Subsea 7 S.A. Release of Q3 2019 Results

Transcript

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Speakers:

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

Operator

Welcome to the Subsea 7 release of Q3 2019 results call. For the first half of this call, all participants are on listen-only mode, so there's no need to mute your own individual lines, and afterwards, there'll be a question and answer session. Just to remind you, this call is being recorded. I now hand the floor to our first speaker, Isabel Green, Investor Relations Director. Please begin.

Isabel Green

Thank you, and welcome 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. Turning to **slide two**, may I remind you that this call includes forward looking statements that reflect our current views and are subject to risks, uncertainties and assumptions. Similar wording is included in our press release. As we announced in September, our CEO, Jean Cahuzac, is retiring at the end of this year, although he will remain on our board as a non-executive director. In the new year, the reins will be passed to John Evans to take us forward into the next chapter of our journey. So now, for the last time, I'll turn the call over to Jean.

Jean Cahuzac

Thank you, Isabel. Good afternoon and welcome to our conference call. I will begin with our third quarter performance highlights, before handing over to Ricardo, who will present our financial results in more detail. I will conclude with a comment on our early engagement and technology efforts and a summary of the market outlook. There will be time for questions at the end of the call.

Starting with the highlights of the quarter on **slide four**, our revenue for the quarter was $951 million, 12% less than prior year, mainly due to continued low level of activity in our renewables and heavy-lifting business unit. This was partly offset by an increase in life of field and SURF activity in the North Sea and the US Gulf of Mexico. Adjusted EBITDA was $181 million, and our EBITDA margin was 19%, one percentage point lower than previous year. Earnings per share was $0.15. Vessel utilisation was 78%, down 7% compared to the previous year, with low utilisation on renewables and heavy-lifting vessels partially offset by high utilisation rates for the life of field vessels and our PLSV. We maintained a solid financial and liquidity position with cash and cash equivalents of $367 million, a net debt of $241 million, inclusive of lease liabilities.

Six new awards were announced in the quarter, contributing to $1.4 billion order intake and a book-to-bill of 1.4. The market for oil and gas projects continue to gradually recover and we have the right integrated and standalone solution to win our fair share.

Coming to **slide five**, to review some of our activities during the second quarter. The Alligin project, off-shore UK, made significant progress in the quarter with the completion of the main off-shore installation campaign using our heavy construction vessel, Seven Arctic. Off-shore Egypt, the Burullus 9B project successfully completed flexibles and flying lay (ph 03.40) installation using Seven Seas and the light construction vessel, Simar Esperança. The Snorre project, off-shore Norway, reached a significant milestone with its first bundle tow out and installation completed. We are now preparing two more bundles for installation in the first half of next year. This project was one of four to use our new sewage lining linear bridge connectors in the quarter. This patented technology enables less complex and lower cost installation of corrosion-resistant water injection line. Off-shore Nigeria, our work on the conventional shallow water PUPP project was substantially completed.

Activity in the US Gulf of Mexico has increased for our life of field IRM vessels. Utilisation was high for both our Jones Act-compliant vessels, Harvey Intervention and Grant Candies, which are now included in our fleet count following an extension of our long-term charter agreement. For the Mad Dog II project, also in the Gulf of Mexico, fabrication works progress in preparation for offshore campaign planned in 2020. In Taiwan, Seaway 7 completed an installation of twenty monopiles and associated transition pieces on the Formosa 1 project using our heavy lift vessel, Seaway Yudin. Our PLSV fleet in Brazil continues to perform very well, with high-level utilisation for all four vessels.

Moving to **slide six,** I would like to comment on our PLSVs business in Brazil. PLSVs are heavy construction vessels that can also lay flexible pipes and umbilical. They are also capable of various installation activities within the project life cycle, such as spruce and jumper installation, pipes and sub-sea structure deployment, pre-commissioning support, just to name a few.

