SUBSEA 7 S.A.

Quarter 2 2016 Results
Transcript

28 July 2016
12:00 UKT

Speakers:

Jean Cahuzac, Chief Executive Officer
Ricardo Rosa, Chief Financial Officer
John Evans, Chief Operating Officer
Isabel Green, Investor Relations Director

Isabel Green - Subsea 7 S.A. - IR Director
Good afternoon, everyone. With me on the call today are Jean Cahuzac, our Chief Executive Officer; Ricardo Rosa, our Chief Financial Officer and John Evans, our Chief Operating Officer. The results press release is available to download on our website along with the presentation slides that we'll be referring to on today's call. Please take note of our forward-looking statements disclosure on slide 2. Similar wording is included on our press release. And, with that, I will now hand over to Jean.

Jean Cahuzac - Subsea 7 S.A. - CEO
Thank you, Isabel, and good afternoon everyone and welcome to our results conference call. I will start with the highlights of our second quarter performance and our view of the outlook before passing over to Ricardo, who will cover our financial results in more detail. I will conclude with an overview of why we believe Subsea 7 is well-positioned, despite the present challenges our market is facing.

Starting on slide 4, market conditions remained challenging in the second quarter, reflecting reduced investment industry-wide compared to the same period last year. Revenue of $961 million was 29% lower year on year, but higher than the first quarter 2016, due to the usual seasonal increase of activity in the North Sea. We have continued to benefit from good execution on projects in the final stages of completion. We are also seeing the benefits of the cost-control measures we implemented in 2015. Adjusted EBITDA was $280 million with a margin of 29%. This included a charge of $53 million relating to resizing measures that we announced in June. We have maintained a strong financial and liquidity position, as reflected in the increase in our net cash balance, which is now $728 million.

Our fleet of active vessels achieved utilization of 82% in the second quarter. Total vessel utilization was 67% with five vessels stacked as of 30th of June, following the temporary return to active service of Seven Waves in the North Sea and Seven Antares in Nigeria.

Backlog was $7.1 billion at the end of June. Order intake in the quarter was $1.6 billion, most of which related to a major wind farm award. There have been a limited number of oil and gas awards to the market in the quarter despite some oil price improvement since January. The timing of awards remains uncertain and we expect few large SURF projects to be awarded to the market before the end of the year. Looking further ahead, we are making good progress towards sustainable lower project costs based on our leaner organization, better ways of working, early engagement, and innovation. We are having more frequent discussion with our clients on early engagement and way of working and we are confident in the long-term outlook for deepwater development.

Turning to slide 5, we have achieved another quarter of strong execution. We have a disciplined approach to risk profile and this helps our projects to progress safely, on time, and within cost forecasts. In the second quarter, we experienced higher activity in the North Sea with clients progressing with planned work during the summer months. Offshore UK, we completed three bundle installations for Premier's Catcher project. Offshore Norway, work progressed on the Aasta Hansteen project for Statoil. We used Seven Oceans to complete BuBi pipe relay and installation of steel catenary risers and this is the first application for both these technologies in Norway. Also offshore Norway, we have made good progress on the Martin Linge project, installing the loading buoy and connecting mooring lines in the quarter. On the Maria project, water injection and gas lead pipelines are ready for rollout and we have successfully applied New Way of Working. We are achieving our planned savings.

Offshore Egypt, we have progressed with fabrication for the West Nile Delta Phase One project and are ready to commence offshore operation using Simar Esperanca and Seven Borealis. On the East Nile Delta project, first gas has been achieved on schedule and the final offshore work is due to be completed by our diving support vessel, Rockwater 2, in September. The TEN project for Tullow, offshore Ghana, is now substantially complete with the conclusion of our offshore operations and de-mobilization of our vessels.

On slide 6 we have summarised our latest reorganisation and resizing measures, which were announced in June. We have implemented a new organisational and reporting structure to support a leaner business and increase our focus on commercial and operational strengths. Oeyvind Mikaelsen is leading our commercial strategy and John Evans continues to focus on execution. The new structure is closely aligned to our market segments splitting our activity into three categories; SURF and Conventional, i-Tech Services and Corporate. We have concentrated our EPIC capability in the SURF and Conventional segment, where we utilise the expertise and experience of our project managers and engineers to deliver complex projects in all water depths. i-Tech Services provides engineering services and projects across the whole life of offshore oil and gas fields worldwide. It includes inspection, maintenance, and repair of operation oil fields, ROV services that operate independently of our vessels mostly on drilling rigs, and decommissioning services. By combining our life of field and ROV expertise into this single segment, our objective is to expand our geographic reach and create growth opportunities.

Lastly, our Corporate segment. We have included our Renewables and Heavy-lift business here, which today comprises our Seaway Heavy Lifting joint venture and the Beatrice wind farm project we were recently awarded.

To enhance our competitiveness, we are reducing our capacity to meet the expected activity levels. We did not take this decision lightly. We believe the strength of our business through this cycle depends on our assertive approach to embed New Way of Working and adapt to market condition. We remain committed to being a leading service provider in our industry and, in spite of the necessary downsizing of our organisation, we are maintaining our core expertise and critical mass.

