PTTEP Q2 2016 Analyst Meeting

Edited Transcript

Venue: *Synergy Hall 6th Floor, Energy Complex Building C, Bangkok, Thailand*
8 August 2016
15:30 – 17:00 Hours

Speakers: Khun Somporn Vongvuthipornchai
President and Chief Executive Officer

Khun Suchitra Suwansinpan
Executive Vice President, Strategy and Business Development Group

Khun Pannalin Mahawongtikul
Executive Vice President, Finance and Accounting Group

The slides of the presentation, as referenced throughout the transcript, can be found here

PART 1: INTRODUCTION

Moderator

Welcome to PTTEP Q2 2016 Analyst Meeting for the announcement of the Company's operating performance in the second quarter of 2016. Before we commence the session, please allow me to introduce the Company's executives who will be presenting PTTEP's performance results.

First, Khun Somporn Vongvuthipornchai, President and Chief Executive Officer

Second, Khun Suchitra Suwansinpan, Executive Vice President - Strategy and Business Development Group

Lastly, Khun Pannalin Mahawongtikul, Executive Vice President - Finance and Accounting Group

And without further ado, please join me in welcoming Khun Somporn to begin the presentation.

Khun Somporn Vongvuthipornchai
President and Chief Executive Officer

I would like to extend greetings to all analysts, investors and honored guests attending the session today. As usual, we will be reporting progress and operating performance of the first half of the year, covering key topics on the industry highlights, financial results and the business outlook.

PART 2: SAFETY PERFORMANCE

Khun Somporn Vongvuthipornchai
President and Chief Executive Officer

Slide 3

Our priority on safety and environment

The first topic is safety and environment which we place utmost importance upon. The key parameter used for tracking the Company's safety performance is the lost time injury incident frequency (LTIF). In general, there are other parameters we are constantly monitoring i.e. Total Recordable Incident Rate (TRIR) and major first aids but the most important one is the LTIF, of which our achievement in 1H 2016 is 0.07 accidents per million man hours. Our target is to sustain in the first quartile of the industry average, as shown in the green zone. The industry's statistics of 1H 2016 has not been released yet but we have always managed to remain the first quartile all along.

For the environmental aspect, the Company had initiated an endeavor to reduce the amount of greenhouse gas emission, i.e. carbon dioxide and methane in 2012, which targets to reduce greenhouse gas emission by 20% in the year 2020 versus its 2012 baseline figure. As of May 2016, we are said to be ahead of target as we have reduced the amount of emission by 17%. However, we will not limit ourselves to 20% reduction but will take the effort further afield. The achievement in reduced emission has been contributed from process improvements, better designs to reduce flared gas emitted to the atmosphere which results in more hydrocarbons recovery and in turn generates revenue for the Company. Apart from these examples, there are several other initiatives that we are working on. Regarding CSR program, we have executed forestation activities which can be beneficial to the greenhouse gas emission offsetting.

Now Khun Suchitra will discuss about the industry highlights.

PART 3: INDUSTRY HIGHLIGHTS

Khun Suchitra Suwansinpan
Executive Vice President,
Strategy and Business Development Group

Slide 5

Oil prices

Talking about global crude oil price, the oversupply condition has been continuing from the end of 2015. The line chart suggested that global crude oil price started to rebound after it bottomed out in February 2016. As mentioned in the previous PTTEP Q1 2016 Analyst meeting, global supply glut was around 1-1.5 million barrels/day. However, for this period, global supply glut was considerably reduced mainly due to higher demand; despite of an increase in crude oil production from Iran and Iraq. Another support to an increase in oil price was the supply disruption especially from Wildfire in Canada.

Looking forward, the oversupply condition expected to remain throughout the remaining of the year but the degree will have lessened substantially. It has been forecasted that global oil demand in 2H 2016 will reach 96 million barrels/day, while supply side will be around 96.5-97 million barrels/day. Thus, the gap between demand and supply should be narrowed down to 0.5-1 million barrel/day. Also, it should be noted that crude oil price will be highly sensitive to global supply disruption events.

