subsea 7

Q2 2022 Results Conference Call

Thursday, 28th July 2022

Operator: Good day, and thank you for standing by. Welcome to the Subsea 7 SA Q2 2022 Conference Call. At this time, all participants are in a listen-only mode. After the speaker's presentation, there will be a question-and-answer session. To ask a question during the session, you will need to press *11 on your telephone. You will then hear an automated message advising your hand is raised. Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Katherine Tonks. Please go ahead.

Introduction

Katherine Tonks

Head of Investor Relations, Subsea 7 SA

Welcome, everyone. With me on the call today, are John Evans, our CEO, and Mark Foley, our CFO. The results press release is available for download on our website, along with the presentation slides we are referring to during today's call. May I remind you that this call includes forward-looking statements that reflect our current views and are subject to risks, uncertainties, and assumptions? Similar wording is also found in our press release.

I'll now turn the call over to John.

Summary of Second Quarter 2022

John Evans

Chief Executive Officer, Subsea 7 SA

Katherine, thank you, and good morning, everyone. I will start with a summary of the second quarter of 2022, before passing over to Mark to cover the financial results.

Turning to slide three.

Second Quarter 2022

In the second quarter, Subsea 7 delivered strong performance in Subsea and Conventional, whilst Renewables was in line with the expectations we communicated in June. Both our core markets improved during the quarter. In Subsea, the industry supply chain challenges stabilised and tenders progressed, resulting in an order intake of $2 billion and a book-to-bill of 2.1x. In offshore wind, pricing and risk allocation have improved for recent tenders and we are preferred suppliers for projects worth over $1 billion.

Turning to slide four.

Sustainability

In the second quarter, we continued our sustainability strategy with a successful trial of biofuels on *Seven Oceanic*. We are happy with the performance of biofuels and are working with suppliers to evaluate if such fuels can be deployed at scale on a global basis.

Turning to slide five and an update on our largest contracts.

Operational Highlights

In Turkey, the fast-track Sakarya project has reached 50% progress. Most of the procurement is complete and deliveries to Turkey are on track. Shallow water pipelay commenced in the quarter.

In Brazil, we continue to manage fabrication for the Bacalhau project, and we are preparing for offshore operations starting later this year. At Mero-3, procurement has commenced.

Additionally, our vessels were busy in the Gulf of Mexico on projects including Anchor, Jack St Malo, Mad Dog 2, and Vito.

In Renewables, we had installed 30 foundations and 21 cables for the Seagreen project by the end of June. Of the 114 jackets, 94 have been delivered to the UK, and the remaining 20 are currently signed off and ready load out from China. We remain on track to complete the work later this year. We also made progress installing cables of our second floating wind project, Hywind Tampen.

Turning to slide six, I'll give you an update on the Renewables contracts that we discussed in our trading update in June.

Renewables Projects Now Making Good Progress

Both Formosa 2 and Hollandse Kust Zuid made good progress against our revised schedule. To date, 90% of the installation scope for Formosa 2, and 67% of Hollandse Kust Zuid is complete, and they are on track for handover to our clients in August and September as planned. As we announced in June, *Seaway Strashnov* will be completing the summer campaign of Dogger Bank A&B in 2023, replacing *Alfa Lift*. The increased installation time and extra cost associated with using *Seaway Strashnov* were reflected in June's guidance.

Next, turning to slide seven.

Managing Supply Chain and Wage Inflation

Last quarter, we outlined our strategies for managing supply chain challenges related to raw material inflation. In the past few months, pricing has stabilised, albeit at a higher level, and a normal tendering process has resumed. Our strategy, dating back well before 2022, has been to protect our margins through back-to-back contracts, index-linked pricing, and escalation mechanism. Wage inflation is also something that we are monitoring closely and have factored into our bids.

Throughout this period, our strong collaboration and early engagement with both clients and supply chain have enabled us to navigate these challenges and continue to successfully tender, win and execute projects.

