Subsea 7 S.A. Release of Q2 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

Hello and welcome to the Subsea 7 release of second quarter 2019 results call. Throughout the call all participants will be in a listen-only mode and afterwards, there will be question and answer session, and just to remind you, this conference call is being recorded. Today, I'm pleased to present Isabel Green, Investor Relations Director, please go ahead with your meeting.

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. Please note that slide six of the presentation has been updated since the initial publication this morning, amending a footnote regarding PLSVs back log. Turning to slide two, may I remind you that this call includes forward-looking statements that reflect our current views on the subjects to risk, uncertainties and assumptions. Similar wording is also including in our press release. I will now hand the call over to Jean.

Jean Cahuzac

Thank you, Isabel. Good afternoon and welcome to our conference call. I will begin with our second quarter performance highlights before handing over to Ricardo, who will present our financial results in more detail. I will conclude with a summary with the market outlook and then there will 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 $958 million. 17% less than the prior year, mainly due to reduction in revenue from renewables. Adjusted EBITDA was $171 million and EBITDA margin was 18%, reflecting steady performance in our SURF and conventional projects. Earnings per share was $0.09. 75% vessel utilisation was in line with the prior year period, held by high utilisation in our PLSVs and Life of Field services. We maintain a robust financial and liquidity position and made significant cash returns to shareholders in the quarter. We completed a $200 million share repurchase programme, just after the quarter ended in July and today have announced a new programme also for $200 million with a two year validity. New awards and escalation totalled $395 million in the quarter, with one new award announced. Our tendering and early engagement teams are busy with new projects but as expected, these are taking time to convert into firm signed contracts.

Turning to slide five to review some of our activities during the second quarter, the West Nile Delta phase two project for BP, off the coast of Egypt, neared completion. We deployed twelve spools and installed flying leads using our flex lay vessels *Seven Seas* and *Simar Esperança*. The PUPP project in the shallow waters offshore Nigeria, reached an important milestone, successfully completing the 20-inch pipeline beach pull-in using *Seven Antares*. The Snorre project offshore Norway, continued with fabrication and preparation for its first bundle tow-out, which was completed in July, just after the quarter ended. Also, offshore Norway, the first reel lay campaign was completed on the Nova project. Nova is the first project to use our Swagelining Liner Bridge connector, shown here on the picture on the slide. This technology has a significant cost advantage over CRA alternatives.

In the Middle East, the Hasbah project nears completion with installation and hook-up. *Seven Champion* laid the last two umbilical and the third party vessel was used for spool installation. Seaway Seven, commenced transport and installation of twenty monopiles and transition pieces on the Formosa 1 (phase two) wind farm project, offshore Taiwan, using our heavy-lift vessel *Seaway Yudin*. Cable installation was completed on the Hornsea One wind farm project offshore UK.

In Life of Field, we commenced a new IRM contract offshore Australia, using an ROV for electromagnetic weld inspection. This was the first for our clients, who have previously relied on diving services for this process. There was little change in demand for our ROV service for drilling rigs, which remained steady, with 62% utilisation of our work-class ROV this quarter. In Brazil, our PLSV fleet remained very busy in this quarter, with all four vessels performing very well.

Moving to slide six, order intake was low in the quarter with $395 million in new awards and escalations, including the announced Sverdrup project, phase 2, offshore Norway. We ended the quarter with an order backlog of $4.6 billion. Since the quarter ended, we have announced two more awards, the EHS bypass project offshore Norway for Equinor and a cable-lay for the Hornsea Two project offshore UK for Orsted. The backlog related to this will be included in our third quarter order intake.

We only announce a new award and add it to our order backlog when we have a firm, signed contract from the clients. In addition to announced order intake, we have received a letter of intent for being selected as preferred supplier on several key projects. These give us confidence that we are competitive and continue to announce our position as a partner of choice. When these projects are awarded, we would expect our pace of order intake to increase and our book to bill to rise above 1x for 2019. As highlighted in the first quarter, we have seen an improvement in pricing for new awards compared to the prior year. We have not changed our views and remain confident in the gradual recovery and our ability to win our share of the upcoming projects.

