SUBSEA 7 S.A.

Fourth Quarter and Full Year 2013 Results
Conference Call Transcript

5 March 2014
12:00 GMT

Speakers:

Jean Cahuzac, Chief Executive Officer
Ricardo Rosa, Chief Financial Officer
John Evans, Chief Operating Officer
Keith Russell, Investor Relations Director

Operator: Thank you for standing by and welcome to the Subsea 7 Earnings Call. At this time, all participants are in listen-only mode. If you wish to ask a question, please press star one on your telephone. I must advise you that this conference is being recorded today, Wednesday, March 5, 2014.

I would now like to hand the conference over to your first speaker today, Mr. Keith Russell, Investor Relations Director of Subsea 7. Please go ahead sir.

Keith Russell: Thank you very much. Welcome, everyone, to this conference call and webcast covering our fourth quarter and full-year 2013 results. Here on the call with me are Jean Cahuzac, our Chief Executive Officer; Ricardo Rosa, our CFO; and John Evans, our Chief Operating Officer.

The full press release containing the results can be found on the investor relations section of our corporate website, along with the presentation slides that we'll be referring to in the call.

The structure of the event today will be that Jean and Ricardo will comment on the slides, and then, following which, they and John Evans will be pleased to answer your questions in the usual way.

Before we start the presentation, however, I'm just obliged to draw your attention to slide number 2, which contains important information regarding forward-looking statements. A similar disclosure is also provided in the press release.

As we need to limit the duration of this event to one hour, I would ask that all questioners please limit themselves, at least initially, to two questions each in the interest of fairness to all.

So with that brief introduction I turn the microphone over to Jean.

Jean Cahuzac: Thank you, Keith; and good afternoon to everyone.

I will start by summarising the main elements of our fourth quarter 2013 performance, before handing over to Ricardo, who will cover the financials in more details. I will then conclude with some observation on the market and the outlook for our business in 2014.

Let's look first at the highlights for the quarter on slide 3. Overall, our results for the final quarter of 2013 were good, in line with expectations. We had good execution across our project portfolio during the quarter and made significant progress on a number of major projects.

Notable accomplishments in the quarter include the installation of the two hybrid riser towers for the CLOV project offshore Angola. The Seven Borealis continued also to perform very well on this project.

We achieved a number of key milestones in executing the Guara-Lula northeast project in Brazil, including the installation of the first buoy and risers and the second buoy was mobilized during the quarter.

The revised cost plan for completing the project, including the deployment of another vessel, has resulted in our taking an additional full life project loss provision of $49 million in the quarter. I will provide an update on the project later on the call.

Despite the additional provision on Guara-Lula, we achieved an adjusted EBITDA margin of 15 percent in the fourth quarter.

Revenue was relatively stable versus the prior year quarter, although the North Sea territory was negatively impacted by the Seven Oceans being deployed in Brazil.

Our financial position remains strong. You will hear more about this aspect from Ricardo in a moment.

Consistent with our aim to provide attractive return to shareholders, and in light of our confidence about the Company's future, the Board is recommending the payment of a final cash dividend of NOK3.6 per share in respect of 2013.

Going to operation, we had strong vessel utilization in the fourth quarter, at 80 percent overall.

I'm also pleased to say that our new vessel construction programme is progressing in line with our time and cost estimates. Our newly built PLSV, the *Seven Waves*, is undergoing pipe-lay trials currently and is expected to become operational in the second quarter of this year, ahead of schedule, under a five-year contract with Petrobras.

We had another successful quarter in terms of order intake, which allow us to maintain our record order backlog at $11.8 billion.

Talking about order intake, notable contract awards in the quarter include the TEN project for Tullow offshore Ghana and two long-term PLSV contract renewals for the *Seven Mar* and the *Seven Condor*, which we operate for Petrobras.

Turning to slide 4, which provides further detail on our backlog. As said, we ended the year at a record high and essentially at the same level as at the end of Q3.

About 50 percent of the backlog is due to executed during 2014, which provides a solid base on which to build the current year's revenue.

