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CGG Q3 2023 Results

Monday, 6th November 2023

Introduction

Christophe Barnini

Head of IR, CGG

Welcome

Thank you. Good morning and good afternoon, ladies and gentlemen. Welcome to this presentation of the CGG's Third Quarter 2023 Results. The call today is hosted from Paris, where Mrs Sophie Zurquiyah, our Chief Executive Officer, and Mr Jerome Serve, our Group CFO, will provide an overview of the quarter results, as well as provide comments on our outlook.

Disclaimer

Just let me remind you that some of the information contains forward-looking statements, subject to risks and uncertainties that may change at any time, and therefore the actual results may differ materially from those that were expected. Following the overview of the quarter, we will be pleased to take your questions.

And now I will turn the call over to Sophie.

Q3 2023 and Operational Overview

Sophie Zurquiyah

CEO, CGG

Introduction

Thank you, Christophe, and good morning and good afternoon, ladies and gentlemen. Thank you for participating in the Q3 2023 conference call.

Q3 & 9M key segment financial highlights

Before reviewing the quarter and market perspective, I would like to start by highlighting the particularly strong ESG rating of CGG. After confirming our high MSCI and Sustainalytics rating, we received a silver sustainability rating from EcoVadis for their evaluation of our reduction of greenhouse gas emissions throughout the value chain. We prioritise ESG and are pleased to see this recognised in our performance.

Macro oil and gas trends over the quarter have been fairly stable, with increasing realisation that all sources of energy will be required to optimally manage across the energy transition for decades to come. Our clients are trying to find the right balance between meeting the increased requirements for future production and managing long-term risk.

To address this, we see progressively increasing interest in exploration, yet in lower time-to-market locations, as an example, in frontier areas that already have discoveries, or in basins where infrastructure is already in place. This not only lowers risk, but importantly, shortens cycle times.

Good data and high-end imaging are fundamental to reduce exploration risk and maximise oil production. We are in a favourable cycle for CGG, where quality and precisions increasingly matter and our clients, especially NOCs, turn to best-in-class organisations capable of delivering integrated geoscience. I expect a continued trend of sustained higher levels of E&P CAPEX, especially offshore and in the Middle East, both key markets for CGG.

Looking at our Q3, we had an excellent quarter, both in terms of operational and financial performance. Geoscience revenue was $78 million, up 13% year-on-year, driven by innovations in higher imaging. Earth Data sales were $107 million, up 74% year-on-year, with solid after-sales at $52 million, up 21%.

Prefunding revenue was $55 million, with a 111% prefunding rate. Sensing and monitoring sales were $122 million, up 42% year-on-year. Overall, our Q3 revenue reached $307 million, up 42% year-on-year. Segment EBITDA was $109 million, up 41%, including our payment this quarter of $20 million to Shearwater to compensate for the non-utilisation of their streamer vessels.

Q3 net cash flow was positive at $63 million, and we had $370 million of liquidity at the end of September, including $95 million of undrawn RCF.

Data, Digital and Energy Transition key financial indicators

DDE segment revenue was $185 million in Q3, up 41% year-on-year, with double-digit growth in Geoscience and strong Earth Data sales. Profitability was solid despite the $20 million impact of non-utilisation compensation fees to Shearwater for their streamer vessels.

Geoscience key business indicators

Geoscience external revenue was $78 million in Q3, up 13% year-on-year, with growth coming from all regions. The Geoscience business remained solid, supported by strong demand and by our technology differentiation, particularly valuable for OBN processing. Backlog is up 3% year-on-year, mainly due to delays in the award of large projects for NOCs. We continue to increase quality and extract more efficiencies as our work becomes more and more data-driven and less people-intensive.

Geoscience – Q3 operational highlights

In Geoscience, demand for our unique elastic full waveform inversion is very high, driven by North America and expanding worldwide. To support the ramp-up of our activities, we are recruiting top talent from the best [inaudible] globally and remain highly attractive because of CGG's culture, advanced technology and focus on innovation.

Our new highly specialised UK HPC Hub is coming online to support running the most compute-intensive algorithms as demand for our advanced technology is picking up in the eastern hemisphere. The picture on this slide is a very nice example of CGG’s imaging added value [inaudible] project. You can see the subsurface in the shallow waters of the Gulf of Mexico. Thanks to our unique high-frequency TLFWI velocity imaging technology, we can show the reservoir pressure differences across the fault and identify high-pressure areas which are not optimal for carbon storage.

