Second Quarter 2021 Earnings Presentation

Wednesday, 28th July 2021

Introduction

Forward looking statements

Welcome everyone. With me on the call today are John Evans, our CEO, and Ricardo Rosa, our CFO. The results press release is available to download on our website along with the presentation slides that we'll be referring to during today's call. 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 also included in our press release. I'll now turn the call over to John.

Business highlights

John Evans

CEO

Results highlights

Thank you and good afternoon everyone. I will start with highlights from the second quarter before passing over to Ricardo to cover the financial results. Turning to slide 3. Revenues improved 59% year on year to $1.2 billion, driven by both renewables and subsea in conventional, but our underlying adjusted EBITDA margin fell to 7.5%. Nevertheless, at the end of the quarter and after paying dividends of $72 million, our balance sheet remains strong, with $390 million of cash and equivalents and net debt of $39 million.

Following the high level of vessel transits we reported in the first quarter, our key enabling vessels were working in the second quarter and utilisation of our active fleet increased to 82%. Whilst we faced challenges in Taiwan, we made good operational progress on a number of projects, including Seagreen. We had a strong quarter for order intake, resulting in a book-to-bill of 1.6.

Finally, just after the quarter end we announced the combination of our Renewables business unit with OHT.

Operational highlights

Turning to slide 4 and our operational highlights. Despite the challenges posed by China's strict COVID-19 restrictions, the Lingshui project was successfully completed ahead of schedule by the Seven Borealis and Seven Eagle.

In Norway, for the Hod project, we completed fabrication of the world's first mechanically-lined pipeline based on GluBi technology. Meanwhile, Seven Arctic installed umbilicals on Ærfugl Phase 2 and Seven Navica made progress installing gas pipelines on Johan Sverdrup Phase 2.

Activity remained high in the Gulf of Mexico on the installation phases of Manuel, King's Quay and Mad Dog 2. Seven Navica was deployed to the US to accommodate the rescheduling of some work from the Seven Vega, meaning we incurred some extra cost to keep project deliveries on track.

In Australia, Seven Oceans spent the quarter installing pipelines for the Julimar 2 phase project, whilst in Angola the fabrication of top sides and jacket for the SLGC project is ahead of plan at the Sonamet yard.

The PLSVs underpinned a solid performance and contribution from Brazil.

Turning to the Renewables business unit. In Taiwan, progress of the Seaway Yudin was impacted by restrictions imposed by the government to control the spread of COVID-19. In addition, conditions at the worksite and changes in scope of the project hampered progress. We are in negotiations to recover incremental costs from our clients in accordance with contractual terms.

Elsewhere in renewables, we continued work on the Seagreen project, where the first five jackets began their transit from China to Europe. A further ten jackets were loaded out from China and the UAE in July and fabrication of the remaining 99 jackets is running according to plan.

Good progress was also made in the UK on the Hornsea 2 project, on which Seaway Aimery, Seaway Moxie and the Simar Esperança were fully utilised during the quarter.

Order backlog

Turning to slide 5. We ended the second quarter with a backlog of $6.8 billion, up 13% from the first quarter this year. During the quarter, we announced two large awards in Brazil, Bacalhau and Mero 3, and including unannounced awards and escalations, we achieved a book-to-bill ratio of 1.6 times. We have good visibility on the revenue for the remainder of 2021, with $2.7 billion still to be executed.

And now, I'll pass over to Ricardo to run through the financial results in more detail.

Financial results

Ricardo Rosa

CFO

Income statement

Thank you John and good afternoon everyone. Slide 6 shows our income statement highlights. Second quarter revenue at $1.2 billion reflected higher levels of activity in both the Subsea and Conventional, and Renewables business units. Adjusted EBITDA of $90 million after incurring net costs associated net costs associated with COVID-19 of approximately $4 million was up from a loss of $9 million in the prior year quarter. The adjusted EBITDA margin was 7.5%. This improvement largely reflects the absence of the restructuring charge of $104 million that was recorded in Q2 2020.