On the long-term, they are a contract for Petrobras in Brazil, our scope is a combination of flexible installation on greenfield developments in and out of a pre-sold area, replacement and maintenance of 40 products, as well as removal of lines from mature field. We have seen recently an increase in replacement and maintenance activities associated with stress/corrosion cracking issues that have impacted some of the flexible risers installed the pre-salt region field. Our PLSVs have been consistently high performers of the Petrobras fleet, with all four vessels being in the top six, as run by Petrobras, for the last twelve months. We expect Petrobras to come to the market with the next round of PLSV tenders in the second half of 2020. It’s too early to give much guidance on the likely pricing or volume of work. It will depend partly on the demand for these vessels on other projects worldwide. At this stage, our base case assumes three of our vessels will remain engaged and the fourth will be reassigned to support other projects worldwide. The rates are likely to be lower than the current contracts, which were agreed at the peak of the market in 2013, and our current contract has a further two years to run before expiry.

Slide seven shows global fleets in heavy construction vessels and the PLSVs currently committed to Petrobras in Brazil. Three of our PLSVs are currently fitted with a 100-tonne crane which is sufficient for Petrobras’ requirements. However, all four vessels were designed and built to accommodate a 400-tonne crane. This means that with some very limited additional capital investment, these three vessels could be upgraded to be used in the global fleet, on par with our other heavy construction vessels. We have one chartered heavy construction flex-lay vessel in our fleet, the Skandi Acergy, with commitment up to 2022. If necessary, after the next round of PLSV tender in Brazil, we have the option to return this vessel to the owner to balance our fleet and improve utilisation.

I will now move to **slide eight** to talk about our order intake and backlog. Order intake was strong in the quarter. We replenished our backlog in the Middle East with approximately $600 million of new work offshore in Saudi Arabia and maintain our backlog with contracts rewarded in both renewables and life of field.

In total, we announced six awards in the third quarter. In addition to the Marjan 2 and 28 Jackets project for Saudi Aramco, we also announced the Lapa North East project for Total for Brazil, the ACE project for BP in Caspian Sea, the Europipe II project for Equinor off-shore Norway and the Hornsea Two project for Ørsted off-shore UK. We have had a strong start to the fourth quarter, with two more wind farm projects off-shore Taiwan and the Pierce project for Shell off-shore UK. We have also been awarded the cable-lay contract for Equinor’s Hywind Tampen floating wind farm, although this fell below our size threshold for stock exchange announcement. Our third quarter order backlog was $4.9 billion, of which approximately $700 million relate to the PLSV. $2.6 billion of our booked work is scheduled for execution in 2020 and $1.4 billion in ‘21 and beyond. Of these, the PLSV’s contribute approximately $320 million in ‘20 and $250 million in ‘21. So, we are still on track to achieve book-to-bill of at least one for the full year. I will now pass over to Ricardo.

Ricardo Rosa

Thank you, Jean, and good afternoon, everyone. I will begin on **slide nine**, with the key highlights from our income statement. Third quarter revenue of $951 million was $131 million less than the prior year period. This was primarily driven by a $97 million decrease in revenue from our renewables and heavy lifting business, following the completion of the major EPCI, Beatrice Wind Farm project last year. Adjusted EBITDA was $181 million compared to $217 million in the prior year period. Adjusted EBITDA margin was 19%. Net income was $42 million, resulting in earnings per share of $0.15 based on a share count of 299 million.

Slide 10 shows additional information from the income statement. Net operating income was $59 million. This included administrative expenses of $73 million, $9 million higher than the prior year due to the timing of certain costs recognised in the quarter. We reported a $16 million net gain within other gains and losses, which was mostly due to foreign exchange impacts. The tax charge for the quarter was $28 million, implying an effective tax rate of 40%, reflecting changes in jurisdictions where the group generates taxable income, together with the impact of increases in revenue-based taxes incurred, compared with the prior year.

Slide 11 shows the revenue and net operating income by business unit. Our SURF and conventional business generated revenue of $826 million and net operating income was $62 million, both lower than the prior year period by 5% and 30% respectively. Activity in the US Gulf of Mexico and conventional work off-shore Nigeria increased significantly compared to 2018, but this was not enough to replace the now completed West Nile Delta GFR project, which was in its off-shore phase last year. We have started to see a positive impact from the better pricing on some SURF projects signed this year, but there is still some way to go before margins fully recover. Our life of field business generated $70 million revenue and $6 million in net operating income. The year-on-year increases of $4 million and $2 million respectively were due to improved market demand for inspection, repair and maintenance services. Renewables and heavy lifting revenue decreased to $55 million from $152 million in the prior year period. Net operating loss was $8 million, reflecting low levels of activity and a competitive market, especially for the heavy lifting vessels.