The range of our offerings in carbon sequestration is expanding, with more projects targeting the monitoring phase, which is the most sensitive from a regulatory standpoint and offers longer-term business opportunities. Our scope of involvement in minerals and mining covers a broad spectrum from exploration, such as a recent contract for lithium mining in Mongolia, all the way to production, where we provide services to assess mine stability.

Overall, our quarterly revenue stream for these low-carbon services is showing a positive dynamic as more companies acknowledge the need for high-end geoscience, as an example, to explore for new mineral deposits buried in the subsurface that are needed for energy transition or to characterise reservoirs to CCUS and better understand their long-term behaviour.

Advanced imaging technology brings value to clients

The most recent implementation of our full waveform inversion algorithm brings a higher geological fidelity to subsurface images. And this, together with our machine learning and AI techniques, is enabling a much more rapid and accurate interpretation of the data. As such, we are becoming increasingly involved in supporting activities that were historically performed exclusively by our clients and are expanding the scope of our services.

Results are particularly striking with OBN data, and this is a key reason our clients are increasingly using OBN technologies together with the high-end imaging, even though it is multiple times more costly than streamer acquisition. Processing is more complex, and, with our differentiation, clients tend to use our unique and leading technology to extract the most value from the OBN acquisition investments.

The images you see on the slide are five years apart, and the 2023 image is based on the most advanced acquisition and imaging technologies. You can see that the details of the fault geometries are defined much more clearly, especially at the reservoir level.

CGG optimised HPC enabling advanced algorithms, including generative AI

In early October, we opened our new UK high-performance computing hub in southeast England. The initial capacity of the centre is 100 petaflops, bringing CGG's global total to just over 500 petaflops. The highly optimised environment, together with the hub’s use of 100% renewable energy, reflects CGG's commitment to sustainably meet the massive computing demand required by high-end scientific and AI applications. I expect the trend of increasing our computing capacity to continue in the future, possibly accelerate, as we not only support our traditional imaging business but also our new and growing businesses in digital and data transformation, as well as new verticals.

We announced this morning another new client, LightOn, a pioneering artificial intelligence AI company, to our emerging HPC business. Our highly optimised and sustainable AI and HPC solutions will help LightOn optimally evaluate and set large language models to support the industrial deployment of AI.

Ultimately, our outcome-driven specialised approach, combined with our proprietary technology, enables companies such as LightOn to accelerate and maximise the return on investment through evaluation, testing, scaling and commercial production. This unique HPC AI solution brings tremendous value to our internal and external clients.

Earth Data key business indicators

Q3 Earth Data revenue was $107 million, up 74% year-on-year. Prefunding revenue was solid at $52 million, bringing the prefunding rate for the first nine months to 93%, and I am confident that we will finish the year above 90%.

Earth Data cash CAPEX was $50 million this quarter, down 31% year-on-year, and after-sales were $55 million, up significantly year-on-year. Overall, we see a strong improvement in prefunding, and we have been more selective on projects this year to focus on shorter-term cash returns.

Earth Data – Q3 operational highlights

In Norway, we completed the Sleipner 1,200 square kilometre OBN acquisition, and the 2023 NVG East-West is now in the processing phase. We have several reprocessing projects ongoing across the globe to revitalise our library where clients are interested. This reflects the trend of renewed interest in more frontier areas where risk and time to market are lower. All these projects have industry prefunding. The APA bid round in Norway was closed on 23rd August, with 25 companies submitting bids. Results will be announced in Q1 2024.

In Brazil, the permanent offer bid run was launched in August, and we expect the bid run to be closed in December. Uncertainty remains around the timing of the Gulf of Mexico lease sales, which typically trigger after-sales. However, we expect clients might still decide to buy data as part of the year-end budget.

Earth Data – multi-client programmes

I would like to highlight two new projects that started in Q4. The Selat Melaka 2D multi-client seismic programme over the Langkasuka Basin offshore Malaysia: this project of 8,000 kilometres will take about 80 days to complete and is well prefunded. It is our first project in Malaysia, a country where we see increase in activity.