The underlying margin excluding items relating to the restructuring provision declined year on year as a consequence of continued delays and challenges affecting renewables projects in Taiwan as well as reduced margins in Subsea and Conventional. The net loss for the quarter was $13 million.

Additional details

Turning to slide 7 for additional details of the income statement. Administrative expenses improved by $12 million against the prior year period, reflecting the absence of restructuring costs, with underlying expenses remaining in line. The depreciation and amortisation charge was stable at $114 million compared to the prior year quarter, with declines in part driven by prior year impairments offsetting the impact of the new-build Seven Vega and the converted Seaway Phoenix.

The quarter also benefited from the absence of impairment charges against property, plants and equipment and right-of-use assets totalling $229 million, and goodwill of $578 million, which impacted the prior year quarter.

The net operating loss of $28 million in the second quarter included a credit of $11 million relating to downward revisions to the cost of the group's resizing programme. The latter follows a significant improvement in the outlook for the industry since we first introduced the cost-reduction plan in the second quarter of 2020. To accommodate a higher level of tendering and engineering activity combined with improved vessel utilisation throughout the year, Subsea 7's workforce is now expected on average to be approximately 2,000 more than forecast in the downsizing plan. However, given the phasing of our current projects and the timing of new orders, plans to reduce the size of the active fleet in 2022 remain in place.

The net loss was $13 million after a $15 million tax credit.

Performance by business unit

On slide 8 we summarise the performance of our operating business units. Subsea and Conventional business unit generated $863 million of revenue in the second quarter, 24% higher than the prior year period, mainly due to improved activity in Norway, Saudi Arabia and China. Renewables revenue was $315 million, a near five-fold increase compared to the prior year, mainly driven by the Seagreen and the Hornsea 2 projects. We recorded $20 million in revenue in Corporate, representing the contribution from Xodus and 4Subsea, our autonomous subsidiaries.

Subsea and Conventional recorded a $10 million net operating loss in the quarter compared to an underlying net operating income of $14 million in the second quarter of 2020. This loss is due to a number of factors. It reflects the early stage of progress of the 2021 offshore campaigns relating to work won at low margin in the competitive environment of 2019 and 2020. Secondly, we incurred extra costs associated with the transfer of some work from Seven Vega to Seven Navica.

The net operating loss of the Renewables business unit was $32 million, a deterioration of $6 million from the first quarter 2020. Progress on Seagreen and Hornsea 2 continued as planned but was offset by the issues that John has discussed regarding the execution of work in Taiwan. As John has mentioned, we are in negotiations to recover these costs from our client.

In the Corporate business unit, net operating income of $14 million included the $11 million credit I have previously highlighted.

Cashflow

Slide 9 shows our cash flow waterfall chart for the quarter. Net cash generated from operating activities was $15 million after incurring a $48 million adverse movement in net working capital, driven largely by increased activity in the Middle East and the timing of milestone payments for various other projects. This increase was partly offset by client receipts on a newly awarded project. The net working capital position is expected to improve in the second half of 2021, with milestone payments and final settlements expected on a number of projects.

Capital expenditure was $34 million, including payments related to the conversion of Seaway Phoenix, a loan of $33 million to one of our non-consolidated joint ventures, and the distribution of dividends amounting to $72 million following approval by shareholders at the AGM in April.

At the end of the quarter, we had $390 million in cash and cash equivalent, a reduction of $137 million since the end of March. We moved into a modest net debt position of $39 million, including lease liabilities of $232 million.

Full-year 2021 guidance

To conclude, slide 10 shows our guidance for the full year. Despite the low margins reported in the first half of the year, our guidance for 2021 remains largely unchanged. We expect increased profitability in the second half to be driven by continued de-risking of projects as execution progresses and commercial settlements with clients are achieved. Compared with 2020, managing COVID-19 has become a more complex challenge as we navigate the differing requirements of various host countries. It remains difficult to forecast the magnitude of our direct costs net of client recoveries, as well as the indirect impact on efficiency, offshore operations and the supply chain in general.

