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CGG.PA - Q1 2019 CGG SA Earnings Call

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## CORPORATE PARTICIPANTS

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

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## CONFERENCE CALL PARTICIPANTS

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**Guillaume Delaby** *Societe Generale Cross Asset Research - Equity Analyst*

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

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## PRESENTATION

**Operator**

Ladies and gentlemen, thank you for standing by, and welcome to the First Quarter 2019 Conference Call for CGG. (Operator Instructions) I must advise you the call is being recorded today, Wednesday, the 15th of May 2019. I would now like to hand the conference over to your speaker today. Please go ahead.

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**Christophe Barnini** - *CGG - Former SVP of Group Communications*

Yes. Thank you. Good morning, ladies and gentlemen. Welcome to this presentation of CGG's first quarter 2019 results. The call is hosted today from Paris, where Mrs. Sophie Zurquiyah, Chief Executive Officer; and Mr. Yuri Baidoukov, Group Chief Financial Officer, will provide an overview of the first quarter 2019 results as well as provide comments on our outlook.

As a reminder, some of the information contains forward-looking statements including, without limitations, statements about CGG plans, strategies and prospects. These forward-looking statements are subject to risks and uncertainties that may change at any time, and therefore, the actual research may results may differ from those that were expected. This being said, now following the overview of the quarter, we will be pleased to take your question. And now I will turn the call over to Sophie.

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

Good morning, ladies and gentlemen. Thank you for participating in this Q1 2019 conference call. Our presentation will cover our first quarter operational and financial results.

Our Q1 2019 results were in line with expectations. We posted a 21% revenue growth year-on-year with solid EBITDA driven by strong sales in Equipment and Multi-Client as well as good operational performance. Most importantly, we delivered the second quarter in a row of positive net cash flow. Our EBITDA was high at $119 million, up 40% year-on-year with a 42% margin driven by the strong turnaround of Equipment. Operating income was positive at $11 million with a 4% margin. The operating income was impacted by a higher Multi-Client amortization rate of 87% versus 53% last year with $25 million impact from the application of the 4-year straight-line amortization implemented in Q4 last year. After $9 million positive IFRS 15 adjustment, $32 million cost of debt, $3 million of taxes and $15 million net loss from discontinued operation, we reported a net loss of $30 million in Q1 2019. Free cash flow from operations was $146 million compared to $18 million last year.

I will now cover our key Q1 2019 operational achievements by reporting segment. I'm on Slide 6 now. Overall, we continue to see improvements in the GGR market in line with what you're all seeing with the E&P budget. It is the first year that the offshore E&P budgets will see growth since the beginning of the downturn. We have increasingly encouraging conversations with clients around quality, away from the good-enough mentality that prevailed during the downturn. The truth is that with more data and better processing, client risks can be significantly reduced and outcome improved. And good enough represented a false economy in making cases -- in many cases. The GGR segment, that includes Geoscience and Multi-Client, delivered a solid quarter, although external revenue was down 3% year-on-year with Geoscience revenue down 9% and Multi-Client up 5%. GGR EBITDA was high at $105 million, a 58% margin, up 8% year-on-year.

Let me provide more information on our GGR activity this quarter. Since the beginning of the year, our order intake in Geoscience was $175 million with our backlog up 10% year-on-year, which is indicative of the market upturn as well as the return to focus on quality that I mentioned. Outstanding bids are up, and we have recently awarded -- been awarded major contracts. The Geoscience market benefits from the increasing demand from ocean bottom nodes and, generally speaking, from the increased density of the datasets acquired. More and better data has allowed our Geoscience organization to bring more processing technology to bear on the difficult imaging problem. Offshore clients are especially interested in applying the latest and greatest processing as an artifact created by poor processing can result in a dry haul, wasting hundreds of millions of dollars and exposing them to other drilling surprises which are never good and need to be avoided especially in deep offshore environment.

Also, as more and more majors participate at the North American unconventional market, we are seeing increased appetite for our land processing technology. These clients have seen the advantages that advanced processing techniques offer them elsewhere and want to apply similar technology to their land data. In addition, this quarter, we delivered solid software sales especially in Latin America, a testimony to our leadership in the specialty software market.

Geoscience total production, on the Slide 8, is the sum of external revenue and internal production, which is the processing of our Multi-Client data. In Q1 2019, Geoscience production was stable with internal production up 22% as we dedicated more Geoscience resources to our Multi-Client projects. Backlog for Geoscience as of May 1 stands at $298 million, increased 13% since the beginning of the year. As mentioned earlier, after Q1 closed, we have been awarded significant long-term contracts. Interestingly as well, the size of the projects is increasing, another positive signal that business is improving.