I will now turn to **slide 12**, which provides an overview of cash movements in the quarter. Cash and equivalents were $367 million at the end of September, a decrease of $53 million on the position at the end of June as we continue to invest in the business and return cash to shareholders. We generated $66 million of cash from operations, despite a decrease in net operating liabilities of $112 million in the quarter. Even with improved collections in the Middle East this quarter, trade receivables and net construction contract assets have increased, reflecting the timing of certain project milestones. Trade liabilities have reduced, as some older projects have neared completion and working capital positions have closed down. Looking ahead over the next twelve months, our working capital balance is expected to improve, but there will continue to be volatility quarter-on-quarter. Other cash outflows included $21 million in cash tax, $6 million in scheduled repayment of borrowings and $27 million for lease payments.

We prioritise investing in our business, keeping an investment-grade profile and returning surplus cash to our shareholders. Capital expenditure of $29 million was somewhat lower than anticipated, as some payments relating to our new reel-lay vessel, Seven Vega, were rescheduled to 2020. Construction is progressing and the vessel is due to be completed in spring 2020, in time to execute the scheduled projects already booked in our backlog. We spent $30 million to early-settle the contingent consideration related to the acquisition of Seaway Offshore Cables, resulting in a small gain recognised within other gains and losses. This cash cost was fully provided for at the time of the acquisition in 2018. In July, we repurchased shares totalling $25 million, thereby completing the $200 million share repurchase programme announced in February this year. We also announced a new $200 million programme at the time of our second quarter results, which we will use to return surplus cash to shareholders over the next two years.

We have a solid financial and liquidity position. We have a $656 million unutilised revolving credit facility to give us flexibility to meet any short-term liquidity needs and an ECA term loan of which $240 million remains to be repaid in quarterly instalments through 2029. At the end of September, we had net debt of $241 million, including IFRS 16 lease liabilities of $368 million.

Moving now to our guidance, which is summarised on **slide 13**. The oil and gas markets are steadily recovering. Based on the assumption that Brent remains above $40 dollars per barrel, our clients are progressing with their greenfield deep-water developments. These are being delivered both as standalone SURF or integrated SURF SPS projects. We have seen an increase in early engagement studies, EPIC awards and project sanctions this year. The projected increase in off-shore activity has helped raise pricing from the very low levels seen during the downturn.

Due to the phasing of activity on certain projects, we have revised our 2019 revenue guidance and now expect it to be slightly lower than that which was achieved in 2018. Our guidance is unchanged in relation to lower adjusted EBITDA year-on-year, double-digit adjusted EBITDA margin and positive net operating income. With only two months to go until the end of the year, we have narrowed some of our guidance ranges for 2019. Administrative expense is now expected to fall between $265 million and $275 million and net finance cost to be between $10 million and $15 million. Depreciation and amortisation is forecast between $480 million and $490 million, including an estimated $100 million charge related to amortisation of right of use assets associated with leases. We have raised our full-year effective tax guidance to reflect changes in jurisdictions where the group generates taxable income, together with the impact of increases in revenue-based taxes incurred, compared with the prior year. We now expect the effective tax rate to fall in the range of 39-41%.

Our capital expenditure guidance for the year is now $20 million lower, ranging between $250 million and $270 million, including $80 million in expenditures relating to our new-build vessel. Approximately $65 million remains to complete the Seven Vega as planned in 2020. We have $2.6 billion of work in our backlog for execution in 2020, which is approximately $400 million higher than the year ahead outlook for this time last year and covers 60% of the current market expectations. This solid starting position and positive momentum on projects pending FID give us confidence that our revenue in 2020 will be higher than 2019 for all three business units. We expect absolute adjusted EBITDA in 2020 to be higher than 2019, reflecting increased activity and continued cost discipline, particularly in our renewables business. Our group percentage margin will take longer to recover, as projects awarded with low pricing in prior years progress to off-shore execution. I will now pass you back to Jean.