However, absent COVID-19 we continue to anticipate revenue and adjusted EBITDA to be above 2020 levels, with positive net operating income. I will now pass you back to John.

Strategy and outlook

John Evans

CEO

Strategy

Thank you Ricardo. On slide 11 we have a summary of our strategy, comprising the subsea field of the future and a proactive participation in the energy transition. Today, we'll take a closer look at the progress we've made in the second quarter in integrated SURF and SPS and we'll briefly revisit our transaction with OHT.

Subsea Integration Alliance

Turning to slide 12, Subsea Integration Alliance is our venture with Schlumberger's OneSubsea business that integrates SPS and SURF into one seamless offering. The aim is to optimise field developments by integrating the engineering, combining procurement efforts and streamlining the installation of the entire subsea solution. It also reduces the number of contractor interfaces for the clients and increases delivery and deployment assurance. This is a highly differentiated offering and in the last couple of years, SIA has become one of the two main players with an SPS-SURF solution.

Since its inception, SIA has a very strong track record for winning greenfield contracts and since January 2020, we have won 68% of the market by revenue. In the second quarter, we added to our success with the award of Bacalhau and Hasselmus, that together prove the relevance of the Alliance to both large greenfields and smaller marginal fields.

The pipeline of opportunities for integrated work remains strong. SIA is the preferred supplier of Scarborough and Ormen Lange III and is currently bidding Lapa South West, BMC-33 and Bay du Nord.

Renewables-OHT Combination

Moving to slide 13, and a quick recap on the combination we announced earlier this month of our Renewables business unit with OHT.

The aim of this transaction was two-fold: to reinforce our position as market leader in the offshore fixed wind industry, and to unlock value associated with renewables for shareholders of Subsea 7.

One of the main drivers for the deal was the sharp ramp-up in activity forecast from 2025, as shown in the chart on the right. This has become more tangible, with higher levels of tendering than we expected and an acceleration of projects, especially in the US.

The combination creates a company with an enhanced fleet of vessels including capabilities for turbines, foundations, cable installation, as well as heavy transportation. This expanded toolkit will enable us to win a greater number of integrated and EPCI contracts and take a larger share of the offshore fixed wind market.

Although a deal in renewables may have come sooner than we predicted a year ago, it's indicative of the strengthening offshore wind market and our nimbleness to seize the opportunities when they arise. It reinforces Subsea 7's long-held strategy to make selective investments that enhance our growth opportunities and accelerate value creation for Subsea 7's shareholders.

Outlook for the next 12 months

On slide 14 we have a view of the outlook for the coming 12 months for subsea and on the following slide we'll address the opportunities in offshore wind. Although several contracts have been awarded to the industry in Brazil already this year, our tendering team remains very active and we continue to work on a large number of prospects for both Petrobras and the IOCs.

In Norway, engineering activity is high as operators work on sanctioning field developments in time to benefit from the country's tax incentive. This quarter, we announced contracts for Aker BP's Kobra East Gekko and OKEA's Hasselmus project, but there are multiple projects still on the radar.

Elsewhere, we see a cluster of new opportunities in West Africa, with CLOV-3 and Begonia in Angola, Pecan in Ghana and even Bonga South West, which marks a potentially important inflexion point for activity in Nigeria. In Australia, we continue to work for opportunities for Scarborough and Jansz-Io.

In the UK, we have started the tendering process for the projects on the Northern Endurance Partnerships, the NEP. This is a partnership of BP, ENI, Equinor, Shell, Total Energies and National Grid to develop offshore CO_2 transport and storage infrastructure in the UK serving two hubs, on Teesside and Humberside.

Overall, we are seeing strong demand for certain vessels in Subsea and Conventional from late 2023 onwards and we're becoming increasingly optimistic about the pricing environments for new orders in that window.

Turning to the next slide, in offshore wind we continue to see good long-term opportunities in Europe and Asia. There is a long list of projects awaiting the next CFD round in the UK, which is currently scheduled for early 2022. We have introduced new prospects in Germany as well as Poland, where our Renewables business unit opened an office earlier this month.

