A strong financial platform to underpin growth

In 2017, the Group continued to moderate investments and preserve a liquidity buffer owing to the force majeure conditions over much of the first half. Following the resumption of operations, a sharp improvement in business performance over the second half translated into a return to profitability and balance sheet improvement

Roger Brown
Chief Financial Officer

The Group continued to benefit from discretion over capital expenditures and in 2017 moderated investments to take account of the interruptions to oil exports at the Forcados terminal in the first half of the year and ensure an adequate liquidity buffer was preserved.

The investments made during the year were primarily directed towards the gas business. Following the lifting of force majeure at the Forcados terminal on 6 June, full production operations were rapidly restored, which enabled the Group to record a sharp improvement in business performance over the second half of the year that translated into a return to profitability and significant balance sheet improvement. In 2018 we will retain discretion over spend, and appropriately phase and scale our investment programme taking into account the prevailing operating environment, availability of export terminals, oil price, debt service obligations and the influence of these factors on free cash generation within the underlying business. We will continue to maintain our strict discipline of only allocating capital to the opportunities that offer the greatest returns to deliver shareholder value.

Revenue

While revenues continued to be impacted during the first half of the year due to the shut-in of the Forcados terminal after the terminal operator, Shell Nigeria, declared force majeure between 21 February 2016 and 6 June 2017 following disruption to the Forcados terminal subsea crude export pipeline, the higher oil production following the lifting of force majeure, together with higher oil price realisations, positively impacted oil revenue, which stood at US$328 million (after stock movements) for the full year, up 121% year on year. Alongside this, gas revenue reached a new record of US$124 million, up 18% year on year and accounting for 27% of total revenue. Consequently, total revenue for 2017 was up 78% from 2016 at US$452 million.

Working interest liquids production in 2017 stood at 17,853 bopd, up from 10,091 bopd in 2016, whilst the total volume of crude lifted in the year was 6.851 MMbbls compared to 3.422 MMbbls in 2016. Global oil prices remained volatile in 2017, with Brent starting the year around the US$55/bbl level and trading down to a low of around US$45/bbl mid-year. In contrast, over the second half of the year Brent traded steadily up to exit 2017 around US$67/bbl. The Group's realised average oil price of US$50.38/bbl in 2017 was up 25% year on year (2016: US$40.4/bbl) and reflects the second half improvement in production and price.

The Group had in place dated Brent put options covering a volume of 3.69 MMbbls to year end at a blended strike price of US$48.38/bbl. The net cost of these instruments in the year was US$19.4 million. The Company has also put in place dated Brent puts covering a further volume of 3.60 MMbbls at a strike price of US$40/bbl during H1 2018 and 3.00 MMbbls at a strike price of US$50/bbl during H2 2018. The Board and management continue to closely monitor prevailing oil market dynamics, and will consider further measures to provide appropriate levels of cash flow assurance in times of oil price weakness and volatility.

To assist in minimising the impact of disruption to key export infrastructure, the Group made necessary repairs and upgrades on two jetties at the Warri refinery that will enable exports to be increased to a gross level of 30,000 bopd if required in the future. In addition to the Warri and Forcados export routes, Seplat is also working with the operator Pan Ocean and NAPIMS (a 100% subsidiary of NNPC) on completion of the 160,000 bopd capacity Amukpe-Escravos pipeline system that will offer a third export route via the Escravos terminal. Seplat plans to tie-in to the new pipeline at the Amukpe location on OML 4. All three export routes are expected to be available in Q3 2018 and the intention is to utilise the multiple export routes to ensure there is adequate redundancy in evacuation routes thereby reducing downtime, which has adversely affected the business over a number of years.

The higher gas revenue year on year was driven by a 20% increase in production to 114.4 MMscfd while the average realised gas price remained relatively stable at US$2.97/Mscf (2016: US$3.03/Mscf). The increase in volume is as a result of the benefit being derived from the Phases I and II expansion of the Oben gas processing facility and production being fully deconstrained following the lifting of force majeure.

Gross profit

Gross profit for the year was US$212 million, an increase of 194% on the prior year (2016: US$72 million). This principally reflects the resumption of full production operations after force majeure was lifted and higher oil price realisations. Direct operating costs which include crude handling fees, barging costs, rig-related costs and operations & maintenance costs amounted to US$80 million in 2017 as against US$83 million in 2016. Production costs were fairly flat when compared to prior year even with a significant increase of 77% in production volumes and 20% increase in gas volumes in 2017 when compared to 2016. This resulted from an improved performance in the overall running & maintenance of the production facility in the current year. In addition, the availability of the Forcados terminal from 6 June reduced the reliance on the more expensive and volume constrained barging operation, which was the only export route available during the force majeure period. Non-production costs primarily consisting of royalties and DD&A were US$160 million compared to US$99 million in the prior year. The DD&A charge for oil and gas assets increased during 2017 to US$82 million (2016: US$54 million) reflecting higher depletion of reserves because of the increased production during the year.