Turning to slide eight, and the Subsea Integration Alliance.

Subsea Integration Alliance Renewal

During Q2, we were very pleased to extend our relationship with Schlumberger for another seven years. As you know, the Alliance has been the cornerstone of our strategy of integrated projects in Subsea and thanks to a strong commitment from both sides, it has proven a success. With major awards in Australia, Brazil, Senegal and Türkiye, as well as tiebacks in Norway and the Gulf of Mexico, our integrated backlog stands at around $2 billion today.

We get very positive feedback from clients on this model of contracting, and this is reflected in our SURF and our pipeline, of which 50% relates to integrated projects. The Alliance has delivered an impressive performance through one of the industry's most challenging periods and we look forward to reinforcing the success as the market improves.

And now, I pass you over to Mark to run through the financial results.

Financial Results

Mark Foley

Chief Financial Officer, Subsea 7 SA

Thank you, John, and good morning, everyone. I will begin the financial results review with some details of performance in the second quarter before turning to the business units.

Solid Backlog for 2022 and 2023

Slide nine summarises the strong backlog position in the second quarter. Order intake was $2.1 billion, equating to a book-to-bill of 1.6x, and backlog at the end of the quarter was $7.8 billion, the highest level since 2014. Order intake included new awards of $1.7 billion, including the Buzios 8 project in Brazil, the CLOV 3 project in Angola, and the TOPR and Ballymore projects in the Gulf of Mexico. These four new awards are credited to the Subsea and Conventional business unit.

In Renewables, it was announced that Seaway 7 was a preferred supplier of the East Anglia THREE and the Seagreen 1A projects. These two projects have a combined value of over $1 billion, but will not be recognised in backlog until final contractual terms have been agreed and final investment decisions have been secured. Escalations of approximately $400 million, comprising variation orders and contractual price escalations across several projects, were largely offset by changes in foreign exchange rates, mostly due to the weakening of the Norwegian krone and the Brazilian real against the US dollar. This had an adverse impact of approximately $300 million on backlog.

$2.5 billion in backlog is expected to be executed over the remainder of the year, and $3 billion in 2023.

Coming to slide ten, and the headline results for the Group.

Second Quarter 2022 – Group

Revenue was $1.2 billion, broadly flat year-on-year, as we continue to execute on large EPCI projects in both Subsea and Conventional and Renewables. Adjusted EBITDA of $144 million was up 48% compared with the prior year period, and the margin increased to 10.7% from 7.5%. I will discuss the drivers of this change at the business unit level on the next few slides.

Slide 11 presents the key metrics for Subsea and Conventional.

Subsea and Conventional

Order intake was $2 billion, equating to a book-to-bill of 2.1, resulting in a strong backlog of $7 billion. Revenue was $1 billion, up 11%, reflecting good progress on the fast-track Sakarya project as well as our other large EPCI projects. Adjusted EBITDA was $171 million with a margin of 17.7%, up from the 10.5% in the second quarter 2021. The high profitability reflects strong operational performance and benefited from projects completed in the Gulf of Mexico and Saudi Arabia during the quarter.

Selected Renewables performance metrics are shown on slide 12.

Renewables

Order intake in Renewables was light at $49 million, taking the backlog to $800 million. As John and I have mentioned, during the quarter we were awarded preferred supplier status on several projects and we will issue the backlog over the next six months. Revenue from Renewables was $260 million, down 17%, mainly reflecting the phasing of activity on the Seagreen project. The Seagreen, Hollandse Kust Zuid, and Changfang Xidao projects made notable revenue contributions in the quarter.

The adjusted EBITDA loss was $49 million, reflecting charges of $28 million and $34 million in relation to the Hollandse Kust Zuid and Formosa 2 projects, respectively. Excluding these two charges, the adjusted EBITDA margin was 5%.

Slide 13 shows the cash flow waterfall for the second quarter.

