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Atwood Oceanics, Inc. (ATW)

Q4 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to today's Fourth Quarter Earnings Conference Call Hosted by Atwood Oceanics. At this time, all participants are in listen-only mode. Later, you will have the opportunity to ask questions during the question-and-answer session. [Operator Instructions] Please note, this call may be recorded. And we'll be standing by if you should need any assistance.

And it's now my pleasure to turn the conference over to Mr. Mark Smith. Please go ahead, sir.

Mark W. Smith

Senior Vice President and Chief Financial Officer, Atwood Oceanics, Inc.

Good morning, and welcome to Atwood Oceanics' conference call and webcast to review the company's operating results for the fourth quarter and 2016 fiscal year ended September 30, 2016. The speakers today will be Rob Saltiel, President and CEO; and me, Mark Smith, Senior Vice President and CFO.

Before we begin, let me remind everyone that during the course of this conference call, we may make forward-looking statements. These statements involve risks and uncertainties more fully described in our latest 10-K, and our other filings with the SEC. Actual results may differ materially. Undue reliance should not be placed on these forward-looking statements, which are applicable only as of the date hereof.

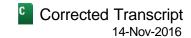
Now, let me turn the call over to, Rob for opening remarks.

Robert J. Saltiel

President, Chief Executive Officer & Director, Atwood Oceanics, Inc.

Thanks, Mark. Welcome to all of you joining today's call to discuss the fourth quarter and full fiscal year 2016 results for Atwood Oceanics. We finished our fiscal year with a strong fourth quarter. I can't say enough good things about how our rig operations and technical service teams have excelled during this difficult downturn, but I

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will try. Revenue efficiency across our fleet was better than 97% in the fourth quarter as we experienced no major downtime events.

We worked another quarter without an unscheduled pull of a subsea blowout preventer. In fact, it has been 6 months since we last pulled a BOP prematurely that was not due to a manufacturer's equipment recall.

Having common BOP systems on all our ultra-deepwater semisubmersibles and drillships, coupled with our rigorous maintenance and testing procedures has enabled Atwood to deliver excellent rig reliability for our clients, and strong revenue efficiency for our shareholders.

We also wrapped up another strong quarter and full-year for personal safety, process safety, and environmental stewardship. Our company's top priority is to keep our people safe from major injury, and we did it again in fiscal 2016. Our employees have now worked nearly 10 million man hours without a single lost time incident anywhere in our company.

Our focus on process safety, preventing the major incidents that can impact the entire rig and its crews, also continues to be excellent. Our drilling personnel correctly handled all well control issues they encountered in 2016, and we experienced no other significant marine or other process safety incidents.

Finally, and importantly, we had no reportable spills anywhere in our fleet for the second year in a row. Preserving the environments where we work continues to be a hallmark of Atwood operations.

Our financial results for the fourth quarter were also strong net of two non-cash adjustments and a bond debt retirement gain that, Mark will detail in his section. Cost control efforts continue to be reflected in our financials, and they have helped slow the decline in our margins.

We finished the fiscal year in a healthy liquidity position with \$615 million available under our revolving credit facility, and with \$145 million in cash on hand. Strengthening our balance sheet, especially as we face a longer and deeper downturn, remains a major focus for management and our board.

Shifting now to our rig operations, the Atwood Condor completed its more than 3-year program with Shell just this morning, and has transitioned to complete two plug and abandonments for Noble Energy in the Gulf of Mexico. We expect that this program will conclude in late January or early February.

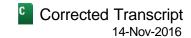
The Atwood Achiever remains on standby rate in Mauritania. Our client, Kosmos Energy, expects the rig to return to drilling mode by or before mid-2017. The Atwood Osprey continues to drill for Woodside in Australia, and this program is likely to conclude at the end of the calendar year.

In early 2017, the Osprey will transition to a 1 to 2 well program with ConocoPhillips. The Atwood Advantage began its mobilization to Israel from the Gulf of Mexico in mid-September, and arrived there in late October. We completed this mobilization at zero rate, and added the transit date to the contract term. We expect the Advantage to remain in the Mediterranean for the remainder of its contract with Noble Energy.

