

Subsea 7 S.A. Q1 2013 results conference call transcript - May 16, 2013

Speakers

- **Jean Cahuzac – Chief Executive Officer**
- **Ricardo Rosa – Chief Financial Officer**
- **John Evans – Chief Operating Officer**
- **Paul Gooden – Investor Relations Officer**

Paul Gooden

Thank you, and good afternoon. This is Paul Gooden, Investor Relations Officer at Subsea 7. Joining us today are Jean Cahuzac, our Chief Executive Officer; Ricardo Rosa, our Chief Financial Officer; and John Evans, our Chief Operating Officer. Today's results for the first quarter which ended on 31st March 2013, the press release can be found on our website, along with the presentation slides we'll be referring to in today's call.

Before we start the presentation, I'd remind you that certain statements made in the course of this conference call which express the Company's intentions, beliefs, and expectations, are forward-looking statements. Future results and trends could differ materially from those which are in such statements. Details of these can be found in the Company's filings, including the Company's annual reports. May I also draw your attention to the more detailed disclosure and forward-looking statements that appear in today's press release.

The call will run for around an hour. And with that, I'll hand you over to Jean.

Jean Cahuzac

Thank you Paul, good afternoon and welcome to everybody. I would like to reflect briefly on the quarter and the market, then Ricardo will run through our financials and before we take your questions, I will make some observations on the outlook.

It was a solid quarter. In the North Sea, we saw a return to more normal activity levels compared to the prior year when vessel utilisation was unusually high. Vessel utilisation was 67% in the North Sea, down on the 82% in Q1 2012, but in-line with the seasonal norm. Despite lower utilisation it was a good quarter in the North Sea, project execution was strong, and we benefited from a commercial settlement. Resources have been mobilised on Martin Linge, the largest ever EPIC project in the North Sea, and on Aasta Hansteen, a technology-rich pipe-in-pipe project awarded during the quarter. Offshore operations on both projects will commence in 2014 and 2015 respectively.

In West Africa, we continue to see good project execution. Seven Borealis continues to operate successfully on the CLOV project, offshore Angola. As we've noted before, CLOV was tendered in a different environment and has lower margins, this project mix explains the moderation in AFGOM margins. A good start has been made on Lianzi, offshore Angola, and on Ehra North, offshore Nigeria. Operations on both projects will commence in 2014 and beyond.

In Asia Pacific, we also saw good project execution. The Sapura 3000, the vessel owned by our SapuraAcergy JV, re-commenced offshore operations on the Gumusut project, offshore Malaysia. Meanwhile good progress was made on the ONGC G1 project offshore India, and on the Gorgon development offshore Australia.

In Brazil, results were impacted by the Seven Oceans being in scheduled dry-dock, and by Petrobras notifying the Group of their intention to remove the offshore scope of the UOTE project due to delays they have experienced in obtaining environmental licences.

In Corporate, we saw a benefit from lower administrative costs and a positive contribution from Seaway Heavy Lifting despite the seasonal bad weather.

Turning to slide 4, the backlog exceeded \$10bn, a record for the Group, and I am encouraged by the quality of our new awards. On slide 5 we highlight the key projects awarded in Q1. The North Sea has been very active, we won our first award in Mexico, and order flow improved in West Africa.

One trend to highlight is the growing importance of technology. We are demonstrating ourselves to be one of the key technology leaders in the subsea industry and our ability to develop and implement new technologies plays a key role in contract awards. For example, the Aasta Hansteen project represents a number of firsts on the Norwegian Continental Shelf in terms of water depth and technology solutions. The project will see the installation of the first Steel Catenary Risers in the Norwegian Sea, and also the installation of mechanically lined pipe by reeling. This is a very cost effective pipeline technology that Subsea 7 has developed together with Butting and forms a part of the technology development program for pipeline and riser systems that puts Subsea 7 in the forefront when it comes to complex field development projects.

Turning to slide 6 and the market, we've not seen any direct impact from oil price volatility on clients' plans, and tendering activity remains high, however in recent months we've seen some industry projects around the world postponed for various reasons. We've seen this in the US GoM with the postponement of Mad Dog 2 and Hadrian, in Asia with Browse, and we've seen a couple of examples in the North Sea. In a context where customers are experiencing inflation pressure our ability to collaborate with clients and propose optimising technical solutions is a differentiator.

Notwithstanding these project postponements, the fundamental drivers of our market remain robust, and we remain positive about the medium-term and long-term prospects despite these delays.

Turning to slide 7, I'll give some flavour by Territory. In NSC, tendering levels are strong, and we see more projects being awarded to the market on an EPIC model. This business model suits our capabilities, and we believe that with the correct risk profile it provides superior added value to both our clients and ourselves.

Turning to AFGoM, in West Africa we've seen some long awaited projects sanctioned and awarded to the industry. There's uncertainty on the timing of further market awards in West Africa, but this is not unusual for the region. In the US GoM we've seen some project delays, but equally expect some projects to be awarded to the market in the months ahead. In Mexico we're seeing improving activity levels with the deepwater Lakach Development currently going through the pre-qualification phase.

In APME, there are increased activity levels including two significant projects in Indonesia, but pricing conditions remain challenging in this very competitive market.