On the bottom right of the slide we provide the breakdown of backlog by Territory. As you can see, work is well distributed between our three major territories: the North Sea and Canada; Africa and Gulf of Mexico; and Brazil. Brazil’s backlog is boosted by the value of the PLSV contracts, many of which will be executed over a five-year term.

Turning now to slide 5 and operational highlights.
In the AFGOM territory, our work in Angola on the CLOV project progressed very well as mentioned. The Block 31 PSVM project neared completion in the quarter, while Block 31 GES commenced its offshore phase.

In the Gulf of Mexico the market was active and we continued executing the L60 and L67 projects in Mexico. Life-of-field work for BP in the Gulf of Mexico also continued.

In the Asia Pacific Territory, our work was concentrated on the Gorgon (lift) project in Australia. In the fourth quarter, we were preparing for the offshore campaign on Gorgon Heavy lift and Ttie-in, which is now underway.

In Brazil, the Guara-Lula project remained our top priority. I would like to provide you with a progress report. The first buoy in the Guara field was successfully installed in December, together with sufficient riser to allow first production from well SPS-77 on February 18, this year. And that's what Petrobras recently announced.

The second buoy in the Lula field was successfully installed on February 7 this year and riser installation is now underway.

In terms of remaining milestones, the third buoy is expected to be installed by the end of the Q1, and the fourth buoy in Q2. In fact, we are presently lowering the third buoy on the field.

The offshore phase of the riser installation is currently anticipated to be completed by Q4 2014. All this is consistent with the revised plan agreed with Petrobras.

The additional full life project loss provision of $49 million was due largely to the decision to mobilize an extra vessel in 2014 on the project, to accelerate project execution during the Brazilian summer season. It also takes into account the updated riser installation schedule for the *Seven Oceans* that we have discussed with Petrobras.

While all our focus is on mitigating the chance of further delay on the project, risk remains until the offshore phase of the project is fully completed.

In NSC, we executed a broad range of SURF projects, as well as life-of-field work. In the UK sector, the Otter project was completed. And in the Norwegian sector, the Knarr and Oseberg Delta S2 projects progressed well. In Canada, we completed the Terra Nova project.

Life-of-field work for a range of clients continued apace, in spite of challenging weather conditions.

We're also well underway in with the project management, engineering and procurement phases of the Martin Linge, Aasta Hansteen, Western Isles and Montrose projects.

On slide 6, you can see details of the vessels we have under construction. Very good progress is made in this area. The sea trials programme for the *Seven Waves* has been successfully completed, on schedule, and the installation and commissioning of the pipe-lay construction equipment is now underway. The vessel will become operational in Q2 this year, under a five-year contract with Petrobras, which is several months ahead of plan.

The other three PLSVs on order are each supported by a five-year contract with Petrobras.

The diving vessel, the *Seven Kestrel*, is scheduled to come into service towards the end of 2015. And we expect that demand for diving services will remain strong for the foreseeable future.

And our heavy construction vessel on order, now named the *Seven Arctic*, will bring superior capability to a sector also with strong long-term growth prospects.

We remain confident that this substantial investment will provide attractive returns for Subsea 7 and its shareholders, and will complement our already strong and diverse fleet.

Our ongoing new-build programme is expected to complete by 2016.

With that brief summary, I shall pass you to Ricardo, who will talk you through the numbers.

Ricardo Rosa: Thank you Jean and good afternoon, everyone. Jean has given you an overview of the quarter and I will now provide more detail on the consolidated income statement, and the Territories' operating results for the four quarter; and then, comment on the cash flow for the full-year 2013. I will conclude with our financial guidance for 2014.

As shown on slide 7, fourth quarter revenue, at $1.6 billion, was just slightly below that

realised in the same quarter of 2012. Compared to the prior-year period, activity levels were somewhat higher in the Africa and Gulf of Mexico territory; clearly, higher in Asia Pacific and Middle East territory; and lower in Brazil, and the North Sea and Canada Territories.

Fourth quarter net operating income was $109 million, compared to $180 million in the final quarter of 2012. This decline was primarily due to a decrease of $43 million in contribution from associates and joint ventures: Seaway Heavy Lifting, in particular, had a multi-month life extension dry docking of one of its two vessels; and a partial impairment of $29 million recognised in respect of the *Seven Polaris*.