Cash flow summary

Net cash generated from operating activities was $94 million, including a $63 million movement in working capital. Cash conversion, measuring the conversion of Adjusted EBITDA to adjusted operating cash, was 88%. Net cash used in investing activities was $50 million, mainly attributable to purchases of property, plant and equipment associated with dry docks and upgrades.

Free cash flow in the period was $42 million. Net cash used in financing activities was $72 million. This included $32 million of dividends paid in May, $27 million of lease payments mainly related to chartered vessels, and $4 million related to the share repurchase programme.

At the end of the quarter, cash and cash equivalents was $464 million and net debt was $88 million, which included lease liabilities of $184 million. The Group's liquidity was $1.5 billion, which included $1 billion of committed undrawn borrowing facilities.

In June, the Group entered into a $700 million multi-currency revolving credit and guarantee facility with a five-year tenor. The facility is available in a combination of guarantees, up to $200 million and cash drawings, or in full for cash drawings. At the same time, the Group's previous $656 million multi-currency revolving credit and guarantee facility was cancelled.

Lastly, in March, as part of our commitment to shareholder returns, we announced a share repurchase programme of approximately $70 million. As of market closing yesterday, $45 million or 64% of the $70 million have been utilised to repurchase 5.6 million shares at an average price NOK75.4 per share. Subsea 7 holds 10 million shares or 3.3% of its issued share capital as treasury shares.

Financial Guidance

To conclude the financial review, slide 14 shows our expectations for the full year. As we announced in June, revenue and adjusted EBITDA are expected to be broadly in line with 2021. Our net operating income is expected to be lower than 2021. We have updated our guidance regarding taxation to be between $50-60 million, adjusted upwards from between $35-45 million. The revision is driven by an increase in activity in higher tax jurisdictions. There have been no other changes to the financial guidance since the first quarter 2022 presentation.

I will now pass back to John.

Outlook

John Evans

Chief Executive Officer, Subsea 7 S.A

Capital Allocation Framework

Thank you, Mark.

On slide 15, we have a reminder of our capital allocation framework that you're probably familiar with by now. In the second quarter, we returned $32 million to our shareholders via a cash dividend and we continue to progress through our $70 million allocated to share repurchases, which is over 60% complete today. A key part of the framework relates to the funding strategy for renewables. Seaway 7 is making good progress in this respect and they expect details on the financial structure in the third quarter.

And now, we move on to our usual outlook slides, starting with the prospects in the Subsea market on slide 16.

Outlook

Subsea prospects

Tendering remains very busy and we are confident in the outlook for new orders for the Group. Three regions – Norway, Gulf of Mexico, and Brazil – continue to be the most active markets, but there are early signs of improving activities in other regions with tenders added to this map in the UK and Morocco.

After the quarter end, we announced our first award in Guyana for Exxon's gas-to-energy project, and we see further prospects in this region.

Availability of our rigid-reeled vessels is tight in 2024, and tightening in 2025 and beyond, which is driving improved pricing for our EPCI services. Overall, we are encouraged by the way the recovery is progressing and remain confident in the outlook for Subsea and Conventional.

On the next slide, we have our wind prospects.

Offshore wind prospects

UK's CFD allocation round which took place in July after a one-year delay has finally unlocked prospects in its region and Seaway 7 is the preferred supplier on East Anglia THREE and Seagreen 1A. In addition, it is preferred supplier on He Dreiht in Germany and a US wind project. We expect this pre-backlog to converge to firm awards toward of this year and early next year, adding visibility to our fleet utilisation into 2025.

Inspiring People

Before I wrap up, a quick look at a different type of project. In May, we published '*Inspiring People – The Subsea 7 Story*' which celebrates 20 years of our company and 75 years of history of the predecessor companies that are part of Subsea 7 today. It is full of stories and photographs taken from our rich heritage of entrepreneurial spirit, adapting, innovation and endeavour. From the industry's first purpose-built pipelay barge, the LE Minor, to Angola's first deepwater project at Girassol, the book shares memories, anecdotes and insights from our founders and executives who spent their careers shaping the industry.