Finally, tendering for projects in the US has accelerated, with a growing list of opportunities that should be awarded from late 2021 or early 2022 onwards.

Summary

To wrap up, we'll turn to slide 16. Although we had a cash outflow in the second quarter after paying our latest dividend, our balance sheet remains strong, with net debt, including lease liabilities, of just $39 million, and liquidity of over $1 billion. We have a growing backlog and very active tendering pipeline in the Subsea and Conventional, with early signs of an improved pricing environment for new awards.

In Renewables, we believe we are creating a business with OHT that will enhance and accelerate value creation in offshore fixed wind for our shareholders, while at Subsea 7 we continue to push ahead with a nascent floating wind business.

Overall, our confidence in the long-term outlook has increased for both our business units and we're optimistic about the range of opportunities for the group.

And now we are happy to take your questions.

Q&A

Michael Alsford (Citi): Thanks, good afternoon. I've got just a question about the Renewables business. I was wondering with the second quarter result, it was particularly weak, I just wondered whether you could maybe try to pull apart the moving parts. How much is relating to the losses relating to Taiwan that you've booked in 2Q? Can you talk a little bit about the underlying performance? Are we seeing better margin capture on the broader portfolio of projects that you're executing on? That was my first question, please. Thanks.

John Evans: Yes, Michael, thank you. Yes, the performance of the underlying projects excluding Taiwan is satisfactory for us. We made good progress on Hornsea 2, good project performance on that one. Similarly good performance continues on Seagreen. We talked in my prepared remarks about the preparation for the offshore campaign this year. So underneath it we have a good business there. Taiwan is the main cause of the challenge and as I discussed in the prepared remarks, it's a combination of the COVID restrictions that have been imposed by the Taiwanese government, which from the middle of May effectively locked down the entire country and that has meant that changing crews and restocking our assets has become harder and harder as time moves on. We have effectively ceased work on that project since the middle of July because we cannot change the crews out and we would expect to restart work in August subject to the Taiwanese authorities providing visas for our crews.

So it's pretty much all around Taiwan and allowing that country to unlock. To add a bit of complexity we also have some different [environmental site] conditions out there and some changes to our scopes, which also need to be managed with our client. But that in a nutshell is the situation with our renewables business at the moment.

Michael Alsford: Thanks. And then just a follow up on the Subsea business. You mentioned about the high market share of awards from the Integrated Alliance but I'm just wondering should that maybe worry us and translate into therefore a lower margin on those projects? Have you been bidding more aggressively to win that kind of work? Because clearly the Subsea margin is also weak in that quarter. Thanks.

John Evans: The margin in the quarter reflects the work that we're liquidating at the moment. So it's about the [mix] of the work that we've got. The other thing I think to remember in this quarter is we've just started the offshore activity on a number of projects. Once we liquidate those projects, which we should do through quarter 3 and quarter 4, we'll have an opportunity to look at our contingencies and allowances in these projects and also we'll have an opportunity to have a discussion with our clients as we settle our final accounts on each of those projects. So again I think it's more about timing, and as I said, [due to the lumpiness of project execution] we're not a very good quarter company but we're comfortable with where we think the year is heading.

Michael Alsford: Okay. Thanks John, I'll hand it back.

Kévin Roger (Kepler Cheuvreux): Thanks for taking my question. I was wondering if you can give the magnitude of the loss that you booked in Taiwan? Maybe if you can give us a kind of guidance, as a follow up on the question that was just asked.

And the second one is related to the commercial dynamic. So two questions in one, if I can. The level of variation orders remains quite important. So should we expect the same kind of activity for the upcoming quarters? I'm just talking about variation orders. And based on that would you say it's likely that you will outpace the order intake of 2020-2021 regarding your order pipeline please?