Second project: we kicked off a large-scale CCUS screening study in Southeast Asia, covering Indonesia, Malaysia, Thailand and Vietnam. Interest around carbon sequestration is growing in Asia, driven by both IOCs and NOCs.

Sensing & Monitoring (SMO) key financial indicators

Our Q3 Sensing & Monitoring segment revenue was high at $122 million, up 42% year-on-year. Land sales at $58 million were driven mainly by deliveries of high number of vibrators. Marine sales at $45 million more than doubled year-on-year, supported by the sales of OBN to the Middle East.

Sales from Beyond the Core were also up at $13 million, mainly from structural health monitoring projects. The profitability of SMO was exceptionally low this quarter, but we expect the profitability of the SMO business coming back to normal in Q4.

Sensing & Monitoring – Q3 operational highlights

Q3 was another quarter of very high delivery, both inland and marine, driven by stronger activity in North Africa and the Middle East. Given the success of our shallow OBN GPR300 that features the best sensor in the industry, we are launching the full range of products to address deeper-water markets.

We are also progressing our range of sources to offer broadband and solutions that lower any potential impact on the environment. Our MetaBlue product offers value-added solutions that complement our marine acquisition systems and make our clients more efficient, both in planning and acquiring their surveys.

In BTC, we are proud of our first commercial successes in Saudi Arabia for the identification and monitoring of sinkholes along railways. This is a multiyear contract which covers an initial phase of analysis and subsequent monitoring. We are also active in the space of wind turbine monitoring.

Let me now give the floor to Jerome for more financial details.

Financial Review

2023 Business Outlook & Financial objectives

Sophie Zurquiyah

CEO, CGG

Conclusion

Thank you, Jerome. This quarter confirms the positive market trends that we saw during the first six months of the year. A favourable cycle is clearly shaping up for our industry as clients continue to look for ways to optimise production from their producing fields and increasingly prioritise new reserves to meet demand. The cycle, together with our technology differentiation, has already driven the Geoscience business back to pre-COVID levels. In Earth Data, as our clients have started to increasingly prioritise the rebuilding of their portfolio of opportunities, the cycle is still emerging and has not fully materialised.

Looking forward, we do see growing interest in exploration, which is positive for Earth Data. SMO, together with Geoscience, will benefit from OBN becoming a reference technology for optimising the production of mature reservoirs as well as for lowering the risk of new field exploration opportunities. The land business in SMO will continue to be driven by the national oil companies, especially in the Middle East, who are taking a longer-term view on the cycle. It is expected that timing of the Middle East mega crews will create some quarterly volatility.

In this context, our core businesses are doing well and should continue to strengthen in 2024, where we already have improved visibility. Our Beyond the Core business activities continue to mature, and we are gaining experience and progressively building our commercial business as we participate in more streams of the value chain, and especially around low carbon and digital. Our new contract for HPC applied to gen AI strengthened our credential in this growing sector, and we expect continued success moving forward.

Finally, we are very pleased to see our structural health monitoring business continuing to grow with the successful expansion into the Middle East. In summary, we are on track to meet our 2023 objectives and continue to see a supportive outlook for our business moving forward. Thank you very much for your interest, and we are now ready to take your questions.

Q&A

Haris Papadopoulos (Bank of America): Thanks for taking my questions. I have four actually, please. First one, could you perhaps give us an indication of working capital for the fourth quarter?

Sophie Zurquiyah: Hi, Haris. Sorry, can you repeat your question? I did not catch it.

Haris Papadopoulos: Yes. I was just wondering, could you perhaps give us an indication of working capital for the fourth quarter?

Sophie Zurquiyah: Working cap for the fourth quarter. That is a question for you, Jerome.

Jerome Serve: It will be slightly negative, around $10 million.

Haris Papadopoulos: Okay. And then on the SMO business, I appreciate margins here were exceptionally low this quarter. How should we think about it for the fourth quarter?

Sophie Zurquiyah: Yes, an interesting question. Again, that is linked to some of the mix of deliveries we had this quarter. But what we did say is that we expect, if you see where we are year-to-date, we will probably stay around that number. So Q4 will be around the sort of average for the year-to-date. So we will catch up and have back to the normal profitability in Q4.

Jerome Serve: And sorry, back to my first answer. As you know, the working capital depends very much on the late sales. So the sales that we will be November, December, and especially our data after-sales, which have a tendency to be booked more in December time.

