

A photograph of an offshore oil rig on the left, with a red tugboat in the middle ground, connected by a cable. The background shows a blue sky with scattered white clouds and distant mountains. The text is overlaid on the upper half of the image.

# DIRECTORS' REPORT

PETORO AS AND THE SDFI PORTFOLIO

# DIRECTORS' REPORT 2017

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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 the SDFI portfolio.

The SDFI scheme was established in 1985. Under this arrangement, the state participates as a direct investor in petroleum activities on the Norwegian continental shelf (NCS), so that the state receives revenues and meets expenses associated with SDFI's ownership interests. Petoro acts as licensee for the state's ownership interests in production licences, fields, pipelines and onshore facilities, and manages this portfolio based on sound business principles. As SDFI manager, Petoro contributed a cash flow of NOK 87 billion in 2017, which represents a significant portion of the state's total revenues from the petroleum activities.

## EXTERNAL TRENDS

The last few years have seen considerable changes in the oil and gas industry, including on the Norwegian shelf. Low prices and increased uncertainty as regards supply and demand for oil and gas over the longer term have clarified the need for efficiency and adjustments. In this situation, the industry and players have been able to considerably reduce costs over a relatively short period of time, thus bolstering competitiveness on the Norwegian continental shelf. 2017 was the first year since the financial crisis where the economy grew on all continents. Heading into 2018, the key financial figures are better than has been the case for a number of years, and the overall global financial growth was a positive surprise in 2017 with a total of 3.7 per cent.

After a period of oversupply, the oil market rebalanced over the course of 2017. This is bolstered by broad growth in global demand, which at 1.8 million bbls per day, was the strongest since 2010. On the supply side, OPEC continued the reduction agreement of 1.2 million bbls per day throughout year, and the decision was made in November 2017 to continue this through 2018. US shale oil production is growing again, and the scope of

shale oil, alongside geopolitical unrest in the Middle East, are key uncertainty factors for future oil price development. The year started off with an oil price around USD 55 per bbl, but this declined steadily toward the summer and reached a low for the year at USD 44 per bbl in mid-June. The price rebounded over the course of the year and ended the year at USD 66 per bbl. SDFI's average realised oil price was NOK 449 per bbl, NOK 88 higher than in 2016. Measured in USD per bbl, the average price in 2017 was 54.2, compared with 43.1 in 2016.

European demand for gas continued its positive development from 2016 and grew by about 5 per cent in 2017. Some of the growth is attributed to factors such as colder and drier weather conditions in Europe. However, there has also been more structural growth in demand from the power sector driven by higher coal prices and the phasing out of coal power plants. While both Norwegian and Russian gas exports to Europe reached new record levels in 2017, LNG imports also reached their highest level of the last 5 years. This reflects a decline in Europe's own production which, combined with production restrictions on the Groningen field, increased Europe's need for imports. In 2017, gas prices declined seasonally toward the summer and rebounded significantly toward the winter. The average gas price achieved for the portfolio was NOK 1.72 per scm in 2016, compared with NOK 1.62 per scm in 2016.

The Paris Climate Agreement appears to be strong, even after the US decision to withdraw from the agreement. Implementation of the Paris Agreement is challenging for several countries, which is particularly demonstrated by the discussions in the EU and several member states. Germany has taken a leadership role as regards climate and renewable energy, but will most likely not reach its climate goals for 2020. In the UK, renewable energy and gas have

replaced coal and contributed to considerable emission reductions. Further reductions will require substantial and costly efforts within transport and heating. Despite various challenges, the long-term goals and ambitions remain firm.

The Norwegian petroleum industry has followed up the national climate goals by establishing a roadmap towards 2030 and 2050 for emission reductions. The goal is to implement CO<sub>2</sub>-reducing measures corresponding to 2.5 million tonnes per year from 2020 to 2030 through low-emission solutions in new projects and energy efficiency measures in existing facilities.

The situation with increased uncertainty in future product prices requires financial robustness as regards investment decisions. This means that measures to develop new and existing petroleum deposits are shifted towards projects with lower break-even prices, shorter repayment periods and phased development.