The link to the online version is on this slide. I hope you'll read it and enjoy learning more about the people, companies and projects that have made Subsea 7 the world-class energy service contractor it is today.

And so, to close, we turn to slide 19.

Summary – Positive momentum

In Subsea, the post-COVID recovery has been reinforced by the West's drive for energy security. Our core markets remain strong and we are beginning to see the uplift of activities spreading to other regions. Prices are improving and the supply chain has stabilised. In fixed offshore wind, our prospects are maturing with over $1 billion of pre-backlog to be converted to firm orders in the coming six months. The market for our services is tightening and this is driving an improvement in pricing and risk allocation.

To conclude, our backlog is at a seven-year high, our tendering teams are busy and we are well-placed to deliver a combination of long-term growth and capital returns for our shareholders.

And with that, we'll be happy to take your questions.

Q&A

Operator: Just a reminder, to ask a question, you will need to press *11 on your telephone and wait for your name to be announced, please. Please stand by while we compile the Q&A register.

Please standby. Our first question come from the line of Kevin Roger. Please go ahead, your line is open.

Kevin Roger (Kepler Cheuvreux): Yes. Good afternoon, thanks for taking the question. The first one is related to the Subsea business. So, you had a very good performance in Q2, almost 18% margin, what we consider the once upon a time as the kind of close to normalised margin at Subsea 7. So will you consider this performance in Q2 as repeatable in the short-term or will you consider it more as a kind of one-off?

And the second one's related to the Subsea. In the presentation, you mention that basically, the backlog is back to the record level that you had in 2014, so back to the level of that time. So, here again, are we, let's say, close to the revival of the performance that you had at that time, please?

John Evans: Yeah. Thank you, Kevin. Thanks for your questions. As we've always said to everybody that follows us, it's best to look at us over a year, and we've guided for where we want to be for the year. So, I don't expect Q2's performance to be repeated throughout the rest of the year. And we did say in our prepared remarks that we had very good operational performance across the suite of projects that we have, as well as some commercial settlements in some regions, as we closed out certain projects.

In terms of longer term, the position that we're in, yes, we have a good backlog, but I think we have guided a number of times that we expect our profitability to improve from the second half of 2023 and then work its way back towards more normalised positions in terms of expectations for profit. So, for us, we are bringing in the backlog, which is good. We'll be executing it starting back end of this year, and we do expect from the middle of next year to see an improvement in our profitability.

Kevin Roger: Okay, understand. And if maybe I can add one, I don't know if you will prefer to keep these questions for the call of Seaway 7? But recently, I note the first project in the US. I was wondering if you can give us, a bit, some visibility on how you will execute the project because execution in this country can be largely, let's say, challenged by Jones Act, etc.

John Evans: Yeah. We can't announce which project it is at the moment because our client has asked to keep that confidential, but it will be cable lay work. And again, we have worked on cable lay in the US in the past. We did the main demonstrator project in East Coast US a couple of years ago. As you know, Subsea 7, the parent has been in the US for nearly 40 years. So, we're very, very familiar with the Jones Act, and our US team has worked very closely with the Seaway 7 team to make sure that we pitch our bid and our offering fully in compliance with the Jones Act.

Kevin Roger: Okay. Okay, perfect. Thanks a lot for that.

Operator: Thank you. We will now take our next question, please standby.

Next question is from James Thompson from JP Morgan. Your line is open, please go ahead.

James Thompson (JP Morgan): Hi. Thanks. Thank you very much for the presentation, gentlemen. Just a couple of questions from me, please. Firstly, just on the Renewables business, I was quite interested to understand of the pre-FID projects. What sort of revenue expectations can we expect from them in 2023? And I know you've only got only around $100-150 million of revenue in hand for that division at this point in time, so just to understand how much influence the large projects that are there and ready, how much influence they can have on next year?