Looking now at slide 7. For the second consecutive quarter, our order intake exceeded the values of orders executed. We ended June with a backlog of $7.1 billion, $600 million higher than at the end of March. The bright spot this quarter came in Renewables with the award of the Beatrice wind farm project. This $1.3 billion project will be run in collaboration with our joint venture company, Seaway Heavy Lifting, and involves the installation of foundation for 84 wind turbines off the coast of Scotland.

We were also awarded the Callater project, the pipeline bundle solution, offshore UK, for Apache. Technology is a key differentiator for this project. Our bundle solution continued to be popular with clients providing a low-risk, low-cost solution, particularly for congested field development.

Our long-term contracts for PLSVs offshore Brazil make up $2.1 billion of our backlog with about 70% of this relating to the four new-build PLSVs. The new-build high-specification PLSVs all have firm signed contracts with fixed day rates, contracted delivery windows, and five-year contract duration. The cancellation of the contract for Seven Mar and subsequent substitution of Seven Mar for Normand Seven in the latter's Contract resulted in a $47 million reduction of our backlog in the quarter. We continue to hold constructive discussions with Petrobras about its current and future needs.

Slide 8 summarises our view of the possible future. Industry-wide tendering and the world activity for new oil and gas projects remains low as clients minimise non-essential expenditure. We are making the necessary changes to stay competitive in this challenging market, but remain disciplined on the project risk profile. We are having more frequent discussions with clients regarding early engagement on solutions to offset declining rates in production with a particular focus on our alliance, technology, and innovation that support extended tiebacks and marginal field developments.

We list on this slide several projects that we believe may be awarded to market within the next year or so. We continue see better opportunity on gas projects than for oil, particularly those for domestic end markets. Our i-Tech Services business is expected to benefit from the consolidation of life of field and ROV services. And we are pursuing opportunities to expand our geographic presence. We are currently tendering for work not only in the North Sea, but also in Gulf of Mexico, Brazil, and Australia. There are additional opportunities for SHL also in the renewables sector. And now, I will hand over to Ricardo to review our financial performance in more details.

Ricardo Rosa - Subsea 7 S.A. - CFO
Thank you, Jean, and good afternoon, everyone. I'll start with the income statement for the quarter on slide 10.

Second quarter revenue of $961 million was down 29% from the prior-year period, reflecting lower offshore activity levels as clients continued to minimise non-essential expenditure. Adjusted EBITDA was $280 million. This included a $53 million restructuring charge, of which $19 million was recognised as an administrative expense and $34 million as an operating expense. In the comparative prior-year period, adjusted EBITDA was $275 million including a $100 million restructuring charge. Excluding the restructuring charges from both periods, adjusted EBITDA was 11% lower year on year. Adjusted EBITDA margin of 29% reflected the relative stage of completion of projects, good execution, and the actions we have taken to control our costs.

Net operating income was $177 million. This included $27 million profit from the share of net income from associates and joint ventures mostly attributable to Seaway Heavy Lifting. Income before taxes was $206 million, $68 million higher than the prior-year period. This was affected by the net foreign exchange gain of $23 million this quarter from functional currency movements, which we report within other gains and losses. In the second quarter of 2015 income before taxes included a $36 million net foreign exchange loss. Our tax charge was $69 million, equivalent to an effective tax rate of 34%. Net income was $136 million, which gave rise to diluted earnings per share of $0.40, 48% higher year on year.

Slide 11 shows the revenue and net operating income by business unit. In the Northern Hemisphere Life of Field business unit, second quarter revenue was $523 million and net operating income was $87 million, both down significantly compared to the same quarter last year due to the lower levels of activity. The 16.6% margin was in-line with the prior-year period despite the lower revenue due to both cost reduction and continued focus on efficiency.

In the Southern Hemisphere and Global Projects business unit, second quarter revenue was $435 million, down 30% year on year. And net operating income was $114 million reflecting the relative stage of completion and size of our portfolio of projects compared with 2015. The strong margin for the Southern Hemisphere this quarter of 26.2% reflected good execution across our portfolio and the relatively high mix of projects in the final stages of completion. As we progress our current projects and our workload diminishes, we will not be able sustain the margin at the levels achieved in the first half of the year. In our Corporate segment, which is now showing on the slide, we reported a net operating loss of $24 million in the quarter and $16 million in the first half year. This segment included the $53 million restructuring charge.

Moving to slide 12, we continue to carefully control our costs commensurate with the lower levels of activity. We have successfully completed the resizing that was announced in 2015 and expect to realise the full $550 million forecast annualised cost saving in 2016. The further resizing announced last month will see up to five vessels leave our active fleet. These include the chartered vessel Normand Seven, which will be returned to its owner when the current charter concludes. We will be reducing the size of our workforce to approximately 8,000 people by early 2017. This is 1,200 people lower than the level at the end of May and 1,800 lower than at the end of 2015. The total restructuring charge related to the resizing this year is estimated to be no more than $100 million. We expect annualised savings from the program of approximately $350 million.