The player landscape on the Norwegian shelf is changing. 2017 saw a continuation of the trend where large international oil companies are reducing their presence, including through the sale of self-operated fields. Industry consolidation through mergers and acquisitions has also included the European industrial and energy companies that, for several years, have strengthened their presence on the Norwegian shelf in both in the development and operations phase. The changes have allowed the small and medium-sized independent oil companies to grow in terms of both size and financial strength. The players that grew in 2017 are primarily financed by Private Equity funds or large industrial players. So far, the industry consolidation and restructuring has not affected operatorships and has only somewhat affected the composition of partnerships in Petoro's producing fields. However, participants in production licences with SDFI participation have been affected, either through mergers and the establishment of larger companies or in that the companies have sold their self-operated activity and associated organisation. Further efficiency and cost improvement measures, in addition to high exploration activity and new discoveries, will be decisive in order for the Norwegian shelf to maintain its competitiveness in the global competition for investment funds.

Although there has been a decline in the number of exploration wells over the last few years, the number of applications and awards in

the last licensing rounds show that there is still interest in exploration on the Norwegian shelf. The 2016 Awards in Predefined Areas (APA) totalled 56 production licences, while the 2017 APA set a new record with 75 licenses.

Over the last three years, the industry and players have demonstrated a sound ability to improve, and the challenge moving forward is to maintain the effect of this and, at the same time, have the capacity for further improvement.

An effort was under way in 2017 under the auspices of Konkraft with the aim of promoting global competitiveness for Norwegian oil and gas over the long term. The report was submitted on 4 January 2018, and the committee points out opportunities for improvement, particularly within digitisation and new forms of cooperation. It is important for the industry to follow up and implement these measures in the time ahead.

#### **SUMMARY OF SDFI RESULTS**

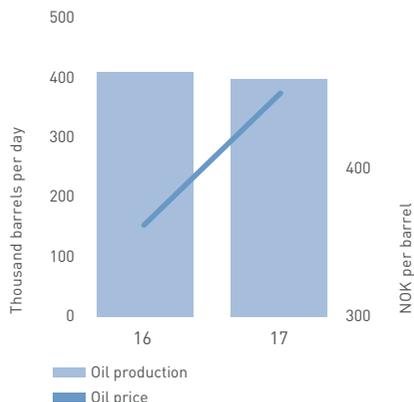
The financial result for 2017 was a net income of NOK 99 billion, NOK 41.5 billion higher than in 2016. Cash flow to the state was NOK 87 billion in 2017, NOK 21 billion higher than in 2016.

The cash flow and financial result are characterised by considerably higher oil and gas prices in 2017 compared with 2016, as well as higher gas volumes. Total production averaged 1.110 million barrels of oil equivalent (boe) per day, up roughly seven per cent from 2016. Gas production reached a record level in 2017, 13 per cent higher than in 2016. The increase is primarily due to increased use of flexible gas production in order to exploit higher prices. Natural production decline from existing wells means that liquids production was nearly three per cent lower than in 2016. Higher regularity and more wells do not fully offset this decline, as has been the case over the last couple of years.

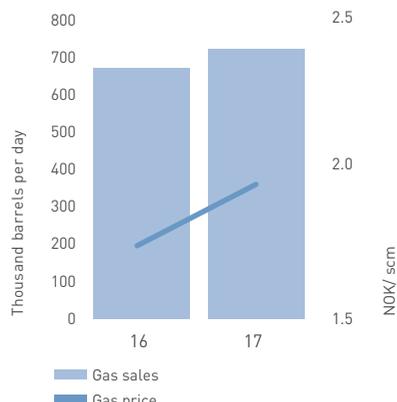
Costs incurred for investment in 2017 totalled NOK 25.5 billion, which is about NOK 3 billion lower than the year before. This reduction is mainly due to lower investment in production drilling as a result of reduced drilling activity on three fields.

The book value of assets at 31 December 2017 was NOK 247 billion. The assets consist of fixed assets related to field installations, pipelines and onshore plants, as well as current debtors. Equity at 31 December came to NOK 168 billion.

