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CGG.PA - Q3 2018 CGG SA Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the CGG Third Quarter 2018 Financial Results Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Christophe Barnini. Please go ahead, sir.

Christophe Barnini - *CGG - SVP of Group Communications*

Thank you. Good morning, and welcome to the presentation of CGG's third quarter 2018 results.

The quarterly financial information are available on our website. Some of the information contains forward-looking statements subject to risks and uncertainties that may change at any time, and therefore, the actual results may differ materially from those that were expected.

The call today is being hosted from London where we will host our 2018 Capital Markets Day and update the financial market about our strategy.

During this call, Sophie Zurquiyah, our Chief Executive Officer; and Yuri Baidoukov, our CFO, will provide an overview of the third quarter results as well as provide comments on our outlook. We will be commenting on our segment's reporting figures, which are the figures used for the company's management purposes. Following the overview of the quarter, we will be pleased to take your questions.

And now I will turn the call over to Sophie Zurquiyah.

Sophie Zurquiyah-Rousset - *CGG - CEO & Director*

Good morning, ladies and gentlemen. I'll give a brief overview of our third quarter results and we'll highlight some of our key operational achievements. Yuri Baidoukov, our new CFO, will review our financial results. And then I'll make some concluding remarks before opening the call to Q&A.

I'd like to thank Yuri for joining CGG and joining his extensive background in corporate finance, management and strategy. His deep knowledge of the industry will greatly contribute to the success of CGG.

This call will be brief as we're having a short while our Capital Market Day where we will present our strategy, provide a perspective of the company's future and zoom into our core businesses.

Let me start with a summary of our Q3 segment results. Overall, we delivered segment revenue of $333 million, up 4% year-on-year, which confirms the gradual market recovery. Our EBITDA was solid at $109 million, up significantly but below our expectations as the material prefunding contract was delayed due to regulatory approvals. They were resolved early October and this contract revenue will be recognized in the fourth quarter.

GGR revenue at $192 million was up 3% with robust Subsurface Imaging & Reservoir activity and with a strong level of market client aftersales.

Equipment sales at $94 million were up significantly by 137%. The sharp rebound was driven by Land Equipment delivery.

Contractual Data Acquisition revenue at $54 million was down 46% as we dedicated fewer vessels to contract work. Segment EBITDA was at $109 million, 22% year-on-year, representing a 33% margin.

Segment operating income was significantly up at $40 million, a 12% margin. GGR and Equipment delivered an excellent combined results, while Acquisition operating income remained negative and down from the same quarter last year.

Moving now to Slide 5, and as a foreword, within our GGR division, we decided to rename Subsurface Imaging & Reservoir that you know as SIR. We will now call it Geoscience and it includes subsurface imaging software, home of the HampsonRussell and Jason brands; geology, home of the Robertson brand; and smart data solutions.

Let me now share some operational highlights of the quarter. In Geoscience, we are seeing continuing demand for high-end imaging and other geoscience services across all geographical areas. It is clear that our clients are getting into a planning mode for increasing their exploration and development efforts. This starts with improving the understanding of the subsurface and with an improved image.

The subsurface imaging technologies have advanced so much that there is value in reprocessing data that is as recent as 2 years old. Our unique capabilities are highlighted by the award of a new dedicated center for PETRONAS called Centre for Advanced Imaging. Three CGG business lines are involved, Subsurface Imaging, Multi-Physics and GeoSoftware. Our ability to integrate multiple disciplines here in multi-physics, reservoir characterization and well information with the seismic method and our global experience and expertise in frontier basins around the world were the key reasons for PETRONAS awarding us this center.

In Multi-Client, we've been very active at extending our footprint in the North Sea. Offshore Norway, we have started an 8,000-square kilometers southern extension to our very successful North Viking Graben Horda and Tampen survey.

We were also active in the Shetland Basin where we started the acquisition of a wide-azimuth survey.

In Australia, the reprocessing project in the Gippsland Basin is generating strong interest from clients and have revived interest in the basin itself.

