

A photograph of a middle-aged man with grey hair, wearing a dark grey suit jacket over a blue and white checkered button-down shirt. He is looking down at a red folder or book he is holding in his hands. The background is a blurred office environment with large windows.

# PETORO'S MANAGEMENT AND BOARD

DIRECTORS' REPORT 2012

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Petoro manages the State's Direct Financial Interest (SDFI), which represents about a third of Norway's total oil and gas reserves. The company's principal objective is to create the highest possible financial value from this portfolio.

Net income in 2012<sup>1</sup> came to NOK 150 billion, compared with NOK 133.7 billion the year before. Total operating revenue was NOK 213.9 billion, compared with NOK 188.8 billion in 2011. This yielded a cash flow to the government of NOK 146.9 billion as against NOK 128.1 billion the year before. Total production averaged 1 132 000 barrels of oil equivalent per day (boe/d), which was 11 per cent higher than the 2011 figure of 1 016 000 boe/d. The net reserve addition in 2012 was 278 million boe.

## INCOME, REVENUES, COSTS AND RESERVES

An income after financial items of NOK 150 billion was up by 12 per cent from 2011. This rise reflected higher gas sales and prices, while that effect was offset to some extent by increased costs in buying gas for onward sale and by greater depreciation and write-downs. Overall oil and gas sales for the year averaged 1 197 000 boe/d, compared with 1 083 000 boe/d in 2011<sup>2</sup>. Further maturation of the portfolio meant only a limited decline in oil production, which was down just two per cent from the year before. Gas output rose by 22 per cent from 2011.

Income before financial items came to NOK 152.7 billion. Net financial expenses of NOK 2.7 billion consisted mainly of calculated interest expenses on future removal liabilities for the SDFI.

Revenue for the year from dry gas sales totalled NOK 106.4 billion as against NOK 81.7 billion in 2011. Total gas sold rose by 20 per cent from 2011 to 44.8 billion standard cubic metres (scm), including sales of third-party volumes. That corresponds to 770 000 boe/d<sup>3</sup>. Troll accounted for 43 per cent of total gas revenue. The average gas price for the year was NOK 2.35 per scm, up nine per cent from 2011.

Total revenue for the year from oil and natural gas liquids (NGL) was NOK 96.3 billion, on a par with the year before. The sales volume totalled 156 million boe, or a daily average of 427 000 boe. The average oil price obtained for the year was NOK 657 per barrel, up by four per cent from 2011.

Other revenues, which primarily comprise tariff earnings from Gassled, amounted to NOK 11.1 billion in 2012 and were on a par with 2011.

Investment came to NOK 25.8 billion, up by 20 per cent from 2011. The biggest spending related to a high level of drilling activity on Troll, Gullfaks and Oseberg, further development of Ormen Lange and the development of a subsea compression facility on Åsgard. In addition come capitalised exploration costs, which brought total investment for 2012 to NOK 26.4 billion.

The cost of operating fields, pipelines and land-based facilities was NOK 16.4 billion, up by five per cent from 2011. This rise reflects increased well maintenance on a number of fields. Exploration-related costs amounted to NOK 1.8 billion, of which NOK 600 million was capitalised as investment related to possible and confirmed discoveries, and NOK 1.1 billion was expensed as exploration costs for dry wells. Correspondingly, exploration expenses totalled NOK 2.3 billion in 2011, of which NOK 1.3 billion was expensed. A total of 12 exploration wells were completed during 2012, two fewer than the year before. Hydrocarbons representing a recoverable volume of 470-580 million boe for the SDFI were proven in seven wells, compared with 320-550 million boe in 2011. The most positive exploration results in 2012 came from Geitungen, adjacent to Johan Sverdrup, as well as from appraisal wells on Johan Sverdrup, Skrugard and Maria.

<sup>1</sup> All figures are based on the accounts compiled in accordance with the Norwegian Accounting Act and Norwegian generally accepted accounting principles (NGAAP).

<sup>2</sup> Sales of entitlement oil, NGL and gas in 2012 totalled 1 129 000 boe/d compared with 1 015 000 boe/d the year before.

<sup>3</sup> One billion scm of gas equals one million scm oe, which corresponds to about 17 200 boe per day (17.2 kboed).



At 31 December 2012, the portfolio's expected remaining oil, condensate, NGL and gas reserves comprised 6 623 million boe – up by 136 million boe from the year before. Petoro reports the portfolio's expected reserves on the basis of categories 1-3 in the classification system used by the Norwegian Petroleum Directorate (NPD).

New reserves totalling 290 million boe were added to the SDFI in 2012. At the same time, reserves were downgraded for certain fields, making the net increase 278 million boe. The biggest contribution came from the decision to develop the Martin Linge field. Substantial volumes were also contributed by Heidrun as a result of adjustments to its reserves as well as the SDFI's increased holding, and by Troll following decisions on new wells and improved understanding of the fluid content in gas from this field. The net reserve replacement rate for 2012 was 67 per cent, compared with 160 per cent the year before, and the average replacement rate for the portfolio over the past three years came to 86 per cent. The corresponding figure for 2009-11 was 49 per cent.

