Event Transcript

Company: Santos Limited

Title: 2016 Half Year Results

Start of Transcript

Operator: Ladies and gentlemen, thank you for standing by and welcome to Santos' 2016 half year results conference call. At this time all participants are in a listen-only mode. There will be a presentation followed by a question and answer session, at which time if you wish to ask a question you need to press star one on your telephone. I must advise you that this conference is being recorded today, Friday August 19, 2016. I would now like to hand the conference over to your first speaker today, Mr Kevin Gallagher, Managing Director and Chief Executive Officer for Santos. Thank you; please go ahead.

Kevin Gallagher: Good morning everyone and thank you for joining us for our 2016 half year results. Joining me here today is our Chief Financial Officer Andrew Seaton. Today I'm going to start with some opening remarks before handing over to Andrew to discuss the financial results. Following that, I will take you through our operations, before opening the call to any questions.

Before we start, please note a disclaimer on slide 2 which highlights that the presentation contains forward-looking statements. This will also be the first financial result that Santos has reported in US dollars. All figures included in this pack will be in US dollars unless otherwise stated.

Ongoing low oil prices continue to challenge our business and the oil and gas industry as a whole. However, the long-term outlook for gas remains strong, driven by population growth, global urbanization and the need for a cleaner energy mix. Santos is well positioned to participate in this growth. Our aim is to create sustainable shareholder value by becoming a low-cost, reliable and high-performance business.

While there is still some way to go, I believe that you will see in our results that we are headed in the right direction.

Slide 4 sets out our key priorities in more detail. We have taken swift and decisive action in the first half to stabilize the business. We are now focused on increasing operating cash flow. Our aim is to be cash flow breakeven at a US35 to US40 per barrel oil price on a portfolio basis.

Good progress has been made on implementing our new operating model and driving costs out of our business. We're building strong technical capabilities and an operating culture, driven by a low-cost and performance-focused mindset. We have adopted a disciplined approach to capital allocation in order to improve returns on capital. We'll also look for opportunities to optimize and shape the asset portfolio to reduce our exposure to higher-cost assets.

Moving to financial performance on slide 5, the first half results reflect the impact of the lower-for-longer oil price environment on our profits and the value of our assets. We reported a net loss of US1.1 billion. This includes the GLNG impairment of US1.05 billion after tax announced earlier this week. The impairment was the result of a slower ramp up in upstream production and increasing costs of acquiring third-party gas. Excluding impairments and other one-off items, we recorded an underlying net loss of US5 million after tax for the half.

In line with the new dividend framework, the Board has resolved not to pay an interim dividend. We accept that this will be disappointing for some shareholders, but the Board considers this decision to be in the overall best interests of the Company.

Operating cash flow was US291 million during the half. We reduced net debt by US220 million from the full year.

Slide 6 sets out a summary of the first half operational achievements. We set the ambitious challenge of making the business free cash flow breakeven on a portfolio basis at an oil price of US35 to US40 per barrel. I'm proud to say that everyone at Santos is embracing this challenge, adopting a low-cost mindset to drive down costs safely and sustainably. I'm also pleased to say that we maintained our excellent safety record, with injury rates at record lows.

First half production was a record 31 million barrels of oil equivalent, up 10% on the previous year. This was driven by increased production from GLNG and strong production results from PNG LNG and Darwin LNG.

Capital expenditure is down 58% to US283 million. Production costs are down 15% to US8.8 per barrel of oil.

As part of our organizational restructure, we have removed 253 positions from the business at the end of June, generating a sustainable cost savings of US35 million per annum. We have identified US110 million in supply chain savings year to date and have consolidated our office accommodation, resulting in the removal of six office leases.

Better operational efficiency has also seen drilling costs in the Cooper Basin and GLNG reduce significantly, down to $5.3 million and $2.2 million respectively.

Importantly, as a business, we were cash - sorry, we were free cash flow positive for the last two months of the half. I am pleased to say this trend has continued through July.

Forecast free cash flow breakeven across the portfolio has reduced by 7.5% during the half from US47 to US43.5 per boe.

Slide 7 outlines our safety performance which is an important indicator of our operational performance and a critical focus for me, as CEO. Santos is committed to a workplace where we all go home without injury or illness. After all, a safe business is a sustainable business.

As mentioned, we have maintained an excellent safety record in the first half, with the lowest injury rates on record. As an organization we have celebrated six months loss-time injury free and our contractor workforce has achieved 10 months loss-time injury free. That's our best contractor record in five years. During this year we were awarded the APPEA Safety Excellence Award, which recognizes excellence in safety performance and management in the Australian oil and gas industry.

I am very proud of these achievements. They demonstrate that even during periods of significant change, our people are focused on staying safe. I'll now hand over to Andrew to run through our results.

Andrew Seaton: Thanks Kevin and good morning to all. Turning firstly to the summary on slide 9, Kevin's already spoken about our near-term priorities and the actions that we've taken in the first half. With the commissioning of the GLNG train 2 in May, our major capital expenditure phase is now clearly behind us.