Finally in Brazil, there continues to be delays in the award by Petrobras of projects in the pre-salt. There is confidence that projects will be awarded in due course and that there will be a mixture of both flexible and rigid pipe solutions for these developments. However there is uncertainty as to when the tenders are to be released and when the subsequent awards will come to market. On the PLSVs, Petrobras continues to negotiate both contract renewals for the existing fleet and to evaluate new-build contracts with the industry.

In summary, we see growth opportunities in all of our markets, but there are variations in the pace of growth and there are timing uncertainties. With that I'll pass you to Ricardo who will talk you through the numbers

Ricardo Rosa

Thank you Jean and good afternoon. As Jean has stated, the results for the first quarter 2013 reflected a generally positive trend. I will now discuss the consolidated income statement and the territories' operating results for the first quarter and comment further on the balance sheet and cash-flow. I will conclude with an update to our financial guidance for 2013.

As shown on slide 8, first quarter revenue was \$1.5bn and first quarter operating income was \$154m. Both are broadly unchanged on the prior year period. Net operating income margin in the NSC improved slightly (up 80 basis points) compared to the prior year period despite lower vessel utilisation, driven by strong project execution and a commercial settlement with Shell on cancellation of the FRAM contract. Net operating income margin was down 150 basis points in AFGOM on the same revenue, driven by the change in project mix Jean referred to earlier. It was a strong quarter in APME, driven by high activity levels and a good contribution from our Sapura Acergy JV. Brazil reported a net operating loss in the quarter. This was largely driven by the planned dry docking of Seven Oceans and by Petrobras notifying us of their intention to remove the offshore scope of the UOTE project. Lastly, the Corporate segment delivered an improved performance due to lower administrative costs resulting from the absence of integration costs, the release of a provision on the successful resolution of certain legal cases and a positive contribution from our joint venture, Seaway Heavy Lifting.

Net income for the quarter was \$132m, up 42% on the prior year period, driven by gains on both foreign exchange and asset disposals totalling \$21m and a low effective tax rate for the quarter of 16%, which more than offset the higher interest charge. Diluted earnings per share of 37 cents compares favourably with the prior year 25 cents despite an increase in the average diluted share count for the quarter.

Turning to slide 9 and the Territories' operational performance in Q1.

North Sea and Canada delivered revenue of \$596m, up 3% on the prior year period with work progressing throughout the quarter on Laggan Tormore and West Franklin, offshore UK; Svalin, Jetta, Eldfisk and BG Knarr, offshore Norway; and Siri Caisson, offshore Denmark. Projects substantially completed in the quarter include Ormen Lange. Resources were mobilised on Martin Linge and Aasta Hansteen, but both were below the 5% POC threshold and so did not contribute to the quarter's results. As previously mentioned, net operating income margin rose despite lower utilisation due to strong project execution and the commercial settlement relating to the Fram project .

Africa and GOM delivered revenue of \$529m, broadly flat compared with the prior year period. There was good progress on CLOV, Block 31 PSVM and Lianzi. Lower margins on CLOV, which was tendered in a more difficult environment, explain why the Territory's margin was slightly lower than the prior year period.

Asia Pacific & Middle East delivered revenue of \$123m, up 44% on the prior year period. Progress was made on ONGC G1, offshore India and Gorgon, offshore Australia. The territory's net operating income improved significantly, driven by high activity levels and a strong contribution from the Sapura Acergy JV as Sapura 3000 moved into the offshore phase on Gumusut.

Revenue in Brazil, at \$217 million was 17% lower than the prior year period reflecting reduced activity in the post-salt largely due to the suspension of the UOTE project. The Territory incurred a net

operating loss of \$22 million in the quarter mainly due to the reversal of the cumulative margin recognized to date on the UOTE project following Petrobras's notification of their intent to remove the offshore workscope from the contract. The uncertainty surrounding the final outcome of this decision drove this profit de-recognition. Also contributing to the loss in the quarter was the Seven Oceans dry-docking prior to it starting work on Guara Lula which continues to be executed with no margin.

Turning to slide 10, I'll comment on some specific line items relating to the first quarter 2013. Administrative costs amounted to \$76m, lower than the prior year period due to the absence of integration costs and the release of a provision related to successfully resolved legal cases. The contribution from associates and JVs rose to \$16m, due to higher activity levels at SapuraAcergy and an improved contribution from Seaway Heavy Lifting. Net operating income of \$154m is stated after depreciation and amortization expense of \$87m, which increased 12 % on the first quarter 2012 . Other gains and losses of \$21m included net foreign exchange gains due largely to the strengthening of the US\$ against most currencies in the quarter, and a \$13m net gain on the disposal of 3 vessels and a shore-based facility in the quarter. Sale proceeds amounted to \$9m. The Acergy Harrier, the sale of which was effected through a finance lease structure, was the largest contributor to the net gain.

Net finance costs of \$18m have increased by \$14m compared to the prior year period mainly reflecting our recent \$500m convertible bond issue, and some non-recurring charges on early repayment of the Seven Havila loan following the recent acquisition of our JV partner's 50% interest in the vessel-owning joint venture. The effective tax rate of 16% for the quarter reflects an underlying effective tax rate of 31%, reduced by certain discrete items mainly comprising adjustments to prior year estimates.

Turning to slide 11. Cash generated from operations totalled \$402m including \$237m in working capital inflow, partially attributable to a reduction in trade receivables in the quarter. Working capital optimization remains an area of management focus.