Jean Cahuzac

Thank you, Ricardo. Turning now to **slide 14**. In a gradually recovering market, early engagement, technology, and digitalisation are clear differentiators in the next phase of our journey. By engaging early with our clients, integrated solutions and new technologies can be introduced to projects at the outset, maximising the economic potential of Subsea developments from concept design and during the life of field. The acquisition of 4Subsea, completed during October, builds on our strategy of moving towards a more digital Subsea environment. In particular, it announces our solution for life of field and asset integrity management, where digital offerings are key enablers for future opportunities. We are confident that 4Subsea will help us to accelerate the pace of development of digital services across all our business segments. It already provides services to off-shore wind farms, as well as oil and gas fields. Another strategic acquisition completed in Australia recently was Greenlight Environmental Consultancy, which provides solutions to sustainable developments and announces environmental performance, reporting from within the Xodus Group.

Moving now to **slide 15**. As I mentioned, we believe early engagement is a key factor in today’s market dynamic. Since the downturn, we have increased our focus on it by developing a flexible approach that can suit a variety of clients. For clients seeking supplier-led engagement, Subsea 7 can provide standalone service solutions or through our Subsea Integration Alliance with OneSubsea Schlumberger, we can deliver integrated SPS SURF projects. We also offer, through the Xodus Group, client-led objective and unbiased engineering solutions which are aligned to our clients objective.

Turning to **slide 16**, we continue to see an increase in integrated greenfield tenders and early engagement studies. This allows us to offer a total lifecycle solution that can unlock the full potential of the field, optimising performance and future returns. Since we established our alliance with OneSubsea, we have been awarded 10 projects, working in five different countries for seven different clients. Our total lifecycle approach begins with early engineering engagements that ensure that the client's needs and key drivers are translated into the optimal solution for the field.

A preferred solution is then selected and delivered through our project execution and technology portfolio. It is then supported during the life of the field by leading aftermarket capabilities. Our superior early engagement proposition with large integrated greenfield projects have been evidenced by awards for the Mad Dog II in the US, SNE 1 in Africa, Scarborough in Australia and Ormen Lange in the North Sea. We are also tendering the integrated Carcará project, off-shore Brazil. This major project is expected to progress to field within a few weeks and FID is anticipated in 2020.

Moving to **slide 17**. This slide shows some of the key projects that we expect to be awarded to market in the near-to-medium term. As the market gradually recovers, we are seeing more demand and better pricing. However, the timing of project awards and FID can be uncertain, especially when projects are sensitive to external factors, such as project finance or licensing processes. The three awards with have listed here, pending FID, are all making good progress and I expect them to advance to EPIC projects in the near term.

Demand for renewable energy continues to grow worldwide, as society seeks to increase energy supplied by lower-carbon solutions. In the short term, the foundation installation segment remains highly competitive, with recent entry oil and gas competitors into this market. However, we expect this imbalance to diminish as demand grows.

To summarise on **slide 18**, the gradual recovery of the oil and gas market continues to unfold. Year to date, we have seen an increased number of greenfield awards and expect more final investment decisions for key projects in the year ahead. We remain optimistic about the future of the renewables market, which continues to grow at an accelerated pace, and we expect excess supply to be absorbed as demand grows. So, to conclude, we are confident that Subsea 7 is well positioned and has the right industry team to take the opportunities that the next phase of our business brings to us. With increased focus on energy transition, integrated solution and new technologies, Subsea 7 is ready to navigate the risk and capture opportunities ahead. John, Ricardo and I will now open the call for your questions.

Q&A

Operator

Thank you. If you wish to ask a question, please dial 01 on your telephone keypad now to enter the queue. Once your name is announced, you can ask your question. If you find it's answered before it's your turn to speak, you can dial 02 to cancel. So, once again, that's 01 to ask a question or 02 if you need to cancel. Our first question comes from the line of James Evans in Exane BNP Paribas. Please go ahead. Your line is open.

James Evans

Good afternoon and thanks for taking my questions. Firstly, Jean, congratulations on, I guess, semi-retirement and all the best for the future. I just wondered if you could share some thoughts on what you think the greatest challenge you leave John and the team is for the next three to five years? My second question, it may be slightly related to your answer, on renewables, you talk about increased competition and the tough pricing environment. Can you just help us understand that a little bit more? Is this similar to the SURF market at the bottom over the last couple of years or maybe not quite that bad? I guess, given we've got an increased visibility on your work starting to come through with the projects you've won, have been selected for, when do you start to become a bit more selective on what you take in? Thank you.

