

Company: Topaz Energy and Marine
Conference Title: Q1 2017 Financial Results Investor Call
Speakers: René Kofod-Olsen, CEO and Jay Daga, CFO
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Operator: Good day, ladies and gentlemen and welcome to the Topaz First Quarter 2017 Investor Call. For your information, today's conference is being recorded. At this time, I would like to turn the call over to Mr René Kofod-Olsen, Chief Executive Officer of Topaz Energy and Marine. Please go ahead, sir.

René Kofod-Olsen: Thank you so much. Thank you, everybody, for calling in. We will, as usual, go through the very short presentation that has been uploaded on our webpage, and then we will open up for a Q&A, subsequently.

Starting on page number three, we are definitely seeing a lot of deterioration in the general offshore markets, as you can all read in the press. But we have actually doubled our backlog since the same period of 2017. So, our total business backlog stands at about \$1.5 billion as of end of quarter one. We have in the same period, secured global vendor status with renowned companies like BP, Chevron, Exxon and latest, Saipem, which of course, is underwriting our future commercial efforts in the market we are in. This is very, very important for the company. And we are ensuring to restructure the business – we have spoken about that before – but in a situation where revenue topline erosion is occurring, you need to ensure that you are taking adequate amount of cost out. We have taken about \$40 million of cost out over the last 24 months to ensure that we have an organisation that is fit for fight in a new oil and gas paradigm.

The cost optimisation programme that we have delivered over the period, is ensuring us – I'm sure my colleague Jay Daga will explain that our margins are basically kept very stable. We will continue to drive those efficiencies through the business, both offshore and onshore to deliver an organisation that will also be fit to fight tomorrow. And by that, I mean

that we are basically embracing the digital revolution. So, during 2017, we are concluding our implementation of our fleet system, which we expect will give even further cost reductions by pushing a lot of vendor decision making onboard our ships.

More importantly, we are keeping a very, very close partnership with our financial partners. Proactively, we have been discussing how to ensure our covenants on our long debt, our 2022 secured debt, are giving necessary headroom for us to manoeuvre freely in the current environment. So, in terms of our liquidity headroom, we have a lot of liquidity headroom by own organic factors. And you will see that we have enhanced our covenant headrooms, which we have concluded to also gain access to our rolling facility, so we have ample liquidity to meet all our expected commitments for the future.

On that note, I will turn it over on page number four to my colleague, Jay Daga.

Jay Daga: With respect to financial performance for quarter number one, while we have a lower revenue of 25% as compared to the similar period last year, however, we have been able to maintain our EBITDA margin. This reflects all the points which René said earlier, that we are very, very focused on our costs and we are very focused on ensuring that the cash flows generated from these revenues are protected. Going forward, we will see there are some green shoots to show improved business performance, but quarter number one has seen some impact of the vessel downtime in the spot work for both in MENA, West Africa as well as some of the assets that came off charter in the Caspian region from the project that was concluded last year.

On page number five, by quarter on quarter, the revenue numbers have deteriorated. At the same time, we have maintained EBITDA margins throughout this period. The impact of the revenue reduction has not

percolated down, like-to-like to EBITDA because significant amount of cost reduced over the period has covered some of the lost ground on revenue.

On page number six – this reflects the utilisation of our fleet. While the overall fleet utilisation has gone down on the core fleet from 75% to 58%, but Caspian, mostly in Azerbaijan, which is the most important fleet we have, has maintained as it stands. It has not gone down to the same proportion as first quarter last year. Some of the headwinds we are seeing in respect of spot work, and that is what is reflected in MENA, Africa and Subsea. On the Caspian, as I explained earlier, the Caspian “Other” fleet, which is again, not very <inaudible> of barges that came off charter from Kashagan fleet. So, these vessels will be standing by and go on charter when Kashagan 2 is commenced again in a year’s time.

On page number seven, contract backlog, I will hand over to René to explain how we have managed to achieve a robust contract backlog of \$1.5 billion.