Slide 13 summarises our cash flows in the first half of the year. Our financial and liquidity positions remain strong. Net cash was $728 million at the end of June, approximately $300 million higher than the position at the start of the year. Cash and cash equivalents was $1.2 billion and we have an additional $1.1 billion of undrawn credit facilities. The $479 million in net cash was generated from operating activities, $198 million of which was generated in the second quarter. Our working capital balance is broadly unchanged as an underlying reversal of our net liability position of approximately $100 million was offset by the provision for restructuring costs and declined advanced payments on the Beatrice project. Net cash used in investing activities totalled $173 million and included capital expenditures of $205 million mostly in our vessel construction program, which I will address in a moment. Net cash used in financing activities was $79 million with only $7 million spent in the second quarter and was mainly used to repurchase our 2017 convertible bond at attractive yields. Our strong balance sheet and unutilised credit facilities allow us to manage an uncertain business environment as well as meet our planned capital expenditures, working capital cash requirements, and our debt repayment obligations. Our undrawn credit facilities, together with our cash position, enable us to take a long-term view of the business and address appropriate strategic investment opportunities that may arise.

As shown on slide 14, our new-build program is in its final stages. The first two vessels to be completed, Seven Waves and Seven Rio, were delivered ahead of schedule. They are on long-term contracts with Petrobras although the Seven Waves is currently undertaking other work in the North Sea while the damaged lay tower is repaired. We have rescheduled the delivery dates for the remaining four vessels in the program to coincide with our planned operational commitments and to optimise costs during the current period of lower activity. Seven Arctic and Seven Kestrel are being built in Korea and we now plan to take delivery of these vessels in the first half of 2017, as this suits our operational needs for the next year.

The arrivals of Seven Sun and Seven Cruzeiro are being timed to meet the delivery windows contracted with Petrobras, which ends in December 2016 and June 2017 respectively. The contracts for these vessels are firm and we are confident that they will start work within the committed dates. When we launched the new-build program, we forecast it would cost no more than $2 billion for all six vessels. We have been successful in keeping within this total cost estimate and our current projection is for a total construction cost of about $1.9 billion, including $55 million to be spent in 2017.

Lastly, slide 15 sets out our revenue guidance for a significant decrease compared to 2015 remains unchanged and is in-line with our year-to-date performance. Our guidance for a lower adjusted EBITDA percentage margin than 2015 also remains unchanged despite the strong result we've reported for the first half of the year. We do not expect to maintain the same strong operational profit when the projects awarded at the peak of the last cycle have been closed out. We expect this to be reflected in the results by the fourth quarter. Our net finance charge is now expected to be no more than $5 million. This does not include any foreign exchange movements reported under other gains and losses. The rescheduled delivery of the new build vessels has reduced our capital expenditure guidance as some of the milestone payments have been rescheduled to 2017 and the overall forecast cost is slightly lower. The revised vessel delivery schedule has also lowered our forecast depreciation charge for this year to between $380 million and $400 million. As for net working capital, we continue to expect the reversal of our net liability position of between $250 million and $350 million over the course of the full year. With that, I will hand you back to Jean.

Jean Cahuzac - Subsea 7 S.A. – CEO

Thank you, Ricardo. Slide 17 summarises our key differentiators; people, technology, assets, and local presence. This industry is facing challenging conditions in the present downturn, but we will continue to invest in innovative technology solutions and we will maintain our project and engineering capabilities.

Slide 18 summarises the importance of highly-skilled and experienced people in our business. Low levels of activity have necessitated a reduction in our capacity, but we are still focused on developing and retaining the workforce capable of delivering safe and reliable results on complex projects worldwide. To protect this capability through the cycle, we have centralised our expertise for large and complex projects into a single project centre with offices in both London and Paris. We have also consolidated our regional offices and relocated certain functions to increase efficiency.

Slide 19 shows our focused investment in technology. Our market-driven and cost-effective technology is enabling step changes in field development and cost of production. We are concentrating our research and development effort on five strategic programs where we see the greatest commercial potential in the near future. To give you some examples, recent technology advances include electrical heat-traced flowline, longer and more specialised bundles, and collaboration with OneSubsea Schlumberger on the development of integrated subsea processing technology. We have increased our spend on technology development over the last two years and this is paying off as shown by the number of patents registered by Subsea 7 and in the successful application of our new technology on projects around the world.

Turning to slide 20, we have one of the most modern and capable fleets in our market segment. Our vessels are capable of the full range of pipelay methods and two-thirds of our active fleet is less than 10 years old. The versatility of our fleet is important as we can apply the most cost-effective solution to our portfolio of projects. We own all our key-enabling vessels to ensure we have access to critical capability at all times in the cycle. Our eight chartered vessels give us the flexibility to adjust the size and functionality of our fleet. Our vessel construction program is close to completion. It is enhancing our capability and improving our operational efficiency as we replace some of the older and lower-specification vessels in our fleet.

So, to summarise, on slide 21, the foreseeable future is still challenging with a scarcity of new awards for our market segment and uncertain timing for those projects that our clients have sanctioned. Once the market award activity improves, it will take some time for this to be fully reflected in our reported results. Large and major projects can take a year to 18 months of planning and engineering before offshore work commences. Subsea 7 is taking the necessary actions to protect its business in the downturn and offer our clients cost-efficient solutions enabled by innovation and early engagement.

