Directors' report 2008

Petoro manages the State's Direct Financial Interest (SDFI), which represents a third of Norway's total oil and gas reserves. The company's principal object is to create the highest possible financial value from this portfolio on a commercial basis. Net income for the portfolio in 2008[1] came to NOK 159.9 billion, compared with NOK 112.6 billion the year before. Total operating revenue was NOK 214.6 billion, compared with NOK 167.7 billion in 2006. Cash flow transferred to the government amounted to NOK 155.4 billion, an increase of NOK 43.1 billion from 2007. Production totalled 1 148 000 barrels of oil equivalent per day (boe/d), which was slightly lower than the 2007 figure of 1 202 000 boe/d.

Income, costs and reserves

The main reason why net income for 2008 improved by NOK 47.3 billion from the year before was a substantial increase in realised oil and gas prices. Lower oil production and higher operating costs offset this positive effect to some extent. Overall oil and gas sales for the year averaged 1 199 000 boe/d compared with 1 251 000 boe/d in 2007[2]. A large number of mature fields in the portfolio again yielded a decline in oil production for 2008. This development was countered by higher gas sales. Measured in oil equivalent, gas represented a higher proportion of total sales than oil for the first time in 2008.

Income before financial items came to NOK 157.8 billion. Net financial revenues of NOK 2.1 billion comprised net realised and unrealised currency gain related to a strengthening of the USD against the NOK.

Revenue for the year from dry gas sales totalled NOK 90 billion as against NOK 57.8 billion in 2007. The volume of equity gas sold was on a par with 2007, at 31.5 billion standard cubic metres (scm) or 541 000 boe/d. Troll accounted for 41 per cent of total gas revenue. The average gas price for the year was NOK 2.40 per scm as against NOK 1.63 in 2007.

Total revenue for the year from oil and natural gas liquids (NGL) was NOK 112.8 billion, compared with NOK 98.5 billion the year before. The sales volume was 222 million barrels or a daily average of 607 000 barrels. Production of oil and NGL fell by eight per cent from 2007. This reflected reduced output from the mature oil fields. The average oil price for the year for the SDFI portfolio was NOK 528 per barrel, compared with NOK 418 the year before. The oil price in US dollars averaged USD 98 per barrel.

Total investment in 2008 was NOK 21.3 billion as against NOK 20.5 billion the year before, with the biggest spending related to Gjøa and Vega. The increase in investment from 2007 was primarily attributable to the development of these fields

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[1] All figures are based on the accounts compiled in accordance with the Norwegian Accounting Act.
[2] Sales of entitlement oil, NGL and gas in 2008 totalled 1 147 000 boe/d compared with 1 201 000 boe/d the year before.

The cost of operating fields, pipelines and land-based facilities was NOK 15.6 billion, on a par with 2007. Expenses in the latter year included a provision of about NOK 1.3 billion for restructuring costs in the wake of the merger between Statoil and Hydro's oil and gas business. The high level of activity put pressure on capacity and led to substantially higher prices in the supplies market. Increased costs were also a consequence of greater maintenance and modification work on the older fields in the portfolio.

Exploration-related costs amounted to NOK 2 billion, of which NOK 0.5 billion was capitalised as investment related to discoveries and NOK 1.5 billion expensed as exploration costs from dry wells. Correspondingly, exploration expenses totalled NOK 1.4 billion in 2007, of which NOK 0.6 billion was expensed. A total of 26 exploration wells were completed during the year, compared with 15 in 2007. Sixteen of the 2008 wells yielded technical discoveries[3], whilst 10 were dry. Several discoveries around Oseberg and close to Grane could be booked as reserves in the relatively near future.

At 31 December, the portfolio's expected remaining oil, condensate, NGL and gas reserves comprised 7 352 million boe – a decrease of 386 million boe from the year before. Petoro reports the portfolio's expected reserves on the basis of categories 1-3 in the Norwegian Petroleum Directorate's classification system[4].

The portfolio's gross addition of expected reserves in 2008 came to 64 million boe. Improved recovery from Troll, Draugen and Gullfaks made the most important contributions to this increase.