I will now pass over to Ricardo.

Ricardo Rosa

Thank you, Jean, and good afternoon everyone. Let's start on slide seven, with the income statement highlights. Second quarter revenue of $958 million was down 17% from the prior year period. Adjusted EBITDA was 8% lower, at $171 million, with an 18% margin, including a $26 million year on year benefit due to the implementation of the new lease accounting standard, IFRS 16. Net income was $24 million included a $6 million loss related to foreign currency movement, compared to net foreign currency gains of $25 million in the prior year period. The tax charge of $13 million reported in the quarter was equivalent to an effective tax rate of 35% in line with our guidance for the full year. Diluted earnings per share was 9¢, based on 308 million average shares in issue, compared to 327 million shares last year.

Slide eight shows the revenue and net operating income by business unit.

In our SURF and conventional business unit, second quarter revenue of $842 million was inline with the prior year period. This reflected increased activity offshore Nigeria and Norway, offset by lower activity offshore Egypt and the Middle East. Net operating income for SURF and Conventional was $60 million, $2 million lower than the prior year. This reflected good execution on projects nearing completion but fewer projects in the offshore phase compared to last year.

In our Life of Field business unit, revenue was $66 million, 10% higher than the prior year period. Inspection, repair and maintenance activities increased, with the addition of the new long-term contract for services offshore Azerbaijan. Life of Field reported a net operating loss of £3 million for the quarter, due mainly to a small number of discreet items including a $2 million adverse impact, related to the implementation of IFRS 16 that will reverse in future periods. The business unit continues to face pricing pressure in an oversupplied market.

Our renewables and heavy-lifting business unit generated $49 million in revenue compared to $257 million in the prior year period. This significant decline reflected the reduction in EPIC project activity following the completion of the very large Beatrice wind farm project at the end of last year. A net operating loss of $10 million in the quarter was mainly due to a competitive environment for the heavy-lifting vessels.

Slide nine summarises our main cash movement in the quarter. We have a robust financial and liquidity position. We had $420 million in cash and cash equivalents as of 30th June, and our $656 million credit facility remains undrawn. Subsea 7 has generated cash through the cycle and our second quarter cash from operating activities was $71 million. This included a decrease in net operating liabilities of $63 million, due to timing of milestones on certain projects and seasonal movements in tax and payroll liabilities.

I wish to emphasise that our revenue recognition parameters are unchanged. Our working capital position in the Middle East improved, with a near completion of the Hasbah project. We are currently projecting our working capital position to improve in the second half of 2019, resulting a slightly positive movement expected for the year as a whole. We invested $82 million in CAPEX, mainly related to the timing of payments on the new-build vessel Seven Vega, which reached a key construction milestone in May. We returned $204 million in dividends and buybacks in the second quarter, taking the total return year-to-date to $304 million when we include $25 million of buybacks in July. The rebalancing of the cash position has given us a more streamlined balance sheet and has delivered on our commitment to return surplus cash to our shareholders.

Turning to slide ten, our priorities are to invest in the business, maintain an investment grade profile and return surplus cash to shareholders. Since 2011, we have modernised and enhanced our fleet with twelve new vessels, in addition to the four renewables vessels, acquired as part of business acquisitions. As a result, we have one of the youngest and most capable fleet in the market. We have diversified our activities with the acquisitions of Seaway heavy-lifting and Seaway offshore cables to create our renewables business unit and we bought ECS to accelerate our strategy to grow in the Middle East.

We acquired technology and engineering expertise with the addition of Swagelining and Xodus. We continued to invest in our in-house technology, maintaining our investment in new products, through this cycle. We have a healthy pipeline of new ideas to add to 159 patents applied for over the last eight years. Our confidence and capacity to invest through the cycle is a reflection of our solid financial and liquidity position.