Net cash used in investing activities was \$167m. The key capital expenditures in the quarter were the acquisition of the Seven Sisters (renamed the SIMAR Esperanca) and the continued construction of our new Pipelay Support Vessel, the Seven Waves.

Net cash used in financing activities was \$283m, with the key items being the early repayment of the Seven Havila loan of \$158m and a loan of \$115m to our asset-owning JV with Eidesvik to finance the construction of the Life of Field Support Vessel, the Seven Viking. Both these transactions are expected to have a beneficial impact on our net financing costs going forward.

We finished the quarter with a cash and cash equivalent balance of \$1.2bn.

Turning to our financial guidance for 2013 on slide 12, we reiterate what we said in March. We expect some progress in revenue and Adjusted EBITDA compared to last year, although the rate of progress will be tempered by delays in project awards, and by a vessel utilisation in the North Sea more in line with historical levels.

I will refrain from running through our guidance line by line as it is unchanged from our March commentary, with the exception of the underlying effective tax rate where we've lowered the range by 1 percentage point to 31-33%.

I'll now pass you back to Jean

Jean Cahuzac

Thank you Ricardo. I would like now to provide some additional guidance by Territory on slide 13. In NSC, the market is strong and tendering activity remains high. However there is a two-way pull in 2013 and the benefits of improved pricing will be somewhat mitigated by lower vessel utilisation. In addition, the Seven Oceans is transferring from the North Sea to Brazil in Q2 2013 where she will operate on the Guara-Lula project. This redeployment will reduce the available Subsea7 fleet in the North Sea in 2013.

In AFGOM, tendering levels remain high, however CLOV is in the offshore phase in 2013 and this is a lower margin project. More recent awards like Lianzi and Ehra North with improved pricing will move into offshore phase in 2014 and 2015 respectively..

In APME, we expect to see a positive trend as Subsea 7 will be in the offshore phase of two contracts under the Gorgon project offshore Australia and the SapuraAcergy JV will be active on the offshore phase of Gumusut, offshore Malaysia.

Finally, Brazil. Starting with Guara Lula, project POC increased from 34% to 47% between Q4 and Q1, and in Q2 we have entered the critical offshore phase. It remains a challenging project. Polaris is working on buoy foundation installation, two buoys are in Brazil and two will transfer to Brazil during Q2 as per plan, the Seven Oceans is being mobilized for pre-lay works, pipe fabrication is expected to start in Ubu at the end of May. Turning to the PLSVs, we recently agreed a new 5 year contract for the K3000 on an improved day rate, and we're in discussions to renew a further 3 of our PLSV contracts which expire later this year. As you know we have participated in the tender for new-build PLSV's and we expect market award later this year. There is still a lack of clarity regarding the timing of tenders or awards from Petrobras in relation to the pre-salt projects. We believe some of these tenders will be for flexible solutions, and some will be for rigid solutions. We are taking a cautious approach to these tenders going forward and will only participate if we can agree with our customer on an acceptable risk profile, taking into local administrative challenges, local content and supply chain constraints. In the post-salt in the Campos basin, we see opportunities with both Petrobras and the international operators.

Turning to slide 15, we set out key changes in the fleet since 2011. We recently announced the commissioning of a new-build HCV which will join the fleet in 2016. We have a number of 400t crane capacity but we're increasingly seeing projects where the lifts are of such a size and weight that we are approaching the limits for these cranes. In the future we see a growing market for larger lifts in deeper water, some associated with the trend towards subsea processing. The high specification crane on our new HCV will help us meet these challenges for our clients.

On slide 16, we set out some of the key technologies we have already deployed or are developing. As I mentioned earlier, we see technology playing a role of growing importance in our SURF business as projects move into deeper waters and harsher environments. We view this as a positive development as it plays to our strengths in innovation and project execution. On slide 17 we highlight the successful collaboration between Subsea 7 and the manufacturer BUTTING which resulted in the world's first qualification for the use of Mechanically Lined Pipe for reel-lay installation of flow-lines and risers globally, this is a cost-effective alternative to solid corrosion resistant alloys. This technology helped us win the Aasta Hansteen contract. On slide 18 we highlight the buoy supported riser an example of which is being installed on Guara Lula. The photograph on the slide shows one the buoys floating in the harbour in Brazil.

In conclusion, turning to slide 19. It has been a good quarter. We are reiterating our guidance for the full year, we've got a record backlog, we see growth opportunities in all of our markets, and, while some industry projects have been delayed or postponed, we are positive about medium and long term market prospects. Subsea 7 is well positioned for the future as we have the people, assets, technology and track record to meet the challenges faced by our Industry. And now let's turn to your questions.

Phillip Lindsay – *HSBC*

Yes, hi, afternoon guys, few questions please. In your opinion, is there a common theme or themes from the project delays and postponements that we are seeing the market today; like project economics worsening because of high costs or inflation or is it sort of case-by-case and project-specific issues? Then relating to this, I know there have been a few issues on Kaombo in West Africa in relation to the FPSOs, but I think the Subsea guys have been asked to resubmit their bids as well. So perhaps, if you could just give us your best guess as to when we may see this key project awarded? That's the first question.