René Kofod-Olsen: Thank you, Jay. We have basically been working on ensuring that the company is fit for purpose for the future also commercially, and one of those engagements has been to go further up the value chain of our clients. And in that connection, we went into a big contract negotiation with Chevron on the huge tankers field in Kazakhstan. And we won that business and have basically doubled our backlog. We even expect more commercial efforts from that coming throughout 2017 as well. This is a tremendous contract for us and transformational, both in terms of the backlog but also in terms of our commercial footprint. We will get closer to the oil majors value chain and do more for less in the future. It has been very important for us to do that and to reset the company to a new norm.

Back to you, Jay.

Jay Daga: On capital structure, page number eight, it continues to show a very stable cap structure. We're still holding the cash of \$57 million at this end of quarter number one. The external debt have been amortised as per the plan. The leverage ratio, although it has deteriorated, it is more the outcome of the lower EBITDA. And we continue to service all our debt and maintaining a very healthy liquidity position.

On page number nine, covenants – as it stands on first quarter end. However, as explained earlier, we have agreed with our senior secured lenders a much flexible covenant structure that would be effective from this quarter onwards, and this is reflected on page number 10. The net leverage ratio has been improved from 4.5 times to 5.25 times EBITDA multiple, a 19% headroom. The tangible net worth requirement has been dropped from \$400 million to \$300 million, giving 41% headroom. Free liquidity of \$30 million has been maintained. However, due to the higher leverage ratios, we have the availability of the \$100 million revolving credit facility. This improves our free liquidity by 352 times, and there's nothing changed in the debt service coverage ratio.

Liquidity position, as it stands on 31st March 2017, we have \$57 million worth of cash balance that is available to us in terms of liquidity. However, with the revised covenant package, we have significant drawing capability on our RCF and that increases our free liquidity to 352%, as I explained on page number ten.

René Kofod-Olsen: And finally, on page number 12, in terms of our safety record – this is really the license for us to operate in the offshore segment – is impeccable. We're very proud of our safety record. We are investing a lot of both management time and training time into this part of our business because without this record, there's no way we would have gained global approval status from the formidable oil companies that I mentioned earlier in the call. So, this is something that we believe is a license to operate in the offshore industry and we will continue to invest in our assets and in our people to maintain that.

On that note, I will pass you back to the moderator and start our Q&A.

Operator: Thank you. Ladies and gentlemen, if you would like to ask a question, please signal by pressing star one on your telephone keypad. If you are using a speakerphone, please ensure that the mute function is turned off to allow your signal to reach our equipment. Again, please press star one to ask a question. We will pause for just a moment to allow everyone an opportunity to signal for questions.

We will take our first question today from Kia Williams of Emirates NBD. Please go ahead.

Kia Williams: Hi, good afternoon, gentlemen. Thank you for the conference call. If I may, just two points or two questions, please. The first one's just a clarification. So, with the new covenants, the full \$100 million is available under the RCF? I just wanted to clarify that.

Jay Daga: While the facilities is \$100 million, but it is linked to the EBITDA margins – it's linked to the leverage issues and the loan to value. So, naturally, as our EBITDA margin improves over the period, it releases the availability of the RCF.

Kia Williams: Okay.

René Kofod-Olsen: But the RCF is available, correct. The \$100 million RCF today, technically, is fully available to us.

Kia Williams: Okay. That makes a big difference to last quarter. Thank you. And then if I could ask you to just spend a little bit more time on the utilisation rates, please. If I look at it on a quarter by quarter basis, they've been relatively stable in the Caspian region for the past sort of three to four quarters. But this quarter, there's been a significant drop. And I know

you went through it briefly, but if you could just give a little bit more colour on exactly why that is and the reasons for that.

René Kofod-Olsen: That's a very good question. So, as Jay was mentioning, we have had a lot of barges, what we call non-core assets, that have been working for the Kashagan field in Kazakhstan. And that field development halted, as per plan. It will recommence at the Kashagan 2, in 2018, where these barges will be fully deployed. But for now, they are in layup in Kazakhstan until they will return on contract, expected early next year.

Kia Williams: Okay. And how many barges are tied up to this project?

René Kofod-Olsen: 13 barges are directly impacted by this. They're quite large barges.

Jay Daga: Out of 13, five are still supporting the production and rest of the work, and eight of them have been released.

Kia Williams: Okay. And sorry, just so that I understand, on this utilisation under the Caspian, does this fall in the Azerbaijan region or segment or the other segment?

