Subsea 7 S.A. Second Quarter & Half Year 2013 Results
Conference call transcript - August 14, 2013

Speakers

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

Paul Gooden – Investment Relations Officer, Subsea 7 SA

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 second quarter which ended on June 30 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 expresses 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 – CEO Subsea 7 SA

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 financial results and, before we take your questions, I will make some observations on the outlook.

Turning to slide 3, Q2 results have been strong excluding Brazil. The Group suffered a net loss of $13m for the quarter due to the $300m loss on the Guará Lula project that we have recognized in the period.

While this was very disappointing, I am pleased with our performance outside the Guará-Lula project. Margins were strong throughout the rest of the business and, excluding the Guará Lula provision, our EBITDA margin was 26%; results in NSC, AFGOM and APME were driven by strong project execution and high activity levels were reflected in the vessel utilization of 86 %. There was also a good contribution from our SapuraAcergy and Seaway Heavy Lifting joint ventures.

I will now give you an up-date on the Guará-Lula project:

Our views on future financial risks associated with this project remain in line with what we presented during our last call in June.

- Design engineering is complete
- We have made good progress with procurement and importation of equipment: the key components of the buoy systems are now either in Brazil or will arrive in Brazil in the coming weeks; supply chain is not presently on the project critical path although we are still experiencing some challenges with one of our subsea equipment suppliers in Norway. We are working jointly with Petrobras to overcome this specific issue in a timely manner.

- Production of risers at Ubu is now progressing well and is not on the project's critical path.
- We have moved into the main offshore phase of the project this quarter with the Seven Polaris and the Seven Oceans deployed on location. Weather conditions remain challenging and are having an impact on installation operations. As we commented in June, we expect these difficult weather conditions to continue until the Brazilian winter season is over in the fourth quarter.
- Overall, the project remains challenging.

Turning to slide 4, you can see the development of our backlog

We had expected this backlog to continue to grow and this positive trend is confirmed:

- In the quarter we announced significant contract awards in the North Sea including Mariner, in the US Gulf of Mexico and offshore Mexico with Heidelberg and Line 67, and in Brazil with the renewal of the Seven Phoenix PLSV contract.
- We have also announced a further $2bn of contract awards since the end of the second quarter, with the renewal of the Normand Seven PLSV contract and awards for three new build PLSVs.

Turning now to the global market, on slide 5, tendering activity remains high

Although some industry projects have been postponed for a variety of reasons, there has been no change in the market since our first quarter conference call. Despite these postponements we remain positive on market trends as we see growth opportunities arising in all major markets albeit at varying paces.

In NSC, tendering levels remain strong, and the trend toward the EPIC model for the larger development projects continues. This business model suits our capabilities, and we believe that we can achieve the correct risk profile for these projects while providing superior added value for both our clients and ourselves.

In AFGoM, we've seen some long awaited projects sanctioned and awarded to the industry in West Africa. As always, there's uncertainty on the timing of further market awards but this is not unusual for the region. In the Gulf of Mexico we're seeing improving activity levels in the United States and in Mexico, although from a low base.

In Brazil, Petrobras has awarded ten new-build PLSVs to the market in recent months, and is in the process of renewing existing PLSV contracts. We believe this underlines Petrobras' long term demand for these flexible pipelaying vessels.

Finally, in APME, activity levels are improving with a number of significant projects expected to come to market in the next few months, but pricing conditions in general remain more challenging than in other territories.

With that I'll pass you to Ricardo who will talk you through the numbers.

Ricardo Rosa – CFO Subsea 7 SA

Thank you Jean and good afternoon everyone. As Jean has stated, the results for the second quarter 2013 reflect a good performance in all Territories, excluding Brazil.

I will now discuss the consolidated income statement and the territories' operating results for the second quarter, and then comment on the cash-flow and balance sheet. I will conclude with an update on our financial guidance for 2013.

As shown on slide 6, second quarter revenue was $1.7bn, up 13% on the prior year period. Second quarter net operating income was $41m, after making a further $300m provision for losses incurred in the quarter and forecast to be incurred over the remaining life of the Guará-Lula project.

After deducting net finance costs of $10m and net foreign exchange losses of $11m, income before taxes was $20m, down $484m on the prior year period which had benefitted from a $220m gain on the sale of our 49% interest in NKT Flexibles and net foreign exchange gains of $43m.

The second quarter tax charge of $33m resulted in an effective tax rate for the quarter of 167%. As previously announced we are not anticipating any tax benefit from the losses incurred on the Guará Lula project due to the tax profile of the affected entities and, as a result, our updated guidance for the underlying effective tax rate for the full year 2013 is 51%-54%.
The high effective tax rate in the second quarter reflects the additional tax charge which was required to bring our underlying effective tax rate for the first half of 2013 into line with the revised full year forecast. I must add that the taxation charge of $59m for the first half-year benefited from certain discrete tax items which reduced the underlying effective tax rate of 54% to an effective tax rate of 33% for the period.

