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OKEA

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QUARTR

MODULAR FINANCE

Speakers

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Diogo
Analyst

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Operator

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Company Representative

Prepared Remarks

Erik Haugane
CEO | OKEA

Welcome to this second quarter presentation from OKEA. This has been the most peculiar quarter we have ever experienced. All the corona measurements that have been taken by various governments have impacted billions of people and billions of companies, including, of course, OKEA. The market of energy fell significantly. The market for petroleum fell by 25%. The oil prices fell accordingly, and we have to do drastic measurements in our own expenditures. We reduced number of people on board Draugen. We reduced or have delayed several exploration activities, lay off a lot of consultants, et cetera. We have managed through this quarter in a good manner. Not only OKEA was impacted, the whole Norwegian offshore industry was impacted, and that led to a lot of activities from the government.

Erik Haugane
CEO | OKEA

The first one was introduced by Government by reducing the production permits, in order to support the cut in production to at least cover some of the losses that oil had in the market. That meant that we had to reduce our production in June. We managed that by pulling forward a already planned maintenance stop that was planned for September, move it into June, and hence, rather than stopping production and do nothing, we did stop the production on the 23rd of June. Just went short of the production permit we had. We are now not in production in Draugen and we'll do all the maintenance work, and we start production again on the 27th of July. A second very important measure that was taken by Government and the Parliament, was a change in the tax regime in Norway.

Erik Haugane
CEO | OKEA

A temporary change that made it more favorable to do investments now the coming two years rather than stopping too much activity. This has a huge impact for the service industry, but it also has a fantastic impact for OKEA. That means that projects like Hasselmus, which is a 2.2 billion cubic meter gas discovery just north of Draugen, which we put on hold in March, has now been taken up again and we intend to pursue that project in order to take advantage of the revised tax regime and have that in production within three or four years. OKEA engaged a lot with the authorities regarding these tax changes because the larger oil companies had a bit different agenda than the smaller oil companies, in the sense that the revenue cash flow for the bigger companies was no problem, but that could become a problem for the smaller companies.

Erik Haugane
CEO | OKEA

That meant that we, despite the favorable depreciation system that was introduced in Norway, could not take advantage of that unless we were allowed to have negative tax terms as we proposed. We are most pleased that the parliament actually improved the government's proposal and put together a tax system that now has enabled us to engage not only in Hasselmus, but we are now looking at two other projects that we put aside in March. We are also now voting in favor of several of the exploration activities that were postponed just a couple of months ago. We will have drilling activities already later this year and also in exploration in March next year. Another issue that OKEA came about because of the corona incidents, the falling oil price, was that we were likely to come in technical breach with some of the bond terms.

Erik Haugane
CEO | OKEA

We had to negotiate with some of the key bond holders, and the bond holder have now approved for a new regime that is more appropriate for OKEA going forward. I leave the microphone to Birte Norheim, our CFO, who will give you the hard figures of second quarter. Please, Birte.

Birte Norheim
CFO | OKEA

Thank you, Erik. As Erik said, this has been a peculiar quarter, and our financial statements are impacted by the financial turmoils, as we will see, both on very low revenues and also on some one-off and non-cash items. Let's start with the revenues. Despite the very high production regularity during the quarter, produced volumes were 20% lower than last year due to planned shutdown, both at Gjøa and at Draugen. We had 16 days of shutdown at Gjøa in relation to tie-in projects, and seven days at Draugen due to the planned maintenance turnaround, which started on the 23rd of June. For Gjøa, we will be compensated for the deferred production when Nova comes on stream in 2021.

Birte Norheim
CFO | OKEA

Sold volumes were 44% lower compared to last year, mainly due to only one lifting from Draugen in the quarter compared to two, also with somewhat higher volumes last year, as well as lower volumes from Gjøa due to general field decline. Due to the turnaround at Draugen, which will be ongoing for most of July, the next lifting for OKEA from Draugen will be in August. I assume it comes as no surprise that the realized prices are significantly down compared to last year. The realized price for liquids were 59% lower than last year, a reduction from $61 a barrel last year to $25 a barrel this year. The realized price for natural gas were 69% lower than last year and at a historical low.