#### **BOOK ASSETS AND EQUITY**

The book value of assets totalled NOK 228.5 billion at 31 December 2012. These assets mainly comprise operating facilities related to field installations, pipelines and land-based plants, as well as current debtors.

Equity at 31 December amounted to NOK 155.1 billion. Long-term liabilities totalled NOK 60.4 billion, of which NOK 58.3 billion related primarily to future removal liabilities. These liabilities are calculated in accordance with an established industry standard based on existing technology. Great uncertainty exists both over the removal estimates and over the timing of removals. Current liabilities, which comprise provision for costs incurred but not paid, were NOK 13 billion at 31 December.

Petoro served at 31 December as the licensee for the government's interests in 158 production licences and 15 joint ventures covering pipelines and terminals, including the interests in Mongstad Terminal DA and Vestprosess DA. It also managed the shares in Norsea Gas AS and Norpipe Oil AS.

#### **STRATEGY FOR PETORO**

The company's strategy falls into three parts, and is directed particularly at activities on mature oil fields. These represent large assets

in the portfolio, and taking decisions to secure their resources is time-critical. Petoro takes the view that it is important to contribute to ensuring that the mature oil fields receive the necessary attention from other licence partners.

#### **Realise the potential in and close to large**

**mature fields:** Petoro's commitment to realising the potential in large mature fields is directed at extending the producing life of priority installations through the choice of technical solutions, efficient drainage methods and the completion of a larger number of wells per year. Its efforts will help to achieve a time-critical change in the way the fields are operated in coming years. The company is also working for integrated area solutions by prioritising selected installations for use as field centres, and to achieve a timely phasing-in of discoveries.

#### **Integrated and timely development of the gas**

**value chain:** The dynamics in and structure of the European gas market have changed significantly in recent years. Major changes have occurred in relation to gas pricing, regulatory frameworks, the competitiveness of gas and its growth potential. What happens in the global and European markets for natural gas in the future, and an understanding of these developments, are crucial for realising the value potential of the SDFI's gas portfolio. Continued development of a robust marketing and sale strategy for SDFI gas together with Statoil is a priority job. In accordance with the marketing and sale instruction, Statoil sells the government's petroleum together with its own petroleum and takes responsibility for marketing and sales. The goal is to achieve the highest possible value for the petroleum belonging to Statoil and the government.

As the largest participant in Gassled, Petoro plays a key role in the gas infrastructure. This role is expected to become more demanding, since production developments and the technical integrity of the facilities will require significant measures related to Gassled's processing plants in coming years. This has become even more challenging in view of alterations to the owner composition and the risk of changes to the profitability of new investment projects.

#### **Safeguard asset values in new discoveries:**

To ensure optimum development of the portfolio, Petoro's commitment to identifying business opportunities in Barents Sea South will have a high priority. On the basis of the Johan Sverdrup discovery, its commitment in this part of the strategy will also

be to secure an acceptable development of licensee interests in major North Sea finds.

### **PETORO'S CONTRIBUTION TO ADDED VALUE**

The board regards creating added value for the SDFI as an important job at Petoro. Results of the company's work are reflected in a wide range of activities which will contribute to substantial added value both in the immediate future and in the long run. An example of an important issue in 2012 was the work devoted to integrated further development of the Gullfaks area, where Petoro is the only partner of operator Statoil. These efforts embrace decisions related to upgrading drilling facilities, improved recovery and subsea compression. Substantial work was also done to secure decisions on developing the Martin Linge field and on investment related to expanded compression for Ormen Lange plus associated infrastructure. Initiatives which contributed to value added also include the negotiated solution for Snorre secured by Petoro in place of a redetermination, and an increased holding in H-north in the Fram area through negotiations on a unitisation and tie-back to Fram. Another example of safeguarding asset values is provided by Petoro's work in connection with the latest Heidrun redetermination, where the northern part of the N segment was embraced by a sliding scale decision and the SDFI interest was increased through an arbitration finding related to the redetermination.

Petoro has a process which seeks to assess the company's contribution to value added. In recent years, estimates have been NOK 5-10 billion per annum.

### **FOLLOW-UP OF THE SDFI PORTFOLIO**

Petoro's efforts were directed in 2012 at long-term development of the Gullfaks, Snorre and Heidrun oil fields with the aim of ensuring maximum recovery of their resource potential during their commercial producing lives. A commitment was also made to continued development of the Johan Sverdrup, Troll, Ormen Lange, Linnorm and Snøhvit fields. Petoro considers the pace of drilling in mature areas to be too low and worked in 2012 to increase this tempo, particularly on fixed installations.

