



Conference call transcript of the 2011 full-year results

Company: Dragon Oil plc
Presenters: Dr Abdul Jaleel Al Khalifa, CEO
Tarun Ohri, Director of Finance
Conference call: Full-Year 2011 Results

Dr. Abdul Jaleel Al-Khalifa: Good morning ladies and gentlemen, welcome those in the room and those on the phone. Thank you for joining me for discussing the results for 2011 for Dragon Oil. We will go through a snapshot of Dragon Oil's history since the year 2000 and then we will reflect on the results of 2011 and then I will turn it over to the Director of Finance, Mr. Tarun Ohri to discuss the financial results and then later I will close by looking at the outlook for the coming three years.

So for the past 12 years the company has grown from 7,000 barrels of oil per day ("bopd") to almost 70,000 bopd in production, a ten-fold increase. We replaced the reserves that were produced at about 193%. We have invested about US\$2 billion. There is an element of operational excellence and cost efficiency in our capital and operational expenditure and there is definitely an impressive cash generation through the period.

This is how production changes through the years and we are proud to speak about 2011 being a year of remarkable increase and production growth at about 30%. Here is a snapshot of the reserves, when the company started in the year 2000 as an operator, Dragon Oil, the reserves were 551 million barrels. We have produced 115 million since that time. We have added 222 million barrels of condensate and liquid oil and today we are standing at 658 million barrels of crude oil and condensates.

We may sound like a producing development company but looking at these reserve additions of 222 million we speak for a company that is humble enough to do appraisals and reserve additions along with developments.

There was a continuous drive at upgrading the facilities and here you see, for example, some of the pictures how Block 1 and Block 2 changed at the top and the new Lam B and Lam C platforms. And over the years we have drilled a number of wells, we have added about six platforms which are platforms A, B and C and the gathering Blocks 1 and 2 and accommodation platform, Lam 22. So there was a remarkable facilities upgrade and installations through the years.



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The processing facility is currently at 100,000 barrels of fluids per day, storage is at about 300,000 barrels of oil and we can do simultaneous loading at the Aladja Jetty terminal.

Here is a profit picture over the years and 2011 is again here by itself at US\$648 million profit. Here is the balance sheet, we are right now at about US\$1.8 billion in our balance sheet out of which US\$278 is for A&D.

Let's talk about the 2011 results. Operational and financial results are quite impressive for the year, thanks for the strong oil price and thanks for the production growth. Reserves and resources growth is great as well. It had enabled us to set 100,000 barrels of oil per day as a target for 2015 and diversification began, which happened in Tunisia as a first step where we had farmed in at 55% in an offshore block. The drilling of the first wildcat will start this year late in 2012. Marketing arrangement has already been secured for the entire year 2012 at a favourable discount.

This is a picture of the production growth. We had averaged 47,200 bopd in 2010. In 2011, our average is 61,500 bopd, this is a 30% growth. The exit rate is 71,751 bopd as compared to 57,000 bopd in 2010, which represents a 26% growth. It is time to grow the production at 15% for the year 2012.

Drilling was successful as well, we have drilled 13 wells in 2011. At the beginning of 2012, we sidetracked an existing well as well as completed a new well, so all in all between last year and January we have added 15 wells to the production stream.

This is a resources and reserves comparison between 2010 and 2011. Today we stand at 658 million barrels of 2P oil and condensate reserves, 1.5 TCF of gas 2P reserves. There are contingent oil and condensate resources of 88 million barrels as compared to 47 million in the year 2010. The contingent gas resource remains at 1.4 TCF. We hope that in the future as we will drill more wells, appraise the area better, some or all of that contingent oil and condensate resources will be converted into reserves.