Birte Norheim
CFO | OKEA

The result of the lower volume sold and the lower prices of petroleum products was a reduction in revenue of 75% compared to last year, ending at NOK 259 million. To avoid confusion, I want to add that we normally use put options to protect against sharp drops in the oil price, and I want to highlight that the effect of hedging is not accounted for in the petroleum revenues, but is classified as other operating income and is also subject to the ordinary corporate tax of 22% and not added the special tax of 56%. In the second quarter, we realized a gain on put options of NOK 28 million, which had a positive cash flow impact in the quarter. However, the effect on the income statement is different due to financial instruments like put options are recorded at mark to market.

Birte Norheim
CFO | OKEA

You may recall that we recognized a gain of NOK 31 million in the first quarter, and we actually had a small loss impacting the P&L in the second quarter of NOK 3 million, as the oil price strengthened from the end of March until we realized the gain in May. Let's move on to the income statement. Starting with the operating income, NOK 275 million, which consists of the petroleum revenues of NOK 259 million, as just outlined, tariff revenue from Gjøa, and also the loss on the put option of NOK 3 million. Production expense amounted to NOK 186 million, or NOK 118 per barrel produced compared to NOK 102 last year. The main driver of the increase per barrel is due to the lower volumes. Impairments amounted to NOK 298 million, which is driven by currency effects, delay in Yme startup, and reduced reserve estimates from the P1 well at Gjøa.

Birte Norheim
CFO | OKEA

We will come back to this a bit more in detail on the next slide. Exploration and operating expense consists of NOK 10 million in exploration expense, mainly relating to field evaluation activities on Hasselmus and general SG&A cost of NOK 23 million. The net financial items represents a gain of NOK 92 million, which mainly relates to unrealized foreign exchange gain on the dollar-denominated bonds due to the NOK strengthening against the U.S. dollar during the quarter. This gain is partly offset by unrealized foreign exchange losses on bank accounts, interest expense, and cost related to the bond amendment process. Taxes had a positive contribution of NOK 205 million, which results in an effective tax rate of 110%.

Birte Norheim
CFO | OKEA

In relation to the second quarter, we observed some impairment indicators, including the strengthening of NOK against the USD in the quarter, which accounts for the largest portion of the impairments, but also that production start at Yme was delayed, which also drives the CapEx. The reserve estimates at the Gjøa P1 project were reduced. We recognize an impairment of NOK 298 million divided between three assets. Technical goodwill relating to Gjøa and Draugen of NOK 54 million, and oil and gas properties relating to Yme of NOK 54 million, plus a deferred tax effect of NOK 190 million. Of the total NOK 298, the post-tax impact amounted to NOK 109 million. Cash at the start of the quarter was just shy of NOK 1.3 billion, and cash at the end of the quarter was in excess of NOK 900 million.

Birte Norheim
CFO | OKEA

The cash from operating activities of NOK 96 million, it is low during the quarter due to the lower prices and the lower volume sold. The taxes paid of NOK 99 million relates to the final installment of tax payable for 2019. Cash to investment activities mainly relates to Yme and also the P1 project at Gjøa. Interest paid during the quarter amounted to NOK 83 million, of which OKEA02 amounted to NOK 33 million and OKEA03 amounted to NOK 50 million. We're very pleased about the government's ability to react swiftly to a challenging situation for the E&P industry as well as the service industry. For OKEA, the temporary tax amendment is a game changer for 2020 and represents a trigger for us to reassess the profitable projects that were put on hold earlier this year.