Three of our jackups, the Beacon, Aurora and Orca completed operations since our last earnings call. All three of these rigs are being idled with the intention of marketing them for immediate return to work.

Turning now to the market. In our view, operator sentiment has not changed much since our last earnings call. Oil prices have continued to languish below \$50 a barrel as the prospects for an OPEC production deal have waxed

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and waned. We had hoped that higher oil prices would accompany the start of 2017, but that now seems less likely. As a result, budgets for 2017 offshore drilling are expected to remain muted.

Like several of our competitors, we do see some promising prospects for ultra-deepwater drilling in late-2017 and into 2018, but these are generally shorter-term programs independent on internal and partner approvals. One positive is that a number of smaller independents are trying to take advantage of lower rig rates and service costs to drill exploration wells in this depressed environment, while the larger players are generally remaining on the sidelines until oil prices rise further.

Longer term, we are encouraged by the regulatory developments that are occurring in Mexico and Brazil. We are hopeful that Mexico's first deepwater licensing round will attract strong interest from the more than 25 companies that have signed up to participate.

In Brazil, the reopening of the deepwater space to international companies is expected as Petrobras relinquish its ownership and operatorship of pre-salt resources. These two highly prospective markets have the potential for substantial new deepwater drilling activity from the second half of 2018 onward.

We note that the decline floater demand has accelerated somewhat since our last call. We count 14 fewer floaters under contract since that call, with most of these declines occurring in the ultra-deepwater segment. We continue to witness a steady stream of early contract terminations, as well as a large number of contracted floaters, which were on standby status.

Floater market utilization has dipped below 70% even though 13 more rigs were cold-stacked or scrapped since our last call. We expect the floater demand will continue to trend lower into 2017. For the jackup sector, demand declined about 6% since our last call. Only six additional jackups were cold-stacked or scrapped, and market utilization fell from 69% to 65%.

We've spoken many times before about the need for aggressive supply attrition in both floater and jackup sectors to keep up with falling demand. This has clearly not occurred as market utilization has not yet stabilized in either sector. As far as Atwood's marketing efforts are concerned, we did not announce any new contracts since our last call, but a number of opportunities are being progressed. While we can't be too specific, we are optimistic that one of our idle jackups will return to work in early 2017. We're also increasingly optimistic that most or all of the open space on the Atwood Osprey schedule in 2017 will be filled with additional shorter programs in Australia.

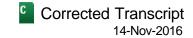
Finally, with the Atwood Advantage now in the Mediterranean, we believe we have improved our prospects to secure follow-on work by being there versus remaining in the increasingly-crowded Gulf of Mexico market.

One negative development for us has been the delay in the expected start of the drilling contract for the Atwood Admiral in Brazil. Our prospective client, Premier Oil has recently received an extension to their license, which has delayed their planned exploration drilling program to the second half of calendar 2018.

Premier is working to expand their rig share group. But with the delay in drilling, there will be a delay in signing the final agreement that we've been negotiating. However, Premier has reaffirmed to us in writing their intention to work exclusively with Atwood on this program.

Given the delay in the Admiral's drilling schedule coupled with the increasing length of this downturn, we've approached the DSME shipyard where the Atwood Admiral and Atwood Archer are being constructed to request further extensions of our latest delivery dates for the two rigs. We believe that we will be able achieve these

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delays. However, as we are still in discussions, I won't be able to be specific about the terms we are seeking. Our goal is clearly aimed at securing sufficient flexibility to take possession of these rigs only when we are able to put them to work.

This concludes my prepared comments. So, I'll pass the call over to, Mark.

Mark W. Smith

Senior Vice President and Chief Financial Officer, Atwood Oceanics, Inc.

Thanks, Rob. Today, I will discuss our fiscal fourth quarter and full-year 2016 financial results, provide guidance for the fiscal first quarter and full-year 2017, and comment on our financial position.