A number of changes were made to reserve estimates, including downgrades for producing fields, which corresponded to a reduction of 28 million boe. The net reserve replacement rate for 2008 was nine per cent, compared with 23 per cent the year before. An average replacement rate of 18 per cent was achieved by the portfolio over the past three years. The corresponding percentage for 2005-07 was 28 per cent. This decline is a matter of concern, demonstrating as it does that the NCS is becoming more and more mature and that few and small discoveries are failing to replace the diminishing production portfolio.

Book assets and equity

The book value of assets totalled NOK 200.4 billion at 31 December 2008. These assets primarily comprise operating facilities related to field installations, pipelines and land-based plants, as well as current debtors.

Equity at 31 December amounted to NOK 141.8 billion. Long-term liabilities totalled NOK 38.4 billion, of which NOK 36.6 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 20.2 billion at 31 December.

Petoro served at 31 December as the licensee for the government's interests in 122 production licences and 14 joint ventures covering pipelines and terminals, including the interests in Mongstad Terminal DA, Etanor DA and Vestprosess DA. It also managed the shares in Norsea Gas AS and Norpipe Oil AS.

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[3] A discovery is a standard designation applied by the Norwegian Petroleum Directorate to categorise the result of a well. It is not necessarily capable of commercial development.
[4] These are defined as remaining recoverable petroleum resources in deposits with an approved plan for development and operation, and reserves which the licensees have resolved to develop.

Strategy for Petoro

Petoro's chosen strategies are area development, maturing reserves and early application of technology.

Area development: Its broad portfolio gives Petoro opportunities to contribute to added value by seeking unified solutions in the interaction between fields and areas, and in assessments across the value chain. Area development rests on individual fields, and opportunities increase when an integrated view is taken of several fields and a range of infrastructure. Business opportunities arise through good knowledge of each field, the area infrastructure and market conditions.

Maturing reserves: Petoro has two principal arenas for maturing reserves – mature parts of the NCS and less explored areas. Focusing attention both on improved recovery from existing fields and on exploration for additional resources is important for value creation.

Early application of new technology: Substantial value creation can be achieved from the SDFI portfolio through early application of technology. Recovering reserves is gradually becoming more demanding in technical terms. Petoro has an important role in ensuring timely implementation of new solutions. It exerts influence through early involvement at the concept selection stage for both new field developments and major conversion projects.

In its pursuit of the chosen strategies, Petoro will act as a constructive challenger by carrying out independent work where the company has expertise, capacity and position.

After an assessment of the company's strategy in the light of general developments, the board concluded that it remains appropriate. Petoro will give priority to identifying good area solutions for the SDFI, and propose them to the operators at an early stage to ensure that they receive consideration. Continued work on strategic projects for improved oil recovery (IOR) will ensure the launch of measures which support the company's ambitions for maturing reserves. Attention will be directed at the early application of new technology and at a clarification of Petoro's role in this work. In the case of major decisions, the company will become involved before a choice of concept is made and priority will be given to sub-surface work on key fields.

Petoro's contribution to added value

Petoro again created substantial added value during 2008 through its work in several arenas. On behalf of the participants in the Snorre joint venture, the company led negotiations with Statfjord over a reduction in costs for processing, storing and loading of petroleum from the Snorre field. Petoro also carried out its own work on Gullfaks during the year, which showed that extending production from a number of old, centrally placed wells would contribute substantial oil despite their high water cut. Without the company's efforts, some of these wells would have been shut down in favour of new drilling targets, with a consequent loss of reserves. Petoro initiated and headed work in cooperation with five other large oil companies on the treatment of restructuring costs following the merger between Statoil and Hydro's oil and gas business. This work led to agreement with StatoilHydro and a smaller cost than the original claim – an outcome with which the company is satisfied.

An annual assessment is conducted of the results achieved by Petoro in individual projects. Its contribution is estimated to have generated added value in the order of NOK 2-3 billion per year, or about 10 times the annual appropriation for Petoro over the central government budget.

Development of the SDFI portfolio

Management of the SDFI portfolio is organised in three business areas – Troll, Tampen/Oseberg and the Norwegian/Barents Seas. Management of participatory interests in non-field-specific pipelines and land-based plants is handled as a separate area.