Birte Norheim
CFO | OKEA

To summarize the key changes, we are allowed to directly expense CapEx with effect for the 56% special tax basis, including an uplift of 24%. This has effect for investments made in 2020 and 2021, and also until planned production start for projects where a development plan has been filed by the end of 2022 and approved prior to the end of 2023. In addition, we are refunded the tax value of losses for the income years 2020 and 2021, rather than having to defer the losses. Importantly, the refunds will be settled through negative installments, which significantly improves the liquidity position of OKEA, as we are not in a tax-paying position for 2020. The cash effect for the tax year 2020 depends on several assumptions, and we see that our latest projections are somewhat higher than the $60 million initially indicated. Finally, about the bond amendments.

Birte Norheim
CFO | OKEA

We're also very pleased to have been able to successfully conclude the bond amendment process during the quarter. Even if we're not in breach of the original covenants at the end of second quarter, there is an overhang effect of the 12-month rolling EBITDA variable in the leverage ratio calculation that required a waiver of the terms from third quarter. This has been a key issue for us to solve, and we're very pleased about the strong support for our proposal in the bondholder meetings on 29th of June. Nearly 76% in OKEA 02 and 84% in OKEA 03 of the represented bondholders voted in favor of the proposal. The revised terms is better aligned with the current outlook and also improves the hedging flexibility.

Birte Norheim
CFO | OKEA

In return, the bondholders were granted a put option of up to 15% of the outstanding bond at par in June next year, an increased redemption price, call premiums of 100 basis points. Securing the existing debt position with improved flexibility, along with the temporary tax amendments as implemented by the Norwegian government, puts OKEA in a very good position to now continue to focusing on creating value to all our stakeholders. With that said, I'll leave the word back to you, Erik. Thank you.

Erik Haugane
CEO | OKEA

Thank you, Birte. That was the financial results of the company. I'm pleased to announce that we have had very good HSE results, both with respect to incidents and no harm to people, but also in terms of emissions and unexpected discharges. We have also have very good production records on Yme and Draugen. Draugen has experienced one of the highest regularities since many years with an average of 98% availability on the Draugen facility during the second quarter, and particularly in May with 99% uptime is extraordinarily good, but also a fantastic target. We know what now is possible. We shall continue to run Draugen for many years. In order to do that, we have to do it more efficient than today.

Erik Haugane
CEO | OKEA

We have embarked on a project where we intend to reduce the operation costs on Draugen by 15% to be implemented during next year. That will enable us to keep the lifting cost on Draugen at a level that make Draugen a profitable project well into the 2030s, and hopefully no abandonment before in the 2040s. With respect to abandonment, we have discovered in the discussions with the investors and the bondholders that not everyone remember the deal we have with Shell, that Shell will actually cover the abandonment from both Draugen and Yme, and that both the budgets for abandonment is going down and abandonment timing is delayed to the benefit of both OKEA and Shell. On Draugen, which is a mature field, there is always a lot of maintenance work.

Erik Haugane
CEO | OKEA

There's a lot of work with the wells. We have had problems for some time with a well we call D2. We did intervention work there during Q2 that failed. We have to return to that well during next year with a more serious repair. Operating a mature field like Draugen has its challenges. We have some problems with or challenges with purifying the produced water, where the core problem generates from the time when, because seawater was injected into the reservoir, a lot of hydrogen sulfide has been created, which again creates chemicals that impact the quality of the produced water, which again demands a lot of chemicals in the purification process on board Draugen.

Erik Haugane
CEO | OKEA

There our staff, together with Schlumberger, has been extremely innovative and tested various way to reduce the origin of the problem down in the reservoir in a way that actually has led to a much cleaner produced water and has not only achieved better results in terms of purification but also reduced the cost of doing this significantly. You can read more about this project on OKEA's webpage. This is absolutely something that also could be used by other fields which has the similar problem. Yme project is, however, seriously delayed. There is work continues to be done on the yard in Egersund, and it is still within reach and the plan to finish the production unit there and Maersk Inspirer is planned to leave the yard later this year to go offshore, sorry. We don't expect production before first half next year.