Jay Daga: It's other segment.

René Kofod-Olsen: It's Kazakhstan. It's the others.

Kia Williams: Okay. And the softness we've seen in Azerbaijan, so you've gone from 94% utilisation in the fourth quarter to 88% now. Could you give us a reason for that as well?

René Kofod-Olsen: There has been some spot vessels that have not been working in the first quarter. They are, however, now working in the second quarter. So, that is more periodic mismatch. It is not something you will see continue deteriorating because if you remember, most of our vessels in

Azerbaijan are actually on a long-term contract. So, this is predominantly between contracts. So, this is just an unfortunate period, you can call it. And I believe we have had two ships in dry dock.

Kia Williams: Okay –

René Kofod-Olsen: You should in principle always see Azerbaijan, as the contract stands today, at about 90 utilization rate%.

Kia Williams: Okay, great. Thank you.

Operator: Thank you. We will now take a question from John Davidovich of Goldman Sachs. Please go ahead.

Apologies, we have a question Zafar Nazim of JP Morgan. Please go ahead.

Zafar Nazim: Thanks a lot, thanks for the call. I had a few questions, if I may. René, if you can just tell us how the current quarter is coming along? I'm sorry if you addressed this in the earlier part of the call – I missed the first few minutes. So, if you can just talk about the second quarter, how it's going so far. Do you think we'll do better in the first quarter or worse, or 31 is a fairly good run rate to consider for the second quarter as well? 31 of EBITDA.

René Kofod-Olsen: As you know, we are not giving that much guidance for the future. But I have before guided towards 2017 being tough and we are sort of addressing accordingly. It's probably not going to be worse or much better. However, the guidance we're giving is that we are seeing some green shoots along the second half of 2017. We're definitely seeing an improvement in our commercial funnel. And if we believe that the oil majors are going to start making decisions, that's good for the business in general. But the guidance is that 2017 is just going to be a tough year. So, that's the best guidance I can give you.

Zafar Nazim: You've had pretty good success in terms of cutting costs. Can you just talk a little bit about whether there's further room for expense management and when should we start seeing expenses start creeping up again, maybe on the back of inflationary pressures?

René Kofod-Olsen: I think we have gone through probably two or three rounds. We have reset the company for the long haul. We have made some massive decisions and we have centralised most of our business because we actually feel this is a right way of running the company. Where I do expect to see more cost retainment on, is the efforts from putting more and more decision-making in the hands of our captains and chief engineers. We feel that they are very highly educated, very good, empowered people, but we believe as an industry we have just not used that capacity well enough. So, we are empowering them now with a fleet-wide system and communication upgrades and equipment upgrade in terms of how they can communicate with the company. And so, a lot of the decisions that have been done with expensive shore people will now be done by the crew. And I actually feel that that is where the new cost savings is going to come from.

See, we are in sort of the situation where with the customers that we are up against, positively up against – BP, Saipem, Chevron, Exxon, Saudi Aramco – there is a limit to cost savings if you want to be a world-class company. You still need to ensure that you can operate your vessels to a world-class standard and you can do contracts and commercial efforts and safety efforts at a world-class level as well. And so, we will never impede those parts of our business because it will echo in the future. One mistake and it will take you years to recover that. And so, I think we are getting very close to an organisation for the future. However, we are very careful for cost creeps and we do expect a lot from sort of the new way of operating our ships and empowering our crew.

Zafar Nazim: Alright, thank you. And on the TCO contract, is the vessel construction going as planned and scheduled? And are you still looking to deploy your first vessel, I believe in – the second quarter of next year?

René Kofod-Olsen: Actually, thank you for that question. We are a little bit ahead of schedule. So, of course, we are very proud of that and we are getting recognised by Chevron and all their partners for that. We are definitely on schedule to start first quarter next year. There is a possibility that one ship will actually start already earlier, as part of them moving some cargos actually earlier. So, that's very positive. But right now, we are ahead of schedule. And as I mentioned earlier, we are seeing indications that there could be even more business for our company on that contract in the future. So, we are quite pleased with that development.

Zafar Nazim: And Jay, just a couple of questions for you. The covenant relaxation, is that for the remainder tenure of the bank facility?