And then, secondly, in terms of your discussions around pricing and the overall environment actually improving for tendering discussions and things like that, I was particularly interested in some of the challenges in the supply chain moderating. John, I was wondering if you could just put some more colour behind that really, how sustainable is that improvement and just help us to understand where the better conditions are really appearing from a supply chain perspective particularly?

John Evans: Okay, James, thank you. I'll take the supply chain one first and come back for the Renewables. I guess, when we spoke at the end of Q1, the market was still very much bouncing around from the Russia-Ukraine issues, and it was quite difficult at that point to get guaranteed slots and guaranteed pricing in the market to allow us to progress with our clients towards surety on a project. What we have seen, from about early May, was that the relevant markets, such as steel and stainless steel, and some of the input materials that we need, at least our suppliers and their sub-suppliers were finding a way of being able to give us the surety that we needed.

As I said in the prepared remarks, the costs are higher, so this isn't that the problems have all gone away. Certainly, the costs are higher, but the surety on production slots and availability of materials has become easier from around early May, which has allowed us to progress to close things like Buzios 8, CLOV 3, as Mark mentioned in his prepared remarks.

So, it's not all back to normal. But there is a way through the mechanisms that I discussed in my prepared remarks about index-linked pricing and such like, that there is a way to pass those elements through to our clients for them to make decisions if they want to proceed with their projects with surety around how we would evaluate price, how we would adjust the price if the project moves ahead, but also, more importantly, to get the production slots and the raw materials available.

So, please don't take it that everything is sorted. But we have found a form of equilibrium that does allow the industry to [award] contracts, and you've seen the backlog in our sector has been quite good across the board in quarter two.

In terms of Renewables, the two main projects are subject to FID by our clients. So, we have those steps to proceed, but the clients are progressing down those paths. Our project for Iberdrola on East Anglia is a transport and install project in the outer years, so I think that the contribution for 2023 will be relatively low, it will be basic engineering and installation activities. Seagreen 1A is an EPIC, so there will be procurement, fabrication, cable manufacture, and such like for 1A. So, two different projects, two different contracting models and that's what we should expect working our way into 2023.

James Thompson: Okay. So, in 2023 some contribution from that, but I guess it can be down year from a revenue perspective. Thanks very much, John, appreciate the answers on both those. I'll hand over.

John Evans: Thank you.

Operator: Thank you. We will take our next question, please standby.

Our next question is from Nikhil Gupta from Citi. Please go ahead, your line is open.

Nikhil Gupta (Citigroup): Hi, I have a question on the bidding pipeline. So, clearly, around the commentaries that the pipeline is increasing. Wanted to understand how much of the increase is compared to, say, six month back, how much is due to inflation, and how much is increases due to the additional work on new projects? So, any kind of guidance or colour there.

John Evans: Yeah. Thank you, Nikhil. I think for us, we're seeing two things. We continue to see Brazil and Petrobras's project pipeline continuing to deliver opportunities each quarter with major new bids arriving. This should not be a surprise because Petrobras has been very clear they intend to develop 15 SURF projects and associated FPSOs in the next three years. And in our discussions with Petrobras on a regular basis, they're pretty clear that the machine will continue to offer those opportunities to the market. Guyana continues to have further opportunities which will come into the market.

And last but not least, and we've discussed this a number of times, we do expect Norway to turn a number of opportunities, where we're the preferred bidder into firm awards for us, on quarter four or early quarter one of next year. And that's all to do with our clients getting their paperwork in and their regulatory requirements in, to make sure they are having their approvals in by the end of this year. So, we do expect Norway to turn in that way as well.