One of the prolific areas and we purposely wanted to highlight it for our analysts is this Lam West area. Lam West is where Lam 28 is located and Lam 28 is located here (pointing on the map) and we continue to report results from this area. We had Lam B in this area (pointing on the map), which is to the west and we recently installed Lam C in this area (pointing on the map) and we are drilling the first well. The results of the first



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well will come to the market in the coming two weeks. Lam D will be installed in the northern part of this area, so this area is an area where we have managed to prove as a fairly prolific productive area. It has a lot of reserves, sustained pressure and very little watercut produced so far, which means that there is a lot of resources and reserve potential in this area that we need to prove over time. Our decision to locate Lam C here was the right decision and it took us two years to put it in the water but now it's there. One well is already being drilled and it's to be tested and completed in the coming two weeks. Lam D is being tendered now and it will come to the northern part of this region. If you consider this area in the future, it is going to have three prolific platforms, Lam 28, Lam C and Lam D, and Lam B, which is sitting at the extreme west and was not very prolific because it's right at the edge of the Lam West area. So this area is going to be part of a great production story of the Lam West area.

This is where we have the reserves, this is where the contingent oil and condensate resources remain to be booked in the future.

For infrastructure, we managed to complete Lam C and it is already housing the Iran Khazar rig, drilling the first Lam C well. Block 1 and Block 2 together are already completed. We have upgraded a number of platforms or we have added drilling slots on them; and part of the upgrade is Lam A where we have added six drilling slots. We have drilled one of them. There remain five slots on that platform and we did a geophysical and geotechnical evaluation of 10 potential locations for future platforms. We are just working ahead of our schedule to make sure when we decide to bring the platforms, the evaluation is already done for the location. As far as diversification is concerned, it's a great story in 2011. We had farmed in in Tunisia at 55% and I am sure all of you have seen the press release about Bowleven which I would be clear here about, I can't comment more on Bowleven. Whenever we have some more news on Bowleven it's going to be released to the market.

We have also pre-qualified for Iraq and we will be part of the fourth bidding round coming in May 2012. Gas monetisation, in 2014/2015 we will complete the gas treatment plant. We are seeking the approval of the agency to go with the tender and it will take us two years, so by then we will strip the condensate and we will have an export gas available for monetisation.

We continue to invest in people. As you know our country managers are local Turkmens, they are capable, professional people. We have 91% of our total number as locals and we are currently trying to introduce a 20% local content for most EPIC



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(engineering, procurement, installation and construction) contracts in the procurement, engineering and construction part over the whole chain. We have created a roadmap for training and career development for the locals in the company at various levels. Our Centre of Excellence is up and running in the field in Hazar, Turkmenistan.

As far as the community support goes, we told you the story about our desalination plant. We continue to refurbish and provide support for a local school and health institutions, but we also started building a polyclinic/hospital at a cost of US\$5 million to improve the healthcare in the Hazar town.

I would like to turn it over now to Tarun to go over the financial results.

Tarun Ohri: Thank you Jaleel and welcome ladies and gentlemen to the financial section of the 2011 full-year results presentation. I am glad to announce that 2011 was a year of record results. 2011 was, you could say a year of the dragon, for Dragon Oil. In most of the areas we had double digit growth whether it is production, revenues, profit for the year as well as other key line items.

So the key drivers in the next slide, revenue, net profit and cash balance, for the first time we touched US\$1 billion and that's on the back of oil prices, which remained quite steady throughout the whole year. The average Brent oil price for the whole year was US\$111 per barrel but there was a considerable of volatility: oil prices fluctuated from US\$120, bottomed out at US\$90, but quarter-on-quarter the oil price was quite flat. Our net profit was 68% higher than the previous year's figure at US\$648 million. Based on the net profit the Board declared a final dividend of about US cents 11 per share and we expect that this would amount to a payout of about US\$100 million for 2011. The payout of the dividend would be after the Annual General Meeting, which is to be held around the last week of April.

If we look at our cash balance, about US\$1.5 billion, this is net of abandonment and decommissioning, so this is the free cash available to the company and it could be put to various uses including aggressive development of the field in Turkmenistan. We have infrastructure programmes. We would sustain a dividend payment of about US\$100 million or so in the coming years. There would also be diversification opportunities.

The next slide is 2011 results summary, it shows key items from our income statement as well as our balance sheet. One of the key things is the significant growth in earnings



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per share and that stems from the strong oil price and the production growth, so these two components flow right down to our bottom line where we reported healthy results.

If we look at the double digit change in revenue, net profit and basic earnings per share of 68%, they are healthy indicators for the year. The capital employed of about US\$2.6 billion, that capital employed is represented by net fixed assets as well as our cash balance, which is split about 50/50. Our net fixed assets are about US\$1.4 billion after a depletion charge; and a cash balance of about US\$1.5 billion contributes to the capital employed in the business.