Erik Haugane
CEO | OKEA

Neptune Energy operator is now going to drill two producers in that segment, and we expect additional production from Yme, the P1 segment, during Q4 this year. Going forward, we did experience a lot of unexpected things in Q2, as mentioned, did millions of other companies. Q2 did not happen the way we thought it's going to happen, but we managed. We managed to cut costs, we managed to defer investment, we managed to assist getting new terms. We managed to settle with the breach. We eventually will go into with the bondholders with new bond terms. Our staff has been extremely adaptive to new circumstances.

Erik Haugane
CEO | OKEA

The board has been active to facilitate those circumstances we came into. The fact that we have come out of this in the way we did strengthen the company going forward. We see that several projects now are having a good runway because of the new tax returns that we have achieved in Norway. We expect to be extremely busy throughout the end of the year. We will also the next quarter prepare the applications for new licenses, and we hope to land other business arrangements as we go forward. That means that despite the kind of backlash we got in Q2, we maintain our production forecast to 14,000-15,000 barrels a day, despite the continuous delay of the Yme project. We expect to invest almost NOK 1 billion in 2020.

Erik Haugane
CEO | OKEA

OKEA is actually the fifth largest offshore operator in Norway, and we intend to capitalize on that experience by taking on new activities as we move forward. We will work a lot around the Draugen area to make sure that we have more resources into Draugen going forward in order to keep the lifting cost per barrel down. To everyone that follows OKEA, we thank you for listening to this presentation, and we look forward to contribute to value creation in Norway and value creation to our shareholders going forward. Thank you very much.

Company Representative

Okay. That concludes the presentation. Operator, we can now move over to the questions.

Q&A

Operator

If you have a question for the speakers, please press *5 on your telephone keypad now. That's *5 to ask a question. We will have a brief pause while questions are being registered. The first question is from the line of Teodor Nilsen. Your line will now be unmuted.

Teodor Nilsen
Analyst | SpareBank 1 Markets

Good morning, and thanks for taking my questions. Birte mentioned that you now expect the cash paid back for tax losses above the NOK 60 million that you previously guided on. Could you give some more details on that, how much you actually expect now, and what's the reason for the deviation? Second question is for 2021, given current project portfolio that you have, how much do you expect to invest compared to 2020? Thank you.

Birte Norheim
CFO | OKEA

Hi, this is Birte here. Yes, you are correct that we do expect more than the NOK 60 million initially indicated. Obviously the tax refund depends on several assumptions, including the timing of listings, the foreign exchange rates on December 31st, realized prices and so on. At this stage, we will not provide any exact number. I think the key point that we are making is that the impact on our liquidity is significant. May I ask you to repeat the second part of your question?

Teodor Nilsen
Analyst | SpareBank 1 Markets

The second question was actually regarding CapEx for 2021. How much do you expect to invest next year compared to this year, given the current project portfolio?

Birte Norheim
CFO | OKEA

Yeah. We are not providing any guidance on 2021, and we are now in the process of reassessing our project strategy following these quite significant changes that have happened now in June. We will revert with the forecast and guiding on 2021 CapEx down the road.

Teodor Nilsen
Analyst | SpareBank 1 Markets

Okay. Thank you.

Operator

As a reminder, if you wish to ask a question, please press *5. Our next question is from the line of Mr. Diogo. Please go ahead. Your line will now be unmuted.

Diogo
Analyst

Hi. Thanks for taking my questions. I have four of them. The first of them is, you mentioned that both the last appraisal well, you got worse results than expected from Gjøa P1. Can I just ask, how is that going to impact the future production profile of that expansion? That's the first question. The second and third, which are relatively quick and related, are you expecting to make any more tax payments in 2020? I saw you had a very big working capital reversal in Q2. Sorry, working capital outflow in Q2. Are you expecting it to reverse in the second half of the year? My last question is with regards to Hasselmus, which my understanding was that project had been pushed more towards 2023, 2024. From your presentation, I kind of seem to read that you're thinking of bringing it forward again.