All in all, it can be summarized that the oversupply condition will still be around but the gap will have been narrowed down compared to the beginning of the year. Additionally, the rebalance of demand and supply might materialize around the middle of 2017, which is sooner than what has been initially predicted by several houses. This depends pretty much on the occurrence of supply disruption. Going forward to the end of the year, the oil price is expected to remain in the range of 40-50 USD/barrel.

Slide 6

Industry's cost reduction

With regards to cost reduction, there have been several adaptations in the industry. The black line demonstrates the oil price while the red line shows the upstream capital cost index, both have been decreasing. The oil price has dropped to around 50 USD/barrel while Industry capital costs have deflated by about 28%. The blue line represents Industry OPEX which have also decreased by about 18% compared to Q4 2015.

Bar chart on the right side represents how E&P companies have responded to the current downturn. We see every company initiated cost improvement campaigns as a new norm. The Peers OPEX fell by around 6% to 21% in 2015 compared to 2014, of which PTTEP's performance was in the top rank with reduction rate of 16%. As long as the oil price remains volatile, the Company has to continue and improve cost efficiency campaigns for long-term sustainable. To sum, this is the reflection of how industry behaviors have been shifted under the challenge of oil price uncertainty.

PART 3: INDUSTRY HIGHLIGHTS (continued)

Slide 7

M&A Updates

With the current oil price environment, it was seen as opportunities for executing M&A deals especially for high-liquidity companies. As you may see from the chart on the left, excluding of the Shell-BG deal with transaction value of 85 billion USD, value of M&A deal in 1H 2016 accounted for 40 billion USD while the 2015 full-year M&A deal value was only 60 billion USD , this indicates a positive sign of recovery in M&A activities.

Majority of the transactions were driven by US Shale companies since a number of small firms encountered liquidity and bankruptcy threats from low oil price. This has led to an upsurge in M&A deals.

Moving over to the Asia-Pacific region, M&A activities were not active. There was only the ExxonMobil's acquisition of Inter Oil transaction in July 2016 which account for 4% of total M&A deal value.

Slide 8

Thailand Updates

Let's take a closer look at the situation in Thailand. The upper left graph shows stable domestic gas demand. For the supply side, there was an increase in LNG for the 5 months of the year to compensate with the planned shutdown of Myanmar gas fields.

Another critical factor affecting PTTEP's business is foreign exchange (FX), which has been forecasted on the tendency of Baht depreciation provided that the Federal Reserve will increase the interest rates. However, for 1H 2016, Baht appreciated against USD from fund inflow in this region. For the remaining of the year, the exchange rate continues to be volatile due to uncertainty in FED policy whether the interest rate will be increased.

Slide 9

Path to re-tendering of expiring concessions in the Gulf of Thailand

Moving to another highlight issue for PTTEP which is the clarity on the expiring concession, the government has announced the auction for the expiring concessions for Chevron 1, 2, 3, 5 and Bongkot field. We see more clarity in terms of key milestone of the bidding process. The National Legislative Assembly is currently reviewing the Petroleum Act and PITA which could take approximately 3 months to be enacted and promulgated while the associated laws targets to complete within this year-end.

In parallel with that, the Ministry of Energy is drafting the term of reference (TOR) which is also expected to accomplish within this year-end. After that, the TOR must be approved by the Cabinet which is scheduled to be completed in March 2017. Following that, the tendering process shall commence by opening dataroom in March 2017 and the concession should be awarded by the end of Q3 2017, however, this is the expected timeline by the Ministry of Energy which can be subject to change.

PART 4: FINANCIAL RESULTS

Khun Pannalin Mahawongtikul
Executive Vice President,
Finance and Accounting Group

Slide 11

Sales volume & unit costs

Let's now take a look at our first half year performance.

Our production operations have been delivered as planned with sales volume in the 1H 2016 averaging 325,257 BOED, well on-track to achieve the target to maintain our full-year sales volume at 2015 level which was at 322,167 BOED. This performance was driven by higher volumes from our domestic projects, mainly Contract 4 and Arthit, following strong domestic energy demand. While Southeast Asian operations saw volumes dropped slightly from FY2015, primarily from the Zawtika project which went through planned shutdown during the first half of the year and a slight decline in Vietnam sales volume. As for the rest of the world, sales volume was boosted by Algeria Bir Seba project which saw its first crude shipment in December 2015 and, with two additional crude shipments this year, contributed to most volume increase from the region. These project performances resulted in 3.1K BOED increase in daily average sales volume of 1H 2016, compared to FY2015.