The net loss for the quarter was $13m, resulting in a diluted loss per share of 5 cents.

I turn now to slide 7 and the Territories' operational performance in the second quarter.

The North Sea and Canada delivered revenue of $705m, broadly unchanged on the prior year period, while operating profit of $136m increased by $43m (up 46%).. The Q2 net operating income margin of 19.3% compares favourably to the prior year period margin of 13.1%. The Knarr project moved into the offshore phase in Q2, and Martin Linge passed through the 5% POC threshold. Projects substantially completed in the quarter include B11 and Jette, while commercial close out was achieved on a number of smaller projects. The Seven Oceans moved to Brazil for 2013 and this partly explains why revenue was slightly down on the prior year quarter despite high activity levels. Overall, the execution of more recently tendered, higher margin projects continues to benefit the Territory's profitability.

Africa and GOM delivered revenue of $699m in the quarter, up 24% compared to the prior year period, while net operating income of $133m gave rise to a net operating income margin of 19.9% which was down only slightly on the prior year period's margin of 20.9%. Good progress was made on CLOV, offshore Angola although at a low margin and MPN Trunk, offshore Nigeria. Progress was also made during the quarter on engineering and procurement for Lianzi, BP GES and Ehra North, the last of these passing through the 5% POC threshold. Profitability also benefited from a number of variation orders agreed with clients during the quarter.

Asia Pacific & Middle East delivered revenue of $142m and net operating income of $33m, up 67% and 20% respectively on the prior year period. Offshore work was completed on ONGC G1, offshore India and the Gorgon Umbilicals project, offshore Australia. The territory's margin also benefitted from the contribution of the Sapura Acergy joint venture, with its vessel, the Sapura 3000,active on the offshore phase on Gumusut.

Brazil reported a net operating loss in the quarter of $294m due to the $300m additional full life loss provision recognised on the Guará-Lula project. As Jean mentioned, our view of the financial risks related to the project remain in line with what we communicated in June. Regarding PLSV activity, we do not expect to see the positive impact on profitability resulting from the contract renewals until late 2013 and early 2014.

Lastly, the corporate segment delivered an improved performance with net operating income rising 87% over the prior year quarter to $32m due to lower administrative expenses and a strong contribution from our 50% interest in the joint venture Seaway Heavy Lifting.

Turning to slide 8, I'll comment on some specific line items.

Administrative expenses amounted to $66m in the quarter, $12m lower than the prior year period due to the absence of post-merger integration expenses and tight cost discipline. The contribution from associates and JVs rose to $62m, due to the higher activity levels at both SapuraAcergy and Seaway Heavy Lifting. Net operating income of $41m for the quarter is stated after depreciation and amortisation of $88m, up $ 3m on the prior year period. We also incurred impairment charges of $11m including $8m related to the Lochnagar which has been classified as an asset held for sale with disposal expected in the third quarter.
Net finance costs of $10m have increased $4m compared to the prior year period mainly reflecting the impact of interest and accretion related to the $500m convertible bond issued in October 2012, while the $11m of Other Losses reflected net foreign exchange losses due to a modest strengthening of the US$ against certain functional currencies as compared to other gains totalling $263m in the prior year period. These resulted from net foreign exchange gains and the gain on sale of NKT Flexibles that I have previously highlighted.

Turning to slide 9

Net cash generated from operating activities in the first six months of 2013 totalled $465m. This included a $313m cash inflow from a decrease in net operating assets. This decrease was largely driven by an increase in operating liabilities arising, in part from the fact that the $300m in additional Guará Lula-related losses recognised in the second quarter have yet to materialise as cash outflows. There was a minor improvement in operating receivables over the 6 month period totalling $8m with improved cash collections in the first quarter being largely offset by increased receivables in the second quarter driven partly by revenue growth and partly by short-term delays in payments by certain clients. Working capital management remains an area of management focus.

Net cash used in investing activities was $312m, the key capital expenditures in the first half-year were the acquisition of the SIMAR Esperanca, the construction of the Seven Waves and the Seven Kestrel (which is the name of our new Diving Support Vessel), and initial milestone payments to the shipyard and equipment suppliers prior to the start of construction of the Heavy Construction Vessel in the second half.

Net cash used in financing activities was $298m, the key items being the repayment of the Seven Havila loan, and a loan to our asset-owning JV with Eidesvik to finance the construction of the Life of Field Support Vessel, the Seven Viking. The dividend of $0.60 per share approved at the Annual General Meeting on 28 June was recognised as payable at 30 June and a $199m distribution was made early in the third quarter.

We finished the quarter with a cash and cash equivalent balance of $1.1bn and gross borrowings of $1.4bn. Our current levels of liquidity and our access to the debt markets position us well to meet our dividend payment and potential convertible debt redemption obligations in the second half of 2013.