Long term, we are confident in the outlook for deepwater projects based on the growing global demand and industry-wide progress on lowering the cost of deepwater production. We are committed to maintaining our position as a leading partner for our clients through our strategy of differentiated capability and early response to the prevailing market condition.

And now, John, Ricardo, and I will take your questions.

Fiona Maclean - BofA Merrill Lynch - Analyst
I have two questions. Firstly, I'm looking at your backlog breakdown on slide 7.

I just want to get clarity on the Corporate number. You've got $1.3 billion. Does that include any of your joint venture backlog? And, if it does, why is there a change in accounting for that? Because my understanding was you never accounted for joint ventures in your backlog so I'd just like clarity on that. I may be wrong. The second question. I'd like to get your views on when you think we are going to start to see an increase in the level of offshore activity? What year are you looking for that to happen? And then, as a follow-on to that, when we start to see that increase coming through, what type of activity are you expecting that to be? Do you think it's going to be more OpEx or brownfield-related or some of the kind of core deepwater CapEx projects? Any color you can give on that would be very helpful.

Jean Cahuzac - Subsea 7 SA - CEO
Ricardo, do you want to take the first question?

Ricardo Rosa - Subsea 7 SA - CFO
Fiona. Just to clarify then, on the backlog. What we have recorded in corporate is the backlog associated with the recent award of the Beatrice wind farm project. Now, you're absolutely right. We do not record backlog associated with our non-consolidated joint ventures and we've been consistent in this. The reason we've recorded the backlog here is that the contracting party is a wholly-owned subsidiary of Subsea 7 and that subsidiary is sharing the work with SHL. So, what you will have, going forward in Corporate, are the results associated with the Beatrice project, both those recorded on 100% basis and our share of SHL's profits arising from this project. With that, I'll hand you back to Jean.

Jean Cahuzac - Subsea 7 SA - CEO
Regarding the market and the outlook, there is still uncertainty on the timing of the recovery as our clients are still cash-constrained due to the present price of oil, although there was some improvement on the oil price recently. Regarding where it will start first, if I start first on the Capex projects and the deepwater or harsh environment projects, what we are seeing today is an increased interest from our clients to look at ways to maintain production as part of their future projects. So, we're talking about tiebacks. We're talking about marginal field. All this requires early involvement, proposal of technology to lower the cost of the projects. But that's definitely a focus of our clients worldwide. Still difficult to put an exact timing on these projects, but to give you a few examples and not going through and exhaustive list; it's true in the North Sea, but it's also true on some projects in Angola, for instance with Platina, BP, Zinia and Total. So, that's an area where we believe that the market will start when it starts. It's definitely one of the priorities.

Regarding the big projects, we see more focus on the gas project than on the oil project, if you talk about the major projects, with countries like Egypt or countries like India where gas production for internal needs with a pre-agreed price with the governments seem to trigger more interest from some of the operators. So, in summary, depletion of the field will drive the area where the market will pick up first. Under long-term project which is also gas, LNG job with Golfinho in East Africa is still on the table for the market. And Mad Dog 2 probably will be in the Gulf of Mexico. So, again the projects are there. The question is when.

Regarding OpEx, very little has been done in the past. And we are seeing, today, in fact, the need for some more repair work being done and some more life a field. But it's still slow and there is competition in this part of the business.

Fiona Maclean - BofA Merrill Lynch - Analyst
Given you have the partnership with OneSubsea; I'd just like to get an update on how things are going there given you're about a year into that now. And what opportunities are you seeing as a result of that partnership that you have?

John Evans - Subsea 7 SA - COO
Yes. The OneSubsea relationship; we're one year in. We've done a lot of good work that year. We have gone through a process of looking at the portfolio from both sides. There's between 10 and 12 good prospects in the hopper that we're working on at the moment, including about three paid studies in that mix as well with clients. They're all very interesting and all very different types of opportunities. It's around clients trying to understand the mechanics of their fields, the layouts of their fields, and how that comes together. I was asked, I think last quarter, whether or not we believed something will come to the industry this year on that type of integrated project and I think that will still happen to the industry. So, there is a lot of good traction in that discussion. But all these fields, as Jean says, are

going through a lot of very hard questions with our clients about whether they're economic for them and when they should press the button. But, making good progress, I think, is the key recap there.

Philip Lindsay - Credit Suisse - Analyst.
Two questions. With the guidance that you've given this morning, the margin implied for Q2 is probably somewhere in the mid-to-high-teens depending on exactly how much lower you think you'll be in terms of EBITDA margin year on year. I can understand the caution in guiding too aggressively in the current environment, but it looks like you've still got several projects in the final stages in the second half, which should be beneficial to margin. So, perhaps you can just sort of help us square the arithmetic on that, please. That's the first question.

Jean Cahuzac - Subsea 7 SA - CEO
Ricardo, do you want to maybe elaborate a bit more on our guidance?

Ricardo Rosa - Subsea 7 SA - CFO
Yes, I think our caution with regard to the second half of the year is, as you say, driven by the fact that we have a number of major projects that are in their final stages of completion and we expect them to be closed out, by and large, in the course of Q3. So, by the time we reach Q4, the prospects are, of maintaining the margins that we've enjoyed for the last two or three quarters, is reduced. We have to remember, too, that, and this was reflected in the vessel utilisation of the fourth quarter of last year and Q1 of this year, that Q4 is traditionally a period of low seasonality and that will have an impact on our vessel utilisation and the absorption of associated costs there. So, when you add up all these elements in the mix, we don't believe that we have been over-cautious in the guidance that we have given our investors.