Slide 9, on Multi-Client. This quarter, our Multi-Client CapEx was $40 million. We were active in Oklahoma, extending our large footprint in the SCOOP/STACK play with the extension of our Chickasha survey. We were also active offshore Australia, offshore Gabon, with an ultra-deep 2D survey that we recently completed. We have a great portfolio of opportunities to invest in and, at this stage, are confident that we will be able to spend in the range of $250 million to $275 million Multi-Client CapEx in 2019 and staying within our $50 million net cash outlay objective. Obviously, the timing of such projects is often conditioned to regulatory requirements, permitting and client budgets.

Consistent with our CGG 2021 strategy, we will continue to expand our library in our core areas and consider the full range of technologies available to address the clients' specific issues. This is where you'll hear us about investing in Multi-Client node surveys.

With this slide, on Slide 10, we'd like to illustrate our Multi-Client approach. During the last 2 years, CGG has been able to develop a 50,000 square kilometer footprint in a mature basin, thanks to our latest technologies. The Norwegian North Sea is a mature hydrocarbon province with major oil and gas fields such as Troll, Osberg, Gulfaks, Snorre and Statfjord having been in production for decades. However, recent discoveries such as Johan Sverdrup showed that there are still discovery to be made in this area around existing infrastructure. Previous exploration focused mainly on the Jurassic sandstone, but more recently, particularly after the discovery of the Kara oilfield, attention has been directed towards the Cretaceous sands with a significant hydrocarbon potential. CGG started the development of this large Multi-Client program in 2014 with the 3D BroadSeis, BroadSource survey. And after receiving strong industry support for our initial survey, we have been continuously expanding our coverage of the area. So far, this has yielded good returns and investment and generated $400 million of revenue with undoubtedly much more to come in this very active area.

In addition to providing high-resolution image of this basin, we offer well data and other geology confirmation that is correlated with and augments the seismic data. We call this type of project a jumpstart as it allows our clients to quickly gain a full understanding of the area and focus on their core activities.

Slide 11, Multi-Client revenue was $89 million this quarter, up 5% year-on-year. Prefunding revenue was $47 million, and our prefunding rate was 106%. After-sales were $47 million this quarter, up 32% year-on-year and in line with our expectations. After-sales were solid across all regions.

Moving on to Equipment. Demand for Sercel land equipment significantly increased in Q1 as a result of activity in the Middle East, India, Algeria and Pakistan. With our flexible model that relies on a wide base of suppliers, we were able to significantly ramp up production to deliver constantly more equipment within the quarter. Just to give you an idea, we're currently able to manufacture in a month 20,000 channels of 508XT and 10,000 channels of 428 systems. Demand for gauges and downhole tools is also booming as land activity is increasing around the world.

In the non-oil and gas business, Sercel officially launched 2 new business lines focused on the monitoring of structures, our dams, plants, railways or bridges; and also on the monitoring of the earth.

Land is the main driver for the strong Q1 Equipment performance. Total Equipment revenue reached $105 million, significantly up 108% year-on-year. In Q1 2019, Equipment EBITDA was $23 million, a 22% margin. And operating income increased significantly to $15 million, a 14% margin. Equipment is a volume business with annual OPINC breakeven revenue of $320 million. And these quarter results show you the kind of improved performance that can be delivered as volumes recover. Indeed, the incremental OPINC year-on-year is 64%.

With this, I will now turn the floor to Yuri for a financial overview.

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**Yuri Baidoukov** - *CGG - Senior EVP & Group CFO*

Thank you, Sophie. Good morning, ladies and gentlemen.

Effective January 1, 2019, CGG applied IFRS 16 by recognizing right of use assets and lease liabilities related to operating leases. The impacts on adoption of IFRS 16 from the 2019 P&L is reflected in the reduction in cash costs of circa $50 million with lease costs previously recognized within gross cash costs replaced by depreciation of circa $45 million and interest expense of circa $10 million. The positive impact on EBITDA for Q1 and full year 2019 is estimated to be $13 million and $50 million; and on OPINC, $3 million and $5 million, respectively.

Looking at the consolidated P&L for Q1 2019, segment revenue from the new profile amounted to $282 million, up 21% year-on-year mainly on a significantly growing Sercel sales. Geoscience accounted for 32%; Multi-Client, for 32%; and Equipment, for 36% of revenue. Segment EBITDA was $119 million, up 40% year-on-year with 42% margin on the back of higher EBITDA in both GGR and Equipment. At segment OPINC level, group performance was positive at $11 million, lower year-on-year due to $25 million impact from the application of 4-year straight-line amortization in Multi-Client business from Q4 of last year. Net cost of financial debt amounted to $31 million, and net loss from our continuing operations was $15 million this quarter. Discontinued operations, corresponding to the former Contractual Data Acquisition and Non-Operated Resources segments, resulted in a net loss of $15 million for the quarter, significantly improving from net loss of $62 million 1 year ago.