On Gullfaks, Petoro has worked to achieve a coordinated development of the main field and the surrounding discoveries and prospects. This contributed to the decision by the licence in June 2012 on an overall plan for continued

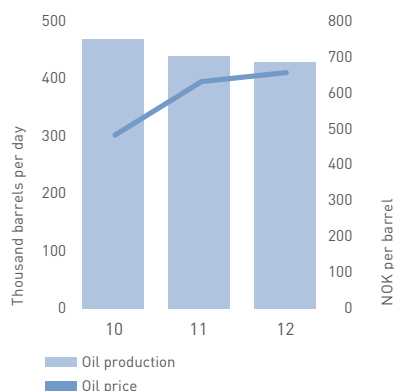
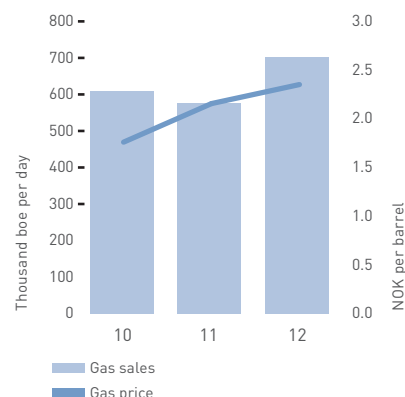
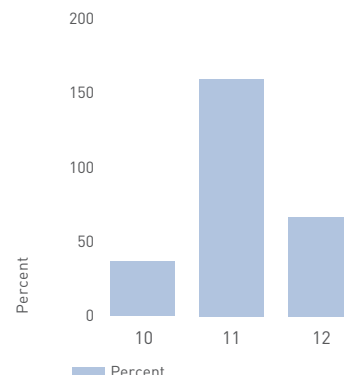
development of the Gullfaks area. The process clarified that the income basis does not exist for a new platform on the field or for a new extended-reach drilling facility on Gullfaks A. Decisions were taken on a further development of the Statfjord formation in Gullfaks South with two subsea templates, a subsea compression facility for gas from Gullfaks South, and an upgrade of the drilling rig on Gullfaks B.

The commitment to Snorre has related to continued development of the decision base for a new wellhead platform on the field, so that the licensees assess this option in addition to a subsea facility until the choice of concept is made in the summer of 2013. Work has focused on establishing the probability of future production from a possible platform in addition to reducing the investment cost through an optimisation of the jacket and the process facilities. Petoro also secured agreement on a negotiated solution rather than a redetermination of interests between the Snorre participants, which improves collaboration and progress in the licence.

An alternative field development plan for Heidrun has been developed by Petoro to highlight that a further potential exists for reserves over and above that identified in the licence, and to clarify the decisions and investment needed to realise these assets. Petoro's alternative plan, which includes a new platform on the field, is now under consideration in the licence.

Where Johan Sverdrup is concerned, Petoro has worked to establish unitisation principles which will safeguard the government's interests in a field extending across several production licences with differing partner compositions. The company is seeking to achieve good commercial solutions by obtaining an understanding of and influence over the reservoir base, appraisal wells, drainage strategy and field development. A collaboration agreement has been established with Det Norske Oljeselskap ASA on this work. A concept selection is planned in 2013.

The commitment to Ormen Lange has related to the development of a future compression solution. In association with work on new infrastructure for gas in the Norwegian Sea through a Polarled pipeline, land-based compression has been incorporated as part of the Nyhamna expansion project. Polarled would cover about 70 per cent of the costs and provide the opportunity to launch the project in

**OIL PRODUCTION/PRICE****GAS SALES/PRICE****RESERVE REPLACEMENT RATE**

2015. Petoro has also worked on the Linnorm development, which was halted as the result of a substantial rise in costs. A new well is planned for the spring of 2013.

A priority on Snøhvit has been to develop the resource base and ensure expanded capacity at the Melkøya facility, either through a new process train for gas liquefaction or a new gas pipeline. Reserves in Snøhvit have been upgraded, and the licence implemented a project in 2012 to assess increased capacity in order to accelerate production from the field. A substantial increase in costs as a result of a stressed supplier market meant that the capacity expansion project became much less robust against changes in prices, reserves and investment. The project was accordingly halted for the time being in the second half of 2012.

The performance of the existing Snøhvit facility remained unsatisfactory in 2012, and Petoro worked in the licence to establish an improvement project. This has been launched in 2013.

No signs of any improvement in the pace of drilling from fixed installations on the mature fields were seen during 2012. In addition to assessing opportunities for new platforms to secure a substantial increase in the drilling pace, Petoro has been a driving force for extra wells on Heidrun and has assessed the use of lightweight rigs in addition to existing drilling facilities on Gullfaks.

Plans for development and operation (PDOs) of Martin Linge and Svalin were approved in 2012. Decisions were also taken to install permanent subsea seismic arrays on Grane and Snorre.

This will contribute to improving recovery through a better decision base for new wells.

Visund South, the first "fast track" project for operator Statoil, came on stream in 2012 – 35 months after the reserves were proven. A number of such developments are due to be completed in coming years and will help to maintain production.