Moving on to sales prices. As you would be aware, due to a lag time in price adjustment, we are seeing a downward trend in our gas prices throughout this year as the drop in oil prices in the latter part of 2015 starts to yield an impact on our gas products. Gas prices averaged at 5.84 USD/MMBTU during 1H16 and, as it continues to decline, are expected to average around 5.5 USD/MMBTU for the full year of 2016. With our liquid prices which move in accordance with the global oil prices, our weighted average sales price in 1H16 was 35.84 USD/BOE, dropping by 21% from the previous year. Like before, gas and liquid volume mix ratio remains at around 70:30.

With respect to cost performance, if you would recall, we started the year with the goal to bring down our unit cost by not less than 10%. After 6 months, we are very pleased with achievements we have made so far in the cost saving space. Reductions by as much as 24% were achieved on both unit cost and cash cost levels, compared to the previous year; these reductions represent a combination of sustainable, on-going activities and one-time events.

PART 4: FINANCIAL RESULTS (continued)

Reductions were seen in most cost categories. One major driver is the unit DD&A which was brought down from reserve additions booked in December 2015 as well as impairment charges recorded in the third quarter of last year. DD&A for the full-year 2016 could however rise to around 19 USD/BOE. Finance cost also came down from 2.14 USD/BOE in 2015 to 1.98 USD/BOE in 1H 2016. The decrease was a result of loan repayment and prepayment amounting to 1.1 billion USD last year. In addition, we completed the repurchase of 176 million USD bonds around the end of the first half year and expect to start benefiting from reduced interest expenses from the third quarter onwards. Royalties also dropped from 3.62 USD/BOE to 2.98 USD/BOE in 1H 2016, primarily in line with declining sales prices. Meanwhile, G&A expenses have dropped by about 35%, from 2.39 USD/BOE in 2015 to 1.56 USD/BOE in 1H 2016, a good reflection of our efforts to revisit costs concerning staffing, hiring of expatriates and optimization of office infrastructures. Exploration expenses also dropped significantly by 55%, from 1.56 USD/BOE to 0.7 USD/BOE with only 2 wells written off, worth 2 million USD combined, as opposed to the write-off of 16 wells in 2015 totaling 140 million USD. Operating expenses decreased by 22% from 6.04 USD/BOE in 2015 to 4.7 USD/BOE in 1H 2016, mainly due to optimization of our maintenance and logistical activities. Although, due to higher maintenance programs planned in the second half, we expect the operating expenses averaged for the whole year to fare slightly higher. As with operating expenses, lifting costs also dropped in a similar direction.

Slide 12

Cash flow performance

Our cash flow performance remains strong, with the EBITDA margin of 73% and the recurring net income of 270 million USD for 1H 2016. And, despite losses from oil price hedging and financial instruments, we achieved net profit of 232 million USD as opposed to net losses in 2015 in an absence of impairment charges this year.

The source of funds, which essentially represents cash flow from operations, amounted to 1,038 million USD after tax payment being deducted. The use of funds comprises 583 million USD for CAPEX and investments, 225 million USD for dividend payment for 2H 2015 performance, around 100 million USD for interests and other finance costs and lastly 184 million USD for bond buy-back. Based on these cash inflow and outflow activities, net cash flow as of 1H 2016 came in at a slight negative; although if the one-time bond buy-back were excluded, our net cash flow would have been in a positive territory for the period.

PART 4: FINANCIAL RESULTS (continued)

Slide 13

Financial position

This slide features the Company's balance sheet. Our assets have decreased slightly as of the end of June 2016, mainly due to a drop in PP&E and intangible assets, i.e. depreciation, as well as account receivables. Debts have also decreased as a result of bond buy-back; while other liabilities decreased as a result of tax payments made in Q2 2016. On the other hand, equity increased slightly, with the booking of 232 million USD net income offset with dividend payment for 2H 2015 performance and net interest expenses for the hybrid bond.