This is a key turning point and the Company has now been free cash flow positive in each of the last three months. We remain heavily leveraged to the oil price. Our operating sensitivity is such that a US1 a barrel movement in oil price results in a US30 million per annum change in operating cash flow.

So, to be clear, if the oil price continues to average above our breakeven price of US43.50 a barrel, we expect to be reducing debt, or net debt, month on month. Of course, debt reduction remains our focus, with net debt down by over US200 million in the half to now sit at US4.5 billion.

Turning to slide 10, you can see the results summary for the first half. As Kevin previously noted, this result is presented in US dollars for the first time, reflecting the primary currency of our revenues, assets and liabilities.

EBITDAX was down 39% to US491 million, as favourable movements in sales volumes and production costs were more than offset by lower commodity prices and other operating expenses.

Production costs were 7% lower in absolute terms, or 15% lower on a unit basis, as the cost reduction focus continued. Other operating costs increased by US80 million, including US26 million one-off charge for an onerous pipeline contract. I'll speak to these costs in more detail on a subsequent slide.

Kevin's already spoken to the GLNG impairment. I reiterate that the impairment will not have any impact on our debt facilities. S&P confirmed on Monday that it will not have any impact on our credit rating.

Net finance costs were higher, notwithstanding our lower debt balance, as GLNG funding costs were expensed following start up rather than capitalized.

Moving to slide 11, production was a record for the first half and 10% up on the corresponding period. LNG production was up 37%, reflecting the ramp-up of GLNG and strong performances from both PNG and Darwin. Our 2016 full year guidance is maintained at between 57 million and 63 million barrels of oil equivalent.

Moving to slide 12, sales revenue was 6% lower, notwithstanding the higher production. Clearly the key contributor was lower realized prices, with the oil price down 29% and the LNG price down 42%. Sales gas and ethane revenues increased, mainly reflecting higher sales volumes of domestic gas in Western Australia and also the ramp up of the Horizon contract.

This result also demonstrates the defensive nature of our domestic gas business, where some of our gas sales contracts, particularly in Western Australia and Indonesia, are not impacted by lower oil prices.

Moving now to production costs on slide 13. Cost savings and efficiencies are being realized across our operated assets and we're also seeing similar outcomes in assets that are operated by others. The main focus here has continued to be labour costs, procurement, supply chain management and other process improvement initiatives.

In aggregate, unit production costs were down 15% to US8.8 a barrel in the first half. At the individual asset level, Cooper Basin, PNG LNG and Bayu-Undan unit costs were each down between 12% and 16%. Based on this first half performance, we've lowered our full year guidance to between US9 and US10 per boe.

LNG plant costs increased as GLNG trains 1 and 2 started up in September 2015 and May 2016 respectively. Pipeline tariffs and associated compression costs increased. This was due to the supply of Santos portfolio gas to GLNG which is delivered at Wallumbilla.

In addition, we've recognized a one-off US26 million charge for an onerous contract for unutilized pipeline capacity. This primarily reflects the expected lower availability of third-party gas in Eastern Australia, as a result of the lower oil prices.

On slide 14 the chart on the left clearly shows the step-change down in CapEx over the last three years, as our major LNG investment phase has come to an end. Year-on-year CapEx is down nearly 60%, reflecting a more prudent and disciplined approach to capital allocation in the present environment.

Our guidance for 2016 is maintained at US750 million. This reflects an expectation of higher CapEx in the second half due to phasing of expenditure in both the Cooper and GLNG, combined with higher exploration spend, mainly due to the drilling at the Strickland-1 well in PNG.

Slide 15 shows our net debt and liquidity position. Operating cash flow was US290 million for the half. Including proceeds from asset sales, and after accounting for investing cash flows, the Company generated US311 million in free cash flow, of which US43 million funded the final 2015 dividend payment, with the remainder applied to net debt reduction. As a result net debt has reduced to US4.5 billion as at June 30.

The make-up for our debt facilities is summarized on a back-up slide. But included in the net debt is some US1.8 billion of non-recourse, PNG LNG project finance, and also US1.1 billion relates to the European hybrid notes. These subordinated notes mature in 2070, while we do have the option to redeem the notes from September 2017. The remainder of our debt, which is our senior unsecured debt, is around US2.3 billion.

The total liquidity stood at - US3.3 billion at the end of the period, including US1 billion in cash.

In closing, while the external environment remains tough, we continue to take steps to stabilize the Company. We have made material and sustainable cost reductions, albeit with more to be done. We've reduced our net debt and we are now free cash flow positive at current oil prices. I am confident that we've taken the necessary steps to ensure that we have a solid platform to manage the business through this business of low oil prices. With that I'll hand back to Kevin.