We have maintained an investment grade profile and low financial gearing with a ratio of net debt, including leases, to adjusted EBITDA, always within investment grade parameters. Our financial strength gives our clients, alliance partners, suppliers and people confidence and is a commercial advantage when tendering new work. We have completed five share repurchase programmes and paid six special dividends since 2011. We temporarily suspended cash returns to shareholders in the toughest years of the downturn to increase our financial security at a time when the outlook was uncertain. As the recovery began, we resumed dividend payments and this morning we announced our sixth repurchase programme. At our general meeting on 17th April, shareholders renewed our authority to repurchase and cancel shares up until October 2021. Today we are cancelling 5 million shares representing 1.8% of the shares outstanding, confirming our commitment to capital discipline and shareholder returns.

Slide eleven shows how our capital has been allocated in line with our priorities since 2011. The largest spend has been on growing and strengthening our business, with $4.5 billion invested over eight years. Most of this investment has been to renew and maintain our fleet, with new vessels designed by our team of marine engineers to ensure the right balance of cost and capability. The investment reflects the challenges of working in deeper waters and with more advanced flow-line technology.

Looking ahead, we expect a significant reduction in fleet investment required to meet the needs of our clients. The vessels we operate today have an average age of ten years and the necessary capability to execute the projects planned for the foreseeable future. We expect to spend between $5 million and $225 million per year to maintain our fleet, but capital expenditure on new vessels should be substantially reduced. We have returned a total of $1.9 billion to shareholders through share repurchases and dividends since 2011.

As we stand today, our balance sheet is healthy and our financial outlook is positive. We no longer have a significant pool of surplus cash, so we anticipate the new share repurchase programme to be executed at a slower pace than the last one. We have spent approximately $400 million on business acquisitions since 2011, net of cash acquired. However, this does not include the borrowings assumed as part of the transactions, which was subsequently repaid and, if included, would increase the investment to approximately $600 million.

Looking to the future, we will continue to target opportunities to grow and strengthen our business organically and by acquisition. Slide twelve sets out our 2019 guidance, which is unchanged from last quarter and already reflected in market expectations. Revenue is expected to be broadly inline with 2018, with 85% of this covered by backlog and revenues reported to date. Slightly less than usual for this point in the year. Adjusted EBITDA is still expected to be lower year-on-year, after including the approximately $100 million uplift from the change to lease accounting with the introduction of IFRS 16. Net operating income is expected to be positive. It is too early to give guidance for 2020, however with $2.2 billion of backlog already secured and a gradually recovering market, we remain confident that 2020 results will show an improvement on 2019.

I will now pass back to Jean.

Jean Cahuzac

Thank you, Ricardo. Turning now to slide 13, market conditions are gradually improving as we recover from one of the toughest industry downturns most of us have ever experienced. Tendering and engineering studies that increased in 2017 drove an increase in tide-back and field extension awards in 2018. We are now seeing large greenfield projects awarded to market. The number of new field and early engineering studies that we are asked to perform today is a positive indicator of future growth. We expect availability of key construction vessels in the market to tighten from mid-‘20 resulting in better pricing on new work, but are not yet back to mid-cycle margins on these new awards.

Slide fourteen shows some of the large greenfield projects that we expect to be awarded to market within the next twelve months. This is not intended to be an exhaustive list, it’s just some of the key market awards we anticipate. Many of the greenfield tenders and early engagement studies we are working on integrate the SURF and SPS work scopes. Our alliance with OneSubsea and Schlumberger is strong and enables us to deliver market leading integrated solutions. On some last projects, our clients are awarding sole supplier feed or early engineering contracts six to twelve months ahead of final investment decision. Early engagement drives better solutions for our clients, with greater certainty on cost and time to first oil or gas, and enables us to plan well in advance for associated increase in capacity and procurement.

Subsea 7 specialises in projects and services for offshore energy developments. Several of the last projects awarded to market this year have been for work outside of our operational scope, but we expect awards relating to our focus markets to increase in the second half of the year, which should continue into 2020. We have been selected as the preferred supplier for several projects that are awaiting final investment decisions or other conditions to be met before the contract is formally awarded. This includes greenfield projects such as SNE 1 and Scarborough, as well as HKZ in renewables, Marjan 2 in conventional and several smaller brownfield projects. Once signed, order intake on this would be in excess of $1.6 billion. In addition, we have a significant amount of potential work in our tendering pipeline for clients with whom we have long-term exclusive partnership and alliances.