Philip Lindsay - Credit Suisse - Analyst.
The second question. I suppose it's in two parts really. Part of it is business development, but it all relates to Beatrice. Now, clearly, this bigger than anything you've won previously in renewables. Should we consider this as sort of one-off or opportunistic move or is the strategy deliberately targeting a diversification into other business lines? And on the Beatrice project itself, this is the second part of the question; can you just help us understand the risk profile of the contract a little bit better? Perhaps a comment around the relative complexity versus a more traditional SURF project and how you've thought about it continuously.

Jean Cahuzac - Subsea 7 SA - CEO
Yes. I'm going to let John answer all the questions. But just before I pass you to John; what is very important for us is risk profile management, and we are applying the same rules in all business that we are run; oil and gas, but also renewables. So, from a risk profile perspective, I'm comfortable that we are not increasing our risk profile. John, do you want to elaborate on the SHL and Beatrice?

John Evans - Subsea 7 SA - COO
To answer your question, Philip; as you know, we have been in the renewables space through our SHL business for a number of years and they have a very strong track record of installing foundations in that market. Beatrice is a project where the client approached Subsea 7, five years ago, with a view to getting involved in that development. So, we've been involved for the last five years, working with our client, between ourselves and the consortium of Siemens, who do the power grids and the turbines. So, it's been a very steady project with a lot of good work that's been done on it. What we found on Beatrice was the combination of Subsea 7's EPIC experience in engineering procurement and the cables that go in this work along with the T&I experience of SHL was a very good combination here. As Jean said, it's a large piece of work, but it's done in a manner which is in-line with how we run all our big EPICs, which is to understand the risk profile and how we bring that together. So, we've already started on the project. We have awarded our main fabrication contracts for the foundation units. We've awarded the cable subcontract as well. So, again, like any big project, there is a method and a process that we follow, which brings together what we do as Subsea 7 in the SURF space with what SHL have done very well in the renewables space for a client that we worked with for five years on this project.

Jean Cahuzac - Subsea 7 SA - CEO
I would add that SHL remains very proactive to bid for smaller projects, both T&I and EPIC projects, and have shown in the past that they are quite a successful company.

Michael Rae - Redburn Partners - Analyst
Just two questions. Just looking at the plan to cut headcount to 8,000 by early next year and then considering the new-build program, do you expect the headcount will start to rise again from that level

as you add crews and staff for the new vessels? And then the second question is just a follow-up to Fiona's question about Beatrice. Can you roughly disclose the proportion of the contract which is addressable by Subsea 7's engineers and expertise and how much of the work belongs to Seaway? Since I think that will become relevant for the minority line in the accounts, if I'm not mistaken.

Jean Cahuzac - Subsea 7 SA - CEO
To take the first part of your question, I mean regarding when we'll start operating the new builds. We see additional costs associated with new builds, these new-build vessels will be manned appropriately. But we don't intend to increase overall the headcount before the market picks up. We will adjust it when the market picks up. So, I think one of the things that we've demonstrated in the past and that I'm quite comfortable with is the fact that we are managing our cost and our manning very, very efficiently. One of the things that we have defined offshore, and I would like to thank our offshore personnel who operate very positively with us to find solution, has been flexibility in the contract terms flexibility in terms of number of days worked during the year. This flexibility that they agreed to accept will allow us, in fact, to increase operations without increasing headcount up to a certain level. Regarding the consolidation of Beatrice, would you like to clarify the point, Ricardo?

Ricardo Rosa - Subsea 7 SA - CFO
As I indicated earlier in my discussion with Fiona, what we have is a wholly-owned Subsea 7 entity that is effectively the contracting party with BOWL. We're not, for commercial reasons, obviously going to disclose the respective split of the share of activities and profits between our wholly-owned subsidiary and SHL. Suffice to say, that it reflects the risks and rewards that are applicable to the contribution of both parties. What you will see is, by consolidating it through the corporate segment, you can assume that a significant proportion will be picked up either through the recognition in EBITDA, in the case of the wholly-owned subsidiary, or by the equity pickup given that we have a 50% ownership of SHL.

Jean Cahuzac - Subsea 7 SA - CEO
In terms of organization of a project to ensure, I mean control, but also performance and good delivery, as we are doing on our EPIC project; we have a fully-integrated team, SHL and Subsea 7. We're actually jointly the project with very well-defined responsibilities. So, it has been set up in the right way for the size of this project.

Mukhtar Garadaghi - Citi - Analyst
Both of my questions kind of relate to pricing. Could you help us think about the level of margins? Once we're past this 3Q and we kind of get back to normal, should we think about 4Q as the new normal level or do you expect sort the variability there as well? I'm just trying to think about the mix that we are going to see in the fourth quarter, maybe early next year. Do you think that reflects the new cycle? The second question; just in terms of your discussions with clients, you've touched on it a bit, but are you building any clauses to recover some of the margin discounts when the market picks up? And how are you seeing the brownfield market developing? What sort of competitive pressures are you seeing there?