Kevin Gallagher: Thank you Andrew. As you all will be aware, Andrew will be retiring as CFO following 11 years of service. I'd like to take this opportunity to thank Andrew for his contribution to the Company during his tenure. Andrew's insights and knowledge have been invaluable to me over the last six months. The Executive search for Andrew's successor is well advanced and we will update the market in due course.

Slide 17 details our longer-term journey to become a low-cost, high-efficiency producer and a market leader in onshore gas operations. The first six months of this journey have been one of the most challenging and exciting periods of my career. The pace of positive change has been very reassuring. In six months we have completed a full review of our asset portfolio, restructured the business and implemented a new operating model, established a new leadership team, instilled a disciplined approach to the allocation of capital and commenced a cost-out program, underpinned by a low-cost mindset that is starting to deliver some real results.

Looking to the future, we will maintain a disciplined approach to capital allocation and look for opportunities to optimize the asset portfolio. But to be absolutely clear, the best thing we can do for our business right now is to continue to take costs out.

Slide 18 sets out the new asset-based management structure. We've transitioned from a geographic business unit structure to a centralized, asset-based organization, built around strong technical capabilities and exploration, development, production and sales.

We have established a new leadership team, reducing it from 13 to 7 direct reports to myself. I would also like to welcome our most recent appointment to the team, Naomi James, who joined us at the beginning of August. Naomi has been appointed as the Executive Vice President, Environment, Health & Safety and Governance, and will focus on integrated outcomes across those areas. I am confident we are building the right team for the journey ahead.

Moving to the Cooper Basin on slide 19, we are working closely with our joint-venture partners to maximize value and improve margins. Unit production costs are down 15% on the previous corresponding period and drilling costs are down US2 million from 2014, to US5.3 million per well.

Let me say how impressed I am by the attitude of our team in the Cooper who are committed to searching for every opportunity to safely and sustainably drive costs down further. The Cooper Basin is an important asset for Santos and we are reviewing opportunities to maximize its value as we optimize our portfolio.

Moving to slide 20, the material impairment charge on the value of our interest in GLNG will not affect our capacity to deliver currently contracted off-take commitments. During the course of 2016 there has been a slower ramp up of GLNG equity gas production. Fairview continues to perform well and Roma, the Pleasant Hills and Hermitage areas are performing to expectations. However the Raslie area is taking longer to de-water than expected. It's too early to say whether the slower production will continue. You can be assured we're keeping a close eye on it and, I remind you, that the Roma field has more extensive opportunities than the current three producing areas alone.

At Arcadia, we have successfully implemented our slower draw-down philosophy, that minimizes stress and maximizes de-watering rates. Gas rates have increased and the vertical frac well type is now proven. The first phase of field development is expected to be online by year end.

We have shipped 50 cargoes since first LNG in September 2015. This reflects the near-flawless start-up of trains 1 and 2 which have set a new industry benchmark in LNG commissioning and start-up operations. Our aim now is to deliver value by safely and sustainably establishing GLNG as an industry leader at low-cost onshore operations.

Touching on PNG on slide 21, this is a region that we've been investing in for over 20 years and it remains a core region for our business. To the north-west of the PNG LNG fields we are currently drilling the Strickland-1 exploration well. The well is testing a large Toro structure in the foothills adjacent to the Juha gas condensate field.

At PNG LNG Exxon-Mobil are continuing to deliver excellent operational results. The project has shipped 214 cargoes since start up and has an annualized production rate of 7.7 million tonnes per annum. Santos will continue to invest in PNG and look to participate in the expansion of the PNG LNG project over time.

Moving to slide 22, Bayu-Undan and Darwin LNG continue to deliver strong and reliable performance. The operator, ConocoPhillips has also done an excellent - exceptional job in reducing cost and running the facility safely and reliably. Our successful three-well appraisal campaign was completed for Barossa-Caldita in 2015 and this has resulted in a significant increase in the resource base for the fuel with back-fill potential for Darwin LNG.

The joint venture has committed to an extensive engineering and sub-surface program to progress development of the resource. It is also continuing concept and feed development planning studies and preparing for appraisal drilling early next year.

Santos has a significant resource base across Northern Australia, including Crown-Lasseter and Petrel-Tern, and these provide potential growth opportunities in this region.

So to recap, over the last six months we have completed a full review of our asset portfolio, restructured the business and implemented a new operating model, established a new leadership team, instilled a disciplined approach to the allocation of capital and commenced a cost-out program underpinned by a low-cost mindset that is starting to deliver some real results.

However, as I have already said, there is still a long way to go in our journey. Over the next six months we will continue to increase operating cash flow through cost reduction and productivity improvements. We will continue to focus on reducing net debt. Allocation of capital will remain disciplined. We will continue to look for opportunities to optimize and shape our asset portfolio. The objective is to create a good balance of conventional and unconventional assets, that will provide more stable returns through the cycle.

Thank you. I'll now hand over to the operator so that we can take your questions.