Moving to slide fifteen, most of the oil and gas projects awarded since the recovery have good incremental return in investment for our clients, even at prevailing oil prices. We have seen a steady level of activity in the North Sea and the US Gulf of Mexico with fast-tracked tieback projects and IRM services to maintain and enhance production. The first wave of brownfield projects awarded 2018 are mostly offshore this summer, with further campaigns scheduled for 2020. Our market leading flow-line technology has been instrumental in our success to capture opportunities.

For example, we have applied eclectically heat-traced flow-line technology for the first time in a project in the North Sea and US Gulf of Mexico and we have three projects in progress, using our cost-effective pipeline bundle solutions. In UK and Norway, the pace of awards has temporarily slowed down since the first wave of activity, partly due to a transfer of ownership of fields in the North Sea from oil majors to smaller operators.

Shallow water conventional projects are the lower break-even price. We have many years of experience in conventional and in Nigeria, supported by well-established joint venture in country fabrication and locally flagged vessels. In the Middle East, Saudi Aramco is executing large programme investment and we expect significant awards to market to continue over the coming quarters.

Slide sixteen shows the outlook for our renewable business, Seaway 7. We have tendered to new markets with awards in Taiwan and the US and trends for globalisation of offshore wind and larger wind turbines are expected to continue. We have recently seen increased competition for foundation installation services with competitors from the SURF market moving into renewables. This increased supply has led to more competition on recent tenders, but we believe the structural growth in demand will rebalance the market in due course. At the moment, wind farms are being installed with fix foundations in shallow water, but longer term, we expect advances in technology and engineering to enable floating wind farms to become economic.

We are part of this innovation journey, having installed cables on Equinor’s Hywind projects and through a minority interest in technology for floating offshore wind foundations. So, to conclude on slide seventeen. The offshore oil and gas market is gradually recovering. Around the world, offshore projects make sense at the prevailing oil price or even at lower oil price and the demand for energy continues to grow. Encouraging progress is being made on greenfield SURF, with more awards to market and final investment decision. This is leading to a gradual improvement in pricing and better visibility of future work. Demand for inspection, repair and maintenance services is steady and there is a robust outlook for conventional awards in the Middle East. Offshore wind farms are projected to grow at a double-digit pace, which in time should be able to solve the excess capacity caused by recent new entrants. Subsea 7 is a global leader in markets with high barriers to entry. Our differentiated capability and integrated solution positions us very well for competitive success and we look forward to 2020 and beyond with confidence.

Ricardo, John and I will now open the call to your questions.

Q&A

Operator

Thank you, ladies and gentlemen, if you do wish to ask a question, please press zero one on your telephone keypad. If you wish to withdraw your question you may do so by pressing zero two to cancel. Our first question comes from the line of James Evans from Exane BNP Paribas. Please go ahead.

James Evan

Hi, good afternoon, thanks for taking my questions. Simple one for you, Ricardo, could you just help us understand a little bit that bridge that revenue guidance, I think you commented, that the coverage level is a little bit lower than in the past, so why do we get there? Is there more short cycle projects to come in the second half of the year, for example? Then, secondly, I guess maybe one for Jean, you mention the prospects that you have, $1.6 billion plus for intake, and I guess there’s just a little bit of concern from investors recently that some of these projects that you have been selected are a little bit at risk of delay for various reasons. Be it financing or cost, and I know you can’t comment on any specific projects from a client point of view but can you just maybe give us any idea if there’s anything that you see that could reassure us on the likelihood of these projects reaching FID as expected? Thank you.

Jean Cahuzac

I can maybe start with the second question and I’ll let Ricardo answer the first one. I’ve listed some of the projects, which are today visible on the market, the reason why we are confident on our comments of book-to-bill for 2019 above one, is in fact, there is no question that these projects make sense at present oil price or even lower oil price. We don’t see any question from the clients about the viability of the projects. There are also some uncertainties on the timing of the project award, particularly in Africa, but to actually reach our objective, we don’t need all these objectives to materialise. So, I would say with good confidence that our estimate will materialise.