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

Thanks for your questions. Regarding the project delays, in fact, it's for various reasons. In some cases it comes from drilling results which force the operator to review their options to develop the field, look at the alternative technical solutions; and that takes more time. It's been the case, for instance, on Fram in the North Sea. In some other cases, it can be a question of cost. If you take Browse in Australia, where our understanding is that the present trend of cost onshore in Australia basically forced our clients to review in some cases, the option they are taking. And for some other projects, there is the overall pressure on prices which comes from the industry and from the equipment manufacturers which leads to questioning some of the options that the client had initially. So it's various reason, it's not necessarily unusual, but it's true that we've seen over the last couple of months a number of projects being delayed or postponed. Regarding Kaombo, I think it's an example of what I just mentioned and I think it's also an example where there is a very good coordination communication between Total, the client, and the service industry. There are some cost challenges on the projects and the process, which has been initiated, has been to actually work with Total to review what is the optimum design of the field and how, together, we can lower the cost for the development of the field. And Total has been doing that with the subsea industry, with us, and I suspect with our competitors too, but are also doing that with the FPSO company. All that takes time and it's difficult to have an exact idea of when this contract will be awarded. It could be a bit later this year or it could be delayed a bit further. I don't really know.

Phillip Lindsay – *HSBC*

Okay, that's fine. And then a couple of project-specific questions. Can you just comment on the Ekofisk contract in Norway, where another contractor is experiencing some problems? Are you able to confirm that you're in no way affected by these issues? And then, secondly, on the CLOV contract, is there any difference between your margin expectations on CLOV right now versus when you bid it? I remember right, when you originally won the contract, it was bid with another vessel, the Polaris, I think. Has the execution with the Borealis helped your margins in anyway?

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

I'm going to answer on CLOV and then I'll let John answer on the other question. I mean regarding CLOV, the project is being executed as per plan. The Borealis is a more efficient vessel than the Polaris that we had planned to put on the vessel initially. My comment regarding the profitability of CLOV was related to the fact that the project was awarded in a more challenging business environment and, therefore, the profitability of the project is lower than some other projects that we've executed in the past like PazFlor, or some other projects, or projects that we will execute in the future. But the CLOV project is being executed as per plan. John, do you want to comment?

John Evans – *Subsea 7 – Chief Operating Officer*

Yes, we have a number of contracts with ConocoPhillips on Ekofisk and we have a big bypass to do with them at the end of this month, early next month, which means there is a shutdown of the platform and we do the bypass there. That is all going as per plan and, as we speak, we're mobilising the vessels associated with our contract. So we have certainly seen no change in our client's plans for our work at Ekofisk.

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

And we don't see any negative impact on what could happen on this project for us.

John Evans – *Subsea 7 – Chief Operating Officer*

Yes.

Phillip Lindsay – *HSBC*

Okay, fully understood. Thanks very much.

Operator

The next question comes from the line of Frederik Lunde of Carnegie.

Frederik Lunde – *Carnegie*

Hi, good afternoon, just going back to capex which has been a bit of a recurring theme. Given the signals you were referring to about project delays; I know this is nothing new, but still we've seen oil pricing flat for three years, we see cost inflation creeping up, oil companies being probably a bit more prudent in terms of their capex. It really makes sense for Subsea 7 as well as to take a step back and reconsider kind of the five-year investment time which will require most of the capex. It's also the cash flow as it looks to me. Why this urgency to renew the fleets?

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

Well, I will let the client answer themselves on their view on the capex and what's being planned in their development programme. We haven't seen a material or significant decrease in this tendering and,

in particular, in the North Sea. We still see ambitious plans from our operators. Timing of projects can be difficult, but the projects are still there. Regarding our own plans, I think we are taking a very cautious approach on the capex side. It's true that we have announced some capex numbers and but what you have to keep in mind is that, when you look at the capex that we are foreseeing in the years to come, they come from different sources. I mean the first one is success or no success in the PLSV contracts with Petrobras and we expect Petrobras to award to the market a number of PLSVs at the end of the year.

If we were to commit to this capex, it will be with the backup of long-term contracts and with rates which allow us to exceed our financial objective in terms of cost of capital or recover more than our cost of capital. So I believe it's a pretty good investment if we were to be successful on these contracts and the future will tell if we are not. Regarding the additional vessels that we are committed to; we committed to a new-build DSV last year. We see a very high activity in the North Sea not only in the foreseeable future, but the long-term for this type of vessel and it's part of the renewal of the fleet. And our newly announced heavy construction vessel, in fact, is to position ourselves at the high-end of the market using technology and crane capability, but also some other technology which will allow us to execute the project the way we see they will be developed by the clients in the future, and in particular with Statoil in Norway. So I think it's a prudent investment plan that we have and no capex is committed to without a thorough analysis and without us coming to the conclusion, and the Board coming to the conclusion, that we will get the necessary financial return.

Frederik Lunde – *Carnegie*

You've clearly been very good at securing a low cost on debt. I'm wondering what cost on capital do you apply for new projects?

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

Ricardo, do you want to comment?

Ricardo Rosa – *Subsea 7 – Chief Financial Officer*

Frederik, when we are evaluating our projects on a standalone basis and our investments associated with them, we will use a hurdle rate somewhere between 10% and 11%. So we would be looking for returns, value-adding returns, in excess of that hurdle rate.