But again, what we just said is, we – ambition, as we already mentioned it in Q2, to have a cash flow generation breakeven, including working capital variation, although the guidance we have made earlier this year was excluding working capital.

Haris Papadopoulos: And then thirdly, I appreciate your liquidity target. I remember it was $150 million; this means that you currently have a large cushion over that. Would you perhaps consider using your 10% special redemption goal, or something else?

Jerome Serve: It has been communicated in the past that we needed $150 million to operate, minimum. And depending on our outlook for 2024, that is something that we indeed may consider paying down, reimbursing out of our debt.

Haris Papadopoulos: Okay. And then finally, perhaps again on the capital allocation front, how should we think about M&A?

Sophie Zurquiyah: So the question is about where we are with M&A; is that correct?

Haris Papadopoulos: Yes.

Sophie Zurquiyah: We keep cash for M&A. We don't have a large M&A in sight, but we are always opportunities like we had last year. So we like the bolt-on M&A in that range of $20 million that our technology adds to what we have. Right now, we are actually not working on any, but yes, but we feel like organically it is something we can afford.

Mick Pickup (Barclays): Just a couple of questions. Can I just check that, in DDE, that increasing cost base, that is all the Shearwater payment that we have seen in the quarter?

Sophie Zurquiyah: Yes. Thank you, Mick, and good evening, and thanks for the question. And for the benefit of everyone, that is the reason. And we have seen in the Geoscience, revenue per head continued to increase. We are actually increasing productivity. So actually, what is hiding, if you want the increases of the good performance on profitability has been those payments, and they have been significant enough that we have been flagging them for the last two quarters.

Mick Pickup: Okay. Perfect. That is clear. And the next one is, can I just talk about, on the multi-client business? Obviously, your investments appear to be running a bit lower than I think you were looking for for the year, and you mentioned that it is much higher prefunding. Just wondering how you balance that going forward with your clients wanting to rebuild their inventory of prospects. And clearly, that would suggest spending more going forward, but you are on the path of trying to spend a bit less at the moment. I wonder how this all balances out.

Sophie Zurquiyah: What we look at – and this is not new. We manage multi-clients from the cash outlay, which is basically how much CAPEX we – basically, prefunding ratio way, right? So this is the CAPEX minus the prefunding revenue, and we look at how much we are willing to invest, and that number has been, over the years, like $15 million. This year, it is going to be less, but we have been going all the way to $15 million.

So we look at the project by project on the merits of if we see prefunding or not and when that prefunding might be coming. So this year, I would say, if we had had a compelling project, we would have invested, provided that we saw the prefunding. And that is the reason that, in particular, there was a couple of projects in Norway that we decided to delay until 2024 because we knew – and the client had told us they did not have the budget this year, so we did not see a point of putting more cash out and wait until next year to get the prefunding. So we are trying as much as we can to line up the investment with the prefunding, just to manage the cash, basically. So I do not think you should read much into the level of CAPEX. It just depends a little bit on client interest and quality of the projects. So I do expect and I hope we will invest, for example, in OBNs in the Gulf of Mexico, so that might drive some of the CAPEX up in 2024.

Mick Pickup: Okay. And then just finally, obviously, a low margin in Sensing & Monitoring, and you are saying low-margin equipment, but 10% is a big step down from, what, 20%-odd you did last quarter. So can you just talk me through exactly what is driving it, because you suggest [inaudible] very low margin.

Sophie Zurquiyah: Yes, it is low, and we were very disappointed. It is very simple: it is the vibrators. So those are the vibrators, and we have sold a large number of vibrators to Saudi Arabia. And they just typically – it is the equipment, and have seen those vibrators or trucks over the years typically attract a lower margin – lower value-add, if you want – and it is just an unfavourable mix this quarter. But the GPR products, for example, have the typical SMO high margins. So that is why it was just, again, a bit of a volatility it all happened in that quarter, but next quarter, we are confident that it will be back.

Baptiste Lebacq (ODDO): Just a very quick question regarding the potential merger between Exxon and Pioneer and Chevron and Hess in this context. Can you benefit into 2024 of transfer fees if the mergers are done?