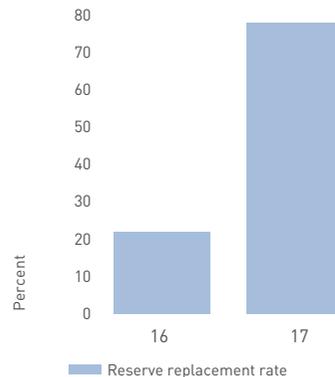
**OIL PRODUCTION/PRICE**



**GAS SALES/-PRICE**



**RESERVE REPLACEMENT RATE**



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

The HSE results for 2017 show a positive development compared with the previous year, but the number of serious near-miss incidents and personal injuries is still too high. The serious incident frequency (number of serious incidents per million hours worked) declined from 1.0 in 2016 to 0.7 in 2017. The personal injury frequency (number of personal injuries per million hours worked) is at same level as the previous year and came to 4.2 in 2017, compared with 4.1 in 2016. No serious discharges to sea were recorded in 2017.

In 2017, Petoro has been particularly concerned with risk assessments in a major accident perspective linked to effects from efficiency measures in the licenses. Petoro also conducted a number of management visits in 2017, focusing on health, safety and the environment on selected fields and onshore plants.

Beyond the activities on the Norwegian shelf, Petoro, as licensee in the Martin Linge project, experienced the tragic accident at the Samsung shipyard in South Korea on 1 May 2017, where 6 people lost their lives and 25 were injured. This accident is a powerful reminder of the importance of managing major accident risk linked to all parts of our activities.

**PRINCIPAL ACTIVITIES IN 2017**

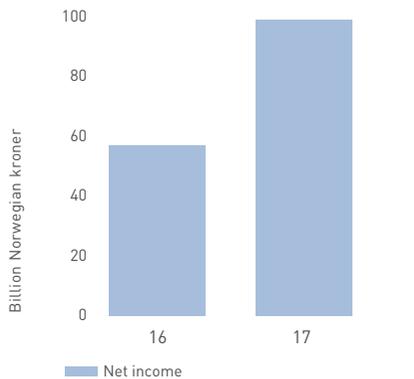
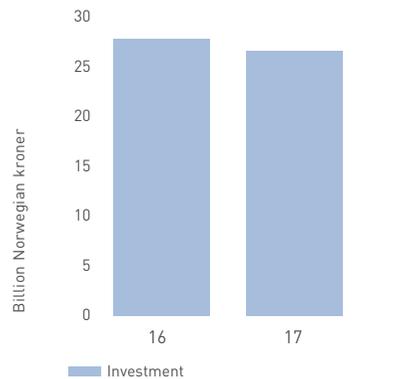
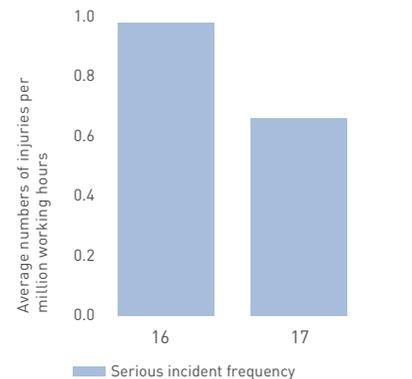
As of the end of 2017, the portfolio consisted of 186 production licences, 6 more than at the beginning of the year. In January 2017, Petoro received participating interests in 13 production licences under the Awards in Predefined Areas (APA) 2016. Petoro also received participating

interests in 17 production licences in APA 2017 in January 2018.

Production from mature oil fields continues to dominate liquids production in the SDFI portfolio. The Troll, Oseberg, Åsgard, Heidrun, Grane, Gullfaks and Snorre fields accounted for 70 per cent of total liquids production in 2017. In 2017, gas accounted for 64 per cent of overall production measured in oil equivalent. Just over 70 per cent of gas output came from Troll, Ormen Lange and Åsgard. Three new fields came on stream in 2017: Maria, Sindre and Flyndre. Maria started up in December, nearly one year before the original schedule and development costs were considerably lower than presumed in the Plan for Development and Operation (PDO).