The Troll business area

This embraces the producing Troll Oil, Troll Gas and Kvitebjørn developments and the pipelines tying them to the Mongstad and Kollsnes terminals, as well as the Vega and Gjøa developments and a number of production licences in the exploration phase.
Troll is the largest component in the SDFI portfolio and alone accounts for roughly 37 per cent of its estimated remaining net present value of NOK 815 billion. This field is expected to remain on stream beyond 2050.

Total production from the business area in 2008 was 412 000 boe/d, down by 17 per cent from the year before. Output from Kvitebjørn was reduced during the first half of 2008 because of damage to its gas pipeline, and the field was shut down in the second half to await repairs. As a result, gas exports also ceased from Visund for the second half.

Operating expenses for the area came to NOK 2.5 billion, with the rising trend experienced in recent years strengthening in 2008. The increase for the year primarily reflected well and maintenance costs and expenses related to reservoir management. Unit costs for the area are growing but remain relatively low because of the high level of production from Troll.

Capital spending in the Troll area increased from NOK 4.6 billion in 2007 to NOK 7.6 billion, primarily because of the Gjøa and Vega developments.

The Troll partnership has worked on a long-term plan to extend oil production from the field, and a plan for development and operation (PDO) for a set of Troll projects was submitted to the government in June 2008. These embrace gas injection on Troll B, a move to larger-diameter production tubing, a new gas pipeline from Troll A to Kollsnes and an expansion of the living quarters on the A platform. A number of measures are under consideration which could form the basis for investment decisions in coming years and which will help to increase reserves.

New wells on Troll boosted reserves in 2008, but estimates for other fields were also reduced. The net addition of reserves in the Troll area was accordingly modest.

Three exploration wells were drilled in the area during 2008, with two discoveries in the Pan and Pandora prospects on Visund.

Petoro is concerned to ensure optimum value creation from Troll by ensuring a good balance between oil and gas reserves. Doing so could allow the long-term ambition of increased oil production to be realised, while opportunities for improving gas recovery from the area can be assessed. The contribution of this area to production in the future depends on the Gjøa and Vega projects as well as on successful further development of Troll's oil reserves. Access to rig capacity and more efficient drilling are essential if this potential is to be realised.

The Tampen/Oseberg business area

Activities in this area are dominated by the challenges faced with mature fields. The largest producers Oseberg, Gullfaks, Snorre and Grane, and a number of smaller fields are in a late phase. Possible new reserves have also been identified in Hild, Valemon and production licence 169. The area still has large remaining reserves, while a substantial resource potential exists close to existing infrastructure. Work is therefore under way to identify measures for improved recovery, facilitate cost-effective operation, identify resources close to infrastructure and ensure their timely phasing-in, and adapt aging installations for an extended economic life.

Total production from the area in 2008 was 337 000 boe/d, somewhat lower than the year before. Liquids accounted for 77 per cent of this total, and showed a decline of 10 per cent. Three small developments close to Oseberg came on stream in 2008, helping to offset the oil production decline from the mature fields. Gas offtake from the area was 77 000 boe/d, with Gullfaks and Oseberg as the most important producers. The level of gas offtake is governed by the value potential of gas injection for IOR.

Operating expenses for the area have been rising over a number of years, and grew by 10 per cent from 2007 to NOK 6.2 billion. The bulk of this increase related to more extensive well maintenance as well as the price and volume of injection gas purchases for Grane. Costs for basic operation and maintenance also grew. A combination of many older installations with an increasing need for maintenance and higher prices from suppliers contributed to this development. Identification of future savings from the planned restructuring of the offshore organisation for fields operated by StatoilHydro is under way, and a possible effect is first expected to make a contribution in 2010.

Capital spending in this part of the North Sea remains high and came to NOK 5.2 billion in 2008, down by NOK 0.2 billion from the year before. The biggest investments related to drilling, development of Oseberg Delta and Rev, the modification project on Snorre, and development and modifications for low-pressure production.

The increase in reserves for the area was moderate in 2008, with the biggest contributions related to improved recovery and new discoveries.

Eleven exploration wells were completed in the Tampen/Oseberg area during 2008, with four drilled as sidetracks into exploration prospects when drilling new producers. The result was six discovery wells. Several of these will be tied back to existing infrastructure in the area.