Operating profit

Operating profit for the year was US$112 million compared with a prior year operating loss of US$158 million. Contributing towards the return to operating profitability was a 28% reduction year on year in general and administrative expenses which stood at US$82 million (2016: US$114 million). The operating loss reported in 2016 was also driven by a charge of US$101 million relating to unrealised foreign exchange losses principally on amounts owed by our joint venture partner NPDC.

Tax

The pioneer tax incentive granted by the Nigerian Investment Promotion Commission for a three-year period elapsed at the end of 2015. The Company has prepared its 2017 financial statements including the effect of post pioneer tax status which correspondingly forms the basis of the net tax credits of US$221 million, owing primarily to deferred tax credits of US$224 million, compared to taxation credit of US$6.7 million for the same period in 2016.

The taxation credit is mainly as a result of unutilised capital allowances from accumulated capital expenditure during the pioneer status period. The Group recognises deferred tax assets on unused tax losses and unutilised capital allowances carried forward where it is probable that future taxable profits will be available for utilisation. This requires management to make judgements and assumptions regarding the amount of deferred tax that can be recognised, as well as the likelihood of future taxable profits.

Our relative share price performance vs indices and peers

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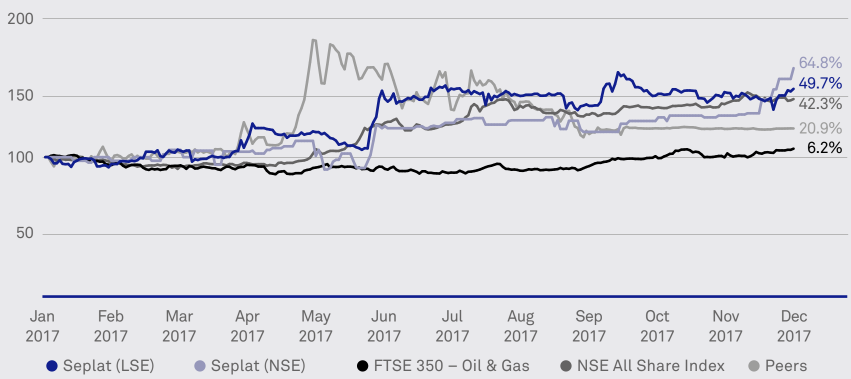
In 2017, both lines of Seplat's equity on the Nigeria Stock Exchange and the London Stock Exchange outperformed relevant indices and peer average, recording top quartile performance.

Share price performance versus indices and peers (rebased to 100)



Source: Bloomberg.

The Group reassesses its unrecognised deferred tax asset each year taking into account changes in oil and gas prices, the Group's proven and probable reserve profile and forecast capital and operating expenditures. The deferred tax credit is expected to gradually reverse in subsequent years as the Company makes profits and utilises the capital allowances.

In line with sections of the Companies Income Tax Act which provides the incentives available to companies that deliver gas utilisation projects, Seplat is entitled to a tax holiday of three years extendable to five years on the new Oben Gas Plant. The Federal Inland Revenue Service was notified in 2017 that there will be a claim on these incentives for the three-year period in the first instance.

Net profit

Profit for the period before tax adjustments was US$44 million, compared to a full-year loss before tax of US$173 million in 2016. This return to profitability was driven by performance in the third and fourth quarters where net quarterly profit before tax of US$24 million and US$46 million respectively offset the US$26 million loss before tax recorded at mid-year. Net tax credits of US$221 million, owing primarily to the deferred tax credits of US$224 million, increased the overall profit after tax for the year to US$265 million. The resultant EPS for 2017 was US$0.47 compared to an LPS in 2016 of US$0.29.

Dividends

During a period in which Seplat's key focus was on preservation of liquidity and selective capital allocation, to ensure the Company maintained a necessary level of financial flexibility, the Board took the decision for 2017 that the Company and its shareholders were better served at that point in time by selectively deploying available capital (on a discretionary basis) into the portfolio of production opportunities and preserving a liquidity buffer.