Operator: Thank you. Ladies and gentlemen, if you would like to ask a question today please press star followed by one on your telephone keypads and wait for your name to be announced. If you wish to cancel your request, please press the pound or hash key. Our first question today comes from the line of Dale Koenders from Citigroup. Your line is now open.

Dale Koenders: (Citigroup, Analyst). Good morning gentlemen. A couple of questions; just firstly, Kevin, for confirmation, with the announced redundancies and the small reduction in OpEx guidance, can you confirm where we are in the cost-out? So is restructuring benefits now down, and it's really the next six to 12 months we'll see cost-out at the asset level delivered?

Kevin Gallagher: No, look, that's a good question Dale. The cost-out program has really only commenced. What we've been able to communicate to you today is the reduction in headcount has resulted from simply restructuring the organization at a high level. The further optimization across the different parts of the organization will continue throughout this year and throughout the first part of next year.

Dale Koenders: (Citigroup, Analyst). Do you have any aspirational targets for that cost-out?

Kevin Gallagher: Look, it's too early to be setting notional targets. It's - I see this more as a continual, ongoing program. I think there will be still significant costs to come out in the future.

Dale Koenders: (Citigroup, Analyst). Okay. On the production and OpEx guidance, can you fill in the blank for me? I guess, production costs US8.8 per boe in the first half and full year guidance of US9 to US10, infers a 20% increase half on half. Production guidance of 57 to 63 versus 31 mmboe in the first half infers like you're taking mid-point flat to down production in the second half. Is guidance just conservative or is there something we're missing?

Andrew Seaton: Perhaps if I take that one, Dale. The guidance for between US9 and US10 operating costs in the second half, we expense shut down activity work over activity, so you sometimes get lumpy expenditure through the year and that's what we're expecting in the second half. Then so, the lower to bottom end of that guidance range is really based on the performance that we've seen in the first half.

But it's not only Santos that's taking cost out. I made the point earlier; our joint venture partners we're seeing a lot of costs out. So what we're seeing there as well is budgets revised, coming back from our partners.

Your second part of the question on production, we've held up with the range since the start of the year. We've had a good solid performance in the first half and we hope that that extends into the second half. Obviously it's a complex portfolio with a lot of different moving parts. We will be taking GLNG train 1 down for a period of time in the second half. We'll probably look to narrow the guidance range when we come to our third quarter report in October.

Dale Koenders: (Citigroup, Analyst). Okay. Then on GLNG, I guess the comments about - with the impairment, focusing on delivering gas to contractual levels, does that mean the CapEx guidance, US900 million per annum for the first five years, is possibly too high?.

Kevin Gallagher: Sorry Dale, I missed that. Could you just repeat the second part of your question?

Dale Koenders: (Citigroup, Analyst). I guess your comment, Kevin, about delivering gas for GLNG to meet contractual obligations and not looking to, I guess, produce at higher levels, I guess the CapEx guidance for GLNG stays at US900 million for the first five years on average? You're obviously looking at cost reductions in wells as well. Is that guidance too high there?

Kevin Gallagher: Yes, well, I think what I would say on that, Dale, is that the previous guidance, I don't want to get hung up on previous guidance or on CapEx. We will look at our CapEx over the longer term for this project. Our production quantities are obviously set to an annual delivery plan process on an annual basis. We will be adjusting our CapEx assumptions down and up according to whatever those contractual commitments demand.

Dale Koenders: (Citigroup, Analyst). Okay. Then just finally on Arcadia, obviously connecting [intra-pilot] [unclear], it sounds like those results are doing well. Could you maybe tell us what you're seeing in terms of average flow rates in Arcadia? From my understanding there's only about half a tcf of gas included in the reserve for Arcadia so is there potentially an upside there.

Kevin Gallagher: I think we'll wait until that field comes on line before we give any guidance or any communications on well performance.

Dale Koenders: (Citigroup, Analyst). Okay. Thanks guys.

Kevin Gallagher: Cheers Dale.

Operator: Our next question today comes from the line of James Redfern from Merrill Lynch. Your line is now open.

James Redfern: (BofA Merrill Lynch, Analyst). Hi Kevin, good morning. I just have a few questions please. The first one, can I just confirm that all gas outs from the Cooper Basin will be oil linked from the end of this year, I.e. there are no legacy CPI-indexed contracts, as I say, from the end of this year?

Second one, in terms of lowering free cash flow breakeven from US43.50 to US35 to US 40 on an ongoing basis, what do you think is the biggest lever you can pull there? Is it further reductions in the Cooper Basin production costs, or is it somewhere else in the business that you think that you can make these big step changes? Thank you.

Kevin Gallagher: Okay. Thank you James. Look, on your first question about Cooper gas being oil linked, predominantly it will be oil linked from the end of this year.