To end, I now turn to our financial guidance for 2013 on slide 10. If we exclude the impact of the $300m in Guará-Lula related losses recognised in the second quarter, we expect to deliver progress in full year EBITDA compared to 2012.
We have revised downward by $20m our guidance for administration expenses to between $330m and $350m but have increased the projected range for the underlying effective tax rate to between 51% and 54 % to reflect the lack of tax benefit associated with the Guará Lula project losses, for the reasons I have already discussed. The other items of guidance remain unchanged from the previous quarter.

I'll now pass you back to Jean.

Jean Cahuzac – CEO Subsea 7 SA

Thank you Ricardo.

I would like to provide some additional guidance by Territory on slide 11 & 12

In NSC, we expect normal seasonal vessel utilisation in Q4 and I must remind you that the Seven Oceans has transferred to Brazil, which impacts NSC revenue in 2013.

In AFGOM, we expect to continue to make good progress on recently awarded projects like Lianzi and Ehra North although I must emphasize that they do not start the offshore phase until 2014 and 2015 respectively. Project execution was good in the first half and will remain key to financial performance in the second half.

In Brazil, the Guará-Lula project – as I mentioned earlier - is in its offshore installation phase but we expect weather to continue to impact progress until the end of the Brazilian winter period.
We are making progress in implementing our business strategy for PLSVs. The Lochnager is to be retired in early Q3 and we expect that discussions with Petrobras for the renewal of the Seven Mar and Condor PLSV contracts will be completed later this year.

Turning to APME, 2013 will be an active year for the SapuraAcergy JV which is in the offshore phase of the Gumusut project in Malaysia. Subsea 7 is also active in the offshore phases of both Gorgon projects in Australia.

On slide 13 we set out the new build vessels currently under construction.

Starting with the PLSVs

The construction of the Seven Waves is going well. The hull was launched in Rotterdam in Q2, sea trials will take place in Q3 and the lay and construction equipment will be installed later this year. We expect the vessel to become operational in H2 next year.

We have committed to three further vessels during the quarter. These new build PLSVs will also be built in Rotterdam by the same contractors we are using for the Seven Waves. These new-build vessels are all backed by 5 year contracts with Petrobras, and our experience with the Seven Waves gives us confidence that they will be delivered on schedule and within our cost targets.

Our new DSV, the Seven Kestrel, is aimed at the North Sea diving market where we see continued strong demand. This project is also on schedule and in line with our cost targets with start of operations projected for early 2016.

And finally our new Heavy Construction Vessel is aimed at the growing market for increased subsea lifting capability. As the trend toward subsea processing and development of deeper fields becomes a reality, we believe the 600 ton crane on this vessel will position it well for future work.

Slide 14 highlights some of the technologies we are developing

Technology continues to be increasingly important in our industry, and there is growing technology richness in the projects we are tendering. In response to this trend, Subsea 7 consistently invests in new technologies.

One proprietary technology I want to highlight today on slide 15 is towed bundles. This is a technology particularly suited to the North Sea. Our facility in Wick gives us the ability to assemble and tow offshore pipeline bundles up to nearly 8km long, and then install them on often congested sea beds in the North Sea. The latest example of Subsea 7 success with this technology is our 71st bundle we have just completed for the West Franklin project.

So, in summary, turning to slide 16

Outside Guará-Lula, we have delivered good results during the quarter driven by robust project execution.

Our views on future financial risks associated with the Guará-Lula project remain in line with what we presented during our previous call in June.

For the full year, excluding the $300m in Guará-Lula losses, we expect to deliver progress in Adjusted EBITDA compared to 2012.

We have a record backlog exceeding $10.4bn at the end of the quarter and foresee growth opportunities in all markets in spite of some industry projects being delayed or postponed.

And now let’s turn to your questions.

Operator

(Operator Instructions). Phillip Lindsay, HSBC

Phillip Lindsay – HSBC

Three questions please; first of all, on Guará-Lula can you run through, step by step, the key execution milestones and the timetable against those milestones from now through until the end of the project?
And, I think as you've done previously, perhaps you could give an indication of physical progress on the contracts as we stand today? That's the first question.

The second one is just on how the competitive situation is shaping up in the North Sea. We've seen recently one of the JVs set up to target your dominance in that region, that's been dissolved. So I'd be interested in your views on how this changes things and perhaps any other developments that you're currently seeing in that market.

And then the last question is really around some current bidding activity. Assuming that Technip win the TEN project in Ghana, do you have a role on the contract? And if so, how big is your role in percentage terms?

And then the other was just around the Gendalo project in Indonesia, where it looks like you've teamed up with a local E&C player there, who as far as I can see, has got very little sub-sea experience. I know you've not formally announced this, but the industry press suggest that you've won it. So I'm just interested on how you intend to manage the execution of that project. That's it, thank you.

Jean Cahuzac – CEO Subsea 7 SA

Regarding the Guará-Lula project, as I mentioned in my opening statement, we made progress in a number of areas from engineering, to procurement, to now the Ubu spoolbase facility being in full production mode.