Moving to Slide 17, cash flow statement. Our financial position at the end of March 2019 remains solid with higher liquidity of $475 million. Group gross debt before IFRS 16 was at $1.18 billion with maturities of first lien debt in May 2023 and second lien debt in March 2024. While our segment EBITDA increased by 40% this quarter to $119 million, our segment free cash flow grew to $146 million, significantly up from $18 million in Q1 2018. Paid cost of debt was $7 million this quarter. Cash costs from discontinued operations were $53 million. Cash costs related to the implementation of our CGG 2021 strategic plan were $25 million. Net cash flow was positive at $44 million this quarter, the second in a row positive quarter with cash generation.

At the end of March, gross debt -- group gross debt before IFRS 16 was at $1.18 billion. And with liquidity at $475 million, our net debt was at $704 million. Before IFRS 16, our net debt-to-LTM EBITDA ratio was 1.2x at the end of March 2019. Group gross debt after IFRS 16 was at $1.34 billion, and net debt was at $868 million.

Moving to our group balance sheet. Our capital employed was at $2.5 billion, up $100 million from December 31, 2018. Net working capital after IFRS 15 was at $138 million, down from $189 million at the end of 2018. Receivables were at $428 million, down from $520 million. And inventories were stable at $205 million. $1.2 billion goodwill corresponding to 49% of total capital employed and 76% of equity was flat. Multi-Client library net book value after IFRS 15 was at $616 million, down from $633 million, with cash prefunding rate at $106 million in Q1 2019 versus 230% in Q4 2018. Multi-Client amortization rate was at 87% in Q1 2019 and would have been at 59% excluding changes to 4-years straight-line amortization. [NDE] of Marine library was at $546 million; and NDE of Land library, at $70 million. Other noncurrent assets, fixed assets in the slide, were at $660 million, up from $509 million at the end of December 2018. PP&E were at $345 million, up from $189 million, representing mainly the impact from IFRS 16. Other intangible assets were at $259 million, down from $266 million. And other noncurrent assets were stable at $32 million. Shareholders' equity and minority interests were at $1.65 billion, including shareholders' equity at $1.6 billion and $43 million minority interest mainly related to a Geoscience joint venture.

Now I'll hand the floor back to Sophie for her concluding remarks.

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

So I'm pleased -- we're on Slide 20 now. I'm pleased with the progress of our acquisition exit in Q1. We're on schedule and set to achieve the cost reduction targets set in our 2019 objectives. We have significantly reduced the cash burn from acquisition compared to last year as we reduced our footprint and are very selective about the projects we work on. We're having encouraging discussions with potential marine strategic partners. And there is appetite for our good vessel fleet. It is still early to be more specific, but the outlook is better than I had anticipated last year. The land acquisition wind-down is progressing as we complete the delivery of the committed contracts, which should be finished by the end of Q3

In conclusion, I am pleased to say that our Q1 2019 results were in line with expectations. Our cash flow performance has been good, and we will remain focused on strong cash generation. Looking forward, we confirm signs of a gradual recovery in 2019 as upstream project economics, especially offshore, have improved, and sub-clients start to focus on growth. CGG is consolidating its position as the partner of choice for geoscience which will become more and more visible as activity increases. In this context, we confirm our 2019 guidance and our 2021 targets while remaining focused on strong cash generation.

Thank you for your interest, and we're now ready to take your questions.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) The first question we have today comes from the line of James Evans from BNP Paribas.

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

Just off with a couple, if I could. On the Equipment side of Land, it was very good Q1. I just wondered, is that a bit of a one-off strong in terms of the deliveries, or are you seeing continued momentum in terms of ordering activity for the rest of the year? And then secondly, sorry to ask such a boring financial question, Yuri, but I wondered if you could give us the IFRS 16 impacts, a rough split by division for the full year, that would be useful.

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

Okay. So on the Equipment side, I guess it's -- I want to avoid you drawing the straight line. It is not really a one-off. It is linked to really increased activity. But at this point in time, it is a bit early to see if this is going to be a continuing trend at that increased rate through the year. So I'd say yes, we're definitely seeing improvements in the Equipment side. It is not likely the Q1 is the specific way to write a one-off. But at the same time, it is quite a substantial improvement compared to last year, and I don't expect necessarily we will see the same improvement carry through the whole year, if that answers your question. So now the IFRS 15, I'll leave it to Yuri.