Sophie Zurquiyah: Yes. Thank you, Baptiste, and good evening. So Exxon-Pioneer is clearly land onshore US. And if you remember, we sold our land onshore data business at the end of last year, so we are not going to benefit any of that. Chevron-Hess, there is definitely a potential for transfer fees that will be, I would call them, in the mid-range. If you remember, the Oxy one was in a higher range. So it is going to be significant, but not as significant, and that would happen at the moment of closing.

And of course, it always depends on the appetite of the buyer to transfer the data. So that means we are in the process of identifying which data they do not have that likely they might want to transfer, but they could still make a decision not to transfer the data, so I do not have the final numbers until those conversations take place.

But we should – definitely Exxon-Pioneer, nothing on that side, and then Chevron-Hess, there should be something. Just to remind everyone on the line, the US land library last year generated around $18 million of after-sales. And so, when you compare the year-on-year after-sales from 2022 to 2023, you have to take into account the footprint change.

Jerome Serve: Year-to-date.

Sophie Zurquiyah: The **y**ear-to-date.

Jerome Serve: $6 million in Q3.

Baptiste Lebacq: Maybe still one question, if I can, regarding M&A. Let us say two of your competitors – or clients; it depends on where you stand – want to merge. What is your view? Can you share with us your view? Is it for you positive? Or are you afraid by, I do not know, bigger competition because they are by far bigger now than previously?

Sophie Zurquiyah: Yes, sure. So in terms of the client, I think generally speaking, less clients is not necessarily good. Now it depends who is the buyer and who is the company that bought and what is our position with them, so there is a lot of consideration in that. But in general, we benefit when there is a larger client base. For that general churn of M&A amongst our client base, we will benefit in the short term with chance to feed, but in the long term, I would rather have more clients.

Now the good news is that there are some start-ups, private equity-backed companies that are creating some of the basins and the mature basins. And what we are seeing as well, which is also a good thing and new trend, is NOCs are trying to go more international. So that opens up another new client base, if you want.

The second one is on our competitor. Probably you are referring to the TGS/PGS merger. I would say it is relatively neutral in the sense where it creates a larger competitor in the multi-client space. The multi-client is not really about scale, it is more around position. And so in that sense, whether you are midsized like us or larger size, it does not make a huge difference. And then on the processing side, they were both quite small, so the combination remains small, so nothing on that side. And on the acquisition business, it just moves from one player to another player, but it is the same business in the end, so that particular consolidation is fairly neutral for us.

Jean-Luc Romain (CIC Market Solutions): You had a very strong third quarter in SMO and a very strong year so far. How should we expect at the end of the year compared to the past quarter? As good, or even better? And how do you see from today 2024? You mentioned quite a few possibilities of mega crews. Do you see a higher 2024 already for SMO?

Sophie Zurquiyah: Thank you, Jean-Luc, for the question, and good evening. So in terms of year-end, I think we are going to be on the trend of a high quarter. Hard to give you the comparison on Q3 or Q1 and Q2, but every quarter has been fairly high above the $100 million mark, and that is the range that we expect in Q4 results. It will be a very good year. But keep in mind that the business of SMO is composed of two revenue streams. If you want a certain recurring revenue stream, which is linked to our installed base, a replacement, if you want. And then there is those mega crews that create volatility from a quarterly basis.

So, to date, we have one mega crew identified in Saudi Arabia, I would call it a super mega-crew in the sense that it is equivalent to two traditional mega crews, so it is fairly significant. Now if you remember this year, the bid was being delayed, and there has been a lot of delays. So right now, it seems like deliveries would be targeted to Q4 next year, meaning that it could easily slip from Q4 into even 2025, right, creating some volatility.

So that is for the super mega crew in Saudi Arabia. We have in mind as well some large crews in North Africa that we will be pursuing. And on the node side, it looks like it might be more deeper water request, but it is not associated to specific mega crew, but it is just general increasing demand for OBN.

Jean-Luc Romain: Are companies doing [inaudible] finally starting to replace streamers, which should be quite hard by now?

Sophie Zurquiyah: Yes, but we are always looking at the age of our streamer base. So the age of our streamer base is somewhere around 11 years old. So you think that, by now, they are definitely going to replacement cycle. I told you, the replacement cycle is taking a different shape than we anticipated, in the sense that our clients are replacing portions of the streamer set. So they are doing a mix and match between old streamers and newer streamers. They are trying to refurbish as well. Now, eventually all these streamers will have to be replaced, and we are definitely seeing requests for quotation, but not really a significant increase in orders. It is a still at that recurring level, not at that forward placement level yet. I would expect that at least that replacement level sits at the higher level.