Frederik Lunde – *Carnegie*

And does that number take into account where you are in the business cycle and kind of where do you think you are in the cycle now?

Ricardo Rosa – *Subsea 7 – Chief Financial Officer*

If you mean in terms of the hurdle rate, I mean we tend to work with a small range of hurdle rates as I mentioned – between 10% and 11% – and the decision to go or not go on a particular capex project obviously is a function of how we see the marketplace evolving in the coming years.

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

But as you can imagine, I mean we run, low case and base case and do sensitivity analysis, so that management and the Board can feel comfortable that it's very likely that we meet the objective.

Frederik Lunde – *Carnegie*

Great, thank you.

Operator

Your next request comes from the line of Andrew Dobbing of JPMorgan.

Andrew Dobbing – *JPMorgan*

Yes, hi, good afternoon. A couple of questions from me. First of all, the North Sea, you talk about utilisation deteriorating in 2013. I guess you're still assuming that's going to recover in 2014 and, secondly, a quick question on your technology slide; you mentioned composite materials. Can you talk about how you think developments are going on the kind of development of pure composite risers on flow lines? Is that something you are involved in and can you comment on how you think progress is going there? Thank you.

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

Yeah. First, maybe to clarify your point, I may not have been clear on the deterioration of utilisation in the North Sea. What I meant by that is that in fact in Q1, and probably in Q4, we will see utilisation more in line with the past year taking into account seasonal effect. So when we are talking about low utilisation, it was lower utilisation than Q1 2012, where we had seen at the time an unusually high utilisation. But overall, I mean, we foresee a good utilisation of the vessels in the North Sea.

Andrew Dobbing – *JPMorgan*

Okay.

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

What is putting a bit of headwinds in the North Sea for us is the fact that the Oceans after going to dry-dock will be on her way to Guar-Lula into Brazil and therefore won't be available in the North Sea for operation and that's one less vessel in the North Sea. But I didn't mean to say that we are foreseeing low utilisation in the North Sea overall. Regarding the technology, I'm going to let John comment on that.

John Evans – *Subsea 7 – Chief Operating Officer*

Yes, you know composite materials is one area that we are tracking in terms of the potential developments. We are involved in a joint industry project and we have a specific discussion with one of the provider's offline as well. I think it's going to take quite some time for the composite technology to make its mark on the industry. In theory it offers a lot of opportunity in due course, but we are certainly making sure that we track that capability, but I think it's first deployment will be in very benign environment, in very standard environments that we work in – shallow waters and such like – initially for it to get its track record and credibility. But we're looking at five to ten years before we get to that stage, we believe, and then its use in the much deeper, much harsher environments will take longer in again.

Andrew Dobbing – *JPMorgan*

Okay, thanks very much. Just one more question, a quick question on pricing in Brazil. You talk about higher pricing on the renewal of PLSV contracts. I assume that pricing will be sufficient to offset higher capex or higher opex costs in operating in that region?

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

Absolutely. I think the industry in the past years – if you go back a number of years from now – had underestimated the cost of inflation on the people side in particular. I think it's today something that we do understand and monitor pretty well and we have taken into account when we propose a day rate to Petrobras, not only a better formula, but also the necessary contingencies to cover the inflation of a salary that we foresee in Brazil. So it's something where we've taken a cautious approach and we are comfortable with the numbers.

Andrew Dobbing – *JPMorgan*

That's clear. Thank you very much.

Operator

Thank you. Your next request comes from the Goran Andreassen of RS Platou.

Goran Andreassen – *RS Platou Markets*

Yes, hi, good afternoon, just two questions for me. First one is regarding 2013 margins. They seem actually to be holding up pretty nicely considering offshore execution on projects booked in the lower price in that environment in 2010 to 2012. You also have a higher than usual level of early phase work in the mix due to the fact that you've been successful in booking larger projects that are more complex, and you also have Guar-Lula at no margin contributing around 7%, 8% of your revenue this year. Considering that, we should expect to see significant margin expansion at one point, but it's probably not a 2014 event but 2015, 2016 onwards. Could you comment on what you see potentially where margins could go in this cycle?

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

Well, you know, it's a difficult question. Margins are improving and we see things going in the right direction. The tightness of the market depends on the type of project and the type of assets, but I think when you look at the overall margin for the Group, it also depends on the portfolio of projects. The fact that we are seeing larger projects, large EPIC projects, means that we foresee in the future more revenue coming from procurements, in particular, and it can represent a very high level of the value of projects; in some cases up to 30% or 40%.

What we are doing when we look at risk mitigation on these projects is actually mitigate the risk and balance the risk with our clients on the procurement side and therefore, there is a lower margin on the procurement than there is on the more added-value of the rest of the project, which is project engineering and offshore execution. So while we see this overall trend of margin improving, difficult to give you a value for 2014 or 2015 or 2016. It also, obviously, depends on project execution, and you mentioned Guará-Lula, which as you know is a loss-making project. But I'm quite pleased with the execution that we have on the other projects worldwide and providing that we maintain this good execution, we should also see improvement of the overall market. But very difficult to give you numbers and I would not go in this direction.

Ricardo Rosa – *Subsea 7 – Chief Financial Officer*

Goran, I'd just like to add one observation to Jean's comments and just to clarify a potential misunderstanding. We don't distinguish... we don't have differing margins depending on the phase at which we find ourselves in the course of a project. So we don't have a distinction... we recognise a blended margin across the life of the project as we recognise the percentage of completion.