Certain aspects of the most recent redetermination for the Heidrun Unit were handled in a way which did not accord with Petoro's view. These disagreements were settled in part through appeals to the Ministry of Petroleum and Energy and in part by arbitration. Petoro won acceptance for its complaints, resulting in an increase of 0.39051 per cent or about 5.7 million boe in the SDFI's share.

Petoro is the largest partner in Gassled, with an interest of 45.793 per cent. This joint venture embraces gas infrastructure and terminals on or associated with the NCS. Day-to-day operation is handled by Gassco, which is not a partner. The SDFI received an income of NOK 10.7 billion from Gassled during 2012. Investment and operating costs came to NOK 966 million and NOK 2.1 billion respectively, on a par with 2011. Regularity at Gassled's export points to the markets was 99.65 per cent, compared with 99.17 per cent in 2011. Gassled decided in 2012 to build a new Norpipe terminal in Emden.

**MARKETING AND SALE OF THE PRODUCTS**

All oil and NGL from the SDFI portfolio is sold to Statoil. The latter is responsible for marketing all the SDFI's natural gas together with its own gas as a single portfolio, but at

the government's expense and risk. Petoro is responsible for monitoring that Statoil's sales of the SDFI's petroleum achieve the highest possible overall value, and for ensuring an equitable division of total value creation. Petoro concentrates in this work on Statoil's marketing and sales strategy, issues of great significance in value terms, matters of principle and questions relating to incentives.

Oil prices were particularly influenced during 2012 by two factors – weak global economic growth on the one hand and geopolitical conditions on the other. Weak growth helped to keep the rise in oil demand below the historical trend, while geopolitical tensions contributed to reducing world crude output and thereby to keeping prices relatively high. With brief exceptions, oil prices moved within a band of USD 100-120 per barrel. The average figure for 2012 was USD 113 per barrel compared with USD 114 in 2011, or NOK 657 and NOK 632 per barrel respectively.

European demand for gas declined by about four per cent in 2012, with developments varying by plus/minus five per cent between the different countries. Foreign sales of Norwegian gas increased by 16 per cent, while Russian exports fell by eight per cent. Part of the gas volume sold to Europe is priced in accordance with market quotations which reflect the balance between supply and demand (spot pricing). Spot prices in the European gas market were stable during 2012 and marginally higher than the year before.

The average gas price for the SDFI portfolio in 2012 was NOK 2.35 per scm, compared with NOK 2.15 the year before. About 65 per cent of the SDFI's gas production was sold under long-term contracts at 31 December, with the rest sold in the spot market. Gas prices in the long-term contracts are primarily calculated in relation to the price of oil products and quotations in the gas market.

Crude prices again helped to maintain a differential between oil-indexed contract prices and spot prices for gas in 2012. This position led to pressure on the level of prices in the long-term oil-indexed contracts.

Petoro has worked to ensure maximum value creation for the gas portfolio, including realisation of the value potential in the long-term sales contracts. The company is concerned to ensure that available gas is sold in the market at the highest possible price, and that

the flexibility of production plants and transport capacity is exploited to optimise deliveries.

Petoro also monitored and assured itself that petroleum sales to Statoil's own facilities are made at their market-based value. In addition, checks were made to ensure that the SDFI was being charged an equitable share of costs and received its equitable share of revenues.

## **HEALTH, SAFETY AND THE ENVIRONMENT (HSE)**

HSE results for facilities in the portfolio have been improving over a number of years. The serious incident frequency (SIF) per million working hours was 1.3 for 2012, an improvement of almost 15 per cent from the year before. This is based on 47 incidents registered as serious on the 18 fields in the target group. No fatalities were suffered in Petoro's portfolio during 2012. Dropped objects and incidents related to mechanical handling continued to dominate the statistics, despite big improvements in these categories over the past three years. The personal injury frequency per million working hours has been stable at around 5.3 for the same period.

Petoro works both with operators and the industry as a whole to achieve reductions in personal injuries and serious incidents. It participated in several HSE management inspections on selected fields and installations during 2012.

The company focused attention during the year on measures to reduce the risk of major accidents. To identify risk elements in the licences, efforts were made to establish best practice through a collaboration project with ConocoPhillips, ExxonMobil and Total. Brainstorming sessions were conducted in 14 Statoil-operated licences during 2012 to identify risk elements with a major accident potential. This work will continue in 2013 with the goal of further operationalising the process. The project has been presented to the Petroleum Safety Authority Norway, and received a positive response.

With regard to the natural environment, Petoro wants to ensure that power from shore is considered for new field developments and major conversion projects. See the section on the natural environment in the chapter on corporate social responsibility.

## **ATTRACTIVE WORKING ENVIRONMENT AND EXPERTISE**

The individual Petoro employee is crucial to the company's deliveries and success, and the board gives emphasis to ensuring that the company offers a stimulating working environment which attracts people with the right expertise and positive attitudes. Helping each employee to achieve the professional and personal development needed to attain the company's goals and secure good utilisation of its overall expertise is a management responsibility.