John Evans: Thank you Kévin. A number of questions in one there for me. Let me take them one by one. We don't give specific numbers on individual projects as we're in discussions with our clients on that. But I think it's fair to say that what we have done is to forecast the loss to completion on that project, considering the circumstances that we have in front of us today. We have allowed for what we believe we can recover from our clients and we've also allowed for some of the areas that we may not be so sure we can recover from our clients on that work, considering the complexity of the changes in law in Taiwan at the moment. So that's the way we've looked at it in terms of where we're at as a company at the moment.

In terms of the commercial dynamic for the second half of the year, you're correct that our business involves escalations to our current contracts, and that can be in the form of variation orders or amendments to our contracts. As we said I think in Ricardo's prepared remarks we expect to see the benefit of some of those coming through in the second quarter and we remain comfortable with what the year end looks like for us.

In terms of order intake we see a good pace for order intake in the market at the moment, and I think on a previous call I was asked whether or not we would feel comfortable that we can meet our book-to-bill for the year of over 1, and I think we can say that we're comfortable that we should be able to achieve that this year. Just, as usual, subject to our clients' timing of awards but in the discussions we're having at the moments with the projects that I see fitting into place there, I think that is a reasonably clear intent on our part.

Kevin Roger: Okay, perfect. Thanks a lot, have a good day.

Vlad Sergievskii (Bank of America): Good afternoon and thanks for taking my three questions. The first one is on the backlog. Based on the backlog you provided, revenue this year could approach $5 billion. But at the same time, backlog for execution next year currently stands about $1 billion less than it was 12 months ago for execution in 2021. So in that sense, is there a scenario which could help you to avoid a significant revenue contraction next year compared to obviously very strong this one?

The second one is probably an accounting question for Ricardo on contract assets. So we obviously have seen a pretty big build in contract assets this quarter and this is normally not what we would like to see. Could you shed some light on what drove this increase and how you expect it to develop from here?

And very last thing on COVID cost. Obviously the net COVID cost is pretty low, $4 million this quarter. Is it primarily driven by the fact that operations are getting more predictable and straightforward or you are just basically able to recover more from your customers to offset that? Thank you very much.

John Evans: Thank you Vlad. If I take COVID and the backlog and I'll ask Ricardo to talk about our contract assets. If we look at COVID costs, we provide a net figure and net includes recoveries that we may have received from clients from previous quarters worth of activities where we incurred costs and recoveries that we have received this quarter. Ricardo said it in his prepared remarks, we've actually seen quite a bit of complexity in each different region that we're working in at the moment [and this affects our direct COVID costs]. So in Taiwan, where your efficiency goes down, [is not reflected in the direct COVID cost], whereas our quarantine costs and suchlike and people standing by and the testing costs are in the direct [$4 million net] costs.

So we all have to be careful with COVID. It's complex and we're working our way through and Taiwan is a great example. You know, first phase, no issue. Second wave of COVID, no issue. Third wave, [stopped work in] the country. So we keep a very careful eye on that.

In terms of our backlog, if we join the dots together in terms of backlog what we see here is a pick up for work going offshore in late 2023 and 2024, and as Ricardo mentioned, we are sizing our fleet next year for the work that we will have, which means that we will reduce the size of our fleet to get it to be the right size. Conversely, we are hiring a significant number of engineers and supply-chain experts to come in to go through the lower margin procurement and supply-chain phase of those projects that will happen in 2022. So an interesting dynamic in 2022.

Maybe Ricardo you can talk about the contract assets question that Vlad raised?

Ricardo Rosa: Good afternoon Vlad. I think your question on contract assets ties back to my prepared comments regarding our working capital movements. Yes, our contract asset balance has increased and this is linked, as I briefly explained, to factors such as the timing of milestone payments, progress on projects, the fact that we have increased activity in the Middle East, where one major client in particular is relatively slow in making payments. However, as I indicated, I am optimistic that the working capital position, which is strongly affected by our contract asset balances, will improve in the course of the second half as projects progress and settlements take place with clients, particularly with respect to those that will be closing out in the course of the second half of this year.

Vlad Sergievskii: John and Ricardo, thanks very much.