Our debt profile is 100% in USD in line with our functional currency. As the bonds that were the subject of the buy-back program have a maturity in about two years and have the coupon rate of 3.707%, following completion of the bond repurchase, our average loan life went up from 8.17 years at FY2015 to 8.65 years and our average cost of debt also increased slightly. Nevertheless, should there be any needs to raise funds through the capital markets, we are confident that new bonds or loans can be issued at an interest rate lower than the bond we recently re-purchased.

Slide 14

Dividends

The Company has made dividend payment for 1H16 at the rate of 0.75 Baht per share, with the payout ratio of 37%. The XD will be on August 9, 2016 and the payment will be made on August 25, 2016. And this sums up the overall picture of our 1H 2016 financial performance.

PART 5: OUTLOOK

Khun Somporn Vongvuthipornchai
President and Chief Executive Officer

Slide 16

Cost reduction progress

As it has been continuously reiterated, the Company's strategy moving forward is under the principle of 3Rs; Reset, Refocus and Renew. The objective of 'Reset' is to revisit the cost and capital structure in each project to ensure competitiveness and resilience to withstand the changing business environment. Whether or not the oil price remains to be volatile, we have to continue to push forward our best effort in cost-reduction.

The rationale of 'Refocus' is to emphasize on the areas or projects that we are familiar with. Investment priority will be in Thailand, and other Southeast Asian countries such as Myanmar.

Lastly, the significance of 'Renew' is to prepare our organization for sustainability development in terms of capability build up as well as the exposure to other non-related E&P businesses. Speaking of the actual performance on 'Reset', last year we had successfully reduced costs, i.e. budget by about 20-30% and unit cost by about 10%. And we do anticipate an on-going effort and success in this cost reduction initiative during 2016-2018.

For 2016, our key CAPEX elements are the drilling cost and the wellhead platform cost. We use 2014 as a baseline for comparison given it was the starting point of oil price slump, it is the year that the oil price has begun to drop. This year, it is our target to reduce the drilling cost by about 30% from 2014 base figure. The success in drilling cost reduction has been contributed from the improved efficiency such as design optimization, effective work processes and shorter time taken to drill each well. Another factor enabling drilling cost reduction is cost deflation. Due to a drop in oil price, contractors have facilitated us on the lower costs in terms of rigs and different sorts of consumables, as well as logistics concerning drilling activities.

For wellhead platform, we anticipate to reduce the cost per unit by about 35% from the 2014 base figure. Even though this cost has not been fully realized, it is our target to achieve once the design and installation are completed. The cost reduction drivers can be categorized into two; cost deflation as a result of lower EPC costs, and the design optimization as we are trying to optimize designs to fit for purposes and any extra or unnecessary designs might have to be discarded for the time being.

For OPEX and G&A, we expect to reduce cost by 35% from 2014 baseline. There are several components of OPEX but major ones include logistics, routine maintenance, fleet, transportation, surface operations as well as maintenance cost of wells. Dark green bar charts illustrate what we had successfully achieved in 2015 and lighter green bar charts signify what we anticipate to achieve in 2016. All in all, these are just a few examples of how the Company has been trying to 'Reset' our cost structure in order to be competitive.

PART 5: OUTLOOK (continued)

Slide 17

RESET cost structure to maintain competitiveness

In terms of 'Reset', we still maintain the same production target as that of the previous year. As always, we not only focus on meeting production target, but we also ensure that our safety standards are not sacrificed. We have been able to reduce unit costs by about 10% in 2015 and it is our goal to reduce further by about 10% this year. We are quite certain that this target will be met given a considerable amount of cost has been reduced by far. Nevertheless, the unit cost reduction achieved in 1H 2016 might not represent what is going to happen in the second half since there might be other activities in operations taking place in 2H 2016.

As for the yearly guidance, the picture is somewhat similar to what has been provided earlier this year. The average gas price should remain somewhere around 5.5 USD/MMBTU. Also, we will be trying to maintain production at the same level as 2015. The EBITDA margin should be around 65-70% of sales revenue. Lastly, the unit cost should be approximately 31 USD/BOE.