Let's start with highlights for the recent quarter and fiscal year ended September 2016. The company generated revenues of \$189 million versus \$228 million for the previous quarter, totaling \$1 billion for the fiscal year.

Quarterly revenue declined primarily due to the Atwood Advantage, which operated for 65 days at the reduced rate of \$240,000 per day for Noble plug and abandonment work, and incurred 13 days at zero rate for the mobilization from the Gulf of Mexico to Israel, along with revenue decline due to the Atwood Beacon, which idled in August.

Revenue efficiency for the fourth quarter was 97% compared to 95% in Q3. The fleet operated 573 days versus 634 days in the previous quarter, totaling 2,776 days for the fiscal year 2016 compared to 4,015 for fiscal year ended 2015.

This reduction in operating days reflects the substantial idling of our jackup fleet and the Atwood Eagle and disposal of the Atwood Falcon earlier in this past fiscal year. The company generated diluted earnings per share of \$0.07 in the fourth quarter versus \$1.53 in the third quarter, totaling \$4.09 for the full fiscal year.

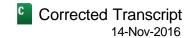
These fourth quarter results include a gain on extinguishment of debt from our tender offer, as disclosed on our previous quarter's call. In this fourth quarter, we also recorded a non-cash charge of \$38.6 million for fleet-wide drilling equipment, which was included in asset impairment, and a non-cash \$3.9 million charge to increase our reserve for excessive and obsolete materials and supplies inventory, which was included in contract drilling costs. These two non-cash charges reduced the fourth quarter diluted earnings per share by \$0.66 collectively.

Contract drilling costs excluding reimbursable cost of \$5 million totaled \$77 million for the quarter, in line with our previous guidance compared to \$81 million net reimbursable costs for the previous quarter. Contract drilling costs totaled \$379 million for the fiscal year. The reduced fourth quarter contract drilling cost is attributed to the completion of idling the Atwood Eagle in Q3, offset by cost to idle the Atwood Beacon in Q4, incurrence of cost to prepare the Atwood Advantage to mobilize to Israel and the aforementioned increase in materials and supplies reserve.

General and administrative expenses remained flat quarter-on-quarter at \$12 million, which is in line with our previous guidance. General and administrative expenses for the full fiscal year totaled \$51 million compared to \$57 million in fiscal year 2015. Our full-year effective tax rate was 15%.

Moving to the balance sheet, capital expenditures totaled \$26 million for the fourth quarter versus \$24 million for the third. Capital expenditures for fiscal year 2016 totaled \$224 million, of which \$156 million including capitalized interest relates to our new build drill ships.

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Year-end accounts receivable and accounts payable balances are substantially less than prior year due to reduced rig activity. Total debt reduced to \$1.2 billion in the fourth quarter from \$1.4 billion at the end of Q3. Reducing our debt was a focus of this management team in fiscal 2016.

During the course of fiscal 2016, we repurchased \$201.4 million aggregate principal amount of our senior notes. This along with credit facility payments of \$215 million throughout the year reduced total debt from \$1.7 billion at September 30, 2015 to \$1.2 billion at September 30, 2016, resulting in 27% debt reduction year-on-year.

Cash on hand at September 30 was \$145 million. The amount drawn into the revolving credit facility at September 30 reduced to \$780 million, from \$885 million at June 30, leaving \$615 million available under the revolver. This resulted in liquidity improvement of \$50 million with liquidity of \$760 million at the end of Q4 versus \$710 million at the end of the previous quarter. Subsequent to year-end, we repaid \$55 million on our revolving credit facility, resulting in \$670 million available under the revolver at October 31, 2017.

I will now provide guidance for the fiscal first quarter and full fiscal year 2017. Our contract backlog was \$753 million at September 30, 2016. Our latest fleet status was filed in early November, noting the Atwood Advantage has incurred 34 days at zero rate due to its mobilization to Israel, of which 21 days falls into fiscal year 2017. We do not have any planned out-of-service time for 2017. We estimate reimbursable revenues to range from \$7 million to \$10 million, of which \$4 million to \$5 million is expected in the first quarter.