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

But what happens is that on every project we have contingencies and the large amount of contingencies relate to operation. So when we come to operations on the well-executed projects, what happens is that we release contingencies and you see an improvement of the margin at the end of the project but it comes through the accounting method. It's basically to represent the actual milestones which are reached and successfully executed in the life of the project.

Goran Andreassen – *RS Platou Markets*

Okay, so then regarding contingencies, you had actually quite okay margin in West Africa this quarter. Was that helped by contingencies released on the MPN Satellite project?

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

I am not going to comment on an individual project. It's again a portfolio of different things, but I think we results show that we are executing very well in Africa.

Goran Andreassen – *RS Platou Markets*

Yes. And then just a final question, you did mention on Guar-Lula that it has entered into the offshore phase, which is critical of course, but that also means that you are in more control of the remaining policy scope, but still you say that it remains a challenging project. Should we take that as some early warning of potential additional losses or is it just, should we, does it look okay?

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

When we made this comment we want to highlight that we are indeed starting the most challenging phase of the project as far as operations are concerned. I mean the Polaris has started the operation in April; the Oceans will operate later on. We are going to install the buoys. And that's all that in an environment in Brazil, which is more difficult than in some other countries; that relates to administration, to importation, to local suppliers. I mean all the things that we talked about in the past and then also the time of the year where the weather in Brazil can have an impact on some operations. So when we were talking about challenging project, it was basically referring to the phase where we are in for the project as well as there are still, in Brazil, some challenge which maybe don't exist in other countries. That was the comment.

Goran Andreassen – *RS Platou Markets*

That's very helpful. Thank you.

Operator

Thank you. Your next request comes from the line of Ian Macpherson of Simmons.

Ian Macpherson – *Simmons & Company International*

Thank you. Jean, there has been some media noise recently about Aasta Hansteen and the government wringing hands over, I guess, the cost of the project and more broadly, I guess, the impact of recent tax... higher taxation in Norway. Is there anything to that based on your perspective and any sort of backlog risk you see with that project? And, more broadly, do you see any impact on Norwegian activity as a result of recent tax changes?

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

No, any impact on tax in the wrong direction is not positive, but we haven't seen an immediate effect and we don't foresee an immediate effect. I would like to take, however, the opportunity to comment on the cost and the cost in Norway, which is definitely a concern. And, in particular, the costs associated with regulation and people in Norway, which means that it's more and more difficult for the Norwegian industry to be competitive outside of Norway. So the general comment about the cost of projects going up, the cost of operation going up is true worldwide but, in particular, in Norway, we are seeing more and more accelerated cost and I personally don't think it's good for the industry. But we haven't seen an impact for Subsea 7 and we don't see in terms of the tenders, in terms of the activity, but it's increased the cost for the clients, without any doubt. Even if it is a pass through of cost from outside, it increases the cost of the development in all

Ian Macpherson – *Simmons & Company International*

And you're not seeing anything specific with regards to revised outlook for Aasta Hansteen?

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

No, we haven't seen at this stage anything specific.

Ian Macpherson – *Simmons & Company International*

Just a quick follow-up. It hasn't come up but I just wanted to sort of confirm that... of course you don't guide specifically, but I think that we infer that you are effectively still okay with the consensus EBITDA estimates for 2013 based on your comments today?

Ricardo Rosa – *Subsea 7 – Chief Financial Officer*

I think we repeated what we said at the end of the year that we will see some progress compared with 2012 and obviously, I mean, if there was some significant change compared with consensus and/or our review, we will notify the market as soon as we would be aware of these changes.

Ian Macpherson – *Simmons & Company International*

Very good. Okay, thank you.

Operator

Your next question comes from the line of Rob Pulleyn of Morgan Stanley.

Robert Pulleyn – *Morgan Stanley*

Hi, good afternoon, gentlemen. A couple of questions from me if I may. First of all, regarding oil company behaviour, in your view, in your experience, are delays between the start of, I suppose, leading indicator engineering activity and progression to final investment decision and contract award... are those delays getting longer on average or are they similar to in the past? If you can maybe put a little bit of colour around that, that would be great? And secondly, obviously you highlighted the working capital improvement in the first quarter. Could you give us a little bit of guidance as to how we should think about that for the full year? Is it going to be sort of steady state from now or is that going to reverse over the course of 2013? Thank you very much.

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

Thank you. I will let Ricardo answer on the working capital, but first one on the delays, which would come from engineering the project management. The challenges of the industry have been there for a while. I mean there are constraints on the people availability as an industry. There are constraints from the supply chain. There is the operator working with a company like Subsea 7 and others to review the optimum technical solution to lower the cost on the project. So that means that, in some cases, it takes more time to launch a project. I wouldn't say it's true for every project. I think it would be a bit of an

exaggeration, but we are seeing the constraints of supply chain, the constraints of lack of human resources with the right qualification in some cases, delaying a bid or the project. Nothing new in this quarter compared with what we've seen for the last 12 months. It's one of the themes which I had identified in the past. What does it mean for Subsea 7? I think it means two things: it means that we need to have a very detailed and total review of the resources available and making sure that we don't compromise the quality of what we are doing in our approach by trying to do too many things, or whatever. So I think we have a good control on that. I think it also brings opportunities because there are not many companies in the industry which can provide the clients with the flexibility on the vessels, but also the resources and the expertise that we have to answer to their needs. So I would say, overall, it's a differentiator for Subsea 7 to be able to face these challenges with the client. Regarding the working capital, Ricardo?