In terms of levers around reducing our free cash flow breakeven point, there are a number of levers, James. Yes, reducing OpEx is a big part of that. That's not simply a case of asking people to do more with less. It's also around re-engineering our operating model across all of our assets. But a bigger lever is maintaining discipline in the allocation of capital and driving capital efficiency across those operations, so whether that be drilling costs or any other CapEx expenditure that we have, and ensuring that we're getting the best bang for the buck.

James Redfern: (BofA Merrill Lynch, Analyst). So, just as a follow-on to that, is that putting more pressure on your service companies to lower their costs, your joint providers? Or what is the -

Kevin Gallagher: Look, it's about re-engineering the way we do things and our service providers are a big part of that, yes, sure. But some rate reduction is a consequence of the drop in oil prices, However we all know that they'll come back in the future. So what we're really focusing on is sustainable cost reduction and becoming a low-cost, reliable and high-performance business in the longer term. We'll only do that by becoming efficient, becoming a learning organization; not doing things that we shouldn't be doing and driving a low-cost mindset across our business. A big part of that is building a business that can focus on delivering what we promise.

James Redfern: (BofA Merrill Lynch, Analyst). Okay, thank you. Can I just ask one more question, just relating to GLNG. If we assume that the production is now 7.2 million tonnes, being your contracted volumes pending for ramp-up of train 2, are you confident that you have enough 2P gas reserves within your portfolio as well as contracted third-party gas to deliver those volumes for the life of the project? Or do you still need to buy more third-party gas at some point? Thank you.

Kevin Gallagher: Thank you. First of all, we don't comment on the contracted volumes because of the confidentiality nature of the contracts. But those volumes are set through an annual delivery plan process. As I've stated previously, between our current reserves position and the strategy for third-party gas, we are confident that we can meet those contract commitments.

James Redfern: (BofA Merrill Lynch, Analyst). Okay. Okay, thank you Kevin.

Operator: Our next question today comes from the line of Nik Burns from UBS. Your line is now open.

Nik Burns: (UBS, Analyst). Thank you. My first question is just around the asset portfolio review you've undertaken, Kevin, since you've been there. I guess I just wanted some high-level comments or thoughts from you, once now that you've completed that process, were there any surprises that came out of it from your perspective, and any opportunities or risks that emerged through that process, and whether there were any logical assets that were earmarked for sale as part of that process. Thank you.

Kevin Gallagher: Just on - yes it's a very comprehensive asset review process. What I would say is that we are under no pressure to sell any assets. There are no current sales processes for any assets. Obviously we wouldn't be doing our job if we didn't consider opportunities that optimizes the portfolio mix and shareholder returns and we would always look to do that. But we have a range of options available. That was - I guess that's one of the pleasant surprises, that we have growth opportunities within the portfolio. We'll do what's right for the business in the longer term, by managing the business on a portfolio basis and making those decisions when appropriate.

Nik Burns: (UBS, Analyst). Right. So is that - I guess we'll learn more about that later this year at your Investor Day, where we could get more colour on your thoughts around individual assets?

Kevin Gallagher: Yes, I'm sure there will be some updates throughout the year and Investor Day that we would be able to talk about some of those aspects.

Nik Burns: (UBS, Analyst). All right. Just on GLNG, just your commentary around the slower ramp up, and I take your point that it's just one of the three areas focused on to date that has underperformed, I guess if we look at your total Roma acreage footprint, it's quite a large area; in my estimates, I think around 50% of GLNG's equity reserves are in the Roma area. So should we be concerned that this could have implications for reserves around - in the broader Roma area given, generally speaking, you tend to develop your better acreage first? Could that lead to, potentially, either having to drill more wells further down the track and, potentially, higher CapEx rather than lower CapEx or - yes. If you could comment on that please, I'd appreciate it.

Kevin Gallagher: All right, good. Let me just say, and it goes back to your previous question, Nik, around the asset review process as well, that one of the things I talked about in February, that ultimately I would like Santos to be an organization that's known for delivering what it promises. The asset review was part of that. The first step in that process is to ensure that the promise is correct. So that's what the asset review was all around. Unfortunately an impairment was part of the outcome of that.

So in terms of the Roma part of that picture, as I've said already, two parts of Roma are performing to expectation. Raslie is water - de-watering is slower than expectation. But what's important to note here is that it's far too early for us to tell whether that's a structural issue or not, a reservoir issue or not. As we've also said earlier on, there are further opportunities across the Roma field.

A good example is Arcadia. Arcadia a couple of years ago was having de-watering issues and it was by learning the right well types and the vertical well type [that were proven up], that we were able to overcome some of those problems, and the process of drilling wells, the radial approach to drilling wells, that helped us to improve the de-watering performance on Arcadia. Now Arcadia is performing well.

So, look, I think it's far too early to tell. What we will do though and what we will commit to doing is to continue to update you as we learn more.

Nik Burns: (UBS, Analyst). Right, that's clear. Thanks Kevin.

Kevin Gallagher: Thank you.