Ricardo Rosa

Yes, James, good afternoon, in response to your question about revenue and revenue coverage in backlog, I think what you need to factor into your assessment of our future growth in revenue is not just what’s in backlog but also the potential to spot work, in particular in the North Sea, where you do tend to have a number of smaller projects coming through that don’t necessarily meet the announcement threshold of $50 million per contract. We also perform a fair amount of early work on larger projects, to an extent is billed, and I think Jean has referred to this already in his earlier comments. Lastly another area where we do see potential upside is in conventional, and in particular in Nigeria, we have seen in a number of cases, examples of scope growth throughout the year. So, I think those elements are the main drivers for our confidence with regards to 2020.

James Evans

Okay, understood, and I don't know if you can help me with this, how big is that West Africa conventional business expected to be for you this year. Obviously, a little bit less visibility on it than we do on, maybe, on some of the Saudi work, so, I know it used to be a billion dollar business, where are we today?

Jean Cahuzac

It's significantly lower than what it used to be prior to the downturn. So, it's a gradual recovery, mainly driven by Exxon Mobil in particular, and others. So, it's a gradual recovery but I would say a reasonable size, but below what we have seen prior to downturn.

James Evans

Thank you very much.

Operator

The next question comes from the line of Fredrik Lunde from Carnegie, please go ahead.

Fredrik Lunde

Yes, good morning, very happy to see the new buyback mandate, I was just curious because you previously indicated that you were considering a new-build vessel for potential down to 3,000 meter water depth, is that still, sort of, on the horizon, or is that less likely as you see the market now?

Jean Cahuzac

I think the consideration of a new deep water vessel is new to me, we are delivering *Seven Vega* in 2020, which is well-advanced, if it's what you were referring to, but what we have in the fleet today is 100% suitable for the years to come.

Fredrik Lunde

That's great, also, on the renewables segment, could you give an indication of how much depreciation you have? What I'm getting to is, you know, EBITDA in that business unit because I guess it's quite heavy on depreciation?

Ricardo Rosa

Fredrik, we don't usually disclose those figures on a quarterly basis, I think you'll have to wait until we provide that sort of information as part of our annual report.

Fredrik Lunde

Okay, thank you.

Operator

The next question comes from the line of Vlad Serhievskii from Bank of America. Please go ahead.

Vlad Serhieveskii

Hello, thanks for taking my question. Two, actually. First, if I can start talking about 2021 conceptually. Looking at your backlog composition, you currently have almost $1 billion lower backlog for 2021 compared to what you had at the same time last year, for the execution in '20. Are you still confident in the ability to improve vessel utilisation in 2021, and how much time do you have left to fill this 2021 vessel utilisation with large offshore Greenfield projects, particularly around Africa? That's the first question, and second, a more housekeeping one. On the balance sheet, your provisions have reduced by about $34 million during the quarter, would you be able to comment to what extent it has had a positive impact on your reported EBITDA during the quarter. Thanks very much.

Jean Cahuzac

I will answer your first question, I mentioned earlier that we are expecting higher order intake in the second part of this year from the indication we have from our clients and LOIs that we have received. A number of these projects will be for execution in '21, so, no reason at this stage to be concerned with 21 forecast. Ricardo?

Ricardo Rosa

Vlad, good afternoon, with regards to the balance sheet movement, I think, well, certainly we're not in a position to disclose the impact that these provisions would have on the EBITDA for the quarter. I mean, I would say that, you know, this is an account that moves on a reasonable basis up and down throughout the year and on a year to year basis, not had a significant impact.

Vlad Serhievskii

That's great, thanks very much. If I can squeeze another last one very quickly, on the PLSV pricing. According the recent media reports, Subsea 7 is a front-runner on some of the new projects for PLSV specifically in Lapa in Brazil. I appreciate it's still on-going tender, so, you won't be able to give a lot of colour, but just some colour on what's you see on the pricing front for new tenders versus some pricing which is still enjoying with Petrobras. Directionally, what's going on there, would be very helpful, thanks very much.

