Dana Gas Q1 2017 Investor Call transcript
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Presentation

Operator
Hello, good morning, good afternoon, and good evening everybody. This is Ankit Gupta, and on behalf of Shuhaa Capital, I am pleased to welcome you to the Dana Gas First Quarter 2017 Results conference call. Sitting down the table we have CEO Dr Patrick Allman-Ward, CFO Chris Hearne, Technical Director GM UAE and President Egypt Iman Hill, and Head of Investor Relations Mohammed Mubaideen. So with no further delay, I will now pass onto Mohammed Mubaideen to outline the presentation.

Mohammed Mubaideen
Many thanks, Ankit. Welcome to the call everyone. We note that this presentation contains forward-looking statements. As such, we encourage you to have a look at the disclaimer on page two. I will now hand over the call to Dana Gas CEO, Dr Patrick Allman-Ward, to start the presentation, which will be concluded with a Q&A session.

Dr Patrick Allman-Ward
Thank you, Ankit and Mohammed, for the introduction. I welcome you all to our first quarter earnings call. Without further ado, let's turn to slide five. I will take you through a short summary of our achievements before I pass you over to Chris for a more in depth analysis on the financials.

Let me begin by taking you through our operations. Group output was up 16% year-on-year, close to our aspirational target of 70,000 barrels of oil equivalent per day. Our Egypt production was over 40,000 barrels of oil equivalent per day, a 24% increase on first quarter 2017. Kurdistan was marginally up to 26,500 barrels of oil equivalent per day. However, in the UAE, production dipped below 2,000 barrels of oil equivalent per day, carrying on the trend from last year. Despite this, it has been an excellent operational performance from the company overall. It is noteworthy that this operational performance comes after we achieved significant cost reductions in 2016 to our G&A by 43% and OpEx by 7%. This year, we have had to dial back further on capital and operational expenditure in Egypt. The former is down 78% and the latter down 23%. We are focused solely on completing those projects that were already in progress sand those related to maintaining plant asset integrity and safe operations. Although it took place after the end of the first quarter, I am also very pleased to report that we successfully concluded our first international condensate sale on the April 15th. This cargo of 150,000 barrels of Wastani condensate is a direct result of the gas production enhancement agreement we put in place with the relevant Egyptian Government agencies in August 2014. It has brought us $7.2 million in hard currency and we expect to be able to deliver another three cargoes in the next 12 months. Despite a delay in the execution of this programme, we are pleased it has finally borne fruit. It shows willingness from all the parties to make the GPEA agreement work and provide a mechanism by which Dana Gas will be able to collect on its overdue receivables.

Let me now move onto the financial highlights. We reported gross revenue of $118 million and a net profit of $11 million as compared with $82 million and $6 million in the first quarter of 2016. Our gross profit is 35% higher this quarter over quarter one 2016. This is a good set of results, not only reflecting increased production and improved realised prices, but also the continued success of our cost reductions with respect to G&A and operational expenditure. In Kurdistan, at the request of the KRG, we have switched our condensate sales agreements. We are now selling direct to the Government, exporting the condensate through the Jambour pipeline where it is spiked into the oil export stream to Ceyhan. As a result, the prices we are able to get are at a premium to sales on the local market. We continue to focus on managing our costs. As previously reported, we made a lot of progress in 2016. Whereas there is a limit to how much more cost we can remove without it directly affecting the company's operations, we continue to work hard to keep them in line with the current status quo, which given the increase in production, is an achievement in itself. Nevertheless, we have already been seeing positive results, and in this quarter, our operational expenditure was down a further 23% as compared to quarter one 2016.

Looking at liquidity, I will start by stating that our cash in hand by the end of the quarter was $298 million. We continue to face difficulties in making collections in Egypt, where collections were just 42% of invoices in quarter one, lower even than the level of collections of 64% in 2016, which was itself the worst year since 2011. We are obviously talking to the Government on a regular basis, but so far have no clarity on when industry payments will be made. In Kurdistan, by contrast, collections are running at over 100%, as a result of the consortium continuing to collect pro rata payments for the $100 million peremptory order. However, by end of the quarter, the total receivables owed to the company by the Egyptian and Kurdish regional governments together exceed $1 billion.