Slide 16

REFOCUS and RENEW

In addition to cost reduction endeavors, we also emphasize on strategies to advance for our long term growth in the future. First of all, we will be reviewing our portfolio rationalization of new and existing projects. As you might have been aware of, we have successfully obtained concession of the offshore exploration project in Sarawak in Malaysia. This site is considered to be specifically in Malaysia's territorial waters. Previously we have been working alongside Petronas in the joint-development projects. So this marked the first time that we will operate in Malaysia which we believe we are well equipped with experiences in terms of operations, logistics, as well as geological settings. Moreover, we will study on the potentials of LNG import from this project for our domestic consumption.

The next highlighted project is Algeria HBR of which the exploration and appraisal drilling had been completed. There are seven wells altogether; the latter two appraisal wells gave positive results which are better than our expectation, thus the development plan will need to be adjusted accordingly. The process of preparing field development plan and submitting the paperwork to the authority shall be done by early 2017.

The last project that I would like to focus on is the Mozambique LNG project. We still have to pay attention and follow up on the progress in various aspects especially the LNG market condition which is currently considered as a buyer's market. Thus, project operators or joint ventures have been attempting to make a conclusion regarding the LNG sale and marketing as soon as possible in order to proceed on the key matters such as finalizing a regulatory agreement with the government and considering project financing.

As for new investment projects, we currently focus on Bongkot concession expiry in which we are preparing to participate in the bidding process. We believe we are well positioned as the asset operator with high degree of expertise and ability to maintain the consistent gas production for the benefit to Thailand in which the government places great emphasis on. As a national oil and gas company, we are ready to continue this mission and now awaiting the clarity of the bidding process. Regarding M&A opportunities, we started seeing deal execution in Southeast Asia, though not a whole lot. Nevertheless, we still pay attention to potential deals that might materialize in Thailand and other countries in Southeast Asia.

PART 5: OUTLOOK (continued)

In terms of LNG value chain, we will be working collaboratively with PTT in identifying gas fields viable for LNG development since Thailand has increasingly relied on LNG imports and PTT has been given consent to expand LNG receiving capacity.

The last point is about getting ourselves prepared for being competitive in years to come. We will be placing greater emphasis on technology development especially in the exploration process, with the aim of improving discovery rate and of identifying ways of being at the forefront of the industry. Additionally, we will be looking into the technology that will help elevate recovery factor in our existing production, e.g. S1 or other gas fields in the Gulf of Thailand. For instance, we have previously been using the water flooding methodology and we will continue to explore other technologies to improve efficiency. The increased recovery factor can be regarded as the success in exploration endeavors. If the recovery factor can be increased from 20% to 25%, that means almost one-fourth of the product can be added to the S1 reserve, for example. Lastly, we are also looking into the green technology in order to gain acceptance from countries in which we operate. In order to maintain our competitive advantage, we have set up a dedicated team of individuals to study about the renewable energy, alternative energy and possible opportunities for E&P-related diversification. The team works under the philosophy that once threats are present, we should understand them clearly. Meanwhile, if any of these threats is interesting to pursue and can further PTTEP's capabilities, then we might consider making investments, which we will have to keep our shareholders, i.e. PTT, informed before taking any further steps.

This is the overall picture of the business direction for the rest of the year and probably for the next few years.

PART 6: QUESTIONS & ANSWERS (Q&A)

Question # 1

What is the oil price hedging policy for FY2017?

Answer from PTTEP Management

The main objective of oil price hedging is to secure desired level of cash flow and liquidity. In general, the hedging policy is to hedge not more than 70% of the liquid volume to protect baseline cash flow of the company's total portfolio. For FY2017, the level of hedged volume is not yet finalized, this would need to be considered together with the market conditions for next year.

Question # 2

Could you please discuss about second half dividend payment?

Answer from PTTEP Management

The Company consistently maintains the policy of dividend payment not less than 30% of net income. However, the decision of the dividend payment would also depend on several factors including investment opportunity and remaining cash on hand during the second half of 2016.

Question # 3

Could you please elaborate on way forward for "RENEW" strategy about diversification? Is there any budget allocation for this?