The critical operations that we have to execute are the installation of the buoys and we estimate that these buoys will be in position around the end of this year, around the end of 2013. That really is the critical milestone. When we review the project, as we are today, we have no reason to make comments which are different from the one that we made in June.

Regarding the North Sea, you mentioned dominance in the region. There is competition in the North Sea. We are well positioned in the North Sea, but we are not dominant in the North Sea. We have competitors against us.

I think what has happened in the North Sea is that we think that differentiators -- our key differentiators come with the size of our fleet, our engineering and project management skills, as well as the technology that we are using, like the example that I mentioned on the bundles; that positions us very well compared with some other competitors. Regarding the alliance or joint venture between our competitors, I will let the competitors comment on what their plans are and how they will evolve.

Regarding the bidding, as you know, we are waiting for award of the TEN project to the market. And should we be successful we will be successful together with Technip, because we are in consortium on this project. Should this project be awarded to the Subsea 7 Technip Consortium then we will announce the share of work scope that we have between the two companies. And then you mentioned the Gendalo project, I mean we -- the project has not been awarded to the market. We are well placed for this project but I would not necessarily conclude that we will win this project; there is still a long way to go. We are quite comfortable with our local partner, who is a pipeline company which would, if we were to be successful execute the shallow part of the installation of the pipeline, which is something that they are used to, and they have quite recently a barge to do these operations. We will do the more sophisticated deep water operation and we will work together as part of the consortium. So we are quite comfortable with the expertise of our partner and also the way we have defined the scope of work between him and us.

But, again, the project, the timing of the project award on Gendalo to the market is still to be seen.

Phillip Lindsay – HSBC

Okay understood, very helpful thank you.

Operator

Erik Tonne, SBI Markets

Erik Tonne – SBI Markets

Just to start with a question on West Africa, you have previously, I think, repeatedly stated that we should expect lower activity in West Africa this year and that 2013 would be a bit of a transition year in West Africa. But now you reported a highly decent first quarter and the second quarter I think was very, very strong and somewhat surprising, I guess, for most of us.

So the question is, what's actually happening, is it that you're getting more variation orders? And do you still expect 2013 to be sort of a transition year? So should we expect a significant softening of the result in that region in Q3 and Q4, or are we just sort of sailing smoothly into 2014?

Jean Cahuzac – CEO Subsea 7 SA

No, I think -- a general comment on West Africa, I'm very pleased with project execution in Africa, and it confirms the comment that we had in the past saying that the Guará-Lula project was really a one-off issue that we were facing, and that, generally speaking, execution outside of the Guará-Lula project was very good. That explains some of the results of West Africa.

There have been some variation orders, as we're always seeing on projects in West Africa. And then it's a question of also timing with the CLOV project coming to the offshore phase, although the CLOV project is a project which was bid at a low margin, taking into account the business market at the time. The execution of the project is going on very well.

Regarding the activity for '14, it's too early to comment on activity of '14. The only thing I can mention is that when you talk about Ehra North and Lianzi, the operation will be in '14 but also '15, so it will not be only '14. And should we be the winner of the TEN project, the execution of the project will be post '14 too. So a strong result in Africa driven by execution, and additional -- some additional deals, but I think overall I have not changed my view on the region.

Erik Tonne – SBI Markets

Okay is it then fair to say that we should assume a fairly corresponding performance also in the coming two quarters?

Jean Cahuzac – CEO Subsea 7 SA

I think the comment that we've made is that we were expecting, outside of Brazil, a progress on EBITDA overall. It's always difficult, as you know, on the quarterly basis to exactly know what will be the timing of some projects or some commercial discussions with a client. So when you look at the overall Group level, we will still show progress compared with 2012, once you have removed the $300 million loss in Brazil and Guará-Lula from the equation.

Erik Tonne - SB1 Markets

Excellent, and then one question if I may on Guará-Lula as well, if -- I don't know if this is possible, is it possible for you to quantify some kind of a run rate here; that if you are, let's say, for example, one month additionally delayed compared to your current plan, what would the sort of costs of that be, sort of additional time delay?

Jean Cahuzac – CEO Subsea 7 SA

As you can imagine, when we've done the review of the project, and we are doing the review of the project on a monthly basis, or even more often than a monthly basis, we run a number of what-if scenarios. And some of these scenarios take into account delays on weather, taking into account the wind turbulences seasons. And it's a consolidation of all these ifs, which led us to announce this loss of -- additional loss of

$300 million. When we look at how we see the project, and the way forward during the winter season, we have made a number of assumptions about delays which are included in these numbers.

Erik Tonne - SB1 Markets

But you don't want to quantify some kind of a run rate or the costs surrounding extra per month on this?

Jean Cahuzac – CEO Subsea 7 SA

It varies a lot; I can't really answer your question, it depends where you are, what stage you are, which vessels are involved, there will be vessels coming into the project, going out of the project, so it fluctuates.