Jean Cahuzac

Yes, I think you will understand that especially because we are very close to client decision on there that I cannot really comment on commercial matter in Brazil, or anywhere else by the way, I mean, it's sensitive information.

Vlad Serhievskii

Okay, no, thanks very much for that.

Operator

The next question comes from the line of Michael Alsford from Citigroup. Please go ahead.

Michael Alsford

Hi there, good afternoon, I've just got one question, if I could, on renewables. I was just wondering if you could, perhaps, to translate your view around the market growth opportunity. You talked about double-digit growth over the medium term and how that would translate into where you would see, I guess, Subsea 7's revenue opportunity in terms of, maybe, quantum relative to historical levels and/or, a percentage of the overall business in terms revenues for that renewable heavy-lift business? Thank you.

Jean Cahuzac

Just an initial comment, and then I will let John elaborate a bit more on how we see the market. The double-digit growth that we are referring to comes from outside sources and market analysts and we fully concur with this view. It's not only us that see that, but John, you want to comment on the market?

John Evans

Yes, so, I think, as Jean says, you know, the overall market is due to grow and the information there can be collaborated pretty well in that we can see growth in Taiwan, we can see growth in the US, you'd have seen last week that Orsted ordered some very big offshore fields in New York and New Jersey. So, we're seeing this expansion from what was traditionally a northwest European business to being a more globalised business. The main impact for us is whether the clients take the work on transport or install, or they take it on EPIC, and as Jean mentioned in his narrative, we are seeing a number of our SURF competitors entering into the business. So, we're seeing quite a competitive environment there at the moment and on some of the very larger projects, we are not very comfortable with the margin and the risk profile on some of those. We do expect the market to normalise and sort itself out in the next eighteen months or two years with an underlying growth pattern of expanding around the world. So, at the moment, we're taking some T&I projects, with a lower risk profile, but we think that the market with definitely grow in due course and we will have a place in it.

Michael Alsford

Okay, thanks, and then to just follow up on the PLSVs, it sounds as if that, obviously, the higher utilisation there helped the margins in the quarter in the SURF and conventional business, so, I'm just wondering whether we should expect that similar effect to go into 3Q, i.e. margin, EBITDA margins being supported by higher activity there? Thanks.

Jean Cahuzac

Well, I think what I could say about the PLSVs, that they are a good contract and our operations are very good and we're optimising revenue from these PLSVs. As you know, these PLSVs contracts are to be renewed '21, '22, so, we'll see what happens at the time, but quite a good operation for us.

Michael Alsford

Okay, thank you.

Operator

The next question comes from the line of Amy Wong from UBS. Please go ahead.

Amy Wong

Hi, good afternoon, a two-part question from me, please. The first one is, Jean, in your prepared remarks, I think you made a comment, you said that some of the work awarded to other players in the market were outside the scope of Subsea 7, can you just elaborate on that comment, whether that precisely relates to the SURF business or the offshore wind and what kind of scope are you referring to when it's outside of Subsea 7? Then, my second question is just, on the Life of Field business, back in February '18 you announced the intention to form a joint venture with Schlumberger, I don't think we've heard much from there yet, so, can you just give us an update on what's happening there please? Thank you.

Jean Cahuzac

Yes, I mean, your first question, we were in fact mainly referring to work in the Middle East where our competitors are onshore LNG and fabrication etc. where we are not really into this business and a very large volume of their order intakes come from there. We're not really competing on that. Regarding where we are with OneSubsea Schlumberger, I think, in a nutshell, we're very pleased with what we see today in terms of the engagement, the relationship with OneSubsea and Schlumberger overall. You may have seen that we went successfully through the antitrust, which allowed us to put a joint management organisation in place and this joint organisation in place is now able to get involved, not only on the early engineering, but the winning of the project and the execution of the project in a fully integrated approach. So, that's very well-received by our clients, we are getting very positive feedback on where we are. A significant volume of the contract that we expect to get in the second part of the year, or early '20, will be integrated projects with the alliance. So, altogether, very encouraging and continue to go in the right direction with a lot of momentum.

Amy Wong

Okay, and just to confirm, will there be any changes to the accounting, after the formalisation of this entity?