Jean Cahuzac

Thank you. Thank you, James. To answer your first question, I think the first point I would say is that the team over the last few years has put Subsea 7 in a very good position in a new market, in an evolving market. The recipe of the past cannot be repeated today. Early engagement, the success of SIA, the success that we had recently on a number of technology projects I think are preparing the company for the future. So, the challenges are still the same in our industry. We've always been a cyclic business. We will keep the same approach, a prudent approach from the balance sheet and everything else. So, I see more opportunities than challenges, to be fair and I have absolutely no doubt that (a) Subsea 7 is very well positioned, (b) Subsea 7 has the right management team under the leadership of John in the future to move forward.

John Evans

James, I'll take the question on renewables, if that's okay. The renewables question you asked there is the fact that we work in two different sectors in renewables. In the array cables, we have a good, strong position there in the top three players in array cables and we can see some very good prospects coming down the pipeline there. What we have seen in the last year, though, with the foundations business, which historically was four big dredging contractors and ourselves, we have seen Heerema move in on the T&I side and we have seen Saipem on the EPC side. So, at the moment, we are seeing quite a lot of pressure in terms of the competitiveness of the bidding. As Jean mentioned earlier, we will remain very cautious on our risk profiles and that's a new and evolving market sector. So, again, not only the pricing but the price and associated risk profiles are what's on our mind as to why we're being cautious about some of the foundation opportunities that are out there. Longer term, we think that, directionally, there will be far more renewable work coming and that market will balance itself out and everybody gets a good understanding of risk and reward.

Jean Cahuzac

I think one point I may want to add on the first part of your question and where Subsea 7 is very well positioned is taking opportunities and on the medium-long term, improve the ROIC and the ROI. Basically, obviously, to go back to the targeted number that we are aiming for, we need the market to improve, and we are seeing this market improving today, but the heavy Capex is behind us. I think there will be limited Capex in the years to come, and from that perspective, we should be able to recover with this parameter too, in terms of the return on capital.

James Evans

Great. Thank you and good luck.

Operator

Thank you. Our next question comes from the line of Amy Wong at UBS. Please go ahead, your line is open.

Amy Wong

Hi there. I just had one question. It was related to your recent announcement or award of the Ormen Lange project. In the language used by yourselves and your partner there, the communication suggests that the project was awarded to OneSubsea and that the work for the installation was sub-contracted to you, rather than being awarded to the Subsea Integration Alliance. Could you help us understand some of the subtleties, differences between awarding a project directly to the alliance? What does that mean in terms of that early engagement and helping contracts materialise through to EPC phase? Thanks.

Jean Cahuzac

John, do you want to take that question?

John Evans

Yes, thank you, Amy. You're correct. The contract is awarded by our client to OneSubsea but the OneSubsea contract has a full EPIC package to be negotiated and to be awarded at the back end post-feed and it'll be the SIA that'll execute the work. It reflects basically the flexible approach that we take towards our clients. Ormen Lange is a great opportunity for compression, and the pumping systems that OneSubsea have are industry leading there. So, the conversation had started initially around the benefits of putting compression into the Ormen Lange field and that's how that conversation started with Shell. So, in due course, it will be executed by the SIA members and, as you know, we're very flexible with our approach, with our clients. We can take two separate contracts and then have an interface and bridging agreement which effectively allows them to get the full benefit of the SIA. So, that's how that project came along, that has been executed with a full SIA team.

Amy Wong

That's very clear and helpful. Thank you very much, I'll turn it over.

John Evans

Thank you.

Operator

Thank you. Our next question comes from the line of Sahar Islam of Goldman Sachs. Please go ahead, your line is open.

Sahar Islam

Thank you for taking my questions. I had two please. So, firstly, on cost inflation in the supply chain and how healthy the sub-contractor markets are, please, and then secondly, some of the IOC's recently have highlighted some cashflow tightness versus their own capital return plans. Has the outlook for 2020 Capex in off-shore slightly worsened? I appreciate your point, that you said $40. At $40, a lot of these projects still work, but if we look at where we were earlier this year, have we seen a slight slipping in some of the projects?