Jean Cahuzac - Subsea 7 SA - CEO
I'm not going to be able to give you numbers on the margins of the different projects. As you can imagine, the projects that we are presently executing or completing now, I mean some of them have been signed in better times with higher margin. There is pressure on margin on the new contracts, as one would expect in the present downturn. The Q1 and Q4 financial results are impacted by the seasonality of the operation and of the North Sea, as Ricardo mentioned before. We're going to see that this year and in the year to come. On one hand we have the pressure on margins coming from our clients and the competition. We have improved our competitiveness by lowering our costs and implementing New Way of Working, which makes us quite competitive to acquire more jobs. The margins are under pressure. Regarding the clause to actually recover the discounts when the market picks up, there is no such clause. The new contracts, when the market picks up, will be better margins. But we have to wait for that.

David Farrell - Macquarie Research - Analyst
Two questions from me. Firstly, could you go into a little bit more depth about the possible non-renewal of PLSVs in Brazil? I'm thinking specifically of the Seven Condor, Seven Mar, Seven Phoenix, which is coming off contract over the next couple of years. Second question about the market more broadly. Obviously, a lot of capacity has been taken out from the likes of yourselves, Technip, Saipem. But where is that capacity going? Is it just being returned back to charter owners and, therefore, not actually taking out structural overcapacity? Or is it actually going to be fully-retired and scrapped thus giving you a bit more pricing power in the recovery?

John Evans - Subsea 7 SA - COO
As we've explained previously, the issue of blocking revolves around Brazilian-flagged vessels being given priority over international-flagged vessels. What we need to think about is, again, if we just look at the categories there, the big PLSVs or the new class of PLSVs, there are no Brazilian-flagged vessels in the 550-ton class capability. We also have some triple-lay assets in our fleet. The Condor and the K3000 do tripling and there are no Brazilian-flagged triple-lay capability in there. So, the remaining assets then are the Phoenix and the Mar, which fit those criteria of being international-flagged vessels. We've had our licenses renewed for this year. So, for us, it's a situation where, again, next year the question of how they will be renewed will come up. We have been through this process a number of times and, as you've seen here, we have successfully renewed them this year. Blocking remains an issue, but it needs to be set in context with the overall nine vessels we actually have in the fleet.

In terms of capacity and scrapping vessels, for ourselves we have certain older assets in our portfolio. So, should the K3 come to the end of its life and the Condor come to the end of its life we'll again look at their contracts and look at whether we life-extend them or not. But they are generally the older-class assets that we've got in our Brazilian fleet.

David Farrell - Macquarie Research - Analyst
I was just wondering if you could maybe say something about the industry as a whole. Do you think these older vessels are being stacked, waiting for a recovery or do you think that people are actually more inclined to scrap them because they structurally going forward there's going to be less demand.

Jean Cahuzac - Subsea 7 SA - CEO
I can try to answer to that. I think when you look at some very old vessels, low-capacity vessels; it would cost probably more money to reactivate them then actually scrap them or sell them. Having said that, we are in a business where the vessels are the enablers of the projects. The difference is project and engineering. So, we are looking at supply and demand on the vessel side, but I mean what actually triggers the success of our business is more project management and the number of projects which are there, not so much the vessel. We are not really a vessel company, as such. We use vessels to enable, to deliver projects. So, I wouldn't put us in the category of vessel owner. We are in a different business.

Frederik Lunde - Carnegie Investment Bank AB – Analyst
Thanks for your time. First question on the PLSVs. Have you concluded in the discussions this year, leading to the delay in the new builds? Is that it?

Jean Cahuzac - Subsea 7 SA - CEO
As we said in the announcement, we are still discussing with Petrobras and I think it's in a positive way. Once it's finalised, we'll let you know.

Frederik Lunde - Carnegie Investment Bank AB - Analyst
As always, you have a very impressive cash generation, but maybe slightly less you are using it. So, my usual question is; what do you deem as sufficient cash reserve and how do you plan to address your over-capitalised balance sheet?

Ricardo Rosa - Subsea 7 SA - CFO
As you know both the board and management of Subsea 7 have shown a strong commitment to returning excess cash to shareholders over time and I think that's reflected in the dividends that we've paid in the past and share buyback programs that we've executed. But our view is that, given the current uncertain environment, it's important that we maintain a prudent strategy for capital management. And, in particular, in view of the uncertain market outlook that Jean has been articulating on this call and the fact that we have a number of potential cash calls, both in the form of our outstanding bond, which is maturing late 2017, so in the pretty near future; our remaining capital commitment to complete our new-build program; and the forecast working capital outflow that we are projecting at being $250 million to $350 million this year alone as compared to the position at the end of 2015. So, when you add all that up, that's a pretty substantial potential cash call that we have there.

In addition, we have put in place liquidity, credit facilities in support of our liquidity, and we have found that there are a number of benefits that we believe, ultimately, are helpful for our shareholders. We have found that our relationship with clients has been strengthened because of the strength of our balance sheet and their view that we are a reliable contractor both financially as well as operationally. It gives us a lot of flexibility to target strategic investment opportunities as they arise. And I would say that our financial institutions also respect our prudent financial management and, therefore, provide us that additional support that is so necessary in these difficult times. The last point that I would make is that we have also benefitted our shareholders by not exposing them to unexpected dilution through having an over-geared balance sheet. And I hope, with that, that I have given you a sufficiently comprehensive response to your question.