Our net cash from operating activities is US\$1 billion and that results in a net cash balance of US\$1.5 billion, we have maintained zero debt in 2011 as in the previous years and this gives us enough flexibility to raise debt should it be required in the future.

The next slide is the 2011 income statement. As we discussed the revenue, we earned over US\$1 billion and this is on the back of our entitlement of about 53%. In the previous year the entitlement was 61%, so the entitlement barrels have come off and that is because of the working of the fiscal terms and the PSA. There are a couple of factors, which determine this, one of which is the oil price, so when the oil price is high we end up with a lower entitlement rate but the value to the operator still remains quite considerable.

The cost of sales has remained flat and this is a result of movement in the lifting position. The cost of sales and operating costs have remained at US\$3.5-4.0/ barrel. The administration expenses are around US\$28 million, there's not much change though in the previous year when there were some one-off charges. We didn't have one-off charges this year. The operating profit was about US\$856 million, our operating margin this year was about 74% because of the cost efficiency and ability to contain the inflationary pressures; they have impacted our gross profit margin. Our finance income was US\$15.5 million and this was with an average yield of 1.3% on an average cash balance during the year. This is due to lower interest rates, high liquidity in banks and for 2011 the six-month LIBOR was about 0.8%. We have done better than LIBOR. Our income tax is about 25%. That leads to the net profit of US\$648 million.

The next slide is on the cash flow. We began the year with US\$1.3 billion in opening cash, which included A&D (abandonment and decommissioning) funds of US\$175 million and we ended the year with US\$1.8 billion with about US\$279 million of A&D. So net cash generated from operations was US\$1 billion. We have discussed the interest



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received on bank deposits. We have spent about US\$407 million in drilling and infrastructure activities – this is a capital expenditure: \$351 million was spent and there is movement in payables, which resulted in an outflow of the balance, and financing activities, we had a dividend payout of US\$180 million. This was the maiden dividend for 2010 and the interim dividend for 2011. There was a share buyback programme of 5 million shares and the average acquisition price of £4.84 per share, so that had an outflow of about US\$58 million. The deposits are maintained in various international banks. We try to limit exposure, we do a lot of risk management and the cash is held in plain vanilla deposits with maturities of about six months.

This is our 2011 balance sheet. The oil and gas assets are US\$1.4 billion, represented by infrastructure: wells and onshore/offshore infrastructure. Inventories, trade and other receivables are at US\$191 million, this is mainly represented by accounts receivable, which are sales for that month and have been realised subsequently.

We have talked about cash and term deposits of US\$1.8 billion and if you look at the liabilities, we've got non-current liabilities of US\$116 million. These are deferred income tax liabilities, which are expected to be unwound in the future. That's due to the accelerated charge in the books. Our current liabilities of US\$646 million comprise three items: provision for taxation, our A&D provision of US\$278 million as well as payables of about US\$45 million.

The 2011 capital expenditure: our drilling expenditure was about US\$186 million for 13 wells completed last year and on that basis you would expect the average drilling cost per well to be around US\$13-14 million. That's based on the fact that we drilled about eight wells from existing platforms using the land rigs, Rig 40 and the other land rig we have, so these two rigs contributed to a large number of wells drilled in 2011.

The infrastructure expenditure of US\$165 million was about 41% of the total capital expenditure and this expenditure was lower than what we had expected at the beginning of the year and that's driven primarily by where we operate, the challenges in the Caspian region where there are a limited number of contractors which we are seeking to expand. There are also delays faced by contractors because of the weather and because of their ability to access financing in the region. In 2012, we expect our infrastructure spend to be higher and in the next four years we expect to spend about US\$1 billion on infrastructure in 2012-15 to enable us to achieve our target of 100,000 bopd in 2015.



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With that I will hand over to Jaleel. Thank you.

Dr. Abdul Jaleel Al-Khalifa: Thank you Tarun. On the production we expect to complete 13-15 wells in 2012 and potentially a number of workovers of existing wells. We target a 15% production growth in 2012. On the rigs we expect the Caspian driller to come this year, hopefully in 2012 to join our drilling fleet, to help increase our drilling capacity. We are also tendering for an additional land-based rig. As you know the current NIS rig will be released and this will be a replacement of that rig.