Jean Cahuzac

I'm going to take your second question and let John answer to the first one. We said last year, there has been some uncertainty on the timing of FID, but we have not seen changes really on the plans today for 2020. When we talk about uncertainty, it's a couple of months, but there is no indication today that what we had on the radar screen as far as our new project, and greenfield in particular, will change. So, we are at this stage confident that our plans and our estimates are right.

John Evans

In terms of the supply chain, it's a very good question and the supply chain is an area that we keep a very careful eye on. In general, the supply chain is okay at the moment. There are one or two areas, such as valves and stainless steel tube supplies for umbilicals which can be constrained. That really is a question of what the final timing of the projects, some of the larger greenfield projects, will be, but again, I think the industry is very aware of those areas and we work very closely with our clients around those areas.

Sahar Islam

Thank you.

Jean Cahuzac

I think it's also fair to say that over the last couple of years, we have built a very strong relationship with some key suppliers, with some partnership approach, which are showing very good results and makes us confident.

Operator

Thank you. Our next question comes from the line of Frederick Lunde of Carnegie. Please go ahead, your line is open.

Frederick Lunde

Hello there. Just one question on 2020. You mentioned a comment that you expect book-to-bill exceeding one for 2019. Would you dare to say maybe 1.5 times being within reach for 2020?

Jean Cahuzac

I'm not going to comment on the number. I think it's a bit premature, but I would just say that we are seeing the gradual recovery of the market continuing, so future will tell, but I think the trend is going in the right direction.

Frederick Lunde

Okay, thank you, and thanks for a very good service over the last 11 years now.

Jean Cahuzac

Thank you. It's been fun.

Operator

Thank you. Our next question comes from the line of Anna Gjøen of Handelsbanken. Please go ahead, your line is open.

Anna Gjøen

Thank you. I have also a question, or a couple of questions, related to 2020. I wonder if you could elaborate a little bit on the tax rate. Also, then, is it likely it could come below 30% or also more closer to 40%? When it comes to Capex in 2020 and 2021, is it likely that it's going to be significantly lower than in 2019?

Jean Cahuzac

Ricardo, do you want to take these two questions?

Ricardo Rosa

Yes. Anna, good afternoon. With regards to the tax rate, as we've indicated in our press release, it is sensitive to the change in mix of jurisdictions and also the extent to which we are operating in jurisdictions that have revenue-based taxes as opposed to those that are directly linked to the profitability of our operations in those countries. As a result, when you go through a period of relatively low profitability, the effective tax rate tends to increase. Going forward, as we've indicated, we're expecting an improvement in absolute terms of profitability in 2020 and, assuming the cycle continues, we would expect that to continue into future years. This should have a positive effect on our effective tax rate, which, as you know, has in the past tended to be between 25% and 30%. I think there's no reason at this stage to believe that, based on what we know to do, that should change.

As far as capital expenditure is concerned, and I'll leave Jean to back me up if I don't give you the full story, I think we've highlighted that on a run-rate basis and with particular regard to the existing fleet, we don't expect capital expenditures to exceed the range of $170 million to about $230 million in any one year, remaining significantly below our depreciation levels. Of course, there are the occasional one-off items, a particular investment that's required, potentially an opportunistic acquisition such as the Pegasus that we had earlier this year, but as Jean has highlighted, we don't foresee the same level of capital intensity as was seen in the last cycle. So, our expectation is that Capex will remain below depreciation for the foreseeable future and the source, ultimately, of cash flow.

Jean Cahuzac

We will continue to look at opportunity to invest in technology and digitalisation and 4Subsea is a great example of the way forward, but it's a relatively low, limited Capex, so it doesn't change the overall features that Ricardo just described, but we will continue to invest in technology in a prudent but proactive manner.

Anna Gjøen

Good to hear, thank you.

Operator

Thank you. Our next question comes from the line of Erwan Kerouredan of RBC, please go ahead, your line is open.

Erwan Kerouredan

Hi, everyone. Erwan Kerouredan from RBC. 2019 is expected to represent a low point in the cycle for group's profitability. What are the risks of this low point to linger into 2020? My second question on renewables, you mentioned increased competition, especially you mention oil and gas players entering into the game. So, I guess my question is, what are Subsea's competitive advantages against those kinds of players?