Work to ensure and further develop good governance in the joint ventures was again given priority in 2008. Good practice has been established and provides a solid foundation for purposeful further development, good decision processes and risk management in the production licences.

Petoro also focused attention on the projects for Snorre further development, Gullfaks 2030 and upgrading of drilling facilities, as well as on such issues as rig availability, integrated operation and measures to improve oil recovery. Assessments related to low-pressure production as well as the potential for increased water and gas injection and other advanced injection methods have played a key role in identifying new IOR measures. Extensive work was also carried out with Snorre to arrive at a future solution for processing, storing and transporting oil from the field through existing or possible new pipelines. Petoro has led negotiations with relevant bidders to provide such services from competing fields. This work is expected to be completed in 2009.

The Norwegian/Barents Seas business area

This area embraces eight producing fields on the Halten Bank and one in the Barents Sea, plus 17 discoveries from earlier drilling which are now under evaluation. Exploration activity has been substantial, with attention concentrated on maturing reserves and proving new fields – particularly in the deepwater parts of the Norwegian and Barents Seas.

Production in 2007 derived primarily from the Åsgard, Ormen Lange, Heidrun, Draugen, Norne and Kristin fields. Total output from the area in 2008 came to 398 000 boe/d, compared with 348 000 the year before. This increase primarily reflects the build-up of production from Ormen Lange and improved regularity on Snøhvit.

More than half the area's output in 2008 derived from the oil producers. Gas production is rising rapidly and should account for more than 50 per cent the area total from 2009, primarily as a result of growing output from Ormen Lange and Snøhvit.
Three new wells on Ormen Lange began production in the autumn of 2008. The Snøhvit operator has faced problems with the gas liquefaction plant on Melkøya. A total of 84 turnaround days were worked during 2008, and the facility was shut down for 57 days. After the most recent shut-down in the autumn, plant capacity has shown a marked improvement. A PDO for Yttergryta was approved in May 2008, and the field came on stream in January 2009.

Operating costs for the area in 2008 rose from the year before to NOK 5.3 billion. That reflected higher costs for basic operation and maintenance as well as increased activity on Ormen Lange and Snøhvit.

At NOK 5.8 billion, total capital spending was significantly lower than in 2007. Completion of the Snøhvit and Ormen Lange developments during 2007 were the most important reason for this reduction.

Reserve addition in the area was again positive, but somewhat lower than in 2007. The increase came generally from fields in operation as well as Yttergryta. Kristin downgrades pulled down the growth in reserves to some extent.

Twelve exploration wells were completed in the area during 2008, including two drilled as sidetracks. The result was eight discovery wells. Five were in the shallow areas of the Norwegian Sea – Dompap is a small oil discovery north of Norne, while Galtvort and Noathun are small gas/condensate deposits north-west and north of Norne respectively. Two new gas finds, Ververis and Arenaria, were made on the Bjarmeland platform in the Barents Sea. Ververis is the most promising. More work is required on these discoveries, which could contain mostly gas and be demanding to develop. In addition, an appraisal well drilled on Nucula in Barents Sea South yielded less oil than expected. Work to assess the size of this discovery will continue during 2009. An exploration well was spudded on the Obelix prospect in early December, and its results will be available in the first quarter of 2009.

Petoro has increased its commitment to commercial negotiations in the Norwegian Sea as a result of the changes in the licensee structure following the Statoil-Hydro merger. The company is thereby leading negotiations on behalf of the Åsgard and Norne partners related to phasing new fields into the established infrastructure in the area.

Pipelines and land-based plants

Gassled is a joint venture comprising gas infrastructure and terminals on or in association with the NCS. The SDFI's revenues from Gassled in 2008 were NOK 9.8 billion, while capital spending and operating costs came to NOK 1.5 billion and NOK 2.1 billion respectively. The Gassled partners are very concerned with regularity and plant integrity in order to ensure stable gas deliveries to customers in continental Europe and the UK. Regularity at Gassled's export points to the markets was 99.8 per cent in 2008. In addition, the partners are paying particular attention to the level of operating costs.

A priority in 2008 was to ensure good execution of the sanctioned modification and upgrading project at the Kårstø complex. Petoro is actively involved in planning new projects to ensure good technical solutions through to concept selection. It was resolved in 2008 to incorporate the Norne gas transport system, Etanor DA and the Kvitebjørn gas pipeline in Gassled with effect from 1 January 2009.