The additional full life loss provision of $49 million for the Guara-Lula project, recognized in the fourth quarter 2013 adjusted EBITDA, was comparable to a $52 million loss provision recorded in the same quarter of 2012.

After deducting net finance costs of $9 million, and including net foreign exchange gains of $14 million, income before tax was at $114 million; down $57 million or 33 percent, compared to the prior-year period.

The $42 million tax charge for the quarter was equivalent to an effective tax rate of 37 percent, and was reported net of the benefit of certain discreet items.

Net income for the quarter was $72 million, resulting in diluted earnings per share of $0.22.

I will now turn to slide 8, and the Territory's operational performance in Q4.

Africa and Gulf of Mexico delivered revenue of $673 million for the quarter; up 10 percent, compared to the prior-year period. While net operating income, at $89 million, gave rise to a net operating margin of 13.3 percent; down 2.5 percentage points on the prior-year quarter's margin of 15.8 percent.

Significant progress was made on the CLOV project, offshore Angola, in the quarter, as well as on the Lianzi SURF, Block 31 GES and Block 31 PSVM projects.

In the Gulf of Mexico, the pipe-lay activities were completed on the two projects for Pemex - Line 60 and Line 67. The reduction in the Territory's margin was due, in part, to CLOV, which, though well executed to date, was won at a low margin.

Asia Pacific and Middle East delivered revenue of $160 million, an increase of $105 million on the prior-year quarter, as activity was considerably greater, owing largely to the execution of the Heavy Lift and Tie-in, and Umbilical projects on the Gorgon fields in Australia.

Net operating income was $9 million, half the level of the prior-year period.

The strong contribution from the SapuraAcergy joint venture in the fourth quarter of 2012, was not repeated in the fourth quarter of 2013, as the heavy lift vessel, the Sapura 3000 was being prepared for work on the Gorgon project.

In Brazil, revenue declined by $35 million from a year ago, to $206 million. We recognised an additional full-life loss provision on the Guara-Lula project of $49 million in the fourth quarter, for the reasons Jean has already outlined. This resulted in a net operating loss for the territory of $13 million. The comparable figure in 2012 was a loss of $29 million, which included a $52 million full-life loss provision on Guara-Lula.

The year-on-year reduction in the Territory's net operating loss was mainly attributable to increased activity by the five PLSVs laying flexible pipe for Petrobras on day-rate contracts and completion of an installation project on the Sapinhoa and Lula fields.

North Sea and Canada generated revenue of $544 million, down 22 percent on the prior-year period; while net operating income amounted to $63 million, a decrease of $25 million or 28 percent.

The reduction in revenue compared to the final quarter of 2012 is partly due to reduced activity in Canada, while vessel utilisation in the North Sea, at 76 percent, was lower than the high of 88 percent achieved in the fourth quarter of 2012.

In addition, no project revenue was generated in the territory in the fourth quarter of 2013 by the *Seven Oceans*, as it was deployed on the Guara-Lula project during the quarter.

Lastly, the corporate segment had a net operating loss of $39 million, reflecting the $29 million partial impairment of the *Seven Polaris's* carrying value. This partial impairment, which is a non-cash item, was the result of our regular review of the carrying values of all our vessels, having regard to their age, marketability and technical specifications.

In the corporate segment we also had a lower contribution from the Seaway Heavy Lifting joint venture, owing to the life-extension work on the *Stanislav Yudin*, which was in dry dock during the quarter.

Slide 9 summarises 2013 full-year revenue and net operating income generated by our four Territories, and highlights the profitability of our activities outside Brazil, which was affected by the full-life project loss provisions totaling $355 million recognised on Guara-Lula in the year.

Going to slide 10, I'll comment on some specific line items.

Administrative expenses in the fourth quarter amounted to $81 million, which is $25 million lower than the prior-year period, owing to the absence of integration costs, and our continued focus on expense reduction.

The contribution from associates and joint ventures fell significantly, to $1 million, when compared with the prior-year period, due to reduced vessel activity in both Seaway Heavy Lifting and SapuraAcergy, as I have previously explained.