Let me now say a few words on the arbitration cases. We continue to wait for the final judgement regarding the NIOC damage claims. Due to a long post-hearing submissions timetable, the final damages award was delayed and is now expected towards the end of 2017 or early next year. Regarding the KRG, we are obviously extremely pleased with the outcome of the London Court of International Arbitration's third Partial Final Award, issued on 30th January, which found in our favour on the most important issues under dispute. We did not win on all points but overall it was an excellent outcome. The final damages claim will be heard in September. Whilst many people have understandably questioned the nature of our relationship with host governments as a result of these arbitration cases, I am pleased to report that in the case of the KRG the Consortium has now been requested to move forwards on its appraisal and development plans. With respect to NIOC our understanding is that negotiations are taking place with a view to them starting the supply of gas for the UAE gas project.

Of course, the elephant in the room is that we have $700 million of outstanding Sukuk that falls due for repayment at the end of October of this year. We have formally requested our bondholders to enter talks and we hope this will lead to a positive outcome for all stakeholders.

Despite the successes that Dana Gas has had operationally, in affirming its contractual rights with the KRG and NIOC, in establishing the Company's unchallenged rights to payment of $713 million by the KRG and the anticipated payment of billions of dollars of damages claims, the Company needs time to realize its full value for the benefit of all of its stakeholders. Time will allow the Company to collect on circa $1 billion due to it from the KRG and Egypt and to realize value from the damages claims. These factors provide a real opportunity for value creation and represent upside for all the Company's stakeholders. In the meantime, as a result of the continued uncertainty with respect to collections, we need to conserve our cash reserves in both the short and medium terms in the interests of all of the Company's stakeholders.

I will pass on to Chris now to take you through the financial results in more detail.

Christopher Hearne
Thank you, Patrick, and welcome everyone. Let's start on slide seven. I am pleased to report that we started this year positively. During the quarter, gross revenue came in at $118 million, a 44% increase. This increase is the result of a considerably higher production in Egypt, coupled with higher realised hydrocarbon prices. In addition, our cost-cutting programme and reduction in expenditure had a significant impact on our gross profit. The gross profit of $38 million was one-third higher than the $22 million we reported in Q1 2016. Gross margins improved from 27% to 32% in Q1 2017. Net profit also increased significantly. For the period, net profit was $11 million, 83% than the higher corresponding figure last year.

Turning to slide eight, the first graph gives the company's production numbers for this quarter as compared with the equivalent number in 2016, and also the previous quarter. These charts illustrate the company's strong operational performance. Group production is up to just short of 70,000 boepd and in Egypt is up over 40,000. Kurdistan is fractionally up to 26,500. Only the UAE continues to lag behind and this is due to the various operational issues, which are currently being addressed. We anticipate keeping output at this level for the remainder of the year, even as we reduced capital and operational expenditure considerably.

The next chart gives the average realised price in the quarter, and you will notice that for the first time in four years, there is an increase with an average realisation of $42 per barrel. This realised price is lower than the global average, but this needs to be put in context. In Egypt, our condensate is sold at a slight discount to international prices, and in Kurdistan, a local market demand discount greater than the global average from us and others, as those traders are factoring in a higher cost of transport, security, and other related expenses. This will improve now, slightly, given that we are selling our product to the Government through the Jambour pipeline as Patrick mentioned earlier.

Now, onto slide nine. Here, we present the company's operational and capital expenditures. We have continued with our cost optimisation drive and during the quarter, we have manged to further reduce our operating cost by 23% to $10 million. This is due to further rationalisation of costs in Egypt and reflects the benefits realised following the steep devaluation of the Egyptian pound. We continue to balance our expenditures with our collections in Egypt. Accordingly, all non-critical CapEx has been cut and CapEx has been reduced to $7 million during the quarter, considerably lower than the $32 million spent in Q1 2016. This reduction is partly due to the completion of the Zora development in Q1 2016. In the UAE and KRI, our CapEx is minimal.

Moving onto slide 10, which covers the company's liquidity position. Gross debt is down to $786 million, and has declined further subsequent to the period end, as we repaid the outstanding $60 million of our Zora loan. The loan repayment averted a breach of covenant and also will avoid the negative carry in the future. Our cash position at the period end stood at $298 million. Cash preservation is critical to the company and we continue to focus on this and managing our cost. As mentioned previously by Patrick, we recently initiated discussions with the company's bondholders to restructure the outstanding Sukuk. We will make a further public announcement on this in due course. The right hand chart highlights our free cash flow. Due to improved collections in Kurdistan and lower CapEx, we are reporting positive cash flow of $26 million in this quarter.

This leads me perfectly to slide 11. Egypt's trade receivable balance has increased to $283 million from 265 million in the previous quarter. Collections worsened, representing only 42% of billing. On a positive note, the collection rate in Kurdistan has increased to 119%, thereby reducing receivables to $712 million. This improvement was principally due to direct sale of liquid products in regulator payments by the KRG against the peremptory of $100 million. Overall, total group receivables are now nearly $1 billion.