Opportunities for professional and personal development will help to retain, develop and attract good personnel. Learning and expertise development goals with associated plans are drawn up each year at company and individual level. The company audited its system for performance assessment reviews during 2012, and also thereby its efforts to continue developing a culture which focuses on the individual employee's most important contributions to achieving goals. In addition, a two-pronged development programme to strengthen relational competence was completed. The aim was to enhance Petoro's ability to succeed with its goals and strategies in the licences.

The company's human resources policy aims to ensure diversity and equal opportunities, develop expertise and facilitate a good working environment.

Petoro had 64 employees at 31 December 2012, compared with 67 a year earlier. Six staff left during 2012. The company has sought to strengthen its organisation through new recruitment in recent years, particularly technical specialists with higher education and relevant experience. The labour market for this type of expertise is tight, and recruitment processes are complicated and time-consuming. Petoro expects to increase its staff to 69 during 2013.

Sickness absence came to 2.35 per cent, compared with 1.9 per cent in 2011. Despite the increase, this represents a positive result. The rise from 2011 reflects rather more long-term sick leave in 2012, while short-term absences were reduced. Petoro has an inclusive workplace (IA) agreement, and gives weight to close follow-up and dialogue as well as to making arrangements which can ensure that such absences are as short as possible.

Collaboration with the company's working environment committee (AMU) and works council (Samu) lays an important basis for achieving a good working environment in the company. Work in these bodies again functioned well in 2012.

## **CORPORATE SOCIAL RESPONSIBILITY (CSR)**

Petoro's management of substantial assets on behalf of the Norwegian government calls for good corporate governance which fulfils the expectations of its stakeholders and society at large. The board adopted guidelines in 2012 for the exercise of corporate social responsibility (CSR) at Petoro. CSR embraces the activities voluntarily pursued by the company over and above existing legal and regulatory obligations. Petoro undertakes to conduct its business operations in an ethically acceptable, sustainable and responsible manner. Funding for discharging its management duties and for running the company is provided through appropriations from the government, and Petoro has no mandate to provide monetary support for social purposes. The board emphasises that the company's CSR forms an integral part of its activities and strategies. This is reflected in part through its values. Petoro's CSR was earlier addressed as part of its business ethics through the guidelines on this subject. Measures which ensure that Petoro discharges its CSR include the following.

**Ethical guidelines.** The company has guidelines on business ethics, which are publicly available. Their purpose is to clarify principles which govern the company's commercial operations and employee behaviour. All employees sign the company's ethical guidelines every year. These guidelines cover such considerations as the duty of confidentiality, possible conflicts of interest and issues related to the receipt of gifts and services. Petoro has established security requirements for data and for information and communication technology (ICT) in its operations. Its information systems and data are secured against unauthorised access. The consequences of breaching Petoro's guidelines on business ethics are covered in a separate section. The company expects its partners and contractors/suppliers to maintain the same ethical standards set for its own business operations.

**Openness on money flows and anti-corruption work.** Petoro does not accept any form of corruption or other malpractice. Employees are not permitted to receive remuneration

from others in their work for the company. Petoro reports money flows related to the SDFI portfolio on an annual basis to the extractive industries transparency initiative (Eiti). Details of the remuneration of directors and senior executives are provided in a separate note to the accounts for Petoro AS.

**HSE declaration.** Through its HSE declaration, Petoro has a goal of creating a good physical and mental working environment for all employees. It has routines for reporting conditions open to criticism. The board encourages the company's employees to raise ethical issues and to report any breaches of the regulations they encounter. The internal audit function is an independent whistleblowing channel with the right and duty to report to the board. No cases of whistleblowing were recorded in 2012.

**Diversity and equal opportunities.** Petoro will not discriminate on any basis. Women accounted for 36 per cent of the total workforce in 2012, similar to the year before, and for 42 and 25 per cent of the company's directors and executive management respectively. Petoro gives weight to equality between the genders in terms of opportunities for professional and personal development, pay and promotion. The company facilitates a flexible customising of working hours. When determining pay and in pay negotiations, Petoro is conscious that men and women must be treated equally. No systematic or significant differences exist between male and female pay in the company. Petoro has employees from several countries.

**Natural environment.** Petoro undertakes as a licensee to ensure that operations in which it participates are conducted in a sustainable manner which minimises negative impacts on nature and the natural environment. The NCS has a good record for environmental impacts compared with other petroleum provinces. Further improvement is nevertheless the goal.