Operator: Our next question today comes from the line of John Hirjee from Deutsche Bank. Your line is now open.

John Hirjee: (Deutsche Bank, Analyst). Thank you. Good morning everyone. A couple of questions if I may. Firstly let's start with GLNG. I just wanted to get an update on to how the performance of the Horizon contract is going into GLNG. Obviously you're the key supplier there, so just wanted to understand the Horizon contract is performing to expectations, are you at your maximum or where you are with that particular contract.

Andrew Seaton: Yes, John, Andrew here. Yes, we're delivering into that full contract, 147 terajoules a day and we have been doing so for some time.

John Hirjee: Okay, thank you. The second question relates to PNG LNG, and obviously you're seeing Oil Search, Exxon movements there in terms of InterOil. I just wanted to get an understanding in terms of potential expansions how Santos could benefit from the integration of the Papua LNG and the PNG LNG and how Santos expects to participate in some of those expansions going forward? So could you just elaborate on Santos' position with regards to expansion of PNG LNG.

Kevin Gallagher: Yes. Look, I think, first of all let me just reiterate what I said earlier, that PNG is a core asset for Santos. We've been there - we've been investing in PNG for over 20 years. It's too early to tell how it's all going to pan out in PNG, but we're very focused on maintaining PNG and potentially strengthening our position over the longer term in PNG. We will look to continue to invest and participate in the project expansion.

Beyond that, I'm not really prepared to speculate, John, at this point in time. On the basis of what I've said, I think we'll wait and see how it all pans out over time.

John Hirjee: Okay, fine. Thank you. Finally a question, Andrew, in terms of the debt reduction that you achieved in this period, obviously you're constrained by not being free cash flow positive, but you mentioned that you were free cash flow positive in the context of the last three months. Is it fair to say that the largest proportion of that free cash flow will go to debt reduction; is that a fair estimation of what we should assume going forward?

Andrew Seaton: Yes, John, there's an absolute focus on debt reduction. So Kevin's talked a lot about capital discipline and capital allocation. Really the discipline we are bringing to the portfolio now is to make sure that we're in a position where we can repay debt through operating cash flow and therefore free cash flow.

Kevin Gallagher: John, just on - and by the way, that was three questions, but we'll let you off with that today. Just on that, I've said from the outset that the first six months was all about stabilizing the business. What we meant there was getting the business to a point where we're not bleeding cash month to month. So it's pleasing to see that already, for the last three months, we've been free cash flow positive. So all of those things we talked about, the review of the assets, understanding the asset performance, restructuring the business and putting in place a new operating model, getting the team in place, instilling that capital discipline that Andrew talked about, was critical, given that we're operating in this tough environment. It was critical in order to put in place a sustainable business model that stabilizes the business if you like and sets the foundation so we can start to go forward.

John Hirjee: (Deutsche Bank, Analyst). Thank you very much.

Kevin Gallagher: Thank you.

Operator: Our next question today comes from the line of Mark Samter from Credit Suisse. Your line is now open.

Mark Samter: (Credit Suisse, Analyst). Yes, morning guys. I think rang that I'm going to ask this question, and my last note, so hopefully someone forewarned you that I am going to ask the question. Obviously the ADP hasn't been done for next year for GLNG but - and we all know there's a contractual route but none of us, on the outside, know what the contractual route looks like.

Is there any possibility that you can honour the 2017 contractual obligations through 1 train and it's operationally efficient to mothball the second train, or maybe, with a little bit of help, one of the other trains which is still - on one of the other projects which is still operationally more efficient?

Kevin Gallagher: Look, Mark, thank you for that question. Yes. I was aware that that's a question you've been asking previously. The reality at this point in time the ADP has not been finalized for '17. That process is ongoing just now and the budgeting process that goes with that is ongoing just now. However what I would say is that we wouldn't be looking to ever mothball 1 train. We have no plans whatsoever at any point in time, and our forecasts, that we communicated the impact of earlier this week, don't envisage that scenario.

But what I would say is that we will operate both trains, but potentially at reduced capacity, to optimize the production across the facilities. That will change with time, from year to year, depending on market conditions and depending on the annual delivery plan requirements.

Mark Samter: (Credit Suisse, Analyst). Okay, perfect. Then just I think one other question around the volumes. Do they have any implication on a go-forward basis on the volumes Horizon has to deliver into GLNG, or should we effectively think equity gas will swallow all of the delta in LNG volumes?

Andrew Seaton: Yes, Mark, the Horizon is a fixed contract. It is, as I said before, 147 terajoules a day or 50 petajoules a year for the next 15 years. The project has been successful in picking up some additional third-party volumes over the last year or so. So again the project will budget, each year, for an amount of CapEx and an amount of third-party gas to manage the throughput.

Mark Samter: (Credit Suisse, Analyst). Yes, actually, is it considerable next year that you actually have excess gas, beyond what honours contractual obligations and what would you do, if you do, or is that not really particularly considerable to know?