Ricardo Rosa – *Subsea 7 – Chief Financial Officer*

Yes, Rob, I guess, working capital management in our industry is, as you are aware, a pretty complex task. Our target is to minimise any increase in working capital. So for 2013, we would like to keep working capital at or below what we had for 2012; preferably below. That is the broad target that we are looking at. But I do want to add a couple of comments that may help you model it going forward. First of all we, as a Company, are very conservative in the way we recognise potential changes to scope in the form of variation orders that we can agree with clients. We have to have a very high level of confidence that we will reach agreement with the client before we record a receivable, and clearly that has an impact on working capital. Our activities are a mixture of lump sum contracts, where we aim to be cash neutral throughout the life of the contract, absent any very significant variation orders that may arise. On the other hand, we are also a Company that runs on a day-rate basis, particularly with regard to the vessels and, for instance, the PLSVs in Brazil. There we would tend to have positive working capital, because we will build at the end of each month and we will have perhaps 30 to 60 days receivable outstanding. And the last comment I'd make is that client mix does have an impact and, in particular, there is Pemex in Mexico that, as part of its standard contractual conditions, will insist that all materials procured on its behalf for a contract be received and certified before any payment is made to the contractor. So if there is a very significant growth in our activity in Mexico, you would expect some upward movement in working capital.

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

But, Ricardo, that's something that we price in the project.

Ricardo Rosa – *Subsea 7 – Chief Financial Officer*

Yes, that's right. We price it but it clearly has a working capital impact, were we to have a lot of work in that part of the world.

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

But we take that into account when we evaluate our cost, and the cost of capital is obviously important.

Ricardo Rosa – *Subsea 7 – Chief Financial Officer*

Exactly.

Robert Pulleyn – *Morgan Stanley*

Okay, very helpful gentlemen. And one follow-up question if I may. In terms of return of cash to shareholders, last year obviously you returned a larger volume and you haven't committed to a, shall we say a constant dividend stream going forward? Is it correct to assume that you are awaiting the outcome of the PLSV tendering process in Brazil and on the subsequent announcement of who has won those units; you'd be in a better place to decide whether you could return more cash to shareholders?

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

I'll let you answer, Ricardo.

Ricardo Rosa – *Subsea 7 – Chief Financial Officer*

Okay, Jean. The Board has already indicated that it will recommend a dividend be paid of \$200 million in 2013. Obviously, that dividend is subject to shareholder approval. So it is not as if there is any absence of cash returns foreseen this year. The fact is that we clearly take into account when we are evaluating any additional returns of cash to shareholders our capital expenditure commitments. And I wouldn't like to say that it's the PLSVs to drive that, but we have provided guidance on the level of capex that we're foreseeing this year and in the next few years. The other factor too is the maturity of the convertible bonds. In October this year we have \$500 million of converts that mature. At this stage, our share price is quite close to the strike price of the bonds, so there is a question mark as to whether or not this bond will convert or whether it will have to be redeemed for cash and clearly that plays into our evaluation of our cash needs. But the evaluation of our cash needs is a topic that's reviewed very regularly with the Board, and to the extent that it makes sense and the Company can afford it while prioritising growth opportunities, it will consider returns of cash, both in the form of dividends and in the form of share buybacks.

Robert Pulleyn – *Morgan Stanley*

Thanks very much.

Operator

Thank you. Your next question comes from the line of Erik Tonne of SB1 Markets.

Erik Tonne – *SB1 Markets*

Yes, hi, thank you for taking my question. Two questions, if I may. The first is quite short. Could you potentially comment roughly on the size of the settlement on Fram with regard to how that's impacting the North Sea operating margin for the quarter? The second element is we're seeing more projects

postponed, as you were saying, but could you just shed some light on how you see prices developing going forward in the different regions in the current environment? Thanks.

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

Fram is commercially sensitive and we are not in a position to comment on the value. Regarding the project, the pricing on the project, etc, you know although we are seeing projects being postponed, as we said, we are also seeing a very high tendering activity, in particular in some parts of the world; and we mentioned the North Sea, but we also see increase of tendering in the Gulf of Mexico. Although the timing of the project award to the market in Africa is always difficult to define, we have seen and we probably will continue to see projects being awarded to the market in the future. So the comment that I made before regarding the profitability going in the right direction of this new project still stands. We are in a good market in spite of projects being postponed and we need to remain cautious, but the market is still going in the right direction. So profitability should be improved.

Erik Tonne – *SBI Markets*

Okay, thanks.

James Evans – *Canaccord Genuity Limited*

Hi, sorry to go on about costs. I've got a couple of questions, if I may. Firstly, can I just ask what the inflation rates you're seeing in subcontractor works along with different equipments and subcontracting lines and also in salaries at the moment? And secondly, obviously, there is a lot of bidding activity going on in West Africa at the moment. I just wonder if you could talk how local content in Angola and Nigeria relative to maybe, say, Ghana and Congo is influencing costs of those projects; if you can? Thanks very much.

