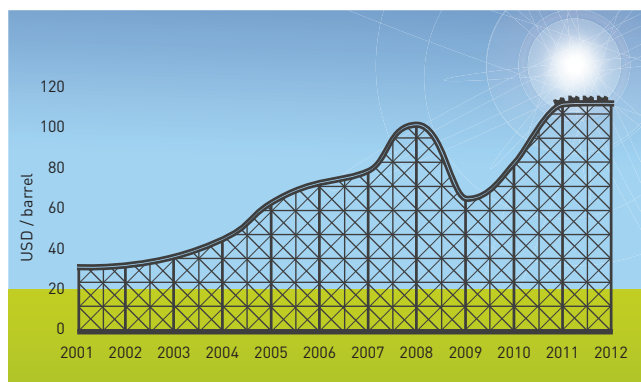




VIEW FROM THE TOP OF THE ROLLER COASTER



Oil price developments 2001-2012

Petoro's birth in 2001 occurred during what was in several respects a memorable year for Norway's oil and gas industry. Statoil was privatised and had to transfer the State's Direct Financial Interest (SDFI) portfolio to Petoro. And oil output peaked at an average of 3.1 million barrels per day.

The Norwegian continental shelf (NCS) has subsequently experienced an extreme transformation. Production has halved for crude and doubled for gas. Oil prices have tripled. The number of oil companies on the NCS has risen from 14 to 54. Statoil and Hydro have become a single dominant operator. Petoro originally managed assets in 80

licences – that figure has risen to 158. Cash flow from its operations is up from NOK 94.5 billion to NOK 147 billion in 2012, and it still produces an average of 1.13 million barrels of oil equivalent per day (boe/d).

Major changes have also occurred in the world market for oil and gas. The USA is moving from heavy dependence on imported Middle Eastern oil to energy independence. We thought Europe would embrace gas as an energy source, but coal is once again bigger than gas in UK electricity generation. The gas market has become more uncertain, and a bigger commitment is needed to defend Norway's interests as a substantial exporter.

Mood swings related to the NCS have been considerable among players, government and general public. During the first few years of our millennium, exploration activity slowed down to an extent which prompted the government to establish generous incentives for new players. That helped. But

the discoveries remained few and small. The Barents Sea became more like a distant dream. However, rising oil prices eased the mood – until the financial crisis in 2008 caused us to start worrying about pressures in the economy and the labour market. So sub-prime mortgages in the USA pulled us down again, into uncertainty and fears that the oil companies would be reluctant to invest.

But the mood changed once more, and has since turned to jubilation over high oil prices, a world-class Johan Sverdrup discovery and a Skrugard find which sparked a completely new level of interest in the Barents Sea. That once again proved too much of a good thing for those who like to surf ahead of the mood wave. They are worried about pressures in the economy and contracts going abroad.

Are we at the top of the roller coaster, or starting a stomach-clenching descent?

We will probably not learn the answer until it is too late to turn. That dynamic has characterised the petroleum industry ever since “colonel” Drake drilled the first modern oil well in 1859. Hydrocarbons are the world’s largest source of energy – and thereby of growth and prosperity for billions. Big fluctuations in supply or demand for such a commodity could cause major price swings in themselves. And the fear of even bigger price swings might cause them to happen. Similarly, the balance between supply and demand could also be affected by major technological breakthroughs or big geopolitical changes.

In the prosperous west, we seem to be increasingly concerned with security and the absence of danger. That makes living with very dynamic conditions uncomfortable. Norway is a small economy by comparison with our energy exports. Relatively small variations in the level of activity can have big effects. Nor did it take us many months to move from fear of recession in 2008-09 to rising concern over boom conditions.

Some are quick to call for stronger government controls. But fine-tuning activity in order to tailor it to the national economy or fabrication order books is difficult to achieve through official action in such a big business as the Norwegian oil and gas sector. Nor is such regulation popular with those who have committed a lot of capital and expertise to developing the NCS.

I have seen some people point to Petoro as an instrument for adjusting the level of activity. They need to remember that the company and its portfolio of oil and gas holdings are primarily a commercial instrument for securing a very high share of value creation for the state and society. Through its role as a licensee, however, Petoro is also an instrument for ensuring a long-term and coherent development of the NCS.

On a commercial basis, the company demonstrated this by putting pressure on other players when the financial crisis and capital discipline threatened to curb profitable investment projects on the NCS.

In the present circumstances, too, when many other companies are devoting most of their attention to new developments and to exploring for more oil, Petoro has an important commercial job to do in safeguarding time-critical investment in order to maximise the value of the big mature fields. It will also contribute to maintaining our position as a big exporter to Europe by exploring for more gas at a time when most of the attention is on oil.

The changes I described initially have fundamentally altered the preconditions for Petoro to perform to its role. Before, it could mobilise substantial capacity and expertise by allying with Hydro in licences where Statoil was the operator – and vice versa. After the merger, Petoro must do more of the advanced technical and economic work itself. It has gladly accepted that job in order to exert genuine influence over the choices made in the licences. This is being done at the same time as its licence interests have doubled, while the players the company must deal with have increased many times over.

As my time at Petoro’s helm draws to a close, I am very satisfied with the position secured by the company as a commercial player in the Norwegian oil industry. But I am convinced that the company and its very competent employees have more to give their owner and the industry, both in the form of value and by being an active participant in the actual business. However, that calls for a high level of expertise, greater capacity than at present and more commercial flexibility.

At the same time, I see that there has never been such a broad comprehension in the political community of the necessity for a genuine strengthening of Petoro. Of particular importance has been the opposition’s recognition of the significance of more flexible and commercial financing for the company. Precisely in an industry and a world characterised by the sweeping changes I have described above, it is critical for a company to be able to respond to the opportunities and challenges represented

by these developments in a commercial and flexible manner.

That is why it is so important that the cost of operating Petoro becomes a flexible component of the SDFI budget, rather than a fixed item in the annual government budget – where expenditure which increases long-term state revenues must compete with spending on what many people regard as more pressing needs in education, health and transport.

With such a change and strengthening, I believe Petoro would secure the weight to play an even more important role over the next 12 years.

That would be to the benefit of Norway Ltd.



KJELL PEDERSEN
President and CEO, Petoro AS