The company's strategy was continued in 2017 and is twofold: Increase the competitiveness of the portfolio and realise value in mature fields. Through focused follow-up, supported by in-depth professional commitment, Petoro works to reinforce value creation opportunities with emphasis on long-term business development. The company's climate policy emphasises that Petoro shall contribute to ensure that the oil and gas industry on the Norwegian shelf is at the forefront as regards addressing the climate challenges. In this area, the company has focused its efforts on energy efficiency measures on the fields in the portfolio with the highest CO2 emissions.

In 2017, in line with the strategy to realise the values in mature fields, particular efforts have been aimed at the Snorre and Troll fields, in addition to well maturation on selected fields.

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

On the Snorre field, Petoro has been an active driving force over a number of years in the realisation of additional profitable reserves. Efforts have primarily been aimed at strengthening reserve potential through expansive technical reservoir studies. In December 2017, the license decided to invest in a further development project consisting of 6 seabed templates adapted for 24 new wells. The application for approval of the amended PDO for further development of the Snorre field was submitted to the Ministry of Petroleum and Energy in December. Production start-up is anticipated in 2021, and the project will contribute to considerably increased values from the Snorre field.

The Troll field is facing important decisions as regards further development of the field. Throughout 2016 and 2017, Petoro has been actively engaged in helping ensure that work on the Troll phase 3 project will ensure the most comprehensive and flexible further development possible. Efforts have primarily been aimed at ensuring that the effect on oil production is understood through comprehensive technical reservoir studies. An investment decision is expected in spring 2018, and start-up in 2021.

On the Heidrun field, Petoro has also been carrying out technical reservoir studies over a longer period of time in order to contribute toward improving the profitability of further development measures. In 2017, the license made an investment decision for phase 1 of the Heidrun Subsea Extension project. This project includes construction of a new production flowline and an upgrade of subsea equipment in the northern part of the field. This will enable

the drilling of 11 new wells, which will yield considerably greater values from Heidrun.

In December 2017, along with the other partners in the Johan Castberg license, Petoro made an investment decision and subsequently submitted the application for approval of the PDO for the Johan Castberg project, which comprises 10 seabed templates, two satellites and one production vessel. This project has undergone extensive changes and cost improvement measures, where Petoro has been particularly focused on preserving the opportunities for new profitable additional volumes in the field's operations phase. The change work carried out by the operator Statoil along with the suppliers has yielded very good results and has resulted in a substantial improvement in the project's profitability.

Petoro is highly involved as a partner in the Johan Sverdrup field, where phase 1 of the project is in the implementation phase with two platforms under construction in South Korea and two in Norway. A dedicated facility is also being constructed at Kårstø to supply the field with power from shore.

In addition to following up the implementation of phase 1, Petoro has been involved in preparations for the investment decision in 2018 for phase 2 of the project. Johan Sverdrup has also experienced a positive cost development in 2017, which helps boost the project's profitability.

The authorities approved the PDO for the Dvalin field in 2017. The development plan for Dvalin comprises a subsea template with four wells tied into the Heidrun platform, as well as gas

export via Polarled and Nyhamna. Petoro is also a licensee on Ekofisk, where the authorities approved an amended PDO in 2017 for the Ekofisk South Water Injection project. The objective of the project is increased recovery through the installation of a new subsea template with four water injection wells.

The need for efficiency improvements and cost reductions within the drilling and well service area has been an important issue for Petoro over several years. Petoro has followed the development in drilling pace on ten fixed installations on five selected fields in the portfolio over a number of years. The number of completed wells has doubled from 2014 to 2017. The average drilling time and drilling cost was cut in half from 2014 to 2015. The result can mainly be attributed to increased drilling efficiency, simplified well design and increased availability of drilling facilities. The development in drilling time and drilling cost has levelled out since 2015, and was on par with the previous two years in 2017. Further improvements will require new means, e.g. digitisation and new forms of cooperation.

There will be a significant long-term need for drilling new wells to realise the value potential in mature fields. Petoro has been working to increase the maturation of wells on selected fields, in part by carrying out in-depth studies to identify new wells.