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

Yes, regarding cost; first, when we talk about costs of the project, they are costs that the service industry passes to the clients. So, when we talk about cost inflation on the overall project, the challenges are more on the total budget of the operator. Regarding inflation on compensation, because of a shortage of resources, I mean, there is some inflation on cost. We've seen some moderation overall around the world on this inflation cost. It depends on the countries; still very high in Brazil, but relatively low in some other countries. So I think we've seen some moderation there although the cost inflation is still significant, but probably less than 2012.

Regarding the local content: the local content has the cost and increases the cost of our organisation. When you have to do the work in some other country, I mean, if you take a country like Nigeria or Angola you increase your cost there. It increases the cost for the operator, because it sometimes takes more money, more budget to actually fabricate in some countries than others. So, again, that's something I think we understand well and something that we are putting in our costs when we present the bid to the operator. But the local content remains very important in our other countries;

important in Brazil, important in Nigeria, important in Angola, maybe a bit less cost impact in Congo and Ghana just to give you a kind of the flavour.

James Evans – *Canaccord Genuity Limited*

Okay. Thanks very much.

Operator

Thank you. Your next request comes from the line of Frederik Lunde of Carnegie.

Frederik Lunde – *Carnegie*

Hi again, sorry to keep pushing on this, but looking at Brazil, for example, where you are now chasing these PLSV contracts. On average since 2005 or so the EBIT margin in Brazil has been about 2.5% on my numbers and there's always been promises of better returns going in the future since, last I recall, in 2007/2006; and it hasn't materialised. So I mean why are you so keen on chasing more business there as long as Petrobras sticks to sort of the rigid contract formats and inflation remains quite challenging?

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

I think when I look at Brazil, I mean, there are basically three type business segments. There is the business segment of the PLSVs and day-rate contract. The Seven Seas, by the way, I mean the new contract of the Seven Seas is more than \$300 million is a bit of lump sum, but mainly a day-rate contract; so it's low-risk project. Where I think we do expect margins to improve when we renew the contract or get other contracts, is for the reason that I mentioned before. It's a risk profile that is acceptable. It's a risk profile that we know how to manage. So that's a positive side.

Then you have a second business segment, which are the EPIC projects with the IOCs. It's a limited market somewhat, but to give you an example, the next project to be awarded to market is probably BC-10 for Shell and I think there are projects which are run a similar way as the projects which are run outside of Brazil when they are run by IOCs. And you also have some EPIC projects – small size, middle-size – run by Petrobras with replacement of equipment where the risk is manageable. When you look at our Brazilian results, I mean they have been impacted by Guar-Lula as you know. That's a pre-salt, and I think we've been very clear to say that post Guar-Lula it's not our intention to embark in additional projects with Petrobras with the same risk profile. And that we will pass on a number of projects if we cannot align ourselves with the client to have a risk profile which is acceptable. And we should take into account that the renewal of the PLSV will have a positive impact in 2014. I do expect improvement of our results in Brazil in the years to come, post 2013.

Frederik Lunde – *Carnegie*

All right.

Operator

Thank you. And your last question comes from the line of Henry Tarr at Goldman Sachs.

Henry Tarr – *Goldman Sachs*

Hi there. Just a couple of quick ones. Firstly on order intake, clearly Q1 was very strong. The delays in Brazil and AFGOM, should we expect lower order intake through the balance of the year?

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

It's very difficult to look at order intake on a quarterly basis, so Q4 last year was relatively weak. Q1 was very strong. I think we see good order intake in the quarters to come. I'm not saying it's going to increase every quarter, but I think the trend is still going in the right direction.

Henry Tarr – *Goldman Sachs*

Okay, and then in Brazil, in the quarter, could you just give us some indication as to the split between the dry-docking in the UOTE project in terms of the loss?

Ricardo Rosa – *Subsea 7 – Chief Financial Officer*

Henry, I am not prepared to provide that level of granularity. I mean would emphasise that the UOTE adjustment was effectively the reversal of the cumulative margin on the project as a result of this very significant scope reduction. So you have the impact of, basically, cumulative profits of prior periods. So it's not an insignificant element, but that's as far as I'm able to provide guidance for you.

Henry Tarr – *Goldman Sachs*

Okay. There was no negative impact of Guar -Lula in the quarter?

Ricardo Rosa – *Subsea 7 – Chief Financial Officer*

Guar -Lula continues to operate with no margin, as indicated in previous quarters.

Henry Tarr – *Goldman Sachs*

Okay. And then, just lastly, on the PLSVs; the existing ones. What is left to be renegotiated and what's the timing on that as far as you can see today?

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

We are in negotiation on the day-rate for the renewal of the PLSVs and so, basically the next two which should be on the table are the Normand Seven and the Phoenix; and then the Condor will be later in the year. So, the next two should be the Normand Seven and the Phoenix; difficult to know when we will land with Petrobras, but I think we are making some progress.

Henry Tarr – *Goldman Sachs*

Okay. All right, that's great. Thank you.

Jean Cahuzac – *Subsea 7 – Chief Executive Officer*

Thank you. And with that, I think I would like to thank everybody for participating to this earning call.

Thanks for the questions and looking forward to talk to you again at the next quarter. Thank you.

Operator

That does conclude this conference for today. Thank you very much for participating. You may all disconnect.