Jean Cahuzac

Yes, I will let John answer the second question. Regarding the risk of 2020, during the presentation we gave you the high level of already committed/firm revenue that we have for 2020, at 60%. I think the risk of not to meet our guidance on increased absolute EBITDA is limited.

John Evans

I think on the renewables, to answer your question there, we have a very long track record in the renewables sector and a good reputation with key clients. We also have the main experience of doing some of the largest EPIC-type contracts in the sector, so again, we believe that does give us an advantage in terms of how we position ourselves in a very competitive area at the moment. So, we do expect that over time our competitors, both our traditional and non-traditional competitors, will really understand the risk profiles and therefore then the relevant returns that are needed for taking these types of projects on.

Erwan Keriredan

Thank you.

Operator

Thank you. Our next question comes from the line of Vlad Sergievskii of Bank of America. Please go ahead. Your line is open.

Vlad Sergievskii

Thank you, gentlemen. A question on the backlog phase in place. Obviously, you mentioned you already have a solid footing, a solid base already for 2020 execution. If I compare 2021 plus backlog you have today versus what you had 12 months for 2020 plus, it's probably $400-500 million lower. In this regard, how do you see the risks to revenue recovery continuing beyond 2020? This would be the first question. The second one, I would say, housekeeping on the working capital side. Last quarter, you mentioned you expected a positive move in net operating liabilities in the second half. Can you update us on this guidance, please, and therefore give an explicit, probably, idea of what we can expect in Q4? Thanks very much.

John Evans

So, Vlad, if I take your first question and Ricardo will answer the second on the working capital. The backlog beyond '21 will be affected by the PLSVs. I know Jean mentioned in his prepared remarks we expect the PLSV renewal cycle to take place in 2020. We've given you a view of what we expect that to look like. So, we would expect that the backlog will build during 2020 off the back of greenfield projects and of PLSV replacement cycle that will take place in rebidding next year.

Jean Cahuzac

John, we have already announced a project that we won where we won the feed, subject to FID, and that's a large project and an indication for the market that FID should be in 2020 also.

John Evans

That accounts for roughly about $1 billion worth of projects where we are the pre-contractor, solely subject to the FID taking place.

Jean Cahuzac

There are more projects to come in the near future, that will be awarded to market.

Ricardo Rosa

Vlad, regarding working capital, as we have made no secret of the fact that our working capital needs have increased during the downturn, mainly as a result of the growth of our Middle East business and we hope to continue growing it. I would draw your attention to note 13 on cash flow from operating activities, which is part of our condensed financial statements. It shows that the adverse movements, year to date, this is much more pronounced in operating liabilities than in operating assets when you compare it with 2018. This indicates that our receivables profile has largely stabilised, while movement in operating liabilities reflects close-out of older projects. So, I guess, this being said, in the short term, we're not expecting a very significant improvement in our working capital. We're not expecting a deterioration either. If you're looking at some sort of guidance for the fourth quarter, I am hopeful that we will see an improvement, although potentially not quite as much as some might have expected. It's a feature of the sector that clients have been less ready to fund our working capital needs and although we're expecting this to improve over time, we do expect variability quarter-on-quarter to continue.

Vlad Sergievskii

That's all clear. Thanks very much, gentlemen.

Operator

Thank you and our next question comes from the line of Haakon Amundsen of ABG, please go ahead, your line is open.

Haakon Amundsen

Yes, hi, guys. Just a question on margins. You mentioned in your 2020 outlook that it will take some time before your margins recover. At the same time, you have some drag from PLSVs likely rolling over at lower rates, so could you give some colour on what kind of margin expansion one could see beyond 2020, given those moving parts from better pricing but that role of PLSVs, please?

Jean Cahuzac

Yes, I'm not going to give you exact figures, but as we said, we are forecasting that the absolute EBITDA will be higher in 2020 and we are seeing today and expect to continue to see a gradual recovery of the oil and gas market. It will take time for margin to come back to historical levels, but the margins are going in the right direction.

Haakon Amundsen

Is it possible to consider the assumptions in the market where you actually see a meaningful margin expansion in '21 and '22 over 2020, given the roll-off, or will it take longer?

Jean Cahuzac

You have to look at the timing of the execution of the project and, clearly, a number of projects that we are securing or are going to secure in the near term will be in execution in '21 and '22, so that should have a positive impact.