As part of this strategy, Petoro has worked to increase the portfolio's competitiveness, and the licenses have achieved comprehensive improvements within all areas of the value chain. The substantial cost reductions achieved through optimisation of the development concepts leading up to concept choice for Snorre and Johan Castberg, were decisive as regards the projects' profitability and being able to make investment decisions in 2017. Even with reduced costs, the recoverable resources have been maintained for these projects, which demonstrates a considerable improvement in competitiveness. These experiences provide a sound basis for maturing new profitable projects in the portfolio.

Another example of results from the improvement efforts is that field costs for fields in operation are still declining. However, after achieving substantial cost reductions in recent years, the effect has slowed down, and field costs in 2017 were four per cent lower than in 2016. Further reductions here will also require new measures. Petoro's efforts have been aimed at ensuring that the measures implemented to reduce costs are sustainable and entail an actual gain in efficiency, without weakening the facilities' integrity over the longer term.

34 exploration wells were completed on the Norwegian shelf in 2017, which is about the same number as the year before. Petoro was a participant in 12 of the wells, 10 of which were wildcat wells that yielded 8 new discoveries. The last two exploration wells were appraisal wells. Even though the new discoveries were generally minor, four of them are located near existing infrastructure and are presumed to be commercial. The results from the exploration campaign in the Barents Sea were disappointing, with the exception of the Kayak discovery where an additional appraisal well is considered with a view towards a potential development tied into Johan Castberg.

The portfolio's estimated remaining reserves of oil, condensate, NGL and gas totalled 5879 million boe at 31 December, down by 89 million boe from the year before. Reserve growth in 2017 primarily came from Johan Castberg, but also from the mature fields Snorre, Åsgard, Heidrun, and Visund. Nevertheless, the growth was not sufficient to offset the reduction in remaining reserves from production in 2017.

## **RESEARCH AND DEVELOPMENT**

Petoro contributes to research and development (R&D) through the SDFI meeting its share of the operator's costs for general research and development pursuant to the Accounting Agreement. The funds are managed by the respective operators. This amounted to NOK 507 million for the SDFI in 2017. Projects aimed at field-specific qualification of new solutions or pilot application of technology in licences, where the costs are charged to the joint ventures, come in addition. Petoro does not initiate its own technology development and research projects.

## MARKETING AND SALE OF THE PRODUCTS

All oil and natural gas liquids (NGL) from the portfolio are sold to Statoil. Statoil is responsible for marketing all the SDFI's natural gas together with its own gas as a single portfolio, at the state's expense and risk. Petoro's task is to monitor that Statoil's marketing and sale of the government's petroleum together with its own production complies with the marketing and sale instruction given to Statoil ASA. The objective of the marketing and sale instruction is to achieve the highest possible value for Statoil's and the state's petroleum and ensure just distribution of the total value creation. In this work, Petoro concentrates on Statoil's marketing and sales strategy, issues of great significance in value terms, matters of principle and questions relating to incentives.

In 2017, Petoro has prioritised following up further development of Statoil's follow-up system for the marketing and sale to ensure that necessary routines are in place, including for the new formula for LPG, which was introduced as of 2017.

The company is concerned with ensuring that the products are marketed and sold in the markets where the highest price can be achieved. In this context, optimal utilisation of the capacity and flexibility of production facilities and infrastructure is of great significance.

Selected verifications have been conducted to ensure that the SDFI receives its rightful share of sales-related costs and revenues. The company is in a dialogue with the Ministry of Petroleum and Energy as regards certain clarifications in the marketing and sale instruction.

## WORKING ENVIRONMENT AND EXPERTISE

The company's human resources policy aims to ensure diversity and equal opportunities, develop expertise, facilitate a good working environment, and prevent discrimination on the grounds of age, gender or cultural and geographical background.

Petoro personnel have extensive experience from the petroleum industry and a high level of expertise. The individual employee is crucial to

the company's deliveries and success, and the board places emphasis on ensuring that Petoro offers competitive terms and a stimulating working environment that attracts people with the right expertise and positive attitudes. Opportunities for professional and personal development help to retain, develop and attract skilled personnel.