Ricardo Rosa

Amy, this is Ricardo, no we don't expect any change to the accounting that will derive from this closer integration between the two parties.

Amy Wong

All right, thanks guys, I'll turn it over.

Operator

The next question comes from the line of David Farrell from Credit Suisse. Please go ahead.

David Farrell

Hi, Amy actually just asked my question on the Life of Field, but I'll follow up and just ask whether you think the change in management at Schlumberger will impact that business at all, either positively or negatively. Then, I also wanted to follow up in terms of the renewables business and the entrance by the SURF competitors. Are they providing T&I only or are they also trying to provide the EPIC capability as well?

Jean Cahuzac

I'll take the first question and John will cover the second one. I think Olivier Le Peuch has been driving, with us, the implementation of the alliance and SIA. I think we can say that we are 100% fully aligned on what we're trying to achieve together and today, the fact that he's now the CEO and we're working also very well with Hinda Gharbi his replacement. So, I would say no change there, maybe even more momentum.

John Evans
On renewables, we are seeing both Heerema and Saipem move into the business. Heerema are working on transport and install only, as you know, they exited the SURF business a couple of years ago but now they're focusing on renewables. Saipem, though, are offering a full EPIC capability.

David Farrell
Okay, thank you.

Operator
The next question comes from the line of Julien Ange from Kepler Cheuvreux. Please go ahead.

Julien Ange
Yes, good afternoon everyone, thanks for taking my question, just one follow up regarding the renewables segment please. Jean, if I remember, maybe one year ago you said that the objective was to sign one major EPCI renewable project every two years? Am I right today, to understand in your communication that basically, for the next eighteen to 24 months, you will focus yourself just on the transport and installation because the pricing environment is not attractive on the EPCI?

Jean Cahuzac
No, there are prospects on the EPCI, I think there is more competition with the arrival of Saipem in particular, but we will continue to focus also on winning an EPCI contract, it's just that the market is presently a bit more challenging. I'm convinced we will win our share.

Julien Ange
So, from that, maybe, a follow up, last year you did not get any major EPCI contract. Now we are, let's say halfway through the year, would you say it's still possible to see Subsea 7 securing one major EPCI renewable project by the end of the year, regarding your communication, discussion with clients?

Jean Cahuzac
It's possible, but I would be cautious that when these contracts are awarded, sometimes subject to permit. When in fact the contract can be signed up to year later. So, there is some lag-time there.

John Evans
Yes, there is just one other thing. There is a contract for difference auction in the UK in September of this year, and that will then decide which are the next batch of projects which are available. We are bidding on a number of those at the moment, but they're all subject to contract with differences being awarded to the operators in the first place. So, we should see, at the end of September, who's successful in the contract for different auction and then from that point onwards, then we will continue to bid for those, but as Jean says, we are being cautious on the risk profile on some of those bigger projects.

Julien Ange
Okay, thanks. Thanks a lot.

Operator
The next question comes from the line of Sahar Islam from Goldman Sachs. Please go ahead.

Sahar Islam
Thank you, can I start off with asking about cost inflation, what your seeing today and what your baking into your tendering process please?

Jean Cahuzac
Yes, regarding cost inflation, I think you have to look at it from two perspectives. One is internal cost and second one is supply chain cost. Talking about internal cost, I think it's something that we're controlling very well. What we see is some cost increase from the compensation perspective, for instance, in a reasonable manner. However, that's compensated by efficiency and what we're doing in short term and digitisation in medium term. So, I'm confident that Subsea 7 will remain a very cost-effective and cost competitive company in the future. Regarding supply chain, I think that our suppliers are seeing the same thing that we are seeing, which is a gradual improvement of this market. So, it's sometimes more difficult to get some commitment for a project which will be executed in two or three years. Something that we are taking into account in a very disciplined way in our bids, is something that we're also discussing with our clients and there is a different formula on the commercial side, to be able to compensate for that. However that's always a risk for the industry. When the market picks up, there's always a risk of not controlling your costs properly from the supply chain perspective. That's why we're need to remain prudent in our tenders and we are.