Net operating income of $109 million for the quarter is stated after deducting depreciation and amortisation of $97 million, as well as impairment charges totaling $36 million, mainly attributable to the *Seven Polaris*.

Net finance costs of $9 million decreased by $4 million compared to the prior-year period; while other gains and losses were $14 million positive in the quarter, owing primarily to net foreign exchange gains.

The $42 million tax charge for the fourth quarter represented an effective tax rate of 37 percent, and benefited from certain discrete items, of which the main component was a favorable adjustment arising from the recognition of Brazilian withholding tax assets.

Excluding these discrete items, the underlying effective tax rate for the quarter was 53 percent, significantly higher than the prior-year quarter, reflecting the lack of tax benefits associated with the full-life loss provisions recognized in the year on Guara-Lula.

I turn now to slide 11, which provides an overview of cash flow over the full year 2013.

Net cash generated from operations in the year totaled $981 million. This included $330 million cash inflow from changes in operating assets and liabilities and was largely driven by an increase in operating liabilities, which included client advances and the unutilised part of the provision for future losses on the Guara-Lula project.

Operating assets, mainly comprising client receivables, remained level with the prior-year end. We remain focused, as before, on minimizing our investment in working capital.

Net cash used in investing activities amounted to $679 million. This included $739 million spent on our capital investments during the year, including the acquisition of the light construction vessel *Simar Esperanca*, as previously reported, and milestone payments for the construction of the PLSV, *Seven Waves*; the diving vessel, *Seven Kestrel*, as well as initial payments for the heavy construction vessel, *Seven Arctic*, and the three other new-build PLSVs to be operated for Petrobras under five-year contracts.

Net cash used in financing activities totaled $915 million, the main items being the $337 million in cash used for the partial redemption of the 2013 convertible notes in the fourth quarter; the early repayment of the $158 million Seven Havila loan; and a $150 million loan to our asset-owning joint venture with Eidesvik, to finance the construction of the *Seven Viking*.

Financing activities in 2013 also included the payment in the third quarter of $199 million dividend, equivalent to $0.60 per share, as well as $83 million spent on share repurchases in the fourth quarter.

As reflected on the summary balance sheet on slide 12, we finished the quarter with a cash and cash equivalent balance of $650 million; a reduction of $638 million since the start of 2013, reflecting the needs of our capital investment programme; the ongoing rationalisation of our capital structure; and our continued commitment to providing returns to shareholders.

Borrowings at the end of the year stood at $912 million; a decrease of $624 million from the start of 2013. The main reason for the substantial reduction was the redemption at maturity of the $500 million 2.25 percent convertible notes in October 2013, of which $337 million was redeemed for cash and $163 million was converted to shares at the option of the note holders.

I will now comment on the financial guidance for 2014, provided on slide 13, before Jean provides some comments on the market outlook.

In terms of our expected financial results, we anticipate the full-year 2014 revenue will increase compared with 2013.

Adjusted EBITDA for 2014 is expected to increase moderately from that achieved in 2013, after excluding the full-life loss provision of $355 million, recognized during 2013 in respect of the Guara-Lula project.

Capital expenditures in 2014 are expected to be higher than 2013, ranging between $900 million and $1 billion, primarily as a result of payments due on the six vessels we currently have under construction.

Further multi-year guidance on our vessel new-build programme is provided on side 15. And you will note that it is expected to wind down significantly by 2016.

We estimate the operating capex needed to maintain the operational effectiveness of our existing fleet at between $220 million and $250 million. And it primarily comprises dry-docking, and sundry equipment replacement costs.

In addition we anticipate spending between $120 million and $160 million in 2014, on vessel enhancements, including life extensions; drilling ROVs for the i-Tech division; other offshore equipment; and onshore facilities.

Owing to these projected capital expenditures and the expected cash flow profile during the year, we do anticipate utilising the $100 million cash element of our $600 million revolving credit facility.

To supplement it, we have put in place in the fourth quarter three committed bilateral revolving credit facilities, for an aggregate $300 million. And we therefore do not currently see the need to access the capital markets for term funding.

Administrative expenses in 2014 are expected to be in the range of $300 million to $320 million and we forecast the effective tax rate to be in the range of 29 percent to 31 percent for the year.