In U.S. unconventional land, we just completed our Gini Multi-Client program in West Texas and have started the extension of our Chickasha survey in Oklahoma's SCOOP and STACK play.

In Equipment, demand in the Middle East has strengthened and is expected to continue growing with many important ongoing land projects and tenders in Abu Dhabi, Saudi Arabia, Kuwait and Oman. This should translate into solid Land systems deliveries in Q4 and onwards. We anticipate a heavy workload in our manufacturing plants specializing in Land products and are preparing for it.

In Acquisition, the fleet was busy shooting 60% for Multi-Client. One of our vessels was acquiring a proprietary 4D survey offshore Brazil.

Land operated full crews in Asia and North Africa this quarter. Our team is also providing intensive support to our ARGAS JV new project start-ups.

Slide 6. Our GGR revenue this quarter was up 3% year-on-year at $192 million.

Geoscience revenue was $93 million, up 16%, driven by worldwide demand for advanced processing technologies and high-fidelity imaging.

Multi-Client sales were $99 million, down 6% overall, with strong after sales across key active basins at $63 million, a $28 million increase from last year.

As mentioned earlier, the cash prefunding rate was low at 54%. It is 59% year-to-date, impacted by the contract of around $25 million value delayed October.

GGR EBITDA stood at $113 million, up 11% with a 59% margin.

Segment operating income was $59 million and increased significantly driven by favorable Multi-Client after-sales mix.

The Equipment business showed strong signs of recovery driven by Land activity, and with increased volumes, we achieved double-digit operating income margin. Sales was very strong this quarter at $94 million, up 137% year-on-year. Revenue split was 73% Land and 27% Marine, and 95% external and 5% internal.

We delivered a large number of channels and geophones in the Middle East and Asia. Demand for well gauges also remained very high.

The Equipment EBITDA was $18 million, a 19% margin. Segment operating income was at $11 million, an 11% margin.

The Acquisition revenue was $54 million down 46% from last year. Marine acquisition revenue was $24 million, down 67%, due to higher proportion of our fleet working on Multi-Client programs and a different revenue mix compared to last year when we executed multi-source vessel operation at higher prices. Our Marine fleet continues to deliver strong fleet operational performance with 93% availability rate and 98% production rate.

Land and Multi-Physics total revenue was $30 million, up 9% in a continued commoditized market environment for Land acquisition and a recovering market in the mining sector for Multi-Physics.

The EBITDA of the Acquisition segment was negative at minus $10 million, down significantly. And the operating income was negative at minus $17 million, also down compared to last year.

This completes the business segment review. I'll now hand over to Yuri to comment in more detail on our financial results.

Yuri Baidoukov - *CGG - Group CFO*

Thank you, Sophie. I highly appreciate your kind introduction, and I'm delighted to join CGG team.

I will start with an update on IFRS 15 application for Multi-Client pre-commitments. We have not filed so far any workable accounting path to align our management reporting and IFRS accounts. In line with our 2 previous financial reports, we have included the specific segment numbers, which are used in our management reporting and are based on percentage of project completion. The IFRS numbers show precommitment revenue recognized in full only upon delivery of the final data. We will continue reporting these 2 sets of figures in our future financial communications.

Looking at the income statement. The group revenue, based on our segment reporting, amounted to $333 million during the quarter, up 4% compared to third quarter of 2017 and flat sequentially. The business mix changed from last year as Equipment contribution was up to 27% of the group total revenue while GGR stood at 58% and Acquisition was down to 15%.

At the segment operating income level, the group performance this quarter was at $40 million, significantly up year-on-year as a result of a favorable Multi-Client sales mix and strong Land Equipment deliveries. The contribution from our joint ventures under the equity income was negative at $8 million this quarter due to new project start-ups in SBGS and ARGAS.

The net financial costs amounted to $30 million, reflecting the cash and noncash costs coming from the post-restructuring debt structure.

All in all, our net loss this quarter amounted to $2 million.

Looking at our cash flow. The segment EBITDA was at $109 million, up 22% year-on-year, below our expectations due to delayed prefundend revenue.

The segment operating cash flow was $79 million, up 15%.