Diogo
Analyst

Is that the case?

Birte Norheim
CFO | OKEA

Maybe I can-

Erik Haugane
CEO | OKEA

Perhaps I can take the technical things before I can start, and then you can take over.

Birte Norheim
CFO | OKEA

Okay.

Erik Haugane
CEO | OKEA

The Gjøa P1, the reserves is about half of what was the estimate before the project, which also led to the impairment that we did this quarter. With respect to production, the development of that segment has been reduced. The scope has been reduced from three wells to two wells. The initial production is pretty close to what was the original plans. It is more the longer-term production from that segment that is impacted. We expect the production to come on stream in, as we said, in the fourth quarter. We see the 2021 production from P1 to be pretty close to the original plans.

Erik Haugane
CEO | OKEA

With respect to Hasselmus, we came a long way before we put the project in the fridge in March because of the circumstances that appeared at the time. The plan there is to submit the PDO in due time of the time limit for the new tax regime in 2022. Hence, we may be one year delayed, but it will depend on summer season for installment and we think we can make that in 2023. That's the plan as for now, but the final decisions on that is not made in the partnership yet, so we'll revert to that towards the end of the year. We have re-engaged some of the service companies related to the project, and it's full speed on the planning of that project at least from after the summer holiday. Birte, you take the next few perhaps.

Birte Norheim
CFO | OKEA

Yes. I think for the tax payment, we don't have any tax payments for 2020, but rather we get refunds as underlined by the new temporary tax regulation. We have the final settlement of the 2019 payable in the fourth quarter. As for the working capital, yes, it is somewhat higher than usual in the second quarter, and that is partly related to the fact that we have not offloaded the inventory at Draugen. During the turnaround, there is quite a significant volume in inventory at Draugen. Working capital could depend on the timing of the lifting as well.

Diogo
Analyst

Got it. If I may just ask a follow-up. I understand that the working capital has to do with the timings of the lifts and, in this case, with the offloading after the turnaround. In Q1, my understanding is that part of the negative working capital was a permanent move related with the purchase of the fields. I guess my question more is independent of timing, should we expect that the full working capital of Q2 will be reversed over the next one, two quarters, whatever it is, but should we all expect it to all come back or is there any element of it which is permanent?

Birte Norheim
CFO | OKEA

Well, we do have spare parts and such in inventory that moves slower than trade payables and receivables and so on. The most significant numbers in the working capital will move in line with the liftings and the ordinary payment cycle from vendors and from customers.

Diogo
Analyst

Got it. Most of it will be something that's reversible over, I don't know, one or two quarters, right?

Birte Norheim
CFO | OKEA

Yes, that's right. You are correct in referring to Q1 where we had the settlement of a pro et contra in relation to the Shell transaction.

Diogo
Analyst

Okay. Thank you.

Operator

As there are no further questions from the conference call at this time, I will hand the word back to the speakers.

Company Representative

Yes, thank you. We have one question on the webcast. It's from Magnus Søreide at Fearnleys. Can you elaborate on the two other projects you mentioned in addition to Hasselmus that might be reassessed following the tax changes?

Birte Norheim
CFO | OKEA

Sorry, do you want? Yep.

Erik Haugane
CEO | OKEA

Well, there are several of the exploration projects that is now progressing faster than we said in March both with respect to wells this year and already in the first quarter next year. That goes for one thing. Of course, in addition to Hasselmus, we are also involved together with Equinor in another gas discovery just north of Hasselmus which is also now being assessed whether it should be developed together with Hasselmus or not. Further this regime also incentivize us to look more aggressively on the Grevling development even though that is a more significantly more marginal development than Hasselmus. We will revert to that later this year when we have reviewed the plan and got them approved in the various licenses. The oversight of that will be easier to convey towards the end of the year.

Company Representative

Okay. Thank you, Erik. There's no further question on the webcast, so I think that concludes the Q&A session, and thank you for listening.