On this note, I will hand over to Iman who will provide an operational overview.

Iman Hill
Thank you, Chris. Let me start with Egypt on page 13. On my last conference call, I said our fourth quarter exit production was 40,000 barrels of oil equivalent per day. This figure has remained steady throughout the first quarter of 2017. Our El Wastani onshore gas processing plant remains at maximum capacity. Even with a reduced 2017 work programme, we will continue to complete critical projects like the Faraskur compression project and expect that the current production level will at least be maintained for the rest of this year. Since the end of 2016, all wells of our prolific Balsam field have been tied in and are currently on production. This has enabled us to increase condensate production to 6,500 barrels a day, which is currently the maximum that the El Wastani plant can handle. The first cargo of approximately 150,000 barrels of condensate was loaded on the April 15th 2017. The buyer issued a letter of credit and payment amounting to $7.2 million will be made to Dana Gas directly in US dollars. The cargo is the first to be directly exported by Dana Gas under the GPEA signed with the Egyptian Government in August 2014. The cash proceeds generated from the Government's share of the incremental condensate sales will be used to start paying down the outstanding receivables owed to Dana Gas by the Egyptian Government.

Looking further ahead to Q2 2017, the processing plant will be shut down for several days to performing critical maintenance and repair work and modify the facilities with the aim to improve plant performance and reliability. The required time is estimated at six days for a complete shutdown, while an additional four days of partial shutdown is also needed. This only impacts LPG production.

Slide 14 is indicative of our current exploration activities. Work is progressing on our offshore Block 6 to prepare for drilling an exploration well in early 2018. The Mocha-1 Oligocene exploration well in Block 3 operated by BP found uncommercial amounts of gas.

Whilst this is disappointing, it has opened up the play proving the presence in a working petroleum system. More technical analysis is being carried out before a decision is made on next steps.

Turning to slide 15, Kurdistan has remained steady operationally. Our average annual production was 26,500 boepd during the first quarter. The two big pieces of news is that we have started to sell directly through the Jambour pipeline to the Government, and separately, the Government has requested a field appraisal and development plan for our Khor Mor and Chemchemal fields.

Wrapping up with Zora on slide 16, disappointingly output has slipped further down to under 2,000 boepd. Further studies are ongoing to review a possible well intervention programme and to determine what commercially viable additional work may be required to have an impact on the gas flow rates.

Thank you for your time and ow back to Patrick to say a few more words.

Dr Patrick Allman-Ward
Please turn to slide 17 where I provide you with a brief overview and summary of the Arbitration Cases.

- Both arbitrations have confirmed our contractual rights.
- With respect to the KRG arbitration, the Tribunal at the LCIA issued their third judgment on the 30 January 2017, in which they found in the Company's favour with respect to the most important of the issues under dispute, including dismissal of the KRG's counterclaims in their entirety.
- KRG were also ordered to pay $121 million in respect of condensate and LPG lifted between June 2015 and March 2016 but not paid for.
- Our interest entitlement on unpaid dues was set by the Tribunal at LIBOR +2% compounded on a monthly basis rather than 9% actual cost of capital incurred by Dana Gas as provided for under the terms of the HoA contract. The impact of this ruling was reflected in our FY 2016 financial results.

As regards the NIOC arbitration, we are yet to receive an update on the damages claim but the NIOC has already publicly expressed its willingness and ability to perform against the contract going forwards.

- Let me now summarise the discussion so far with reference to slide 19. Overall, the first quarter has been good. Our operations performance is strong and we have continued to find further cost efficiencies. However, our collections from Egypt remain weak.
- We remain excited about the potential for medium-term growth opportunities in Egypt and development of our world class assets in Kurdistan over the medium to long term.
- Together with the potential damages claims from the arbitration cases the total value of Dana Gas' assets has been assessed externally at over $ 29 billion.

- Our short term day-to-day priorities remain in maximising the operational efficiency of our business through increasing production and minimizing costs.
- In the light of the inconsistent collections that we have been able to make we continue to keep a careful eye on our capital expenditures and keep them in balance with our collections.
- We have initiated discussions with our Sukuk bondholders on restructuring the $700 million of outstanding Sukuk. But in light of unreliable collections and the time that it will take us to monetize the damages claims and realize the value of our growth potential, it is important for the Company to conserve cash for the benefit of all of its stakeholders.