Our CapEx was $91 million, up 35% year-on-year. Multi-Client cash CapEx of $67 million was up 25% from last year as we were able to catch up with the Multi-Client North Sea season. Industrial and R&D CapEx of $24 million were up year-on-year as we upgraded our computing capacity and our manufacturing plants to prepare for the market rebound in these domains.

The paid cost of debt was $7 million.

Segment free cash flow was negative at $17 million before nonrestructuring charges of $13 million related to Industrial Transformation Plan. Despite increasing working capital needs to finance the growth of our Equipment division activity, our cash consumption was limited this quarter.

The group gross debt at the end of September stood at $1.18 billion, with cash at $412 million. Our net debt was at $769 million corresponding to a leverage ratio of 1.9x.

I now pass the call back to Sophie for her concluding remarks.

Sophie Zurquiyah-Rousset - *CGG - CEO & Director*

Thank you, Yuri.

To conclude, this quarter as well as the first 9 months with revenue at $966 million, up 5% year-on-year, are confirming the gradual recovery of our markets. The results of CGG are yet extremely contrasted between our segments. GGR is gradually improving based on our differentiation and improving activity across all geographies. Our Equipment business is benefiting, in particular, from the recovery of its Land market. We expect those 2 segments to deliver increasingly good performance in the future.

On the other hand, the Acquisition segment is still impacted by structural overcapacity, and prices remain depressed, resulting in a poor performance despite our efforts to further reduce our cost base. We continue to see positive signs with the tightening oil market.

While many clients are maintaining a cautious approach to spending, we believe the encouraging fundamentals are leading to a more positive environment for CGG.

Based on Multi-Client year-end potential opportunities and solid Land Equipment demand, we remain on track with our 2018 targets.

We'll be discussing our view of the market in more detail, along with our strategy, at our Capital Market Day, which will begin in approximately an hour at 9:00 a.m. London time.

Thank you very much for your attention. And we're now ready to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And I take a question from James Evans from Exane.

James Matthew Evans - *Exane BNP Paribas, Research Division - Analyst of Oil and Gas*

I'll stick to the short term. Just firstly, around the Multi-Client prefunding, can I just confirm that we should assume or expect after officially high prefunding in Q4 because of this catch-up effect? And secondly, just also on Multi-Client, I just wondered if you could talk a little bit more -- a little bit more detail about what you're seeing in terms of those after-sales opportunities in Q4. I think one or two of your peers have talked very strongly, even saying they've seen the best opportunities in many years. So I know Sophie has run that division for a number of years, just how does it compare to what we were seeing, say, '13, '14, '15 when the market was a bit more robust?

Sophie Zurquiyah-Rousset - *CGG - CEO & Director*

Thank you for the question, James. So definitely expect a catch-up on the prefunding into the end of the year. However, I would just put a word of caution here. If you're comparing it to last year, I certainly don't expect it will be in the range of what we saw in the last year, which is particularly high. So there will definitely be a catch-up. And if you remember, we always say that we are looking for something above the 70% range and we'll definitely be above that number. Now on the year-end, it is definitely active. We've been approached by a number of clients that have come forward with wanting to do sort of a year-end deal and buy multiple data sets and we are definitely in discussions with that. I would just as well put another word there that obviously they are expecting discounts and so that will be the conversation we'll be having.

Operator

(Operator Instructions)

We just have one more question in the queue, Mick from Barclays.

Michael Brennan Pickup - *Barclays Bank PLC, Research Division - MD & Senior European Oilfield Services Analyst*

It's Mick here. Just a follow-up when you said about clients expecting discounts in 4Q. I would expect at this juncture your companies are seeing that the market is about to turn and they're coming to you with possibly massive dollar amounts and saying give us what the best you can get for it. Can you just explain what your approach is going to be as you go into 4Q in determining whether those sales are good for you or not?