Erik Tonne – SBI Markets

Okay, okay thank you that's it from me.

Operator

Mick Pickup – Barclays Capital

Mick Pickup - Barclays Capital

Good results there. A couple of quick questions on Brazil, sorry to be on that; obviously on the last call you said you were going to refrain from bidding until things have come more in the contractors favor. Can you just talk through any initial conversations you would have with Petrobras, and what their reaction has been?

And secondly, given the genesis of Guará-Lula, maybe for Ricardo, have you had a look at the goodwill balance and what's associated in Brazil, and made any decisions on whether that's still appropriate?

Jean Cahuzac – Subsea 7 SA - CEO

Thank you, Mick. I answer the first part of the question and then I will pass it to Ricardo. Well, what we said about Brazil is that we will not bid for projects with a similar risk profile, i.e., the large pre-salt project that Petrobras are planning to execute. We are still bidding and still on the market for IOC projects and for middle sized projects outside of pre-salt for Petrobras, all-day rate projects, like the Seven Seas contract that we signed some time ago with Petrobras.

We had a number of meetings with Petrobras to explain why we couldn't go on with the same risk profile on this very last project. I think Petrobras was receptive to our argument and listening to what we had to say.
There is a specific project where we notified Petrobras that we will not bid, in line as what we had announced before. They were, obviously -- I think they were disappointed that we would not bid, but there is no hard feeling. And I think the plan in the future will be to work together to see how we can align a bit better objective. And I believe that we can achieve this objective, but it's not going to be done in very short term; it's something which will take some time to be completed.

Mick Pickup - Barclays Capital

Okay, thank you.

Jean Cahuzac – Subsea 7 SA - CEO

But we are in discussion with Petrobras. And I would say it's a frank, open and constructive discussion, but you shouldn't expect us to bid pre-salt job in very near future.

Mick Pickup - Barclays Capital

Okay.

Jean Cahuzac – Subsea 7 SA - CEO

Ricardo?

Ricardo Rosa – Subsea 7 SA – CFO

Yes, thank you, Jean; good afternoon, Mick. With regard to your question on goodwill, clearly, the loss that we recognized in the second quarter was an indicator of impairment, and as a result we carried out a goodwill impairment exercise in the quarter. The result of that exercise was that we concluded that there was effectively no impairment.

Now, what you need to bear in mind is that the goodwill balance of about $2.5 billion has been pushed down to the territories, which are cash generating units, CGUs if I remember the term correctly. An amount allocated to Brazil is relatively low, and I think it's disclosed in our Annual Report, and it's less than $300 million. So we're not talking a huge amount of goodwill allocated to Brazil.

Now when we evaluate whether or not impairment is taking place, we look at future cash flows, as opposed to ones that have been incurred so far. And we have shared with you on previous conference calls that it is our intention to turn the corner on Brazil and to bring the territory back to levels of profitability that are comparable to other territories around the world. And based on these projected cash flows, our belief in the growth opportunities and returns on PLSVs we concluded that an impairment of goodwill in Brazil was not warranted.

Mick Pickup - Barclays Capital

Okay, thank you. And while I've got you, Ricardo, can I just clarify on your tax guidance of effective underlying to 50% to 54%? So I think what you said was effective underlying was 54% in the first half plus one-off benefits meant the underlying was 33%, and then the full year is going to be a 54% effective underlying. I should then add back those first half one-off items to get you a tax rate for the year which is lower than 54%?

Ricardo Rosa – Subsea 7 SA – CFO

We draw a distinction between the underlying effective tax rate, which, if you like, is the clean effective tax rate for the year, not taking into account what we call discrete items. And discrete items, as you know, are -- tend to be true-ups, are often true-ups of prior-year estimates or settlements relating to prior periods.
You are correct in your understanding that in the first half we benefitted from a certain quantum of discrete tax items, which are not part of the 54% underlying effective tax rate. So when you project forward, you have to, obviously, project utilizing our guidance on the underlying effective tax rate and then take a view on the discrete items. I can't help you further than that.

Mick Pickup - Barclays Capital

Yes okay, so those one-off items have happened in what -- the first half have happened, they will stay there and then we make an assumption of what happens in the second half on those one-offs?

Ricardo Rosa – Subsea 7 SA – CFO

That is correct.

Mick Pickup - Barclays Capital

Perfect; thank you, sir.

Ricardo Rosa – Subsea 7 SA – CFO

All right.

Operator

Goran Andreassen - RS Platou Markets.

Goran Andreassen - RS Platou Markets

Three questions from me please, first your guidance for your share of net income of associates and JVs remain unchanged at $85 million to $95 million, and that's despite a first half contribution of $78 million. Can you explain why you expect significantly less contribution second half from SapuraAcergy and Seaway Heavy Lifting from the first half? That's my first question.