On platforms: we expect the Zhdanov A platform to come in the second half of 2012 and this is a delay that had been worked out in our drilling plans so we could make up for the shortage of drilling locations. We plan to award a contract from Lam D and Lam E and as I told you before Lam D will be in this prolific Lam location, so by the time we finish with the Lam C drilling; drilling from Lam D will hopefully start and therefore there will be a continuous drilling programme in the Lam area. The infrastructure spend for 2012, we expect it to be US\$250 million if not more.

Over the coming three years for the production, we continue to maintain the same guidelines, 10-15% growth year-on-year. That will take us hopefully to 100,000 bopd in 2015. On average, it will be anywhere between 15 to 20 wells in the years 2013 to 2015. The pilot water injection, it hopefully could start in 2012, results of which will be reviewed, assessed and therefore decision on the scale of this water injection would be made at the right time. On rigs and platforms we are tendering for another jack-up rig if not two jack-up rigs along with a Caspian Driller that will come and hopefully four platforms will be planned and US\$1 billion spent over the coming four years, on average US\$250 million on infrastructure year-by-year.

We hopefully are going to finish the gas treatment plant in 2014 and through this time we will continue talking to the agency and to the Turkmen authorities on gas monetisation; and diversification strategy is being actively pursued as we said before in Africa, Middle East, Central Asia as well as South-East Asia.

I want to thank you for joining us today and I am going to open the floor for your questions and comments if any.



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Kenan Najafov, Citigroup: Good morning. Congratulations on great results. I have a couple of questions, the first questions on reserves. Could you give us an idea of how much of the oil and condensate reserves is actually condensate?

Dr. Abdul Jaleel Al-Khalifa: Anna, do you have this figure off the top of your head? It's a small amount, we did not disclose it.

Anna Gavrilova, Investor Relations: Kenan, I believe you have already asked that question. It's a small amount, we don't disclose it and for the question you have in mind it's not significant.

Dr. Abdul Jaleel Al Khalifa: It's not a big volume. If you remember two years ago before we booked any gas or condensate as a reserve, the number was about 630 million barrels at the time. So when we booked the gas, 1.6 trillion last year as a gas reserve, as part of that booking we booked the associated condensate. So I think it's easy to figure out that the condensate volume is a small volume compared to this entire 658 million barrels.

Kenan Najafov, Citigroup: The second question is a little bit political. I wonder if you feel any impact from the Iranian situation. I know you are using a rig of the Iranian National Oil Company, you don't own that rig. Is there any US sanctions or EU sanctions impact on you at all?

Dr. Abdul Jaleel Al-Khalifa: Our legal team continues to monitor all the sanctions that come through and we are abiding by all legal requirements that apply to Dragon Oil and we will continue to monitor and assess the situation. I don't see it as a problem now and I hope it won't be a problem in the future.



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Dominic Lewenz, Visor Capital: Good afternoon gentlemen, thanks again for the results presentation, very good results. I had two quick questions, one was in terms of the water injection programme. Is there anything maybe you could give in terms of impact on your recovery rates? Secondly, just on your expansion projects, are you not really looking to anything in Turkmenistan, can I just confirm that?

Dr. Abdul Jaleel Al-Khalifa: With regard to water injection, this is a pilot project in the Lam 75 area. It's a mature area of the field and we have already tendered this and we are going to bring equipment on that platform, complete one well as an injector and monitor the pressure and saturation in the opposite wells. If we see continuity in the sands between the wells in this area, it gives us more assurance that there is a continuity of sand for that segment of the field and there is an impact of water injection first on pressure decline. So ultimately it would reduce the number of wells needed to be drilled to maintain the potential; and secondly, it would improve the recovery of the reserves by a certain degree. Now is it 1%, 5%, 10%? We still have to wait and decide on this. With regard to expansion Kazakhstan and Central Asia in general are regions of interest and we continue to see and monitor if there is any opportunity that comes through onshore, offshore be it in Kazakhstan or other countries in that region.