Marketing and sale of the products

All oil and NGL from the SDFI portfolio is sold to StatoilHydro, which is responsible for marketing all the 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 StatoilHydro's sales of the SDFI's petroleum achieve the highest possible overall value, and for ensuring an equitable division of total value creation and expenses. Petoro concentrates in this work on StatoilHydro's marketing and sales strategy and risks, issues of great significance in value terms, matters of principle and questions relating to incentives.

Energy market developments in 2008 were affected by major economic fluctuations, with a substantial increase in prices during the first half followed by an even stronger decline during the second half. From a level of USD 97 per barrel at 1 January, Brent Blend spot prices rose to a peak of USD 145 in July before slumping to just under USD 40 at 31 December. This yielded an average price of roughly USD 98 per barrel. Oil price changes in Norwegian kroner were somewhat less extreme because the USD exchange rate was low when prices were high and strengthened as they fell. Reduced demand for oil as a result of high prices and an economic downturn is the main reason for the price slump. Opec conducted several rounds of production cuts during the autumn, but these were not enough to push up crude prices.

The bulk of the SDFI portfolio's gas production is sold under long-term contracts in which the price of gas is calculated on the basis of the price for oil products over a specified number of preceding months. Prices for gas sold under such contracts accordingly rose during 2008. Sales under long-term contracts accounted for about 90 per cent of the gas sold. The rest was sold in the spot market and is included in total gas sales revenues. The main goals for spot sales are to ensure delivery regularity under existing commitments, bring available supplies to market at attractive prices, and maximise value creation for the portfolio.

Low oil prices will first exert their full effect on the price of gas under long-term contracts in 2009. Gas sold to the UK is primarily priced in accordance with market quotations which reflect the balance between supply and demand. Prices in the UK grew up to July in line with the general price rise in energy markets, but showed a declining trend during the second half despite increasing prices under long-term contracts and a tighter seasonal supply balance. The average gas price for the SDFI portfolio in 2008 was NOK 2.40 per scm, compared with NOK 1.63 the year before.

StatoilHydro's marketing and sales strategy for gas gives weight to exploiting opportunities for value creation and optimisation throughout the value chain. As a participant in the overall chain, Petoro is concerned to ensure maximum value creation for the gas portfolio – including realisation of the value potential in the long-term sales contracts. A large part of the portfolio of long-term contracts was subject to price redetermination during 2008. Petoro also wants to ensure than available gas is marketed and sold in the market at the highest price, and that flexibility in the production line is exploited to optimise the delivery time. An example of price optimisation is provided by the LNG chain, where Snøhvit cargoes have been delivered to Japan as well as to Europe and the USA.

Petoro has also monitored that petroleum sales to StatoilHydro's own facilities are made at their market-based value. Checks have been made to ensure that the SDFI is being charged an equitable share of costs and receives its equitable share of revenues. The arrangement is functioning as intended, with divergences which arise being followed up through dialogue with StatoilHydro and corrected.

Health, safety and the environment

To increase the attention paid to the risk of major accidents, the company has changed its principal parameter for monitoring HSE performance on the fields from the personal injury frequency to the serious incident frequency (SIF). An improvement in the number of serious incidents was achieved in 2008 compared with the year before. Continued improvements were also registered for the number of gas leaks, while the level of other serious incidents – dominated by dropped objects – remained too high.

The number of serious incidents per million hours worked (SIF) was two in 2008, compared with 2.4 the year before.

Petoro participated in several HSE management inspections on selected fields and installations during 2008. The company seeks to influence the operators and the industry as a whole to achieve a reduction in personal injuries and serious incidents with long-term consequences on the NCS.

The Petroleum Safety Authority Norway (PSA) audited Petoro for the attention devoted by the executive management and the board to preventing major accidents. No need for further measures by the company was identified by the PSA.

No major oil spills occurred from the fields in Petoro's portfolio. Operating problems with Snøhvit led to more gas flaring and increased emissions to the air at Melkøya.

No fatal work accidents occurred within the SDFI portfolio during 2008.