Petoro is concerned to ensure that power from shore is assessed for new field developments and major conversions, and that a decision is based on technically feasible solutions at an acceptable abatement cost. One condition for increased use of power from shore is sufficient capacity in the electricity grid on land. A pre-unit agreement was established in 2012 on the development of joint infrastructure for Johan Sverdrup and other discoveries on the Utsira High, including common solutions for power from shore. The purpose of this work is to

establish a robust and sustainable concept for power from shore, based on the requirements of four field developments in the same area. This represents the first occasion that such an area solution is being studied on the NCS. The timetable for such an area solution calls for installation in 2017 and power deliveries from 2018. Plans call for Johan Sverdrup to come on stream in the latter year.

The company contributes to creating environmentally conscious attitudes among all its employees. Waste sorting and incentives to increase the use of public and environment-friendly transport were continued in 2012. Emphasis is given to efficient ICT solutions and good communication systems, with opportunities to replace travel with videoconferencing.

Petoro reports emissions to the air and discharges to water from the portfolio in a separate chapter of this report on the natural environment, based on figures obtained from the operators. No large individual discharges to the sea or on land occurred from the SDFI portfolio during 2012.

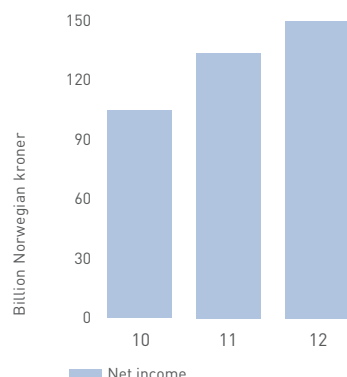
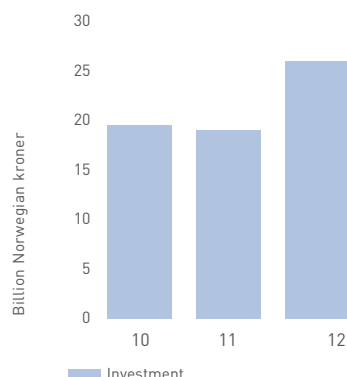
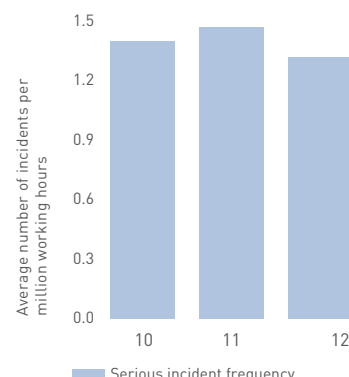
## RESEARCH AND DEVELOPMENT

The oil companies devote some NOK 3 billion per year to petroleum-related research and development (R&D), and the supplies industry spends about NOK 1 billion. Through its interests in production licences, Petoro contributes to R&D by meeting its share of these costs in accordance with its participatory interest in the production licences, where the funds are managed by the respective operators. This amounts to more than NOK 500 million per annum.

Qualifying new technological solutions for field application and their efficient implementation on fields represent a major challenge for the oil industry, including on the NCS. Many initiatives on the borderline between technology development and qualification are accordingly financed directly through projects and in day-to-day operation. The costs are carried on the investment budgets of the joint ventures. Qualification of subsea compression on Ormen Lange, Åsgard and Gullfaks, totalling NOK 7-8 billion over a five-year period, is a case in point. Petoro has worked for a number of years to secure faster adoption of technological opportunities and improved roll-out of new technologies in the production licences.

The company's commitment in 2012 focused



**NET INCOME****INVESTMENT****SERIOUS INCIDENT FREQUENCY**

particularly on maturing a pilot project for subsea compression on Ormen Lange. Petoro was a driving force in 2012 for the decision to install permanent subsea seismic cables on Snorre and Grane, and worked to persuade the Heidrun licence to assess the potential for such facilities.

Efforts have been made by Petoro over a number of years to increase the pace of drilling on the big mature fields. Coiled tubing drilling is a technology which could help recovery from small well targets, while boosting the production contribution of new wells. Petoro worked in 2012 to persuade the Heidrun licence to approve a pilot project for coiled tubing drilling.

**CORPORATE GOVERNANCE**

The board gives weight to good governance to ensure that the SDFI portfolio is managed in a way which maximises long-term value creation. Petoro's management system is based on the Norwegian code of practice for corporate governance to the extent that the code's recommendations are relevant to Petoro's business and the frameworks established by the company's form of organisation and ownership. Further developed in 2012, the management system simplifies the availability of management information and helps to concentrate attention on the attainment of company targets and on the risk picture at all times.

Petoro seeks a corporate culture characterised by commitment and decisiveness within a good internal control regime. Its values base and ethics are embedded in its values and guidelines on business ethics.

**WORK OF THE BOARD**

The board held 13 meetings in 2012. An annual meeting and work plan has been established for the board, with the emphasis on the consideration of strategy, goals, budgets and interim results. The board is concerned with overall value creation from the total portfolio, and with ensuring that the state receives its rightful share and does not get charged a larger proportion of costs than is warranted. Balanced scorecards are a key instrument used by the board in following up the company's results, and it measures the results achieved against established commercial and organisational goals.

