quickly looking at MultiClient revenues by region. North America dominated our pre-funding revenues in the second quarter, while Europe had the lion's share of our late sales. Vessel allocation and utilization, 68% active vessel time in Q2. This is based on six

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3D vessels, including Ramform Sovereign, which operated as a source vessel for approximately half of the second quarter. In Q3, we will have an overweight of contract work, and we will have a relatively significant vessel relocations, i.e., steaming, but most likely slightly less than what we had in Q2.

On gross cash costs, we have a sequential cost increase from \$92 million to \$102 million in the second quarter. This is driven by more operated capacity. Cost will increase further in the third quarter due to higher project activity as well. We have increased our full year gross cash cost estimate to \$425 million. The primary driver is increased activity, including Node acquisition and use of Sanco Swift as a source vessel on a combined node and streamer acquisition project. And also including operating Ramform Vanguard now expected to be through most of Q4, almost to year end. There is also an impact of higher fuel prices as we've seen the oil price gradually increase so far this year.

Balance sheet, some quick comments. Cash and cash equivalents of \$155.4 million, practically the same as at the start of the year. Net interest-bearing debt including leases, which is last line in the table, is slightly down from the start of the year. The book value of our MultiClient library is \$512 million on IFRS basis and \$504 million according to our segment reporting.

Then cash flow. We had positive free cash flow in Q2, \$11.5 million, the third line from the bottom of the table. And this, for avoidance of doubt, is say after everything, after interest and lease payments. Year-to-date, we have a balanced free cash flow or minutely negative, \$1 million negative. And this is after payment of refinancing costs primarily in the first quarter.

Working capital and collections at end of Q2 were somewhat frustrating, still impacted by delay of block ratification formalities to the tune of approximately \$20 million. These formalities are now solved, late Q2, with collection early Q3.

That was my last slide, and I will then give the word back to you, Rune Olav.

Rune O. Pedersen {BIO 16158611 <GO>}

Thank you. Fleet activity in July, as you can see, we have three vessels in Europe with Ramform Hyperion operating in the Barents Sea on the joint node and streamer project. We see Ramform Sovereign and Ramform Vanguard in the Norwegian Sea and North Sea, respectively. The two vessels in Canada, Ramform Atlas and Ramform Titan and Ramform Tethys is operating outside of Angola.

And as the summer becomes winter in the Northern Hemisphere, we will, of course, move our vessels south. We expect to have a few vessels in the Americas, and you've seen us announce a project in Guyana, for example. We will have a few vessels or even maybe even more in Africa, West Africa and Northern Africa. We will have a vessel in the Asia Pacific region, as announced today. Ramform Sovereign will go to Malaysia, and Ramform Vanguard will move to the Black Sea, where she will stay most of the year, if not the entire year.

As I mentioned, we are seeing increasing contract bids and leads levels. And as you can see from the slide, the bids and leads levels are approaching COVID-19 -- pre COVID-19 levels. In fact, the leads are already there, and the contract bids are approaching that level. Based on this, we do expect quite healthy bidding activity also in the second half. It is also positive to note that we have received the first 2022 North Sea bids already at this stage. And there are a few of them actually already at this early stage, which is positive news for the contract market.

On the supply side, we are continuing to see historically low supply, obviously. Moderate capacity increase for the 2021 summer season, part of that obviously our introduction of the Ramform Vanguard. And we do not expect any significant capacity increase going into the winter season ahead of us.

Changing gear a little bit. You will remember that we announced in the third quarter that we have started a new business unit in PGS called PGS New Energy. And this time, I thought I would focus on one of the more promising businesses that this new entity is focusing on, namely CCUS or Carbon Capture Utilization and Storage. Obviously, the focus for PGS New Energy will be on the storage side of it because seismic is at the heart of offshore storage. You need seismic to identify, to characterize and to monitoring carbon storage sites.

First of all, you need seismic, and here we can use MultiClient seismic to find the right structures where you can store and insert carbon or CO₂. Then you need seismic to interpret that structure to see whether the structure has the right characteristics and is suitable for storing CO₂. And finally, if you have found that both of those are in place and you start to insert CO₂ into the structure, you need to monitor what's going on in the subsurface while inserting carbon, and therefore, you need to monitor it. And this is very similar to what we are currently doing in our 4D activity, in a 4D baseline and then you need to continuously monitoring what happens to the subsurface as you are inserting CO₂. There may also be a need to monitor the structure after the insertion is done, but that is probably less intensive. So as you understand, there is complex geophysical challenges at every stage of CCS, especially offshore storage. So that is one reason why this is an interesting area for PGS New Energy.

The other reason, obviously, is that we see a promising near-term market and a potential for a significant business medium to long term. Currently, there are not much CCS activity worldwide. But we are working with two concrete 4D projects for next year and also in dialogue around another two to three, which may come next year or in 2023. So we expect to see some revenues coming out of this already next year.