Petoro had 65 employees at 31 December 2017, one more than the year before. Two new employees were hired in 2017 and one employee retired. Women accounted for 37 per cent of the total workforce in 2017, and 43 per cent of the company's directors and executive management. Petoro emphasises equal opportunities for professional and personal development as well as pay. Working conditions at Petoro are customised to allow employment of people with disabilities.

Absence due to illness was to 2.1 per cent in 2017, compared with 1.7 per cent in 2016. The company considers this to be low. Petoro has an inclusive workplace (IA) agreement, and utilises close follow-up and dialogue to promote good health and prevent absence due to illness. No occupational accidents were recorded among Petoro's personnel.

Collaboration with the company's working environment committee (AMU) and works council (SAMU) lays an important foundation for a good working environment. These bodies also functioned well in 2017.

## CORPORATE GOVERNANCE

The board emphasises good governance to ensure that the state's portfolio is managed in a way which maximises financial value creation in a long-term perspective. Requirements for governance in the public sector are specified in "Regulations on Financial Management in Central Government" and in standards for good corporate governance. The board observes the Norwegian state's principles for sound corporate governance as expressed in Meld. St. 27 2013-2014 "Et mangfoldig og verdiskapende eierskap" (Report No. 27 to the Storting (2013-2014) "Diverse and productive ownership") and those sections of the "Norwegian Code of Practice for Corporate Governance"

regarded as relevant to Petoro's activities and the frameworks established by its form of organisation and ownership.

The management system is tailored to Petoro's distinctive nature, and enterprise management is based on balanced management by objectives, under which objectives are established that support the company strategy. For further details see the separate section in the annual report.

Petoro's values base and ethics are embedded in its values and guidelines on business ethics.

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

Petoro discharges its corporate social responsibility in line with the relevant guidelines, which are tailored to the company's role. Funding for discharging its management duties and for running the company is provided through appropriations from the state, and Petoro is unable to provide monetary support for social purposes.

Measures which ensure that Petoro discharges its CSR include business ethics guidelines, the HSE declaration, climate policy and an HR policy that ensures diversity and equal opportunity. Activity outside Norway is very limited. The board provides a more detailed presentation of the exercise of CSR in a separate section of the annual report.

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

The board conducted an assessment of the risk picture in 2017 on the basis of the approved strategy, and set targets for the coming year. Measures were identified for reducing the most significant risks which Petoro has an opportunity to influence within the company's established frameworks.

Two internal audit projects were carried out in 2017; they assessed the control and follow-up of cash flows in the SDFI and IT security. The results were summarised in a report to the board describing the audit actions undertaken, findings, as well as proposed and implemented measures for the internal audit projects.

The internal audit projects in 2017 were conducted by PwC, which has also been responsible for the internal financial audit of the SDFI for the 2017 accounting year.

### **WORK OF THE BOARD**

The board has overall responsibility for the management of Petoro, including ensuring that appropriate management and control systems are in place, and for exercising supervision of the day-to-day conduct of the company's business. The board met 8 times in 2017. An annual schedule of meetings has been established for the work of the board, with the emphasis on considering topical commercial issues and following up strategies, budgets and interim results. Balanced scorecards are a key instrument used by the board in following up the company's results.

The board considers major investment decisions in the portfolio. It also follows up activities in the licenses and the monitoring of marketing and sales, including assessments of the overall risk picture.

The board has chosen to organise its work related to compensation through a sub-committee comprising two of the shareholder-elected directors, one of whom is the deputy chair. No other sub-committees have been established. A declaration has been drawn up by the board on remuneration of the chief executive and senior personnel.

Conflicts of interest are a fixed item on the agenda at board meetings and in the consideration of matters, and directors with such a conflict withdraw from the board's consideration of the relevant issue.

An annual self-assessment is conducted by the board, which encompasses an evaluation of its own work and mode of working, as well as its collaboration with company management. The self-assessment for 2017 is complete.