Frederik Lunde - Carnegie Investment Bank AB - Analyst
If I may, one more question on the convertibles. You mentioned maturity coming up. What do you think of refinancing that? Would you consider a new convertible at this share price or would you rather go for a straight bank financing in these times?

Ricardo Rosa - Subsea 7 SA - CFO
Frederik, we're looking at all options and, given our current liquidity position, I think we are in a good position to do so. We have the option of not refinancing it. We have the option of looking at various instruments to refinance it. And whatever decision we make, we're confident that we'll do it in the best interest of our shareholders.

Nick Green - Bernstein - Analyst
Could we talk on the fleet, the offshore fleet, and what do you think is the right size of the fleet going forward? Clearly you've now got, you said, 29 active vessels. Some are coming off next year. Would you mind giving some comments on actually why you need a fleet at all, going forward? What would you say to the argument of having four or five key enabler vessels but, in fact, all other boats in the fleet can effectively be hired on the open market and, therefore, aren't necessary to be owning as a company?

The second question relates to the Seven Sun and the Seven Cruzeiro. Could you give us a view as to, or some thoughts, as to why you're so confident Petrobras will accept delivery of these boats? Petrobras doesn't seem to need them. Particularly, it has a lot of capacity available to it at the moment. So why is it you feel that they are going to be delivered at the schedule you've set out?

Jean Cahuzac - Subsea 7 SA - CEO
Well, I think I will start with the second question. The reason is because there is a contract. It's a very strong contract. It's a very good contract. And Petrobras, I'm sure, will honour the contract. So, that's the point. But I think we go beyond that with Petrobras. I mean we try to solutions which are win-win for both sides and that's why we are having these discussions. And it's been going on for a while. But, there is very good communication and very good cooperation with Petrobras on the short, long-term plan.

Regarding the fleet, I think, as you mentioned, it is very important for us to control the high end of the fleet and that's something that we do intend to continue to do. I think it's fair, it's also true that what was called high-end in the past, today some of the high-end vessels in the past or heavy lift vessels are now more, I was going to say, commodity-type vessels as the fleet owners have built a lot of vessels. So, there is less need to own some of these vessels. So, on the longer term, we do intend to keep the same strategy. Hold the high-end and shutter the rest. And in time the fleet could diminish, but that will take time. But it's going to be more than four or five vessels. We need more than that to be able have the flexibility to propose solutions to our clients and control the fleet in a sustainable manner. One of the advantages that we've seen when the market was more buoyant than it is today is the clients coming back to us because we had full flexibility in terms of vessel utilisation, being able to propose all the technical solutions, which makes sense for their projects, to cover the whole range from flexible pipes to rigid pipe to diving vessels to heavy constructions. And that's one of our key differentiators.

Nick Green - Bernstein - Analyst
Is it fair to say that you still feel having a large fleet of, let's say, multi-quality vessels, do you still feel that's a competitive advantage for Subsea 7?

Nick Green - Bernstein - Analyst
Finally, just coming back to answer on Petrobras; could you maybe answer the question in terms of why you feel Petrobras still needs two more 550-ton vessels? Can you talk to us about what it is that a 550-ton vessel allows Petrobras to achieve, which it can't achieve with some of their lower-tonnage PLSVs?

John Evans - Subsea 7 SA - COO
A lot of the pre-salt work that we're working on at the moment to bring the pre-salt FPSOs online, it's all very deepwater, all very heavy-duty installation. So, 550-tons is the tension capacity of the system, which is substantially higher than the 300-ton range machines that were in the market there as well. So, as they get into the deeper water in Santos and keep pushing ahead with that, then that's where they will need some of that big heavy-duty capacity. So, it's a horses-for-courses type question.
Also, the efficiency in terms of how much capacity of product can take out with us, how much we can absorb per trip. So the economics for Petrobras on the larger machines reflect what we generally see in our industry; is that the higher-spec machines are generally more efficient.

Rob Pulleyn - Morgan Stanley - Analyst
Just one question left for me, given the others seem to have been asked. Could you just provide a little bit of clarity on the margin guidance? I just want to make sure we're all on the same page; that the margin guidance, are you including or excluding the restructuring charge of just under $100 million for this year in how we should think about margins year over year?

Ricardo Rosa - Subsea 7 SA - CFO
The guidance that we're providing is all-inclusive. We've indicated that and, therefore, will include any restructuring charges that we have and will incur before the end of the year. And I indicated in my earlier comments that we're estimating them, at the moment, to be around $100 million. And what we're saying is that we're expecting the EBITDA margin, i.e. the percentage EBITDA, to be somewhat lower than what we achieved last year.