And if you look a little bit ahead, we can see concrete plans for developments up to 2025, which is quadrupling the levels we saw in 2020. And from 2025 up to 2030, if we believe the net zero report, there is 10x as much CO₂ storage needed in 2030. And if you go to 2050, you can go another quadrupling from that level again. So as you can see, there is a massive potential in this area, and it has seismic at heart.

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We believe, PGS is well-positioned to take advantage of this potentially very large market with our integrated approach. We have an existing data library, which is large. It's in the right place, and it has the right quality. And I am very happy that we today announced the signing of an MOU for a cooperation with CGG to use our existing libraries and put together maybe a CO2 Atlas and try to take advantage of identification and characterization of sites for CO2 storage. So we have great hopes for this cooperation, and we believe we have a complementary both libraries and technical capabilities in the area.

Secondly, we obviously operate our vessels. We do 4D. We are the leading 4D player in the world. And as I explained, 4D will also be needed as we start to insert CO2 into structures offshore. So here, we see a potential for a large market going forward. And finally, we are also looking into new solutions. As this is a new area, we need to be open for new solutions how to acquire seismic. There could be more high-density seismic, different types of seismic that is needed. And we have recently also increased our ownership share in a company called Ocean Floor Geophysical, which are very technically advanced, for example, in the area of AUVs. So we look forward to both use our existing competence and explore new technologies, new opportunities when we are building this business. So here, we see a large and promising potential market driven by the energy transition.

So a different topic. We have decided to change our internal policy on announcement of contract awards and MultiClient projects. This is done to increase the visibility of how our business is developing between these quarterly presentations. So we will send out stock exchange releases from now on when we receive contract award with an estimated value in excess of the \$10 million to \$15 million. We will do it when we have been awarded strategically important contracts or MultiClient projects. We will do it when we have been awarded MultiClient projects with a duration of more than two months, and we will typically do it when we have signed up to MultiClient projects in joint ventures or in cooperation with third parties. So this is to give you some visibility of when we will send out stock exchange releases.

Guidance; as mentioned by Gottfred, our group cash cost, we are now guiding at approximately \$425 million. This is an increase due to higher activity and higher fuel prices. MultiClient cash investment still stands at approximately \$150 million. And we expect to use approximately 45% of our active 3D vessel time in our -- in MultiClient. CapEx, still at approximately \$40 million for the year.

So in summary, as you can -- as you hear, we believe we are in a recovering market. We are seeing an increased order book. We are seeing contract bids and sales lead approaching pre-COVID-19 levels. So we are seeing an increasing demand for vessel activity, especially contract activity. And we're seeing this in particularly deeper into the fourth quarter and into the first and second quarter of 2021, where we believe the main increase will come. We are also experiencing in the first and in the second quarter strong MultiClient sales from our mature regions and, in particular, in the second quarter from Europe and Norway. And we continue to expect higher segment revenues in 2021 versus in 2020.

So all-in-all, we believe, we are well-positioned with our integrated model to take advantage of the recovery we see coming. And thank you.

Questions And Answers

A - Bard Stenberg {BIO 19147078 <GO>}

(Question And Answer)

Thank you, Rune. We will go over to the questions. We have a rather long questions set here from John Olaisen in ABG. Your MultiClient late sales in the first half were up an impressive 68%. The pre-funding rate was above 100%. And you talk about improving contract prices. At the same time, your net interest-bearing debt is the same now as it was year-end 2020 and higher than it was a year ago. I'm somewhat puzzled, why don't you manage to generate free cash flow? Then it also adds, what is your forecast for the free cash flow in the second half?

A - Gottfred Langseth {BIO 5277539 <GO>}

In a way, the -- comparing the net debt level to where it was a year back, this is obviously impacted by two things: an extremely challenging last nine months of 2020; and then when it comes to development so far in 2021, which is in a way in line with our plans. We're still at the -- at very moderate levels in this period with respect to contract pricing. And we expect our cash flow generation to improve going forward. We will not provide a guidance or an estimate on free cash flow for the second half, but we expect it to be meaningfully-positive.

A - Rune O. Pedersen {BIO 16158611 <GO>}

Yes, when we talk about increasing contract environment [ph] and we haven't mentioned contract pricing, but we also seeing increase in contract pricing. It is not really pricing we have realized much of so far. As you will remember, the first quarter this year was very low on contract pricing, and that also impacted pricing in the second quarter, which we have put behind us, but we are seeing an improvement, that is correct.

A - Bard Stenberg {BIO 19147078 <GO>}

Then the second part of his question, your MultiClient sales are impressive, especially related to your peers. Why do you think you have been able to outperform your peers on MultiClient economics in the first half? And do you expect to see late sales up year-over-year in second half also?