Answer from PTTEP Management

Regarding diversification, the company explores different alternatives in both E&P related and non-E&P businesses. However, this is still in the early stage of study, the company has not allocated specific budget for these new businesses.

Question # 4

If the timeline for bidding process of expiring concession goes as planned and PTTEP wins the bid of Bongkot concession within Q3 2017, will there be any upside to the company's production?

Answer from PTTEP Management

In our current plan, production volume from Bongkot follows DCQ under existing gas sales agreement (GSA) which would be terminated at the end of the concession life. If the company wins the bid, the company would need to negotiate and finalize the new GSA of the obtained concession or PSC including DCQ level. We think the new DCQ is unlikely to be above the existing one. However, in case there is further delay in the bidding timeline (slipping to 2018), there is increasing risk of production volume from expiring concessions to decline from 2018 onwards.

PART 6: QUESTIONS & ANSWERS (Q&A) (continued)

Question # 5

With regards to the 7bn USD decommissioning cost for expiring concessions announced by Department of Mineral Fuels (DMF), how do you compare the figure to the company's decommissioning liabilities on the balance sheet? If new party wins the bid of expiring concessions, how would the existing decommissioning liability be treated or transferred to the new JV operator and partners?

Answer from PTTEP Management

We are not fully aware of the rationale behind the 7bn USD decommissioning liability set out by DMF as appeared in the news. However, PTTEP strictly follows the guideline set forth by DMF in calculating potential decommissioning cost on all producing projects and records 2.1bn USD decommissioning liability on the balance sheet. Decommissioning liability is one important parameter that needs to be clarified by DMF before bidding for the expiring concession can take place.

Question # 6

Regarding the expiring concessions, what are the key activities in tendering processes that targets to be finished within September 2017?

Answer from PTTEP Management

The current expectation is that dataroom process is expected to be around 3 months starting in March 2017, followed by bid submission. Then MoE would require around 3 months to evaluate the bids against the proposed criteria and hopefully announce the winner by September 2017, which is to be followed by new concession or PSC signing. In the bidding process, bidders also require visibility around key commercial parameters such as fiscal regime, remuneration both in terms of profit split and/or taxes, sales volume and prices, and liabilities of each parties including decommissioning.

You can reach the Investor Relations team for more information and inquiry through the following channels:

http://www.pttep.com

IR@pttep.com

+66 2 537 4000

DISCLAIMER

Forward-looking Information

The information, statements, forecasts and projections contained herein reflect the Company's current views with respect to future events and financial performance. These views are based on assumptions subject to various risks. No assurance is given that these future events will occur, or that the Company's assumptions are correct. Actual results may differ materially from those projected.

Petroleum Reserves and Resources Information

In this transcript, the Company discloses petroleum reserves and resources that are not included in the Securities Exchange and Commission of Thailand (SEC) Annual Registration Statement Form 56-1 under "Supplemental Information on Petroleum Exploration and Production Activities". The reserves and resources data contained in this transcript reflects the Company's best estimates of its reserves and resources. While the Company periodically obtains an independent audit of a portion of its proved reserves, no independent qualified reserves evaluator or auditor was involved in the preparation of reserves and resources data disclosed in this transcript. Unless stated otherwise, reserves and resources are stated at the Company's gross basis.

This transcript may contain the terms "proved reserves", "probable reserves", and/or "contingent resources". Unless stated otherwise, the Company adopts similar description as defined by the Society of Petroleum Engineers.

Proved Reserves *- Proved reserves are defined as those quantities of petroleum which, by analysis of geological and engineering data, can be estimated with reasonable certainty to be commercially recoverable, from a given date forward, from known reservoirs and under current economic conditions, operating methods, and government regulations.*

Probable Reserves *- Probable reserves are defined as those unproved reserves which analysis of geological and engineering data suggests are more likely than not to be recoverable.*

Contingent Resources *- Contingent resources are defined as those quantities of petroleum which are estimated, on a given date, to be potentially recoverable from known accumulations, but which are not currently considered to be commercially recoverable. The reasons for non-commerciality could be economic including market availability, political, environmental, or technological.*