So to answer your question, yes, there's inflation in the cost number which is working its way through, but there is a pretty solid demand. We can see things picking up slowly picking up in the UK. We've seen projects like Jackdaw getting approvals. So the UK is starting to move, and that's been a good market for us over the years. And we're also pleased to see Subsea Integration Alliance working with Chariot in Morocco to try to assist them getting the Moroccan opportunity up and running. So, there are new regions and new opportunities starting to come there as well. So, a bit of both, I think is the answer to your question.

Nikhil Gupta: Thank you, I'll turn it over.

Operator: Thank you. Please remember if you'd like to ask a question, press *11 on your telephone. We will take another question, please standby.

Next question is from Haakon Amundsen from ABG Sundal Collier. Please go ahead, your line is open.

Haakon Amundsen (ABG Sundal Collier): Yes. Hello, guys – two questions from me, please. First one, sorry if I missed it in the prepared remarks, but I was wondering if you could give an update on the working capital development you expect during the year, if there is any changes to that from the last time you guided?

And secondly, if you can give some colour on, it looks like your project execution in offshore wind is quite different from in oil and gas, your Subsea and Conventional business, and just wondering if you can give some colour on what is now changing in offshore wind. Are you getting the same kind of escalation inflation protection, other kind of project elements and pricing them into those contracts? Is that what's improving? Thank you.

Mark Foley: Good morning, Haakon. This is Mark, I will take the working capital item. So in Q2, working capital was $63 million and that took us to a working capital build in the first half of the year of $96 million. Our expectation remains intact with the guidance that we previously communicated to the market. We expect the working capital build this year to be in the region of low-to-mid hundreds of millions. The drivers behind that are the projects that we acquired into the backlog. In terms of jurisdiction, Brazil (Mero-3) and Saudi Arabia, where the profile of payments were somewhat more adverse than customary experience elsewhere within the portfolio. So our working capital guidance remains intact.

John Evans: Thank you, Mark. On the Renewables, I guess the Renewables, there's two different areas for us to think about. One is risk allocation, and the industry I think is having a long, hard look at risk allocation. And we could've taken a lot more awards in the first six months of this year, and you can see that Seaway 7's order intake in the first six months is quite thin because we have been much clearer now about getting those risk allocations correct.

So, first of all, it's about getting the balance of risk right for the rewards that we get out of projects. Secondly, Renewables is all about production – repeat production – over and over, and over again. Whereas, a SURF project is multiple workplaces, multiple tasks, multiple activities and therefore, then if there's any issue on your productivity, it doesn't repeat 300 times when you've got (e.g.) 300 pin-piles to put in on an offshore wind project.

Lastly, in Seaway 7's case, as we communicated in June, the Alfa Lift has been further delayed in China in terms of the mission equipment and the delivery of that. And therefore there, we've had to put the *Seaway Strashnov* to work on Dogger Bank next year, which again has a different efficiency factor and, therefore, there are increases there.

So, three different elements which are very different from the oil and gas. Our fleet in oil and gas is fully functioning and built. Our risk profile in contracting models are pretty well established in oil and gas. And oil and gas is about multiple workplaces, ability to manage delays by being able to move assets around in different fields and different projects. Whereas, Renewables is a repeat on a production basis of the same thing many times over.

So, a lot of work has been done by Stuart Fitzgerald and the team over the last six months about the risk profiles we need, and I think the whole industry is going through that learning process. And that's why we are comfortable with our work in pre-backlog and we have tended to shun some of the work that was on offer to us in the early part of this year.

Haakon Amundsen: All right, that was very helpful. Thanks, that's it from me.

John Evans: Thank you, Haakon.

Operator: Thank you. There are no further questions. Speakers, please continue.

John Evans: Okay. Well, thank you very much. I appreciate everybody joining. We know it's a very, very busy day today. I'm sure we'll talk to you offline and we look forward to catching up with you in our Q3 results later this year. Thank you very much.

Mark Foley: Thank you. Goodbye.

Operator: This concludes today's conference call. Thank you for participating, you may now disconnect. Speakers, please stand by.

[END OF TRANSCRIPT]