A - Rune O. Pedersen {BIO 16158611 <GO>}

I'm not going to comment too much on our peers, but I believe we have -- in general, have our core MultiClient library sitting in rather mature regions. And it is, for example, the North Sea, which has been strong this first half; but also other places in the world where we have data and are more or less the only one with a significant data present like Angola, Egypt, and other places, has favored us in this current market environment. We also -- which is different from our peers, obviously, do not have a large presence in the

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Gulf of Mexico, which we have reason to believe that has been muted due to the regulatory changes we have seen there. So that could be part of the explanation. We also believe that the integrated model where we have over time played between the contract and MultiClient market has given us a library which is situated in mature basins where the oil companies are currently focusing.

A - Bard Stenberg {BIO 19147078 <GO>}

Yes. Then Mr.Olaisen also has a concluding comment, which you basically have addressed already. But I can just read it out for the sake of good order. In short, I'm somewhat concerned about the sustainability of your MultiClient economics given that basically all of your peers are delivering rather poor MultiClient sales.

A - Rune O. Pedersen {BIO 16158611 <GO>}

Yes. Not much for me to comment on that. He can be concerned.

A - Bard Stenberg {BIO 19147078 <GO>}

We have a next question from Mick Pickup in Barclays. Last year, you had \$160 million of contract revenues for Q2 to Q4. You've done \$50 million of contract revenues in Q2. Given bookings, this suggests a much stronger Q3 and higher realized pricing, can you comment?

A - Gottfred Langseth {BIO 5277539 <GO>}

I think it's fair to say that we expect higher contract revenues in the third quarter. I think I will leave it with that. The improved pricing that we see in the market will gradually have an increase in impact on our numbers.

A - Bard Stenberg {BIO 19147078 <GO>}

We have another question from Kim Andre Uggedal in SEB. With a cash position in line with what it was at the start of the year and the majority of your vessels capacity booked through the end of the year, do you remain as confident to repay the 2022 debt maturities with operating cash flow as you were six months ago?

A - Rune O. Pedersen {BIO 16158611 <GO>}

The answer is clearly yes. This is going according to our model, and if anything, we have -- we are more confident now than we were half a year ago because we have behind us half a year, which has been a very challenging market where we have delivered according to our plan. But it's still a year ahead, so there can be no guarantees. But yes, we remain as confident as we have been.

A - Bard Stenberg {BIO 19147078 <GO>}

Then we don't have any further questions at this time. We can pause for a minute to allow people to type in any last questions that you may have.

John Olaisen in ABG, another long question. No, not this one. When you say contract prices are up, how much are we talking about? For example, year-over-year, where do you expect contract day rates in second half relative to the daily cost -- cash cost?

A - Rune O. Pedersen {BIO 16158611 <GO>}

If we consider the rates we were bidding a year ago going into the second half of 2020 versus where we have currently bid and what's sitting in our backlog, we are up more than 20% and probably with the margin. Where that is related to cash cost, I'm going to be very careful. But if you assume that we were bidding around cash cost last year, you can probably derive something from that.

A - Bard Stenberg {BIO 19147078 <GO>}

Yes. And then Mr.Olaisen has another question. You mentioned steaming in Q3. How much in percent terms should we expect?

A - Gottfred Langseth {BIO 5277539 <GO>}

Relatively high, but as of today, it looks like somewhat less than the 21% we had in Q2. This is -- this could obviously be impacted by in a way the exact timing of completing the surveys in North Atlantic in a way if they extend or otherwise are executed fast or the opposite executed faster, then steaming will start later or earlier. So -- but that is the estimate today, somewhat lower than the 21% we had in Q2.

A - Bard Stenberg {BIO 19147078 <GO>}

Then we have another question from Mick Pickup in Barclays. Looking at your bidding, how confident are you in further filling the fourth quarter?

A - Rune O. Pedersen {BIO 16158611 <GO>}

Well, as I said, there is a fairly large demand out there. The issue and the problem or what we work with every year at this time is trying to match the jobs we win with the end of the North Sea Canada season. We will as you see have several vessels moving south at the same time around beginning of October. So the challenge is always to make sure that we are able to match the start-up dates of contracts and MultiClient programs in the Southern Hemisphere with the end of the Northern Hemisphere. That is going to be a challenge this year as well. There is no silver bullet here. But the way it looks now, it's a healthy opportunity basket at least, and we are hopeful that we will be able to fill that without too much idle time in between jobs.

A - Bard Stenberg {BIO 19147078 <GO>}

Thank you, Rune. At this time, there is no further questions. We can pause for a moment to allow any last many questions to come through.

Question from John Olaisen in ABG. Will your contract business generate free cash flow after steaming and CapEx in 2021?

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A - Gottfred Langseth {BIO 5277539 <GO>}

That is our estimate, yes.

A - Bard Stenberg {BIO 19147078 <GO>}

And we don't have any further questions at this time. We will pause for a moment to allow for any last questions to come through. Okay. It does not seem to be any last questions from the audience. So that concludes this audiocast of our Q2 earnings release. Thank you all for participating, and have a nice day.

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