Jay Daga: No, I think it – this is for next 24 months and then, you know, it gets tightened.

Zafar Nazim: Got it. Okay –

Jay Daga: – as soon as the Chevron contract comes in, then it improves our credit significantly. And therefore, it is expected that slowly, we will go back to the similar covenants which we agreed at the time of facility.

Zafar Nazim: Okay, thank you. And then just if you can remind us what do we expect as maintenance CAPEX and any additional payments or CAPEX outside of the TCO-related CAPEX for 2017?

René Kofod-Olsen: Basically, very, very minor. We are pushing all those sort of non-essential CAPEX out to the right. So, the Subsea ships will now be taken mid to late 2018. And so, we don't have any big docking campaigns. So, it's going to be between \$10 million and \$15 million, which is basically to

maintain our 100-vessel sort of strong fleet. It's something we're focusing a lot on. So, it's going to be an immaterial amount.

Zafar Nazim: Got it. And the Subsea vessels, those I guess at the backend you had to make a balloon payment. Is that – you're going to fund that to credit facilities?

René Kofod-Olsen: All that is already funded and we have all facilities, both with the Norwegian Export Credit institution and a bank, one of our partnering banks. So, that's already done and we are very comfortable with that. So, we are basically – I think I described that in the last conference calls. It's a double-edged sword. We have quite an interesting commercial funnel for the ships. But as you know, IOCs are reluctant to make decisions right now. So, having pushed them for probably 12 months may prove to be a mistake, but as you have come to know, Topaz, we never deploy hope as a strategy. As we have decided that we pushed them for 12 months in anticipation of a continued sort of troubled market in 2017. So, it's pure conservatism.

Zafar Nazim: Got it. And just one last question. If you can remind us, of your 97 vessels, how many are core versus non-core? And what percentage of revenue and EBITDA do the non-core vessels generate?

Jay Daga: It is 70/30. So, 70% of them are core and 30% non-core. That's in terms of the numbers. And in terms of real dollar value, you know, almost 80% of our revenue comes from core. And those non-core vessels are very unique to Kashagan and some of those fields and they don't even generate 10% of the total revenue.

Zafar Nazim: Got it. Okay, that's all I had. Thank you very much.

Operator: Thank you. Ladies and gentlemen, as a reminder, to ask a question please press star one on your telephone keypad. We will take our next question

today from John Davidovich of Goldman Sachs. Please go ahead, sir. Your line is open.

John Davidovich: Hi. Can you hear me?

Jay Daga: Yes.

René Kofod-Olsen: Yes, yes.

John Davidovich: Hi. Okay, great. So, a couple of questions. So, first of all, the comment about the, you know, the additional commercial efforts for TCO, you've mentioned in the past, you know, \$100 million EBITDA level on a per annum basis. Does that mean you can increase that amount or is it just saying that beyond this three-year contract that you can add additional EBITDA?

René Kofod-Olsen: Yeah. So, if we are successful on this latest project that is an addition, then we are going to increase that EBITDA. And where we are right now, then we have no reason to believe we're not going to be successful. Further, if our client decides to start the contract earlier for some of the ships, then those ships will not start on our layup rate. And that means that that will also be incremental business for the company as they will go straight into cargo runs. So, on both aspects of your question, I believe that's positive for the business.

John Davidovich: And if I could just ask a clarification of the TCO contract – and apologies if this has been said in the past. But just so I understand this better, the ship payments will be in total \$326 million, which are effectively being paid for from the customer with back-to-back payments – will then have the \$100 million per year EBITDA uplift. I think you said in total, it should be \$80 million free cash flow. So, that means there's – if I understand it – \$220 million repayment of the ships going back out. So, is that the way to think of, that effectively you're borrowing from the customer \$326 million for the ships upfront and then you pay back \$220

million over the contract? So, I guess the rest is kind of built into the day rate, would be my assumption.

Jay Daga: No, we've taken \$326 million advance from the customer and we would repay \$326 million over the contract period. So, after paying \$326 million dollars and paying the expenses for operating the ships, we would be left with that kind of money as cash retention on the project. So, at the end of the project, what we expected is that we will have the ship that is fully paid up in our books.

John Davidovich: Sorry, so, \$300 million EBITDA in total for the contract over the three years less it's a \$326 million payment for the ships is the way to think of that.