The work of the board is based on the "Board Instructions", which describe its responsibilities and mode of working. As an appendix to the Instructions, the board has adopted supplementary provisions for matters which it will consider. The board also reviews

the company guidelines on business ethics and CSR, as well as the Board Instructions. Directors must routinely report their ownership of shares or similar interest in other companies which could constitute, or which could be perceived as constituting, a conflict of interest with their position. They are furthermore required to report other relationships with licensees involved in petroleum activities on the NCS or with companies that supply goods or services to licensees.

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 within the business area.

Petoro's board comprises Gunn Wærsted as chair, Brian Bjordal as deputy chair, Per A. Schøyen, Trude J. H. Fjeldstad and Hugo Sandal as shareholder-elected directors. Per-Olaf Hustad withdrew from the board in June 2017, while Hugo Sandal joined as a new director. Directors Ove Skretting and Heidi I. Nes are elected by the employees.

## **PETORO AS AND THE GROUP**

### **SHARE CAPITAL AND SHAREHOLDER**

Petoro AS was established as part of the restructuring of the state's oil and gas activities in 2001, when Statoil was partially privatised and management of the SDFI was assigned to Petoro AS. The company's operations are governed by Chapter 11 of the Petroleum Act. Its general meeting is the Ministry of Petroleum and Energy.

Petoro's share capital at 31 December 2017 was NOK 10 million, distributed among 10 000 shares owned by the Ministry of Petroleum and Energy on behalf of the Norwegian state. Petoro's business office is in Stavanger.

### **PETORO ICELAND AS**

Petoro Iceland AS was established in December 2012 as a wholly-owned subsidiary of Petoro AS. Through a branch registered in Iceland, it is a licensee and participant in production licences in which the Norwegian state chooses to participate. The company's share capital at

31 December 2017 comprised NOK 2 million, distributed among 2 000 shares. It has no employees and has entered into a management agreement with Petoro AS. The third and last production licence, which was awarded in January 2014, completed the work programme for the first phase in 2017. The operator, CNOOC, deemed that proceeding to the next phase was insufficiently attractive and recommended relinquishment based on a comprehensive assessment. Petoro Iceland AS supported the operator's assessment and conclusion and chose to announce its withdrawal in January 2018.

As a result of relinquishing the last production licence on the Icelandic continental shelf, Petoro Iceland AS is no longer involved in any production licences. Some supplementary work for the most recently relinquished license will continue in 2018.

### **NET INCOME AND ALLOCATIONS**

Petoro AS maintains separate accounts for all transactions relating to participating interests in the joint ventures. Revenue and expenses from the SDFI portfolio are kept separate from day-to-day operation of the company. Cash flow from the portfolio is transferred to the central government's own accounts with Norges Bank. 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).

Funds for operating Petoro AS and Petoro Iceland AS are provided by the government, which is directly responsible for the contractual obligations incurred by the companies. The consolidated accounts comprise the parent company and Petoro Iceland AS. Amounts related to internal transactions are eliminated in the consolidated accounts.

NOK 342.7 million was appropriated for ordinary operation of Petoro AS in 2017. The appropriation for Petoro Iceland AS was NOK 7.6 million.

Operating expenses in 2017 were in accordance with the board's approved budget, the company's appropriation and allocation letter. The financial

result for Petoro AS totalled NOK 6.4 million. The group posted a net income of NOK 6.7 million. The board proposes that the profit in Petoro AS be transferred to other equity. Certain elements in the company's unsecured pension liabilities were not taken into consideration and incorporated into the company's pension liabilities in the annual accounts for 2016. Correction thereof amounted to NOK 6.4 million and resulted in other input equity as of 1 January 2017 totalling NOK 0.9 million. Along with the net income, this resulted in other equity totalling NOK 7.3 million as of 31 December 2017. The group's reserves of NOK 9.5 million comprise other equity in the parent company, NOK 2 million in grants from the Norwegian state related to establishing Petoro Iceland AS and accumulated results in the subsidiary.

Pursuant to Sections 3-3 and 3-2a of the Norwegian Accounting Act, the board affirms that the annual accounts for the portfolio and the company provide a true and fair picture of the company's assets and obligations, 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. The company has satisfactory equity and low financial risk.