Sahar Islam
Okay, so if we assume that you're not going to get significant price increases on the supply chain, and you've got better pricing, particularly on some of the longer tied back vessels, so, should you be able to get-,

Jean Cahuzac
Sorry, I think we could see material increase on the supply chain , the question is how do we translate this increase of supply chain in to pricing our project to our customer and how do we continue to optimise the way we plan this job and execute this job, so, at the end, the projects are cost-effective at less than $50 a barrel? That's the challenge, but it's something that I think is achievable and I'm confident Subsea 7 is very well-positioned to face this challenge successfully.

Sahar Islam
Thank you for clarifying that, what I was going to ask was, when you made the comment about mid-cycle margins earlier, were you talking about the current tendering pipeline or what you see for the medium term recovery?

Jean Cahuzac
I think what we said in the past, that we believe that the mid-cycle margins are achievable but we are in a gradual recovery, so it's over time and I cannot today give you an answer with a precise base. It's going in the right direction, depending upon the timing of award of a project, it may go faster or a bit longer, but it's going in the right direction.

Sahar Islam
Thank you, that's very helpful.

Operator
The next question comes from the line of Mark Wilson from Jefferies. Please go ahead.

Mark Wilson
Hi, good morning, thanks for taking the question, and thank you for the clarity on global alliance with OneSubsea earlier. I would like to follow up on that and ask, since it's been formed in 2015, global alliance with Schlumberger, have you actually brought on first oil from any fields yet? Just wondered if you could give us an update on where that stands, and will Mad Dog phase two be the first?

Jean Cahuzac
John, I'll let you answer.

John Evans
No, we have two fields which are working today where we've completed the projects. Dalmatian for Murphy in the US, where we put a pumping system in there to enhance the recovery of that field, is working, and in the UK sector TAQA Otter was again, was a similar type of pump installation to improve recovery. So,

both those fields were completed earlier this year and are fully in production, and as Jean says, very good positive feedback from the clients at where we're at. Mad Dog two we go offshore primarily next year to install the bulk of Mad Dog two next year.

Mark Wilson
Great, thank you.

Operator
The next question comes from the line of James Thompson from JP Morgan. Please go ahead, your line is now open.

James Thompson
Oh, thank you. [Inaudible 45.04-45.10] the UCA reduction in fleets required and vessels required by clients in the long term and obviously you've given some more medium to long-term CAPEX guidance which looks to be structurally lower. If I'm interpreting that right, does that mean you are planning or you are taking an active decision to reduce the size of your fleet through time, or are you expecting to, sort of, maintain a fleet at its current spec?

Jean Cahuzac
I'm sorry, James, may I ask you to repeat your question because the line was pretty bad and I think that will be the last question for the call, but if you could repeat the question please?

James Thompson
Yes, sorry, it is a bit crackly, on my end as well. Apologies for that, but just going back to Ricardo's prepared remarks, I think you said, you expected in the longer-term that significant reduction in fleet and vessels required by clients and also, you've given us a medium to long-term CAPEX outlook which looks to be lower longer-term, I was just wondered if this was you taking an active decision to reduce the size of your fleet? In, sort of, a guise of a pricing in the long term or do you expect the fleet to stay the same size as it is currently?

Jean Cahuzac
Right, let's clarify what we said on that, John, you want to comment?

John Evans
Yes, I think we have the right sized fleet for Subsea 7 for the future. I think the main point that Ricardo was making there is that we will not be building new assets in the same pace as we did over the last five to ten years, over the next five to ten years. So, we do believe that our ability to generate profit against the free cash that we generate will be different in profile for the next five years to where we were in the last five years.

Jean Cahuzac
The clients will need more vessels to execute the projects with more projects coming on, that's why we are saying that we see a higher demand for vessels from late 2021, which will go together with the gradual improvement of profitability.

James Thompson
Okay, great, thank you very much for clarifying that.

Jean Cahuzac
Well, thank you. I would like to thank everybody for participating to this call and for your questions and I look forward to the next earning call. Thank you.

Operator
This now concludes our conference call, thank you all for attending. You may now all disconnect your lines.