Guillaume Delaby (Société Générale): One question for Jerome, basically. I would like to come back on the working capital dynamics to be sure to really understand the different moving parts. So, basically change in working capital after nine months is minus $23.5 million, if I understood correctly, and we all know that forecasting change in working capital is a highly difficult exercise. But I understand that it might be $10 million more, so, let us say, minus $33 million at the end of the year. Your guidance at the beginning of the year was neutral free cash flow, excluding change in working capital, and now you are saying neutral free cash flow, including. So, just to be really sure, I would say, given the fact that you are more or less implicitly forecasting a minus $33 million, so is it, I would say, some kind of increase in guidance, just to be sure?

Jerome Serve: Yes, let us put it that way, because the guidance was excluding working capital, and here – we ambition to be breakeven we include it, so yes.

Guillaume Delaby: Okay. No, I just wanted to be sure. I turn it over.

Sophie Zurquiyah: Yes, Guillaume, just to add, as you know, it is difficult to plan for working cap. And that is why, when we guided for the year, we wanted to exclude the working cap. But now we are fairly advanced in the year and have a good visibility on that and so we are more confident.

But I told you last quarter that our aim was always to have it all inclusive, and that is the number we look at is the net cash flow, including everything. And by the way, including at year-end around $16 million of payments to Shearwater between the $21 million of IDC [inaudible] exceptional, which is going below, and then the $40-some-million that will be included in the EBITDA.

Daniel Thomson (BNP Paribas): Just one question on late sales. Obviously, we had improvement this quarter. But of course, we had $20 million which was delayed from 2Q to 3Q coming in this quarter, so, underlying, still probably not as robust as you want it to be. I think you mentioned last quarter that you saw improvement in order intake trends related to this in the year-to-date figures, so can you just talk about order intake trends in the third quarter – how it has progressed and how it is looking over the first nine months?

Sophie Zurquiyah: Yes. Thank you, Daniel. So I will comment first on Earth Data. So, in terms of order intake – and you see it through the prefunding. I mean the prefunding has been very sustained this year, and that is the reason also is we have invested less in CAPEX. But in terms of after-sales, I did mention that last quarter we were looking at kind of thinking it is around that 10%-ish improvement year-on-year. But outside, keep in mind that exceptional transfer fee that we had last year and our footprint change of demand in US. So corrected for that, we are trending 10% up year-to-date, and we look at it on a rolling basis, and that is pretty much where we are at. So it is improving, but not as much if you take as a reference, 15%, 17% exploration CAPEX offshore improvement in 2023 over 2022.

The Earth Data is a little down. It is down from that macro trend in Q1. And that is where, in conclusion, I said, well, for Geoscience, it is fully materialising, but for Earth Data we are somewhat lagging. And I think the difficulty of Earth Data, its clients are struggling with projecting themselves beyond, say, 2035, 2040, and they are really looking for projects that they think can become material and have an impact on production in the shortest term possible.

But at the same time, we are seeing more and more demand for our data that is not in the core basins than we saw when we are launching the project in Malaysia, for example. So we are doing and we are growing, basically, where the prefunding is. So in general, correcting for those exceptional, it is trending up, but not as high as the macro number or data. But in Geoscience, we are definitely trending along those lines of the macro trends.

And SMO as being difficult to project because it has that volatility of specific deals that could be positioned in a quarter or another, or even from a year to another year. I think I mentioned as well somewhere that, perhaps on the backlog of Geoscience and the reason why it was that 3% year-on-year is because there are two large contracts for NOCs that are pending signature and that we have not put in our backlog. So they are fairly significant. If we had them in there, we would see the significant increase in backlog year-on-year. So we are not concerned that – Geoscience is definitely on that uptrend.

All right. Well, thank you very much. Thank you for the lots of questions and really good questions, and thanks for your time and your interest. We will be in touch in the next few days or weeks. Thank you again. Good evening.

Jerome Serve: Thank you indeed. Good evening.

[END OF TRANSCRIPT]