### **PROSPECTS**

As regards the oil market, the uncertainty over the intermediate term is primarily linked to future developments in shale oil, how OPEC responds, and how the rest of the oil market will adapt to this dynamic. Over the last year, OPEC and Russia have cut production to stabilise prices, but this has simultaneously given investment signals to US shale oil, which is again experiencing significant growth. This supply dynamic, combined with geopolitical unrest in the OPEC countries, increases the risk of a more volatile oil market over the intermediate term. Over the long term (2030+), the oil market is characterised by increased demand uncertainty driven by climate policy and technology development, while cost competition between regions is expected to further intensify. Both of these factors point toward greater price competition, and where OPEC and shale oil are expected to play a key part in covering the demand.

All long-term forecasts for natural gas show strong growth in global demand. Over the short and intermediate term, the considerable build-up in global LNG capacity is expected to continue over the next few years. So far, the growth in demand in Asia and other emerging economies has helped balance the markets. However, leading up to 2022, there is a certain risk of price pressure linked to the build-up in LNG capacity. Over the longer term, new LNG capacity from the US is expected to be price-setting for the gas market, and other players will have to adapt to this price level to be competitive.

There are several indications that the Paris Climate Agreement will help strengthen the position of gas relative to coal globally. Demand in Europe is expected to remain relatively stable over the intermediate term, while global gas demand will continue to grow, particularly in emerging economies and in regions with considerable local air pollution. This will provide investment signals for new global supply capacity, primarily from the US, Russia and the Middle East, which all have substantial gas resources that can be produced at competitive prices. The European market is characterised by tapering self-production, and Norwegian gas, among other things, will be in demand to guarantee European security of supply. Over the long term, however, the positions of both oil and gas will be challenged in a climate perspective.

These changes in the energy markets also affect the Norwegian shelf, which has undergone a demanding transition in recent years. Good results have been achieved through the efficiency efforts on both the cost and income side, which has made a substantial commercial impact and has helped the Norwegian shelf to emerge as more competitive. This has led to decisions to implement several new, profitable projects in 2017. However, the effect of the efficiency measures undertaken in recent years is starting to level off. Moving forward, the challenge is to ensure that the potential in implemented measures is realised while also initiating new measures.

It is crucial to further strengthen future competitiveness, and four factors are important: cost efficiency, confidence in the reserve base, a

functioning and sustainable supplier industry, as well as access to new projects.

Digitisation emerges as the most important instrument to increase income and reduce costs moving forward. The potential is significant and presumes active involvement by the industry to ensure broad implementation of the changes needed in operating models and work processes.

Several important SDFI projects were approved in 2017, such as Johan Castberg and the Snorre Expansion Project. Important investment decisions are planned for 2018 as well, including Johan Sverdrup phase 2 and Troll phase 3. However, there are few new projects in the operators' longer term forecasts. This demonstrates the importance of bolstering competitiveness in order to increase the growth in new projects.

Further development of the Norwegian shelf will require sustained exploration for new resources and maturing attractive investment opportunities that are competitive in a global context. Exploration activity has declined somewhat in recent years, and exploration results have been disappointing. However, the interest surrounding the most recent licensing rounds indicates that the Norwegian shelf is still attractive.

In a situation with rising prices and higher activity, it will be challenging to maintain the cost savings realised in recent years and prevent yet another increase in cost level. Continued focus on efficiency will be important in order to preserve the competitiveness of the Norwegian oil and gas activities.

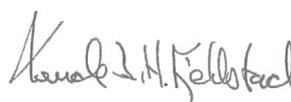
Stavanger, 7 March 2018



**Gunn Wærsted**  
Chair



**Brian Bjordal**  
Deputy chair



**Trude J. H. Fjeldstad**  
Director



**Per Arvid Schøyen**  
Director



**Hugo Sandal**  
Director



**Ove Skretting**  
Director  
elected by employees



**Heidi Iren Nes**  
Director  
elected by employees



**Grethe K. Moen**  
President and CEO