Mark Wilson (Jefferies): Hi, good morning. I'd like to ask about the current margin and pricing dynamic you feel you're getting into the awards that you're winning. Very good book-to-bill but if we look back at the comments for 2019 and 2020 speaking to competitively priced contracts. Is there a step change in the pricing dynamic that you're putting into bids for this year? Thank you.

John Evans: Thank you Mark. As I've said before, our pricing is taken on a project by project basis. We look at the circumstances of each bid that we put in. The more work that's awarded into the market for late 2023, 2024 and into 2025 absorbs capacity, either ours or our competitors, and that will change the dynamic of each bid that we put in step by step as the year progresses. So we tend to look at each one on a case by case basis. How well we're positioned in that particularly country, that particular client, that particular project. So that's the dynamic of really what's going on and as you can see we remain positive that there is quite a good outlook of prospects that are coming there. Near term work in 2022 is competitive but further out it's improving and that's what we're seeing in the market and hence our comments that we are feeling more optimistic about the pricing that we'll see later on in the windows.

Mark Wilson: Okay thank you. If I go back to full year 2019, you spoke to vessel availability tightening for certain SURF projects in 2022 and 2023. Today you speak about certain pipeline from late 2023. Would that suggest that projects have moved out in time or there's additional capacity that has come into the industry to satisfy a 2022 offshore environment? Or do you think that is – that's now been bid and that can be a timing of project that would see some of these improved margins come through?

John Evans: I think when we were talking in 2019, we hadn't seen the oil price shock and the delay in the projects that we've seen, so this is basically a shift as a result of what's happened there. You know, the projects that we were preferred bidder on Bacalhau back in late 2019. We had expected that to be awarded a year earlier than it eventually came to us. So there's a whole timing shift, I think, in the market, that we're seeing there, Mark, and that's been there I think since the oil price crash in Q1 of 2020.

Mark Wilson: Okay, thank you.

Sasikanth Chilukuru (Morgan Stanley): Thanks for taking my question. I just had a question on your adjusted EBITDA guidance for 2021 now, which is higher than 2020 of $423 million. I looked at the consensus numbers prior to the release and it was around $550 million for EBITDA. I was just wondering if you could give some context on where you think your expectations are relative to this consensus figure. And how this has changed with the 2Q results? Thanks.

John Evans: Sasikanth, good afternoon, thanks for your question. I think the main takeaway from our written and verbal comments is that we remain comfortable with this year. We know that if we were significantly out from consensus, we would need to declare that to the market. We've also said in our prepared remarks that we expect to see a stronger second half in terms of profitability on both sides of our business, and that's where we stand here at the moment.

Sasikanth Chilukuru: Thank you.

Nick Konstantakis (Exane): Hi guys, thank you for taking my question. Apologies if these has answered, I came in a little bit late. I want to ask two things: just touching on the 2021 answer you just gave, I want to ask whether that includes any assumption of recovery of some of the costs that you've incurred in Taiwan?

And then secondly, when I'm thinking into next year, obviously lesser flow of work, how does otherwise the mix change? I'm just trying to understand what are the big moving parts when we're thinking about your margin into 2022? Again, apologies if this has been already asked.

John Evans: Well, Nick, as you know we don't generally give guidance for the year ahead and we'll do that a bit later. So, you know, we provide information in the pack here on the backlog and how it's broken down and the different years and suchlike.

In terms of recovery for 2021, as we've stated earlier, we have put in what we believe our full-life position on the Taiwanese project is, including some recovery from our client is in that number. And so we will now go through a process of having a discussion with our client and having those discussions over the next few months. So at the moment we're obliged under the accounting rules to put in what we believe is the position on that.

So for this year we look at the whole portfolio of projects. We see which projects are finishing, we see where we're at in terms of the phasing and we remain comfortable with where we stand for the year.

Nick Konstantakis: Thank you.

John Evans: Well thank you very much everybody. We appreciate your calls. I know it's a busy time of the year and thank you very much to everybody for joining today. We look forward to talking to you on our Q3 earnings call. Thanks a lot, good bye.

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