Kevin Gallagher: Well look, it's one outcome on a range of outcomes, and it really depends on what the ADP reflects and what our contractual commitments reflect. As we've discussed before, Mark, there's a market aspect to that as well, depending on what price you could get for that additional gas, right, which market offered the best opportunities.

Mark Samter: (Credit Suisse, Analyst). Okay, that's perfect. Thanks guys.

Kevin Gallagher: Thank you.

Operator: Our next question today comes from the line of Mark Wiseman from Goldman Sachs. Your line is now open.

Mark Wiseman: (Goldman Sachs, Analyst). Hi guys. Thanks for the update. Just a question - or two questions, firstly on the US65 million liquidated damages. I just wanted to confirm was that in your net operating cash flow as well for this period. If so, it's about a quarter of your net operating cash flow; can you just give some background as to what that contract was and what's happened there?

Andrew Seaton: Okay, thanks Mark. No, that US65 million was not in net operating cash flow and I'll explain the background to it. This was - I guess, that was an agreement which has been on-foot for a number of years now. The original agreement contemplated a liquidated damages regime if the customer wasn't able to take the contractual volumes. But over the years we've actually given that customer some relief by - instead of charging liquidated damages, when they haven't been able to take the gas, we've given them a gas banking type of arrangement. So they have been paying for the gas all along, but it's been going to our balance sheet as deferred income, but it hasn't been going through our profit and loss.

In the first half of this year though we, together with that customer, renegotiated the contract to be more true to the original intent of the contract, which was liquidated damages. So, by renegotiating this contract, what we've done is picked up some of the liquidated damages from the last few years now through the P&L, but there is no cash flow impact. But moving forward we will charge that customer LDs rather than banking arrangements.

So it is a little complex, but it's really just part of our normal business, in working with our customers to meet their needs.

Mark Wiseman: (Goldman Sachs, Analyst). Okay, great. Thanks Andrew that makes sense. Just second question, just on the Roma fields again. I understand what you're saying EURs per well may not change overall; Raslie area reserves may not change. But just, in the interests of transparency, if you're able to give people a bit of a sense of just how much of the booked reserves that GLNG relates to, that Raslie area?

Kevin Gallagher: I think Mark we'd be probably in a position to give more information around that at the Investor Day later in the year.

Mark Wiseman: Okay great, thanks.

Kevin Gallagher: Thank you.

Operator: Our next question today comes from the line of Adam Martin from Morgan Stanley. Your line is now open.

Adam Martin: (Morgan Stanley, Analyst). Morning. Just back on the free cash flow breakeven towards US35 a barrel, do you think the OpEx side of the equation or the maintenance drilling, so the equation has more to offer there and the other side of it is just risks? Clearly you can take out a lot of people, that will drive OpEx down, but just trying to get a sense of risks as well. Thanks.

Kevin Gallagher: Thank you Adam. To answer your first question, yes, it certainly has more to offer. The second point you make is an important one, and that's why it's not just a case of simply reducing people; it's about re-engineering the way we operate our facilities. It's about re-engineering the way we do what we do so we can do it at a lower cost, but that we do not sacrifice reliability.

Adam Martin: (Morgan Stanley, Analyst). Okay.

Kevin Gallagher: As I said previously, it's about becoming a low-cost, reliable and high-performance business.

Adam Martin: (Morgan Stanley, Analyst). Just another question, is there any update on pipeline sales? You've previously flagged 12 to 18 months ago that you had appointed advisors. There was press speculation a couple of weeks ago. Can you update the market on that?

Kevin Gallagher: There's a lot of press speculation. As I've said, from the minute I came into this role, we're not going to comment on speculation. If there's anything to report in that area, if there's any developments or any type of asset sale, it will be talked about at the time there's something to talk about.

Adam Martin: (Morgan Stanley, Analyst). Okay, thank you.

Operator: Our next question today comes from the line of Andrew Hodge from Macquarie. Your line is now open.

Andrew Hodge: (Macquarie, Analyst). Thanks guys. Just the two questions, but I won't ask - I appreciate, I guess, the colour you guys are giving around the breakeven numbers. But I was wondering whether firstly if you could give any further breakdown for GLNG?

The second question that I wanted to ask is really just about WA, because there wasn't really much of a focus there on the presentation. So I'm just - in terms of how you guys have done the asset review, in reviewing things and what's core, I'm just curious about how you guys view those assets within your portfolio.

Kevin Gallagher: Yes. I'm not going to comment on what's core and what's not core. As I've said earlier, and I'll reiterate, we are not under any pressure to sell assets. There are no current sales processes. We'll consider opportunities, any opportunities to optimize our portfolio. We'll continue to look at our business on a portfolio basis going forward.

WA is an important asset to us. It has been a very good performing asset and I think I'll just leave it at that.

Andrew Hodge: (Macquarie, Analyst). GLNG [breakeven].