**Yuri Baidoukov** - *CGG - Senior EVP & Group CFO*

So James, yes, thank you for your question. Basically, for the whole year 2019, we expect the impact from IFRS 16 to be positive $24 million for GGR segment, I'm talking about EBITDA here; and $3 million for Equipment and $21 million for basic group items. And of course, most of this impact, as you saw on the slide, comes from real estate leases. Of course, we think this impact will be much lower because the impact -- the total impact on OPINC is around $5 million.

**Operator**

The next question we have today comes from Guillaume Delaby from Societe Generale.

**Guillaume Delaby** - *Societe Generale Cross Asset Research - Equity Analyst*

One question about the past, in fact, about net income and net cash from discontinued operations. How to reconcile the fact that net income from discontinued operation was relatively good, minus $15 million in Q1, on Page 6 of your press release; while when I look on Page 7 on your press release, cash flow from discontinued operation was minus $53 million. So how to reconcile this minus $15 million in accounting terms and minus $53 million in terms of cash flow? And could we have, let's say, a flavor (inaudible) about cash flow burn on discontinued operation for 2019?

**Yuri Baidoukov** - *CGG - Senior EVP & Group CFO*

So Guillaume, yes, thank you for your questions. So the -- if we look at discontinued operations kind of in more details in Q1 of 2019 from the cash flow perspective, our revenues are actually up in Marine at $53 million from $29 million Q1 '19. And only 26% of our capacity was dedicated to Multi-Client surveys versus 41 -- 44% a year ago. So basically, with that, the main impact comes -- there is annulment coming from the negative change in working capital. That's the short -- that's additional element to obviously OPINC loss because there is no depreciation in discontinued operations since the application of IFRS 5. So basically, I would say that, that is the main driver. Now in the $53 million of negative cash flow from discontinued operations, there is also an element of $7 million which comes from the tail end of implementation of the previous Transformation Plan. So in other words, fewer cash burn from discontinued operations was $46 million. Now in terms of the outlook for the year, we expect the cash burn to -- as we discussed at the -- with Q4 presentation, to reduce in 2019 overall.

**Operator**

(Operator Instructions) The next question we have today comes from the line of Christopher Møllerløkken from Carnegie.

**Christopher Møllerløkken** - *Carnegie Investment Bank AB, Research Division - Research Analyst*

Which relations to the contract Sercel has with -- in the Middle East, could you update us on the scheduled deliveries there?

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

I think I would say on that particular contract that we've been talking about last year, and we pretty much have delivered everything. So it's been through Q4 and this Q1, I would say. But there's other new bids and more activity happening over there, so that's not the only contract.

**Christopher Møllerløkken** - *Carnegie Investment Bank AB, Research Division - Research Analyst*

In GGR, you mentioned that there had been several contracts awarded post Q1 close. But are those contracts included in the backlog as you report backlog as of 1st of May?

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

I would say 1st of May, yes, it is included.

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**Operator**

(Operator Instructions) The next question comes from the line of Pieter Puijpe from ING Capital.

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**Pieter Puijpe** - *ING Capital LLC - MD and Co-Head of Structured Finance Americas*

Just following up on the previous caller's question on the GGR performance, you mentioned that you have seen a solid order intake in Q1 and increasing backlog I think you said 10% to $175 million. Can you please give us a little bit more detail on that? When you compare Q1 order intake in GGR, Q1 '19 versus Q1 '18, how much of a growth have you seen? And so how did the backlog look like at the end of Q1?

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

I'll leave it -- I'll leave this one to Yuri. I mean I just want to get the number. But just to give you a caveat, it is not quite linear. Things sometimes happen in chunks, so it gives you an idea that things are sort of improving and -- but it is not necessarily so obvious in terms of translation.

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**Yuri Baidoukov** - *CGG - Senior EVP & Group CFO*

Now arithmetically, I would say, in addition to what Sophie said, if we compare order intake for the first 4 months of 2019 versus the first 4 months of 2018, it was up around 50%. But again, as Sophie rightfully said, it doesn't mean that the order intake is leaner kind of every quarter. But on that, again, of course, it's an indication that the drag on markets recovery continues to take place.

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**Pieter Puijpe** - *ING Capital LLC - MD and Co-Head of Structured Finance Americas*

Right. So did you say up, is it 15 or 50?

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**Yuri Baidoukov** - *CGG - Senior EVP & Group CFO*

5-0.