Eyad Faraj, Bank of America Merrill Lynch: Thank you. Good morning gentlemen and congratulations on the results. You previously were only looking to development assets but expanded that scope to include exploration assets. Your Tunisian partner is a perfect example of this. Can you elaborate on if you look into more exploration assets now after hiring a new head of exploration? My second question is given the stringent terms that we are seeing in the fourth



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round of the Iraqi oil and gas licensing rounds, how confident are you of winning a contract? Thank you.

Dr. Abdul Jaleel Al-Khalifa: I think it's clear that we are transforming the company into a development exploration company. I think the reserves assessment speaks for itself and the area, but our move into Tunisia, our hiring an Exploration Manager and our continuous search by our new ventures team to find appropriate acquisition targets are a testament for our interest in acquiring an asset. So in the future I would expect to see more acquisitions. With regard to Iraq, you are right, the terms are tight. Fiscal terms are not very attractive for contractors but we continue to maintain interest there and I think we have until May to decide whether we should go or not. We are talking to either members who are interested in that round and if we have to go, we will go in a consortium with other partners.

Vugar Aliyev, Oriel Securities: Two questions, first on the Lam West area, you had some great results there and it sounds like you are very excited about the potential. Is it because the reservoir properties in that part of the field are better than the main field or is it just because it hasn't been explored before and it's the first time you are properly developing it? The second one on gas monetisation, you mentioned you expect or you hope to get gas treatment plant functioning in 2014. Do you now have firm plans to do it or are you still looking at various options, various sizes and capital investments?

Dr. Abdul Jaleel Al-Khalifa: Lam West area was discovered a few years ago, however, at the time we had only one good producer in that area, Lam 28 platform. Since then we drilled a number of wells in Lam 28. We have drilled from Lam B. It's fair to say now that the well in Lam C that we are drilling now,



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and the results will come in the next two weeks, is a good well, which further affirms our assessment of this area. The sand quality is better and the sand is more developed in this area, it's thicker. The shallower targets are far thicker in this area compared to the rest of the field, this is one reason. The second reason is that the original part of Lam has been producing for a number of years and therefore it was more depleted than this area. In this area, even though we are producing for two or three years, the pressure is high, the decline is fairly little. So it is definitely going to be proved further in the future. With regard to the gas treatment plant we have decided what size, we have completed the Front End Engineering Design study, we know what the cost element is, we know what we plan to do, we are ready for a tender. We are just waiting for approval, it's a formality. It's anywhere between US\$200-300 million for the gas treatment plant.

Gerry Hennigan, Goodbody: Good morning Jaleel, maybe if you can outline where you are with regard to distribution beyond 2012 and also your drilling plans with regard to the Bargou licence? There have been some suggestions that you will do maybe a well on the Hammet West prospect in October, maybe you could give some guidance on that? Finally with regard to the Lam D location, I'm not sure if I quite picked it up but can you give us an indication of where that will be relative to Lam C or Lam 28?

Dr. Abdul Jaleel Al-Khalifa: Let's start with Lam D. If you look at Lam West we have Lam C location on the south boundary of Lam West area. Lam D is exactly north of Lam C on the northern border of this area, so we have Lam 28 on the East, Lam B on the West, Lam C on the South and Lam D on the North. With regards to drilling in Tunisia our team is travelling to Australia, they are meeting with our partners and the idea is to firm the plans and drill the well some time in the second half of 2012. The marketing route right now is the Baku-Tbilisi-



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Ceyhan pipeline. We have secured that route for the entire 2012 and some time in 2012 we will decide on 2013 and beyond.

Gerry Hennigan, Goodbody: Ok. Finally if I can, can you comment in terms of your expectations with regard to production and maybe the reserve potential as you move into the Zhdanov field?

Dr. Abdul Jaleel Al-Khalifa: We have Zhdanov A and Zhdanov B platforms to be installed there. Zhdanov A hopefully is in the second part of this year, Zhdanov B in the early part of next year. Until we drill a well with our drilling fleet, with our today's technology and assess the productivity of the formation I cannot honestly tell you a firm conclusion whether the productivity is high or low but all indications from history tell us that when we drilled in Lam with the new technology, the wells were more productive than before, we came to know more about Lam, we came to add more reserves on Lam, so if I were to draw an analogy with Zhdanov, I think Zhdanov hopefully will have more positive surprises in the future.