The reduced effective tax rate compared with 2013 reflects the absence of full-life loss provisions on Guara-Lula, on which no tax benefit is recognized.

Income from associates and joint ventures is expected to decline in 2014 from the high level contributed by Seaway Heavy Lifting and SapuraAcergy in 2013. This mainly reflects expected lower renewables activity in the North Sea in 2014, and the completion of the Gumusut Project, offshore Malaysia, in the same year – in 2013.

Depreciation in 2014 is forecast to be in the range of $400 million to $430 million for the year, higher than the $359 million incurred in 2013, partly due to the *Seven Waves* commencing operations in Brazil in the first half of this year, and foreign exchange effects.

As evidence of our continued commitment to proving returns to shareholders, through March 4 this year we have spent $114.6 million to re-purchase 5.94 million under our current $200 million share re-purchase programme that commenced in October 2013.

In addition, the Board of Directors is recommending that shareholders approve a cash dividend of NOK3.6 per share in respect of 2013, which, if approved at the next Annual General Meeting on June 27, will be paid in early July.

I would like to clarify that although in previous years the Company has denominated annual dividends in U.S. dollars, we have opted this year to denominate it in Norwegian kroner to align it better with the payment process of the Oslo Bors.

With that I'll now pass you back to Jean, to comment further on the outlook.

Jean Cahuzac: Thank you, Ricardo. So let's turn to slide 16. I would like to offer some comment on our markets by Territory, and my initial thoughts on 2014.

Firstly, Africa and the Gulf of Mexico. We are experiencing a high level of tendering activity across this territory. However, the timing of awards for the projects is more uncertain, particularly in Africa, than it has been for some time.

Taking into account the average length of time between tendering and award in Africa, and the uncertainties about the timing of awards, we are cautious about our revenue expectation in this Territory in 2014 for the second half of the year.

I also mentioned earlier the likelihood of a temporary slowdown in the shallow water Conventional market in Nigeria. We are presently experiencing a lower level of activity and expect the situation to continue, at least through the first half of the year. It's too early to conclude on what will happen later in 2014.

We are also tendering for a wide range of projects in the Gulf of Mexico for both SURF and long-term Life-of-Field awards. The operating environment remains competitive in this part of the world.

In APME, we continue to work on the Gorgon project in Australia, which remains our main focus of activity. The Gendalo-Gehem project in Indonesia is a large potential project in this Territory, but timing of market award remains uncertain. Otherwise, we anticipate out activity level in the Tterritory to be at lower level than in 2013.

Turning to slide 17, in Brazil the market remains active, and in line with our strategy we are tendering on a number of smaller projects with the right risk profile. Our PLSVs continue to perform well, and their contribution should be more evident in the second half of the year. The successful completion of the Guara-Lula project remains our top priority.

In the North Sea and Canada, we continue to see some large SURF project being delayed, although here again tendering activity remains at a good level. Our diverse portfolio of business and resources should ensure another sound year in the North Sea. But it should be remembered that the *Seven Ocean*s and the *Skandi Acergy* will be deployed outside of the territory throughout 2014, which has an impact on Territorial revenue.

We recently won an award for work on the Hebron field offshore Canada that will be managed from our St John's, Newfoundland office.

Turning to slide 18 and a summary for the year and the quarter. Both the full year and fourth quarter of 2013 were periods of solid performance by Subsea 7, driven by strong project execution, with the exception of the Guara-Lula project. The turnaround programme in Brazil is on track for 2014.

For the wider market, we have seen project market award delays, particularly in AFGOM, and we expect a lower level of order intake in the first half of 2014, which will lead to a near-term decline in our backlog.

For the full year 2014, we expect Group revenue to exceed that realized in 2013, and for adjusted EBITDA to improve moderately from that achieved in 2013, after adding back the additional project loss provision taken in the 2013.

Finally, despite some near-term uncertainties, I remain positive on the medium and long-term market project for our business. The fundamentals driving growth have not changed. Although we see new competitors coming to our market, our engineering capabilities, project management expertise, technologies, and lastly, position – and lastly, position us very well for the future.

With that, let's now – let's turn to your questions.