The board considers major investment decisions in the portfolio as well as following up and considering the commercial business, including monitoring Statoil's duties under the marketing and sale instruction. It also monitors the company's overall risk picture. The board ensures that control systems have been established and that the business is conducted in compliance with the company's values base and guidelines on business ethics.

Guidelines for CSR were established by the board in 2012. Petoro's CSR had previously found expression in the instructions issued by the board for its own work and that of the chief executive, and is also reflected in the company's guidelines on business ethics. The board has maintained the practice of allocating preparatory work related to compensation arrangements to a sub-committee. Conflicts of interest are a fixed item on the agenda at board meetings, and directors with such a conflict withdraw from the board's consideration of the relevant issue. The board conducts an

annual evaluation of its own work. An external consultant assisted the board in conducting this self-assessment for 2012.

The president and CEO has announced that he wishes to exercise his right to take early retirement, and will step down in June 2013. The board wishes to thank Kjell Pedersen for doing a good job in building up, positioning and running Petoro from its foundation in 2001. Work on appointing a new chief executive has been initiated by the board.

Each director and the board as a collective body seek to strengthen their expertise in various ways. These include participation in courses and conferences and generally following developments in the area. The board conducted a study trip during the year to enhance its own expertise.

Petoro's board comprises Gunnar Berge as chair, Hilde Myrberg as deputy chair, Mari Thjømøe, Per Arvid Schøyen and Nils-Henrik M von der Fehr as the other shareholder-elected directors, and Anniken Teigen Gravem and Ragnar Sandvik as directors elected by and from among the employees.

### **RISK MANAGEMENT AND INTERNAL CONTROL**

The board conducted an assessment of the risk picture in 2012 on the basis of the approved strategy, and set targets for the coming year. Compensatory measures were identified for the biggest risks Petoro has an opportunity to influence through the frameworks available to it. The most important identified risks relate to the delayed availability of new drilling rigs and the quality of drilling services, the threat posed to the profitability of new projects in the planning phase by high costs, and a failure to realise the value potential because insufficient account is taken of new market realities for gas. A risk also exists that the SDFI's agreed unitisation interest in the new Johan Sverdrup discovery will fail to reflect Petoro's view on the division of the assets. In addition, a failure by operators and partners to give sufficient priority to the large mature fields in a long-term perspective could pose a risk, as would the inability of Petoro to win through in the licences with its efforts on Snorre, Gullfaks and Heidrun.

The most important operational risks are followed up in the management committees for priority fields in the business areas. Principles for risk management in Petoro build on the internationally recognised Coso/ERM

framework for internal control, and on in-house expertise.

### **PROSPECTS**

Considerable changes are taking place on the NCS, and the future of the SDFI portfolio depends on progress in the mature oil fields as well as developments in the gas market and in new exploration acreage. Production forecasts for the SDFI portfolio indicate a significant decline in output after 2020, despite major discoveries in 2011 and 2012.

The Johan Sverdrup and Skrugard/Havis discoveries have created optimism and new drive both in mature areas of the NCS and in the Barents Sea. All the discoveries involving Petoro in 2012 were oil finds. Interest in the award of Barents Sea acreage has been high. Petoro is concerned to see a clear area strategy established as the basis for future exploration and field development in this area and for the development of oil and gas infrastructure there. Realising the Polarled gas pipeline project could also yield increased incentives for exploring the Norwegian Sea.

Existing fields contain substantial remaining reserves. This underlines the significance of these producers, and it is accordingly important that the joint ventures for the big mature fields are able to realise this potential.

Increased reserves, effective application of innovative technology solutions and new work processes, combined with high oil prices, have contributed over a lengthy period to extending the producing life of several large mature fields. Oil output is falling significantly every year, and this trend is reinforced by a steady decline in the pace of drilling and fewer wells per year. The extension of producing life calls for increased investment on infrastructure to maintain functionality and technical integrity. Spending on wells is higher than anticipated because of substantial cost rise and a greater need for wells than expected. However, investment decisions are challenged by uncertainty over the remaining reserve base. These challenges are complex, and realising the reserve potential in the big fields is a substantial and demanding job. The board would emphasise the importance of Petoro strengthening its efforts to prioritise the mature fields on the NCS.

Statoil is the dominant player on the NCS and operates about 80 per cent of production from the SDFI portfolio. This means that the choices made by this company have great significance

for the further development of the NCS and the SDFI.

Fast-track development of small oil fields is an approach which has breached the trend for lead times in new projects. On the other hand, the high level of activity on the NCS is pushing up costs. That could challenge the profitability of new developments.

Petoro will contribute to enhanced value creation and gives priority to work in the areas where the value potential and its ability to exert influence are greatest. The company achieves this through purposeful use of the funds allocated to it for independent studies and assessments, and to support and challenge the operators. Where commercial matters are concerned, Petoro safeguards the government's interests in relation to other companies and their priorities. It fulfils this role within the appropriations provided over the central government budget through a purposeful build-up of its own expertise and capacity, and by setting good priorities.