Jay Daga: Yeah, I think – well, it will be helpful, John, if you can call me later, then we can run through all the details so that way you get your head around it correctly.

Jay Daga: Because it is a complicated thing because there is advance, there is a prepayment, there is opex, there's laid-up rates. It's kind of a combination of many factors together. And the vessels don't come at all at one time, they come at a different time over next year, so.

René Kofod-Olsen: But fact is, as Jay is mentioning, it's a significant and transformational contract for us and we actually already now have quite a lot of interest for the ships, subsequently. You know, so it's a very, very interesting business for us. And as I said, we get closer to oil majors' value chain on the oil logistics, which is another upside. So, and what you have to remember on these vessels is that they are unencumbered. So, once we finish the contract, you have all these ships that are basically non-encumbered, non-levered ships as part of our balance sheet.

John Davidovich: Well, that then that leads my last question – and I'll leave it there – is with the high yield bond maturing coming up, what are your plans in

terms of a timing or thoughts around and re-fi? And my question is also, do you have the capacity to give security to a re-fi via these unencumbered ships that will be part of the TCO contract? And can you effectively do it while they're build in-process?

René Kofod-Olsen: Well, I mean, they are sitting in our books. We are the owner of the ship and we have a back-to-back agreement with our client, but so, we will have to take an approval for doing that. But we don't have to do that. We feel that we have ample of security in the system as it stands. But of course, it's a future upside for us to have that amount of ships built to the standard they have been built, as unencumbered assets, and I don't think that we need, necessarily, to give that as a security. It's there in our balance sheet.

So, in terms of the bond, we are, as you would expect, monitoring the market. It was very important for us to get the covenant reset with our financial partners; that has been concluded. And we will find the right time for us to refinance the bond. We, as a company, has never ever brought anything up to the wire. So, we are a conservative-run enterprise and therefore, you should expect us to come out and refinance the bond in a timely fashion.

John Davidovich: Okay, great. Thank you.

René Kofod-Olsen: Yeah.

Operator: Thank you. We will take our next question today from Ithmar Capital Partners, Amer Jeambey. Please go ahead.

Amer Jeambey: Yes, hello. Hi, René. Thanks for taking time for the call. I have – and hi, Jay, as well. Quick question: with the low utilisation today, are you guys worried about further write-downs moving forward? Or do you believe you'll be able to – or impairments – or do you believe you'll be able

to convince the auditors that some of these ships that are laid off now will go back to work?

The second question is, did you mention in Kazakhstan – you mentioned 13 and then Jay clarified and mentioned eight. Are we talking about eight vessels that were out of contract now or 13? If you can add some clarity to this point, please? And thank you.

Jay Daga: Alright, thank you very much. With respect to impairment, it is not a speculation. So, no, I can't give you any guidance that whether we have to take impairment or not. And it's not about whether we can deal with auditors and whether we can convince them. It's about - there is a process, we run through the process and outcome of that process is being checked by auditors and all our internal stakeholders. And we take a very, very pragmatic call. So, to be frank, you know, unless you go through the whole process, unless you see what is the market of for these assets at the time of impairment testing, I can't give you any guidance whatsoever.

And with respect to the second point, we had 13 barges on a long contract with Agip. Out of these 13 barges, eight had been redelivered over the last 12 months and five continue to work. And these barges are, again, they are special purpose barges for North Caspian and they will go back to work when Kashagan 2 comes in. So, effectively, out of 13 barges, only eight have been redelivered and five continue to operate under the contract.

Amer Jeambey: Okay. René mentioned, like we need to see – in our view, the oil majors or the oil companies will be spending moving forward. This is a positive outcome for the company. My question is, you obviously spend a lot of time with the oil majors or the oil companies. What is your view on that? Do you see them picking up spending some time soon? I understand that René managed the downside and is like they can't spend less from here on. There's only so much cost they can cut. But in terms

of pickup, general macro, are you seeing them increasing their spending? What are your discussions with your clients indicating?