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**Pieter Puijpe** - *ING Capital LLC - MD and Co-Head of Structured Finance Americas*

5-0. Okay. So for the 4 months, okay, this order intake. And the backlog is $175 million mentioned before. Is it for the end of April, and this is up 10%? Did I get it right?

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**Yuri Baidoukov** - *CGG - Senior EVP & Group CFO*

Sorry?

**Pieter Puijpe** - *ING Capital LLC - MD and Co-Head of Structured Finance Americas*

Yes, the backlog is up 10%?

**Yuri Baidoukov** - *CGG - Senior EVP & Group CFO*

Yes. The backlog is up 10%, yes.

**Pieter Puijpe** - *ING Capital LLC - MD and Co-Head of Structured Finance Americas*

And it is as of March or April?

**Yuri Baidoukov** - *CGG - Senior EVP & Group CFO*

At the end -- as of the 1st of May so, in other words, at the end of it.

**Pieter Puijpe** - *ING Capital LLC - MD and Co-Head of Structured Finance Americas*

Okay. Okay. Perfect. And you also mentioned that you are in discussions with certain marine partners with respect to the fleet. Can you please give us a bit more detail on what is your objective here and when would we expect any progress?

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

So this one, it's a bit tricky. So obviously, we can't say a whole lot. But in general, and I did say this at the Capital Market Day, we call this a marine partnership because it has several angles to it. So one, we're looking for a company to take over our fleet and operate it. At the same time, we want to secure capacity for our Multi-Client activity. And there's another angle which is around the Equipment side which is securing the fact that the vessel fleet and maybe more continue to use our equipment, the Sercel equipment. So really, 3 angles that we're looking for, and that's why it's a little complicated, and there's encouraging conversations with different companies.

**Pieter Puijpe** - *ING Capital LLC - MD and Co-Head of Structured Finance Americas*

Okay. This is helpful. And good luck with that. Just last question. Is there anything new regarding the capital structure? Any thoughts about refinancing the bonds or any other movements in terms of the RCF?

**Yuri Baidoukov** - *CGG - Senior EVP & Group CFO*

As discussed again last quarter and during our Nordea road show on the back of Q4 results, we're continuously evaluating our refinancing options. The -- at this stage, as you know, the refinancing of second lien debt implies the 20% coal premium which will come down to 12.5% in March of next year. And of course, we're taking that in due time. Equally, we're in continuous discussions and we engaged with our commercial banking partners as well with the objective of bringing back RCF in the future.

**Operator**

We have a follow-up question here from Christopher Møllerløkken from Carnegie.

**Christopher Møllerløkken** - *Carnegie Investment Bank AB, Research Division - Research Analyst*

In first quarter, the Multi-Client activity was quite limited for CGG's part in terms of domestic utilization. Could you update us a bit on the plans for the summer season, please?

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

So yes. And as I mentioned in my talk, there are different elements that have to be considered when doing those Multi-Client activities. Some of it is the -- that I said is the timing. So some of it is the sales in decline, the permitting. So all this comes into play. And then typically, in the Q4 and Q1 of the year, we have less Multi-Client activity. The summer season is going to be very busy. We're going to be pretty busy with most of our fleet. I think the 4 vessels will be utilized on our Multi-Client essentially between the North Sea and possibly Brazil.

**Christopher Møllerløkken** - *Carnegie Investment Bank AB, Research Division - Research Analyst*

And any specific licensing rounds that you would highlight in terms of potential late sales triggers for CGG this year?

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

I guess we -- like I've mentioned, we invest in our core areas, and those core areas are defined because they have regular licensing running and give us the ability to generate regular revenues. So you have the Brazil big rounds. You have, like every year, in Norway the APA rounds. So there's -- it's kind of the usual kind of activity. Now we -- maybe to highlight, we have a large data set in Gabon that sort of is expecting the new petroleum node and some blocks assignment that will generate some revenue.

**Christopher Møllerløkken** - *Carnegie Investment Bank AB, Research Division - Research Analyst*

And final question, Occidental recently agreed to acquire Anadarko Petroleum. Would that acquisition trigger any transfer fees for CGG's part?

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

In theory, yes. Now in practice, it will depend what Occi decides in terms of the data that they want to transfer and, in terms of basins, what they decide to focus on. Obviously, Anadarko, we had sold the substantial amount of data on the U.S. land and in the Gulf of Mexico. So it's yet to see what Occidental is going to want to take over.

**Operator**

(Operator Instructions) There are no further questions over the phone. Please continue.

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

So thank you very much for attending this first quarter call and look forward to meeting you in those one-to-one. And I think we'll finish the call. Thank you very much again.

**Operator**

Thank you very much. That does conclude the conference for today. Thank you for participating. You may all disconnect.