Haakon Amundsen

Thank you.

Operator

Thank you. Our next question comes from the line of Mark Wilson at Jefferies, please go ahead, your line is open.

Mark Wilson

Okay, thank you. A couple of questions, if I may. The first is on Brazilian PLSVs. There are four projects you point to in the outlook and you spoke to Carcará. I was just wondering if any installation part of those projects is covered by current or to-be-bid long-term PLSV contracts? The second question is on short-cycle book and turn revenues. Clearly, this year, a few hundred million of revenue hasn't come through, and hence, the revenue for '19 guided down slightly. I was just wondering if that's an effect on capital discipline, maybe linked to oil price from clients, or is it more a market share effect of competitors taking some of that work? Thank you.

Jean Cahuzac

John, do you want to take it?

John Evans

Yes, if I take the PLSVs first, Mark. As Jean mentioned in his prepared remarks, our thinking at the moment is the fact that when the PLSV renewals will take place, we'd be looking to put one of our PLSVs probably into the main EPIC work of the main SURF business. That could well be also still in Brazil or internationally. So, for us, there are needs for flex-lay vessels to go in on the very large projects which are out to bid in Brazil but also, as you see, for example, on the Lapa project which we just announced this quarter, we'll be taking the Seven Seas, one of our international vessels, back to lay flexible product in Brazil next year. So, again, the main message we want to give, we have an international fleet of heavy construction vessels. Four of them are currently assigned as PLSVs but they are all internationally capable and we'll be moving them in and out of Brazil as we see the opportunities. In terms of your question on the short cycle, I think one of the things that we have seen this year is a number of change of ownerships in the UK sector. That change of ownership has meant slight disruption in some of the near-term plans for some of our clients in the UK sector, which has historically been a sector which has been quite strong for us in quarter three most years. So, we can see that as being a transient phase and as the new ownership position settles down, we would expect that to normalise.

Jean Cahuzac

Thank you. I think we can take one more question before we conclude.

Operator

Thank you. Then our final question comes from the line of James Thompson at JP Morgan. Please go ahead, your line is open.

James Thompson

Thank you. Thank you very much, good afternoon. Just want to join others on the call, Jean, by wishing you all the best for the future. I just had a couple of quick questions, if I may. Firstly, on Brazil. There was a lot of anticipation going into the transfer rights around some of the major operators getting involved there, and I think it was a pretty disappointing result overnight. Obviously, all going pretty much to Petrobras and we'll see what's going to happen with the other pre-salt awards today, but do you see any risk to your medium-term outlook in Brazil from a slightly underwhelming auction cycle at this point in 2019? Just a second point, you have been very successful in the last couple of months in terms of the renewables piece, which is good to see some of those coming through. Do you see opportunity for a positive EBIT in 2020 from that business? Thanks.

Jean Cahuzac

John, do you want to take the question?

John Evans

Yes, I'll take the question. Yes, you're right. The transfer rights were announced yesterday, and as you said, two of the blocks were unawarded and two went to Petrobras. I guess for us the main message we want to give to the market is Brazil continues to be a very exciting business for us and we can see opportunities for international oil companies, such as Equinor or Total, as well as with Petrobras. If it swings more to Petrobras, there are more opportunities for PLSV deployment, and if it swings to international IOCs, there's more opportunity for EPIC work. So, for us, the main message is around the overall health of Brazil. The other thing, I think, to remember is, Brazil has had other rounds of block awards this year as well, which have been very, very successful. People like Exxon putting down very large block bonuses. So, we continue to see Brazil to be (a) an important market and (b) one that will be very key to Subsea 7's future success, but the healthy thing is, it'll be a mixture of international oil companies and Petrobras. I guess on the renewables, we are coming from a position where there is strong competition in there, and it will take time for that business to normalise. So, that, I think, is the key message to look at there.

James Thompson

Okay, thanks, John, and good luck.

John Evans

Thank you.

Jean Cahuzac

Thank you. So, thank you for participating in our results call today. I have to say it's been a privilege to lead Subsea 7 for the last 11 years. When I retire at the end of the year, I do so with full confidence that John will drive the business onwards, supported by a very strong executive management team. So, thank you, again, for the call and all the best to the new team.