Cash flows and liquidity

Cash flows from operating activities

Net cash flows from operating activities in 2017 stood at US$447 million (2016: US$172 million). The outstanding net NPDC receivable at year end, after offsetting NPDC's share of gas revenues and adjusting for reversal of prior impairment, stood at US$113 million (2016: US$229 million). In 2017, NPDC's net expenditure was US$93 million and Seplat received a total of US$219 million towards the settlement

2017 highlights

Revenue (US$m)

+78%

2017	452
2016	254
2015	570

Net cash flow from operations (US$m)

+160%

2017	447
2016	172
2015	38

Cost of sales (US$m)

+32%

2017	240
2016	182
2015	322

Realised oil price (US$/bbl)

+25%

2017	50.4
2016	40.4
2015	51.2

Capital expenditure (US$m)

-37%

2017	33
2016	52
2015	152

G&A (US$m)

-28%

2017	82
2016	114
2015	121

Gross profit (US$m)

+194%

2017	212
2016	72
2015	249

Cash position (US$m)

+173%

2017	437
2016	160
2015	326

Gearing (total debt/total assets) (%)

-29%

2017	22
2016	31
2015	33

Net profit/(loss) (US$m)

-260%

2017	265
2016	(166)
2015	66

Net debt (US$m)

-73%

2017	141
2016	516
2015	573

EBITDAX (US$m)

-303%

2017	199
2016	(98)
2015	232

of outstanding cash calls. As a result of this and the settlement of current cash calls, the US$10 million impairment provision recognised in 2016 was reversed. Seplat has continued discussions with NPDC to ensure further reduction of outstanding receivables in 2018. Included in the opening receivables balance of US$229 million is US$48 million representing interest on outstanding receivables calculated in line with the provisions of the Joint Operating agreement.

Cash flows from investing activities

Capital expenditures in 2017 stood at US$33 million and include costs for drilling the Anagba well on OPL 283 of US$4 million; oil facility projects totalling US$2 million including crude oil quality upgrades on our liquid treatment facilities; gas costs including the completion and commissioning of the Oben Phase II processing capacity expansion project – US$4 million; the acquisition of Oben booster compressors – US$6 million; ANOH upstream costs – US$4 million; other ANOH costs of US$10 million associated with plans towards FID; and US$2 million for others including fixed assets for plants and other office equipment.

Having reached agreement in 2016 with partner BelemaOil, on a revised commercial arrangement at OML 55, which provides for a discharge sum of US$330 million to be paid to Seplat over a six-year period through allocation of crude oil volumes, the Group received total proceeds of US$36 million in 2017 under this arrangement from the monetisation of 637 kbbls.

Consequently, after adjusting for interest receipts of US$4 million, net cash inflow from investing activities for the full year was US$7 million compared to a net cash outflow in 2016 of US$52 million.

Post period end debt refinancing

Post period end, in March 2018, we refinanced the RCF with a new four-year RCF due June 2022 and also issued US$350 million of senior notes due 2023. The proceeds from the RCF and notes were used to repay and cancel existing indebtedness. The successful refinancing underscores the confidence that the market has continued to show in our business and ability to proactively manage our balance sheet through challenging times. Our debut bond issuance further diversifies our long-term capital base and along with the RCF, considerably strengthens our liquidity position which will allow us to scale up our work programme and focus on delivering our growth strategy.

Outlook

Our financial strategy continues to be driven by ensuring we preserve the financial capability and also flexibility that is required to realise the value of our portfolio. Having emerged from an extremely challenging period that saw unprecedented levels of interruption to Seplat's crude oil production, we took proactive steps to stabilise the business and following the resumption of full production operations, were able to rapidly return to profitability and strong cash flow generation. Looking ahead, our near-term priority is to sustain the earnings and cash flow momentum we have carried into 2018, further strengthen our balance sheet and seek ways to optimise our capital structure prior to selectively reinstating a work programme designed to target the highest cash return production and development opportunities within our current portfolio. In order to mitigate against any longer-term over-reliance on a single export infrastructure system, we are working with the owners of the Amukpe-Escravos pipeline to achieve full commissioning and completion of that alternate route in Q3 2018.

With line of sight on three independent crude oil export routes becoming available and offering adequate redundant capacity, there is scope to reduce the levels of downtime which have adversely affected the business over a number of years, and significantly de-risk the distribution of oil production to market. Alongside this, we will continue to closely monitor the oil price, implementing our hedging strategy on a rolling basis to provide a level of cash flow assurance, the performance of our productive asset base and the implications these factors have on financial performance over the near, medium and long term, allowing us to scale and phase our future investments appropriately while continuing to honour our debt service obligations. We will also continue to prioritise expansion of our domestic natural gas business which provides a constant revenue stream that is delinked from the oil price, and underpinned by the strong fundamentals of high demand and increasing pricing. Achievement of these goals will ensure we have a sound financial platform from which we can build and grow further, both through organic means and also capitalising on inorganic opportunities to further diversify our business as and when they may arise.

Roger Brown
Chief Financial Officer