And my second question is on the PLSV contract for Petrobras in Brazil, to build three new builds. Can you give us some more flavor on payment structure towards yard and also on the financing of those vessels? And what we should expect in terms of overall return on this contract?

My third question goes or is about current projects being a bit -- or smaller projects being a bit challenging for your clients from an economic standpoint. Technip said that they are being approached by its client base to come up with new solutions, or help them to come up with new solutions to make this project more economic. Is that a trend that you are seeing as well? And are you expecting that you could have or you have the right technology content in your mix to actually also help out on this towards your clients? Thank you.

Jean Cahuzac – Subsea 7 SA - CEO

I'm going to take the last question, and then I will ask Ricardo and John to answer the two first questions.
I concur with Technip that we are seeing clients coming back to us to work on solution to lower the cost base of the projects -- of some of the projects; I would say it's more the large projects than the small projects -- of the technology-driven projects, in order to overall improve the economics of the project. It's happened for instance on a project like Kaombo and Block 32 in Angola, but it happened also in the North Sea.

It's very good for a company like Subsea 7, in the sense that we believe that we can bring solution to the clients. We are differentiating ourselves through the technology, through our project engineering and project management. So we see this trend as positive for Subsea 7 as a good way of differentiation, especially with smaller company or new [commodity]. It's positive for us. Coming about the share of the joint venture, Ricardo do you want to comment, or John?

John Evans - Subsea 7 SA – COO

I'll take the joint ventures; the two joint ventures are SapuraAcergy where we're working on Gumusut in the third quarter; and then the work changes profile as we get ready to go to Australia to start work on Gorgon Heavy Lift and Tie-ins, which starts in quarter 1 next year. So we have a reconfiguration of the vessel and we have some transiting time, which means that the profile for the fourth quarter will be different around there.

If we look at Seaway Heavy Lifting, the Stanislav Yudin, which was the original vessel in the joint venture, will start a life extension, a piece of docking in quarter 4 as well. So our earning capability in the second half will be different from the first half, although we expect the third quarter to remain strong in renewable work in the North Sea. And moving on to the PLSVs, Ricardo, in terms of the paying structure?

Ricardo Rosa – Subsea 7 SA – CFO

Goran, good afternoon. As regards the PLSVs, our payment structure is, in very general terms, spread over the life of the vessel construction period. We haven't structured it in a manner whereby the milestones are either up fronted or back ended; they are pretty evenly spaced over the, roughly, three years it takes to build these vessels.

And then as far as your question of financing is concerned, [we], obviously, do not have project specific finance. We raise financing at the corporate level and use the additional fund to support our capital expenditure program over the five year period.

Goran Andreassen - RS Platou Markets

Thank you.

Operator

Henry Tarr, Goldman Sachs

Henry Tarr – Goldman Sachs

Most of my questions have been answered, but just quickly on the driver for the lower admin costs in the quarter or for the year, what's driving that please?

Jean Cahuzac – Subsea 7 SA - CEO

Ricardo, do you want to answer to the question?

Ricardo Rosa – Subsea 7 SA – CFO

Yes, Henry, I think if you look at the administrative expenses year to date first half they are down, but they are also positively affected by the release of a merger-related provision that was included in our PPA adjustments at the time of the merger of about $16 million. We disclosed that in our first quarter press release. So you need to back that -- put that back in to get the underlying trend. Setting that aside, I'm pretty pleased with the work that has been done by the organization in controlling our administrative expenses. We've been focusing on a number of areas, a number of variable costs. We've also taking a pretty long hard look at our headcount. And we feel that some of the savings -- at least a proportion of those savings are sustainable and we have, therefore, lowered our guidance for the full year.

Henry Tarr – Goldman Sachs

Okay, very helpful, thank you.

Operator

Ryan Kauppila, Citigroup.

Ryan Kauppila - Citigroup

Just on the recent PLSV new builds, your contract duration was shorter than some of your peers. Wondering if there was a strategic reason for that? And then secondly looking at your backlog now in Brazil, you've highlighted previously the big barriors to entry, your competitive advantages, are more along the soft skills and not along the fixed assets. Just wondering how the increase in PLSV charter activity correlates with those strengths?

Jean Cahuzac – Subsea 7 SA - CEO

I think just to answer your question, the five-year contract duration was a strategic decision on our side. We believe it's the best way to optimize the longer-term return of this vessel for a number of reasons that I cannot detail here for commercial reasons. But we believe it was the best solution and we actually pushed for this solution.

Regarding the backlog in Brazil, the PLSV work is a good business. We expect to return more than our cost of capital in -- for these vessels. It's a day-rate business with a low risk. We generate a good profit and it's a baseline of what we are doing in Brazil.

We intend to turn around Brazil in the second part of '14 from a financial perspective. And on the medium-term horizon, we intend to develop further the work on EPIC, where our work is -- our differentiator is through engineering and project management, the soft part of the business that you mentioned. But we will do that only with the right risk profile, which means that we will have to define, for the pre-salt with Petrobras, a new model, which will take time to define this new model. Once we've done that, we believe that we will be back for this type of business. So it's a pause that we are taking in Brazil on the pre-salt to actually turn around the financial results in the short term, second part of '14, and then grow the business again, but this time with the right risk profile.