René Kofod-Olsen: No, so, I think the guidance I have given is a good question, and of course I'm not an oracle on oil and gas. But in terms of just the simple view, is that for three years there has been a significant underinvestment in oil and gas markets globally. And if you believe that fossil fuels are also a thing of the future, or at least the near-term future, then in any industry, unless there is a huge disruptive commodity, which is not the case here, then you will pay the price for that underinvestment. And if you look at sort of the global GDP, it is still relatively positive. And for GDP growth in the world, you need oil and gas. Then you look at non-OECD countries where the growth is disproportional to OECD countries, and there they need an even higher amount of fossil fuels.

So, if you believe in a world economy that is fueled for now by oil and gas, then the underinvestment of the last three years will have to be paid for in the future. So, bottom line, we are seeing an increased appetite, which is why I'm saying that the commercial funnel is actually increasing. On top of that, not only has there been underinvestment in development of new oil fields, there has also been underinvestment in maintenance of current oil fields that we see because we are bidding for a lot of maintenance contracts that are simply not awarded. It's not because we're losing them, they're just not awarded. And therefore, we do expect that to pick up as well.

So, we definitely see green shoots coming in the second half of 2017 and I actually feel that 2018 could be quite a transformational year. For us specifically, it will be, because Tengiz will kick in in full flow. But for the industry in general, I am personally quite positive on oil and gas right now.

Amer Jeambey: Thank you, René. This was more of a top view and I appreciate that. I was hoping to be able to, from a bottom-up perspective, have some concrete evidence on your positive – on your optimism if whether –

because at the end of the day, your sales come from the budget of these oil majors. And your sales people are out there and they're understanding where are these budgets headed.

René Kofod-Olsen: I understand. And see, for us to get topline incrementals, we need to get utilisation up first. And so, you will start seeing utilisation coming up and then revenue will slowly tick up from there. So, that's sort of the fundamentals of it. But I think, if you look at the first quarter, we saw this from basically all oil majors, you will see that the fundamentals are there. They were all very, very profitable. And for them, this is, of course, a capital gain. They need to ensure that they can underwrite the dividends that they are expected to pay to their shareholders, while at the same time investing for the future.

I do not believe that they can sustain those dividends in two or three years from now if they don't start investing. It's pure mathematics. So, therefore, I think you have enough empirical evidence out there to start seeing a turnaround. That's basically what I base it on.

Amer Jeambey: Thank you, René. Thank you so much. Thanks, Jay.

Jay Daga: Thanks.

Operator: Thank you. We will now take a follow-up question from Kia Williams of Emirates NBD. Please go ahead.

Kia Williams: Hi, thank you. Sorry, just a couple of follow up questions. I know that you used to make available the number of ships in each region. And I was just wondering if you had those figures for us or if there's somewhere that I get those figures from? I just don't see them in the presentation.

René Kofod-Olsen: Sure, Kia. We have tried to convince that it's best possible to be focused on the conversation. And you just call Morten, my colleague who has taken over from Robert on the investor relations desk. He's the oracle

of those answers. So, you just get to call him, Kia, and you will get all those numbers.

Kia Williams: Okay, great. I'll do that. And then, sorry, just one follow up question on the utilisation rates. So, I understand that these ships will not be working until 2018 in Kazakhstan. But just on the 36% utilisation rate we've seen there, it's obviously dropped. And is that a level that we would expect to see for the rest of the year? Or could we see more softness on that number?

René Kofod-Olsen: Yeah, in Kazakhstan, you should expect to see that number. But some of them may go back for spot. But as Jay was mentioning just before, Kia, it's really immaterial in terms of topline because they are very small and not largely revenue generating assets. In Azerbaijan, if you were alluding to that as well, I expect to see a 90% plus as the going utilisation.

Kia Williams: Okay, thank you.

René Kofod-Olsen: Welcome.

Operator: Thank you. Ladies and gentlemen, as a reminder, please press star one to ask a question. Thank you. We have no further questions at this time. I would like to turn the call back over to you for any additional or closing remarks.

René Kofod-Olsen: Thank you very much, everybody, for calling and, again, thank you for your wise questions. It's always nice to engage with you and we look forward to the second quarter engagement. In the meantime, should you have any other follow-up questions, we are always available for a call. Thank you.

Operator: Thank you. Ladies and gentlemen, that will conclude today's conference call. Thank you for your participation. You may now disconnect.