The board expects oil prices to be relatively high but fluctuating during 2013. Prices are balanced between uncertainty on the supply side related to relatively low reserve capacity and persistent unrest in the Middle East, and uncertainty over demand related to world economic trends. Output from the SDFI's portfolio is expected to remain above one million boe in coming years, with a further shift from oil to gas.

Structural market changes and increased availability of liquefied natural gas (LNG) have reduced price levels for gas relative to those for oil. The economic position in Europe is expected to yield persistently weak demand for gas in this market. Great uncertainty also prevails about the availability of LNG to Europe, because this depends on demand in Asia. Viewed overall, the outlook for the balance between supply and demand for gas in Europe is very uncertain. In addition, uncertainty prevails about the role of gas in the future European energy picture. That applies particularly in the electricity generation sector as a result of current processes within EU energy and climate policies.

#### **PETORO AS – SHARE CAPITAL AND SHAREHOLDER**

The company's share capital at 31 December 2012 was NOK 10 million, divided between 10 000 shares. All the shares are owned by the Ministry of Petroleum and Energy on behalf of the Norwegian government. Petoro's business office is in Stavanger.

#### **PETORO ICELAND AS**

The Icelandic government awarded two production licences on 4 January 2013 in the second licensing round on Iceland's continental shelf. A 25 per cent interest in each of these licences is held by the Norwegian state, as detailed in Proposition no 42 S (2012-2013) to Norway's Storting (parliament). Petoro AS established a Norwegian subsidiary, Petoro Iceland AS, in December 2012 with an Icelandic branch to undertake on-going management of the Norwegian state's participatory interests. The branch serves as the licensee and participant in the two joint ventures on the Icelandic continental shelf.

#### **PETORO AS – NET INCOME AND ALLOCATIONS**

Administration of the portfolio by Petoro is subject to the accounting regulations for the government. The company maintains separate accounts for all transactions relating to the participatory interests, so that revenue and expenses for the portfolio are kept apart from operation of the company. Cash flows from the portfolio are transferred to the central government's own accounts with the Bank of Norway. The company prepares separate annual accounts for the SDFI, with an overview of the participatory interests managed by Petoro and associated resource accounting. Accounts for the portfolio are presented both on the cash basis used by the government and in accordance with the Norwegian Accounting Act and Norwegian generally-accepted accounting principles (NGAAP). All amounts cited in this directors' report are based on NGAAP.

Petoro's operating revenue takes the form of a contribution from the government, which is directly liable for the commitments accepted by the company under contract or in other forms. The government contribution for 2012 was NOK 281.2 million, compared with NOK 264 million the year before. Since this sum includes VAT, disposable revenue was NOK 225 million as against NOK 211.2 million in 2011. Petoro received an additional appropriation of NOK 27 million exclusive of VAT in 2012 related to the Johan Sverdrup field. Recorded income related to Johan Sverdrup was NOK 19.5 million exclusive of VAT. Total recorded income, including financial income, for 2012 was NOK 249 million, compared with NOK 221.6 million the year before.

Operating expenses were NOK 256.7 million for the year, compared with NOK 228 million in 2011. These expenses related primarily to

payroll and administration expenses and to the purchase of external services. The purchase of leading-edge expertise relating to supervision of joint ventures in the SDFI portfolio accounts for a substantial proportion of the company's operating expenses. In-depth studies of the Gullfaks, Heidrun and Snorre fields were conducted in 2012. Spending on studies and leading-edge expertise was substantially higher than in 2011 because of participation in the Johan Sverdrup field.

The board devoted attention in 2012 to the company's overall resource position. Further use of resources directed at mature fields and critical activities will be given priority, but kept within available disposable funds.


The net loss after net financial income came to NOK 8.1 million. The board proposes that this loss be covered from other equity. Remaining other equity at 31 December was NOK 13.3 million. The company's equity position is satisfactory, with low financial risk. Its non-restricted equity totalled NOK 5.3 million at 31 December.

Pursuant to section 3, subsections 3 and 2a, of the Norwegian Accounting Act, the board confirms that the annual accounts for the portfolio and the company provide a true and fair picture of the company's assets and liabilities, financial position and results of the business, and that the annual accounts have been prepared under the assumption that the company is a going concern.

Stavanger, 22 February 2013



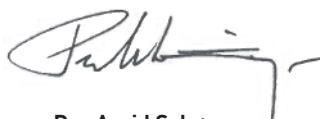
**Gunnar Berge**  
Chair



**Hilde Myrberg**  
Deputy chair



**Nils-Henrik M von der Fehr**  
Director



**Per Arvid Schøyen**  
Director



**Mari Thjømøe**  
Director



**Ragnar Sandvik**  
Director\*



**Anniken Teigen Gravem**  
Director\*



**Kjell Pedersen**  
President and CEO

\* Elected by the employees