Ryan Kauppila - Citigroup

Okay. And then just one quick one for Ricardo, if I can? Didn't think it would be an issue before today, but if the convertible does convert, right now is the plan to use the cash to buy back that dilution or is that something to be decided later?

Ricardo Rosa – Subsea 7 SA – CFO

Clearly, we're looking at both scenarios and have been looking at both scenarios, Ryan. At this point, I'm not sure I really want to comment in detail of what our strategy will be. We have -- in the past, I think, we have a pretty good record of being shareholder-friendly in terms of returning cash to shareholders and, clearly, that will be one of the options that we'll be looking at.
We do also have a pretty ambitious program of capital expenditures and that has to be another factor as well. And a third factor too, obviously, is the potential impact of -- well, the impact of the Guará-Lula-related challenges. But as I say, these are just elements of the equation and we'll be evaluating this in the coming months and we'll provide guidance as soon as we can.

Ryan Kauppila - Citigroup
Great

Jean Cahuzac – Subsea 7 SA – CEO

Just to clarify maybe your point on the Capex plan, it's a disciplined plan with additional investment when we are comfortable or confident that we can return more than the cost of capital to -- with this investment. So the future will tell what we'll do in this area or what we will not do in this area; still not finalized.

Ryan Kauppila - Citigroup

Okay. Thanks for that.

Operator

Kristian Diesen, Pareto Securities

Kristian Diesen - Pareto Securities

Just on the EBITDA guidance, you've stated in the report that progress wording, but previously you've been saying that you're comfortable with the current consensus EBITDA, at that time it was $1,250 million. I was just wondering after the Q2 performance if you see some upside to that figure or if that's still the level we should expect for '13?

Jean Cahuzac – Subsea 7 SA - CEO

Well, I think we stated our expectation for '13. When you look at the results on -- of EBITDA or financial results, I don't look at it in -- on a quarterly basis. I'm very pleased obviously with the results of Q2, outside of Brazil. I would not necessarily extrapolate the margins as a relative margin for all the quarters to come, so you have to take that into account.
The only thing I can say about '13 is that outside of Brazil, taking out the $300 million loss, we expect to see progress in -- compared with '12, in line to what we thought earlier before we took the loss of Guará-Lula.

Kristian Diesen - Pareto Securities

All right. And then just on Guará-Lula, if I remember correctly you stated at the June call that by year-end you should have some clarity on the critical offshore phase. Is that still the case, so that's towards your Q4 report that we should have some more comfort on that project?

Jean Cahuzac – Subsea 7 SA - CEO

Well, the key milestone is the installation of the four buoys offshore, and we expect to complete the installation of these four buoys offshore by the end of the year -- around the end of the year. At that time we will have an idea of where -- not an idea, we will know where we are on this milestone. We will also be in the summer period in Brazil, which will make things easier and that -- we'll comment on that at the time.

Kristian Diesen - Pareto Securities
Okay, thank you.

Operator

Katherine Tonks, RBC Capital Markets.

Katherine Tonks - RBC Capital Markets.

I just had two very short questions. Firstly, you mentioned the impact on the revenues of Seven Oceans leaving the North Sea, but I wondered if there's also a margin impact?

And then secondly, a slight nuance I suppose what you're saying in Brazil, I think in the past you've said that Petrobras, it also has a day-rate approach, I suppose, to their own internal processes and managing their suppliers, like Subsea 7, and they needed to change that to move towards an EPIC model. And I was wondering if there's any sign that they appreciate that they need to change their internal processes?

Jean Cahuzac – Subsea 7 SA - CEO

Thank you for the question. The first point of the question is that Seven Oceans has moved in Brazil and will remain out of the North Sea to complete the Guará-Lula project, the Guará-Lula project being at no margin. There will be no pull through from Seven Oceans, as we had in the past in the North Sea when she was there, so that's what we meant. Regarding the breakeven model and the Petrobras model, the day-rate model that we have the PLSVs work very well, both for Petrobras and ourselves.

The Petrobras model for EPIC is a new way of working and we will have to define, together with Petrobras, a different way of organising the projects, of sharing the risk and handling a number of challenges, which relate to Brazil, such as importation, supply chain, etc., to be able to operate in an acceptable -- with an acceptable risk profile.

So it's not a question of going to day rate, it's a question of moving -- operating differently on the long-term EPIC basis and that's what we will work on with Petrobras in the months to come. But that will take some time. I'm not expecting a short answer to this challenge.

Katherine Tonks - RBC Capital Markets.

Thank you. Sorry, can I just come back on the Seven Oceans, I was thinking of the impact on the North Sea itself, and whether that vessel has contributed a high margin. So should I include in Q3 and Q4 maybe a bit of a margin dilution just because that vessel's no longer there?