For currently contracted and idled rigs, contract drilling costs are expected to range from \$235 million to \$250 million for fiscal year 2017, and \$65 million to \$72 million for the first quarter excluding the reimbursable costs. These costs will increase if additional contracts are entered into with our idled and actively marketed rigs. Upon completion of Noble P&A wells in the Gulf of Mexico, the Atwood Condor is budgeted to idle in South Texas, ramping down to approximately, \$65,000 per day in initial ongoing cost.

General and administrative expenses are expected to range from \$13 million to \$16 million for the fiscal first quarter. Consistent with prior years, our first quarter G&A expense has skewed higher than other quarters, because incentive compensation is determined and paid in Q1. Full-year G&A expense will approximate \$46 million to \$50 million.

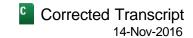
Depreciation is expected to be \$42 million per quarter, in total, \$168 million for the year. This includes accelerated depreciation for the Atwood Eagle, as we have shortened its useful life for the first half of calendar 2021, which corresponds with its next scheduled five-year survey.

Interest expense should be approximately \$17 million to \$20 million per quarter, net of minimal capitalized interest. This interest expense is higher than fiscal 2016, as we are expected to enter the holding period for the Atwood Archer at the end of Q2, thus ending capitalized interest charge to the construction project for that vessel. We expect to pay a cash interest of \$84 million for the fiscal year.

We expect to incur \$6 million to \$10 million in income tax expense for fiscal 2017, which may fluctuate depending on the jurisdictions where we operate.

Now, turning to the balance sheet for fiscal year 2017. Capital expenditures including maintenance CapEx, additions to our capital spares inventory and capitalized interest are expected to total \$140 million inclusive of the final \$94 million payment on the Atwood Admiral at September 30, 2017 under the current delivery and payment schedule with DSME.

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Capital expenditures are expected to total \$12 million during the first quarter. Our maintenance expenditures have been minimized to coincide with our reduced rig activity, and our fleet spares capital expenditures have reduced as we are near the end of our new build program. We will continue to use the combination of cash on hand, the cash flow from operations, and our revolving credit facility to fund these capital expenditures.

We estimate debt to remain relatively flat near \$1.1 billion during the fiscal year as we expect to generate sufficient free cash flow to fund the operations and the final installment of the Atwood Admiral. On average, we project \$700 million in funds undrawn on the revolving credit facility during the year. Our cash on hand target is \$125 million, providing a total liquidity of over \$800 million through fiscal 2017. We project to be in full compliance with our covenants under the revolving credit facility through the end of fiscal 2017.

In this dynamic market with our projected timing for recovery 12 to 24 months out, we are looking at prudent ways to strengthen our balance sheet to see us through this time. We will be opportunistic in fiscal 2017 utilizing our capital structure playbook to increase liquidity, reduce debt and/or stagger debt maturities in an order to reduce the company's refinancing risk and maintain financial flexibility.

That concludes our prepared comments. I will now turn the call over to, Tony, for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We'll take our first question from Gregory Lewis with Credit Suisse. Please go ahead. Your line is open.

Gregory Lewis

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Yes. Thank you and good morning, gentlemen.

Mark W. Smith

Senior Vice President and Chief Financial Officer, Atwood Oceanics, Inc.

Good morning, Greg.

Gregory Lewis

Analyst, Credit Suisse Securities (USA) LLC (Broker)

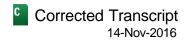
Rob, could you provide a little bit more color around the potential work in Brazil. And you mentioned Premier Oil, but it sounds like that this is going to be a rig share, and just sort of, I guess, a little bit of color around what's going on with the A&P, and then maybe just how this is developing?

Robert J. Saltiel

President, Chief Executive Officer & Director, Atwood Oceanics, Inc.