Kingsley Jibunoh, FirstEnergy: Good morning gents. I wanted to ask a question on your abandonment and decommissioning provision of US\$279 million. Is there any mechanism for that amount and going forward I wanted to have an idea of how much you will be setting aside year on year?

Dr. Abdul Jaleel Al-Khalifa: Let's just talk about the P&A (plug and abandonment). We have awarded a contract to do P&A for both seven-nine wells and it's already in the process. We are going to see P&A activity happening in a month or two. We are currently tendering for another P&A contract to abandon quite a number of wells and then demolish and mobilise platforms out of the water onshore. Currently we are taking 7% for the P&A of revenues aside. Now if 7% is more



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than needed or not, we will talk to the agency as a result of the current contracts awarded and the size of work then to try to reach a consensus of whether 5% is enough or 7% is enough. That level right now stands at 7%. It can be negotiated downward but we have to wait and see what we do with the current contracts.

Anish Kapadia, Tudor Pickering Holt: I had three questions please. The first one is just on the reservoir performance. With the best results that you are seeing at Lam West and potential for water injection, do you think there's the possibility you could get to over 100,000 barrels a day post 2015? What kind of peak potentially can you see? Alongside that, does that mean you could extend the plateau as well?

Dr. Abdul Jaleel Al-Khalifa: Let me take this one first. I think it's clear that we at Dragon Oil so far when we say something we deliver. The reason we have been waiting on 100,000 bopd target to communicate until recently is that we wanted to establish enough history, enough track record at a high production to make sure we commit to the 100,000 bopd. That said I would really want to wait a few years to see our production at higher levels to commit to a higher peak rate, but for now I would say 100,000 bopd is doable and when we said five years again extending five years into seven, eight years or more is also something to be assessed in the future.

Anish Kapadia: The other part of that point was that it looks like you are drilling a much larger number of wells, 15-20 wells over the 2013-2015 period. Is there a reason why you've increased that, I think that's gone up from where we were expecting previously?



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Dr. Abdul Jaleel Al-Khalifa: No, it's because we have increased our target to 100,000 bopd so this is the first time we announced a target of 100,000 bopd and a higher number of wells. The reason is as you produce at the higher rate you are declining at a higher rate as well. So if you were producing 50,000 bopd and your decline rate is 20%, you decline 10,000 bopd a year. If you produce 100,000 bopd you will decline 20,000 bopd a year because it's the same ratio. Then you need to drill more wells to make up for the decline to maintain the higher target and this is why you have to drill more wells if you are to produce at higher rates and with a decline in the depletion field like this one.

Anish Kapadia: Just a couple of questions on the financial side of things, you have taken a provision on the tax side for potential tax pre-2008. Can you say what the absolute number is and why it has been dragging on so long since 2008? Just the final questions on the cash balance, are you still happy post acquisitions to maintain a significant cash balance or given the much larger nature of the company and production, would you be willing to take on some debt and have a more efficient capital structure going forward?

Tarun Ohri: Ok, to address the first question on the tax rate, currently Turkmenistan has offered a stable tax regime, so since the beginning of the PSA the tax rate has been 25% and there are some discussions, currently the payout is at 20% so there are discussions with the agency in terms of addressing that additional 5% and we have not reached any conclusion, so the pre-2008, 2008 is when there was a new petroleum law. Currently we don't have clarity so we have made a prudent decision in terms of provisioning for a partial amount of tax should the decision be applied retrospectively. We have just been conservative and applied this decision though we don't believe that there will be any liability for the past. It would be something in the region of US\$40-50 million. Your other question on



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the cash balance, obviously the Turkmen asset is self-generating, it has generated a lot of cash and is able to sustain development in the field, but that is at the current price level, so it should be as crude oil price levels fall we always like to maintain some sort of a headroom to be able to finance our ongoing infrastructure development. Though we have the ability to raise debt as well, should we need ongoing development programmes beyond the acquisition financing, so we would be able to finance through our existing cash balance but there would be a continued requirement to finance development in those targeted fields.

Dr. Abdul Jaleel Al-Khalifa: Ok. Thank you very much and you all have a good day. We will see you next time.