John Evans – Subsea 7 SA - COO

Hasn't been there for the year.

Jean Cahuzac – Subsea 7 SA - CEO

Yes, she hasn't been there for most of the year.

Katherine Tonks - RBC Capital Markets.

Okay, thank you.

Operator

Haakon Amundsen, ABG.

Haakon Amundsen - ABG

A couple of questions, if I may. First, when it comes to the North Sea you are mentioning about your year-on-year revenues being impacted by the Seven Oceans. Just wondering if that's the kind of year-over-year impact, which I'd expect also for the second half? And also, the margins in the North Sea, the year-over-year impact, is that going to be similar for the second half? And then, also, if you can explain a bit on the capacity additions you then intend for 2014 in the North Sea? And then, secondly, on 2014, I assume you're not ready to provide a financial guidance, but there has been a lot of talk about moderation on Capex by oil companies, at the same time you do have a very good backlog for 2014. How -- just trying to grasp your comfort about the current consensus estimates for next year and should we expect -- is it fair to still expect that earnings growth will accelerate in 2014, if we exclude Guará-Lula in 2013?
Thanks.

Jean Cahuzac – Subsea 7 SA - CEO
On your last point, I'm not able to comment on 2014, it's too early and we will come with comments on '14 later in the year. So I cannot really answer your question on '14.
Regarding the Seven Ocean, as John mentioned briefly before, the vessel has been mainly outside of the North Sea in '13; will be out of the North Sea for the rest of '13; and in '14 will work outside of the North Sea too. She will work on Guará-Lula and then move to some African projects, which are higher margin than Guará-Lula, obviously.

Regarding the margin in the North Sea, the low-margin projects are mainly behind us now. The one that we got when the market was more competitive, was more challenging. What we estimate is going to happen in the North Sea is higher margin on project while they are executed, but we also expect some seasonal effect in Q4, as we've seen in the past, with lower activity in Q4, which is a reflection of the winter period in the North Sea.

So in terms of overall project portfolio, we are seeing an improvement in margins in the North Sea, taking into account the cycle we are in. But we will still see in Q4 '13 and Q1 '14 some seasonal effect with lower activity from our operators during that period.

Haakon Amundsen - ABG

Okay, thanks. And if I may -- a lot of moving parts in that tax guidance for the full year. Is it possible to provide a more precise guidance for the effective tax in the second half of the year, to make it a bit easier for us?

Ricardo Rosa – Subsea 7 SA – CFO

Haakon, I thought we'd been fairly detailed in the amount of guidance that we've given. I think what we're saying is you've just got to think of two concepts, basically. We've got the underlying effective tax rate, which we have revised upward from 31% to 33%, to 51% to 54%, as a result of the adverse impact of the Guará-Lula losses, which do not generate a tax benefit.

And then, what you will have, and we have this every year, as most companies do, are what we call discrete items, which are true-ups of the prior-year estimates after we've filed our tax returns, or true-ups or adjustments to our uncertain tax position. And these can have a positive or negative effect on our underlying effective tax rate. We don't provide guidance on discrete tax items.
I've indicated on a year-to-date basis that the effective tax rate, through June 30, had benefited from certain discrete -- positive discrete tax items. I cannot provide guidance on whether or not there will be additional positive discrete tax items in the second half. So, absent that, you have our projections of the underlying effect of tax rate, which we have guided at between 51% and 54%.

Haakon Amundsen - ABG

Okay, thanks for that.

Paul Gooden - Subsea 7 SA - IR Officer

Operator, perhaps time for one more question please?

Operator
Frederik Lunde, Carnegie.

Frederik Lunde - Carnegie Investment Bank AB

Congratulations on the good numbers. Just one question really, there's been comments previously on the increased competition, in particular in South East Asia on the smaller projects. Just wondering now you see McDermott having some difficulties down there, we've seen Fugro having challenges, how do you see the competitive environment developing?

Jean Cahuzac – Subsea 7 SA - CEO

Well, I wouldn't like to comment on the competition performance or lack of performance, I think they will answer the question. But, basically, we are in the competitive market and we've seen competition all around the world from the recent past in a market, which is overall improving; business environment which is overall improving.

When I look at our position, I have not changed my views. We are a strong Company, we have a way of differentiation through project management engineering, we see more and more EPIC projects, which is really the projects where we can excel, and with the diversity of the fleet and the technology we are very well positioned to face the competition, which is coming, or trying to come back to our market.
So, no additional comment on that, but there is competition and we foresee to have competition in the future.
And I think with that I would like to close the session. We'd would like to thank everybody for the participation. I'm pleased again with our project execution, outside of Guará-Lula. It's a trend which I think will continue. And on that, I will talk to you at the next earnings call. Thanks a lot.

Operator

That concludes the conference for today. Thank you for participating. You may now disconnect.