Sophie Zurquiyah-Rousset - *CGG - CEO & Director*

It's a difficult question. Thank you for that, Mick. I think it'll be a case by case, right? It will depend on our impression of whether we can -- basically, what I wanted to say is that we will not make deals at any cost at the end of the year, bottom line, right? So we'll judge whether we have a better ability to make money by waiting or not. So there's always negotiations with clients, especially when there are large volumes of data that is being bought. And so it's a case-by-case judgment on whether this is a good deal or not for us. And we look at the -- it could be individual project economics, it could be the situation of the given basin, our judgment of whether we could get future sales into next year and the following year. And we don't want to impact, if you want, the value of our library by just discounting it heavily.

Michael Brennan Pickup - *Barclays Bank PLC, Research Division - MD & Senior European Oilfield Services Analyst*

Okay. And secondly, obviously, you've given targets out to '20, '21 now. Can you just talk about what you're hearing from the client about their '19 budgets at this stage? Are you expecting geophysical budgets to be up for your clients in '19? And what exactly are they saying to you?

Sophie Zurquiyah-Rousset - *CGG - CEO & Director*

So it is, I would say, a little bit early. I had those conversation at the -- around SEG time. And it is a bit -- it depends I would say on the different clients and where they stand. So it is, as you say, we're sort of in a crossroads where some clients are taking a quite aggressive stance and are expecting to actually increase those budgets and be more aggressive on putting their hands on data and starting their subsurface work. Others are still very cautious and just deciding to keep things flat, even maybe reduce their budgets to put some room into making acquisitions. So we're seeing varied strategies across-the-board. I would say, in general, we're seeing some improvement and that's why I've been talking about gradual improvement. This is more or less what I see in 2019.

Michael Brennan Pickup - *Barclays Bank PLC, Research Division - MD & Senior European Oilfield Services Analyst*

And that's on top of a flat to upper touch 2018?

Sophie Zurquiyah-Rousset - *CGG - CEO & Director*

I've always said from the beginning of the year is that we were seeing some -- a gradual recovery. And reason to that is because we play -- while exploration might have been actually down in the offshore segment, we've seen improvements in our businesses because we play not just in exploration, but exploration and development. So what we see is a gradual recovery chain going from '17 to '18 into '19. Now an acceleration will be a bit later down the road in 2020, 2021.

Yes, and maybe I'll point out this comment I was making is more from the E&P clients. So that is more relevant to the GGR and Acquisition side, which I understood your question was that if you look at it from the Equipment side it's a different story. We're definitely seeing a strong pickup on the Land side, which is driven from Land Acquisitions and Land clients, which is a different type of clients and more NOC-driven.

Operator

We will now take the next question from Daniele Serruya from Bell Rock Capital.

Daniele Serruya - *Bell Rock Capital Management LLP - Fund Manager*

You have confirmed your full year guidance, which implies a very important realization of sales in the quarter 4. I guess this is, to a large extent, Sercel. Can you elaborate on your capacity utilization on the ability to easily deliver a very large amount of equipment?

Sophie Zurquiyah-Rousset - *CGG - CEO & Director*

So this is actually twofold. This is definitely you've seen Sercel has been overperforming this year, it is that on one side. And we do have the ability to deliver this equipment since we've been preparing already for it. So it's not something that we're just discovering now. So we have the ability to deliver equipment. It is -- a lot of it is in -- we have inventory and we do the assembly. The other point is really on the Multi-Client side. And that is, as you know, it is a difficult business to predict. Now we look at our pipeline, we look at the strength of the discussions that are happening, so the odds are there that it should be a good quarter. So it is based on those 2 sides, a Multi-Client year-end sale, which carry a certain level of risk as always; and then Multi-Client equipment delivery, which we have a better visibility on. It is just about delivering the equipment.

Operator

As there are no further questions in the queue at this time, I would like to turn the call back for any additional or closing remarks.

Sophie Zurquiyah-Rousset - *CGG - CEO & Director*

I would say that I'm assuming there's not many questions because I'll be meeting probably several of you or you'll be listening to the Capital Market Day.

I want to thank you for your attention, and I'll see you shortly. Thank you very much.

Yuri Baidoukov - *CGG - Group CFO*

Thank you.

Operator

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