Well, Greg, I'd love to, but there really isn't that much to say other than, the process has been delayed in terms of the required drilling date for Premier, and for others down there who have licenses on some exploration blocks. So we're just going to have to watch how that situation develops. We remain convinced that this program will go forward.

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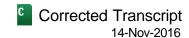
There may be some readjustment of ownership and operatorship positions down there between now and when we actually start that program, but things are still very much influx as there are, in a lot of places across this industry, right now.

I do want to just comment and re-emphasize that we are increasingly enthusiastic about the Brazil market, generally. You've seen Petrobras already effect one of the sales of their assets to an international oil company. We expect to see more of these kinds of transactions taking place where there's a divestiture of Petrobras positions to IOCs, and we think that, that's going to open up more drilling opportunities for the entire drilling industry going forward.

And then, as I mentioned in my prepared comments, Mexico is another area that we're enthusiastic about. They've got a deepwater licensing round, December 5, so we'll be watching that very closely. But regarding your specific question on Brazil, that's about all we could say at this point.

specific question on Brazil, that's about all we could say at this point.	
Gregory Lewis Analyst, Credit Suisse Securities (USA) LLC (Broker)	Q
Okay. Great, Rob. And then just one on the Achiever, I was going back the extended in September of 2015. And I believe, Kosmos had an option to window passed?	
Robert J. Saltiel President, Chief Executive Officer & Director, Atwood Oceanics, Inc.	А
It has not. No, that comes up in early 2017.	
Gregory Lewis Analyst, Credit Suisse Securities (USA) LLC (Broker)	Q
Okay. And if that happens then, the revert is that the initial rate gets paid like a lump sum payment if they decided to do that?	back, so would they sort of transpire with
Robert J. Saltiel President, Chief Executive Officer & Director, Atwood Oceanics, Inc.	A
Yeah, there's a make whole on that if they decide to go back to the origin	al term, yes.
Gregory Lewis Analyst, Credit Suisse Securities (USA) LLC (Broker)	Q
Okay. Perfect. All right, gentlemen, thank you very much.	
Robert J. Saltiel President, Chief Executive Officer & Director, Atwood Oceanics, Inc.	A
You're welcome. Thank you.	
Operator: Thank you. Next, we'll move to lan Macpherson with Simmon	s. Please go ahead. Your line is open.
lan Macpherson Analyst, Simmons & Company International	Q
Hi. Good morning.	

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Robert J. Saltiel

President, Chief Executive Officer & Director, Atwood Oceanics, Inc.

Α

Good morning, lan.

Analyst, Simmons & Company International

lan Macpherson

Q

Rob, you mentioned one jackup opportunity coming up. I think the consensus amongst your peers, and I guess, just sort of looking at historical presence that jackup activity should bottom and recover earlier. Most competitors seem to think that happened sometime during 2017. What is your high-level radar telling you about the shape of the jackup market activity-wise next year?

Robert J. Saltiel

А

President, Chief Executive Officer & Director, Atwood Oceanics, Inc.

Well, I think there's a logic for the jackup market demand bottoming sooner than the floater demand at shorter cycle, more infill-type drilling, and it's obviously a lower cost investment. So for all those reasons, we would not disagree. And frankly, we'll be happy for either the jackup or the floater segment to bottom and start to build. We won't be particular about which one does first, because as you know, we're still in the midst of this downturn with falling demand quarter-on-quarter.

So we don't have a different view on that. We're ready for one of these sectors to bottom. We're also ready to put one of our rigs back to work, and we're feeling increasingly optimistic that we can do that, and we are seeing some other activity out there. Everybody has talked about the Middle East, but we're also seeing some other areas of opportunity. So if what you say is – comes to fruition that we get this thing to bottom earlier, perhaps we'll put more than one of our rigs to work in early to mid-2017.

Ian Macpherson



Analyst, Simmons & Company International

Okay. Is that opportunity that you have something what's in term behind it or is it fairly short-term in nature?