Kevin Gallagher: From a GLNG - we don't break - we don't comment on the breakeven asset by asset. But I can assure you we're measuring every asset and we'll look at improvement opportunities across every asset to drive that breakeven point down.

Andrew Hodge: (Macquarie, Analyst). Okay, thanks guys.

Kevin Gallagher: Thank you.

Operator: Our next question today comes from the line of Baden Moore from CLSA. Your line is now open.

Baden Moore: (CLSA, Analyst). Hi, good morning. Just thought I'd ask a first question on your production cost decline, down 15%. Is there any currency impact in that number and do you know what it would be on a constant currency basis?

Then, second of all, Kevin, I was wondering if I'd be allowed to de-link the two comments you're making on cost out and when you expect the current cost initiatives to be completed by? I think you said the first half of 2017; does that mean we should be expecting that US35 to US40 a barrel by the second half of '17? Is that fair?

Kevin Gallagher: Andrew do you want to take the first?

Andrew Seaton: Yes, let me take the first one. Obviously we've moved to our US dollar reporting basis now and a lot of our costs are US dollar denominated, So clearly we are comparing like for like there on those US dollar costs. But where we've had Australian dollar costs, we have seen a weakening in the Aussie dollar exchange rate over the course of this year. So there is a small FX impact. For example, like in the Cooper Basin, there was about a $6 million FX impact. I'm not sure what that's in dollars a barrel but it's a very small impact.

The majority of the change in - reduction in operating costs is true cost out, true cost saving and also just the mix of the assets.

Kevin Gallagher: Okay, thank you. Thanks for that. The cost-out initiatives, I have stated previously, earlier in the year, I have no idea how low we can drive the cost, cash flow breakeven point to. But we will create a culture and a low-cost mindset in the organization that continually focuses on making that as low as we possibly can. However - so we've set no timeline targets to get to US35 to US40. The important point in the US35 to US40 is that's what we've deemed the range our portfolio has to operate in in the longer term to give us a sustainable business that can fund its OpEx and its sustaining capital activities throughout the cycle. That's the important point of that operating range.

We will have assets in our portfolio at any point in time that will be lower than that and we will have some that may be higher than that. But it's about managing our business on a portfolio basis to ensure if we're in a lower-for-longer environment, or we get an oil price crash from a higher oil price environment, that we're sustainable and we can ride the cycle without having to dip into our balance sheet. That's effectively what that strategy is about.

What I said earlier about - through the mid-point of 2017 was that I would expect that the next phase of cost out would be seen between now and then as we optimize our business across our assets, now that we've restructured the business. Each of my executives are looking within their areas, within their portfolios to how we optimize our business and how we drive that low-cost mindset.

Again I'd like to reiterate the take-up of our staff across our organization has been really impressive and they're contributing to this across all of our major assets.

Baden Moore: (CLSA, Analyst). Thanks Kevin. Could I ask one more question, just on your debt profile, you've got US1.6 billion flagged for refinancing in FY19. When do you think you'll start looking at refinancing that process?

Andrew Seaton: I guess our debt position is such that we've got cash on hand; we've got undrawn bilateral facilities. As part of our normal treasury management operations, we're constantly looking at turning our facilities. I think you'll see us look to go to capital markets for debt, so reduce our reliance on bank debt and export credit agency type facilities. That will happen over time. But certainly our view is we've got a large range of options available in how we manage our debt maturities. As you pointed out, we don't have meaningful debt maturities through 2019.

Baden Moore: (CLSA, Analyst). But no strict plans on when you start marketing that debt?

Andrew Seaton: It's an ongoing thing; as part of our normal treasury management, firstly we're going to be focusing on the cost cutting and so forth that we've discussed today. So that will enable us to repay debt through free cash flow. Then we've got this range of options available, and we'll do what's right for the business at the time. But obviously we'll plan well ahead for any scheduled maturities.

Baden Moore: (CLSA, Analyst): Okay, thanks.

Operator: Our final question today comes from the line of Peter Harris from AMP. Your line is now open.

Peter Harris: (AMP Capital, Analyst). Thank you. If I could just ask the question in a different way; if the oil price was US50 next year, and the spot LNG price was US4, what capacity would you run with two trains at Gladstone at and where would you get the gas from?

Kevin Gallagher: Well we would run the plant to suit whatever the ADP requirements for our customers dictated we needed to run it on. We have gas available to meet those requirements, within the range of our current contract commitments.

Peter Harris: (AMP Capital, Analyst). Okay, thanks.

Kevin Gallagher: Thanks.

Operator: There are no further questions on the line today. Please continue.

Kevin Gallagher: Okay. Well, if there are no further questions, I would like to thank you all for attending the call this morning. I look forward to meeting many of you over the next few weeks. Again, just thank you.

Andrew Seaton: Thanks very much.

Operator: Ladies and gentlemen, that concludes the call for today. We thank you all for your participation. You may now disconnect.

End of Transcript