Kevin Roger - Kepler Cheuvreux - Analyst
Just the first one, a follow-up on the EBITDA margin, because if I well understood, you will complete the TEN project and the Martin Linge project in Q3 and, in that, we could expect another strong EBITDA margin for the Q3. Are you more worried over the Q4? If we look at the backlog maturing this year you still have around $2 billion of revenues to be registered. So, we could assume $1 billion per quarter and this is the level that you had in Q4 2015 when you managed to reach and EBITDA margin 30%. So, could you please elaborate on why you are so cautious on your EBITDA guidance? The second question is on the renewable activity. You mentioned a sustained activity level. Could you please provide information on the size of the project? Could we expect another very large project, such as the Beatrice wind farm, that you recently won?

Jean Cahuzac - Subsea 7 SA - CEO
Regarding the project, one of the things that I mentioned in my comments related to the timing of the project and the industry we are in; one of the things to remember when you talk about the very large project, the major project, it takes about 18 months to two years before we actually go to operation and there is a lag time in our operation. So, until we have more visibility on the timing this award of project, we have to remain cautious on the possible future. Regarding the margins, I mean the new contracts, as I mentioned before when I talked about margins that they were in the prepared remarks.

Ricardo Rosa - Subsea 7 SA - CFO
If I could just also draw Kevin's attention to slide 25, where we show our projects' progression. And you can see there that there are a number of major projects that are very close to completion including, I think, the Martin Linge, which is the one that you've mentioned, Kevin.

So, what we're seeing is a shift in project mix over the course of the next six months. Yes, we will have the PLSVs continuing to operate, and don't forget they represent a significant proportion of our backlog going forward. You have some potential stability there, absent any operational issues. Then, you have, to the effect of unannounced activity, spot work, which, to date this year, has been comparatively low for the whole industry. Those really are the drivers that underpin our caution when we talk about the second half of this year. If there is a sudden uptake in activity in the North Sea and our view on the seasonality of activity changes, then there is a potential upside, but we're not counting on it at this point.

John Evans - Subsea 7 SA - COO
Renewables there is still activity in the renewables space. There's a project called East Anglia wind farm out for bid at the moment, which SHL are bidding at the moment. So, there continues to be a number of projects in that space. Some are EPIC. Some are transport and install only contracts. So, we are seeing some level of sustainability in that space at the moment.

Kevin Roger - Kepler Cheuvreux - Analyst
And can you just give information on the size of those contracts?

Jean Cahuzac - Subsea 7 SA - CEO
I think it varies from more medium, smaller size, on average, than Beatrice in short term.

John Evans - Subsea 7 SA - COO
It varies, yes. Beatrice is one of the larger renewable projects to have been launched in the last couple of years.

Christopher Mollerlokken - SpareBank 1 Markets - Analyst
You mentioned that you see increased tieback activity. Would that result in shorter timeframe from award to the offshore phase? And second follow-up on that; would that also imply a reduced project size and hence increased competition per contract?

Jean Cahuzac - Subsea 7 SA - CEO
The timing depends on the geographical area. I mean there has always been a more fast-track decision in the North Sea than in Nigeria or in other countries of Africa where the approval process is more complicated with local partner, etc. So, the timing depends where it happens. We're talking about a smaller size projects than the major projects, but one thing which is very important for these projects is in fact the cost and the ability to deliver these projects at the lower cost to make them viable. So, although these projects are of a smaller size the differentiator will be on the reliability, but also early engagement, new technology to make these projects viable. And that's where a company like Subsea 7 are very, very well-placed. That's where the difference will be.

Christopher Mollerlokken - SpareBank 1 Markets - Analyst
Just as a small bookkeeping question. You are guiding on administrative expenses for 2016 and in second quarter you did include some restructuring charges. Does the guidance for 2016 include restructuring costs when you guide on administrative expenses?

Ricardo Rosa - Subsea 7 SA - CFO
Yes it does, Christopher.

Haakon Amundsen - ABG Sundal Collier - Analyst
Just, finally, on Beatrice, if you could put some colour on the scheduling of revenues and margin recognition, offshore execution timing on that project, please. And secondly if you could put some colour on what type and size of strategic opportunities is looking most attractive and most realistic for Subsea 7 at the time.

John Evans - Subsea 7 SA - COO
Beatrice is focused on, for the remainder of this year and the best part of next year, the fabrication of all the key jackets. These are 84 small jackets to go in as the foundations. We then go offshore in 2018 and we have some small amount of offshore work in late 2017 on the project. That includes cable installation. There's about 150 kilometres of cables to go in, as well as the 84 jacket foundations and their associated piling. So, late 2017 all the way through 2018 with procurement going through from now to third, fourth quarter of next year.

Jean Cahuzac - Subsea 7 SA - CEO
In terms of the strategic initiative, I think it's quite simple. It's New Way of Working and we are proving that it works. We started that in 2015. It's showing results. It's managing the costs. It's early engagement with our clients. It's focusing on the risk profile so that we continue to deliver the projects as per bid or better. And it's technology. Regarding the geographical focus is wherever we can differentiate ourselves. More of the gas projects in short term; the large gas projects in Egypt, in India, and other places, and all around the world for the rest of the business. So, our strategy hasn't changed. Times are tough, but I think we are navigating through the downturn and the organisation and the teams are reacting very well. So, I'm optimistic in the sense that we are doing the right thing, but there are other things that we cannot control and we will go through that.

With that, I think I would like to maybe stop the call. And thank you for your participation and look forward to answering your questions on the next earnings call. Thank you.