Robert J. Saltiel

Δ

President, Chief Executive Officer & Director, Atwood Oceanics, Inc.

No. It does have some term.

Ian Macpherson

Analyst, Simmons & Company International

year for Osprey, and probably not more than one jackup at an active cost level for the year, is that a correct interpretation.

Okay. And then lastly, if you don't mind, Mark, I just want to see if I could get [ph] a frame (24:20) the cost guidance for 2017, again. If I understood you correctly, it assumes a relatively idle year for Condor, a relatively full year for Osprey, and probably, not more than one jackup at an active cost level for the year, is that a correct

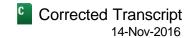
Mark W. Smith

Senior Vice President and Chief Financial Officer, Atwood Oceanics, Inc.

А

That's a correct interpretation, Ian. As I said, "the cost will increase if we secure contracts for these idled and actively marketed vessels."

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Ian Macpherson

Analyst, Simmons & Company International

Okay. And then, for Achiever, does your cost level fluctuate materially between when you're on standby and when you get back to drilling for Kosmos in the middle of next year?

Mark W. Smith

Senior Vice President and Chief Financial Officer, Atwood Oceanics, Inc.

We have been able to reduce our costs somewhat. However, that is really a savings for the client as we've maintained margin neutrality at the 95% standby rate.

lan Macpherson

Analyst, Simmons & Company International

Got it. Perfect. Thank you.

Operator: Thank you [Operator Instructions] Meanwhile, we'll move to Kurt Hallead with RBC. Please go ahead. Your line is open.

Kurt Hallead

Analyst, RBCCapital MarketsLLC

Hi, good morning.

Robert J. Saltiel

President, Chief Executive Officer & Director, Atwood Oceanics, Inc.

Good morning.

Kurt Hallead

Analyst, RBCCapital MarketsLLC

So, I guess we can infer or outright take away from your comments, Rob, that there are some potential green shoots on the horizon from a offshore rig dynamic and maybe can provide your outlook once you get beyond 2017, how do you see the supply/demand dynamics converging for deepwater and then for jackups?

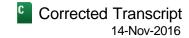
Robert J. Saltiel

President, Chief Executive Officer & Director, Atwood Oceanics, Inc.

Well, on the supply side, as I mentioned in the prepared comments, we clearly have got more supply at this point than we need as an industry. And that's why we're seeing market utilization fall, and obviously that's a big determinant of day rates. So, we either need to see increasing supply attrition and/or increasing demand to get market utilization back in line, because that's really when we as drillers have a chance to get some return on our capital is when market utilization gets to a reasonable level, which it clearly is not right now.

On the demand side, we are seeing some opportunities going forward. I mean, these are green shoots coming off of pretty low base, but there are some opportunities out there. But we continue to believe, and we've said on previous calls that oil price is going to be a big driver of companies going back to the offshore to drill, especially the larger companies.

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And the number we've consistently talked about is \$60-plus, and I know some people want to talk about the 50s, but we think that we really need a sustainable price of \$60-plus to really give offshore drilling the boost it needs to get back on its feet. And obviously, that's anybody's guess when we get to that level. We're convinced that we will, but we certainly hope that sooner rather than later. So, hopefully, that gives you a little color on how we're looking at the market going forward.

Kurt Hallead

Analyst, RBCCapital Markets LLC

Q

Yeah. That's great, Rob. Appreciate it. Thank you.

Robert J. Saltiel

President, Chief Executive Officer & Director, Atwood Oceanics, Inc.

You're welcome.

Operator: Thank you. And at this time, we have no further questions. I'd like to turn the conference back over for any closing comments or remarks.

Robert J. Saltiel

President, Chief Executive Officer & Director, Atwood Oceanics, Inc.

We don't have any closing comments, but other than to say thanks to everybody for joining today's earnings call. Our next call will be in February 2017 to discuss our first quarter results. In the meantime, have a good day.

Operator: Thank you. This does conclude today's conference. You may disconnect at any time, and have a great day.

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