Working environment and personnel

Working environment

Petoro has an expressed vision of being the best partner. Its working environment will be characterised by this vision as well as by the company's values. These are to safeguard human life and the environment, boldness and innovative thinking, a commercial orientation, integrity and collaboration. Petoro had 61 employees at 31 December, up by five from 2007. In addition, two people had signed contracts of employment with the company.

Petoro plans some increase in its workforce during 2009. The average age of employees in 2008 was 45, while average seniority was four years. Turnover for the company, calculated as the number of resignations during the year compared with employees the previous 31 December, was seven per cent.

Petoro conducts an annual workplace climate survey. Results for 2008 were good compared with other companies in Norway. The survey attracted a high response rate and covered such issues as management, expertise, development opportunities and the working environment.

An organisational development project was launched in the autumn of 2008 with the aim of releasing even more energy, enthusiasm and commitment in the organisation to support Petoro’s operations. This project will continue into 2009.

Petoro’s ability to achieve its goals depends on working actively to attract and retain the right expertise. Weight is given to facilitating good development opportunities in the company, in part through annual job reviews which yield individual competence plans. Expertise development measures for the company’s personnel in 2008 included participation in key assignments, a management development programme, and courses and conferences.

The board resolved in 2007 to introduce a variable pay scheme on a trial basis in Petoro. At the initiative of the Ministry of Petroleum and Energy, this scheme will cease from 2009. The company remains committed to offering competitive rates of pay, but will not lead the industry in this area.

Collaboration with Petoro’s working environment committee and works council lays an important basis for achieving a good climate of in-house cooperation. Work in these bodies functioned well.

Sickness absence in Petoro was 1.91 per cent, compared with 1.45 per cent in 2007. With a wellness ratio of 98 per cent, the basis exists for continued progress in creating a healthy working environment. Petoro has concluded an agreement on being an inclusive workplace (IA), and has good routines for active follow-up of sickness absence.

Equal opportunities

Petoro seeks to promote diversity and equal opportunities in its working environment through recruitment and in its human resources policy. Women accounted for 33 per cent of total employees, compared with 34 per cent in 2007. The proportion of women on the company’s board and in its executive management was 42 and 22 per cent respectively, unchanged from 2007.

Research and development (R&D)

Petoro contributes to research and development through its interests in production licences on the NCS. These funds are managed by the respective operators. The SDFI meets its share of the R&D costs in accordance with its participatory interest in the respective production licences. This is in the order of NOK 500-600 million per annum, and an estimated 30 per cent of R&D expenses in the production licences with SDFI interests.

Corporate governance

The board gives weight to good governance to ensure that the government's portfolio is managed in a way which maximises long-term value creation. Petoro's management system will contribute to this, in part through paying constant attention to the company's risk picture. An internal audit of Petoro's corporate governance and risk management was conducted in 2008, and concluded that the company satisfies all the requirements specified in the government's accounting regulations.

Petoro has guidelines on the business ethics which govern its commercial operations and the behaviour of its employees. Together with its values base and instructions on treating inside information in Petoro, these guidelines define the principles for in-house corporate governance and for the company's behaviour in the joint ventures and in other commercial relationships. Information from the company will be credible, timely and consistent.

Petoro seeks a corporate culture characterised by commitment, innovative thinking and positive attitudes to new opportunities, which also sees the value of a good internal control regime.

Work of the board

The board held 14 meetings in 2008. An annual meeting plan has been established for the board's work, with the emphasis on the consideration of strategy, budgets and interim results. A key instrument used by the board to monitor performance is measuring against established goals (balanced scorecards). The board considers major investment decisions in the portfolio as well as following up and considering the commercial business, including monitoring the marketing and sales instruction, and the overall risk picture. The board has chosen to organise work related to compensation arrangements in a sub-committee. Conflicts of interest are a fixed item on the agenda at board meetings, with the good practice that a director with such a conflict abstains over the relevant issue. The board conducts an annual evaluation of its own work.

Petoro's board is chaired by Gunnar Berge, with Hilde Myrberg (deputy chair), Mari Thjømøe, Per Arvid Schøyen and Nils-Henrik M von der Fehr as the other shareholder-elected directors, and with Kristin Johnsen and Arild Stavnem as directors elected by and from among the employees.

Risk

In assessing the company's risk, the board gives weight to the risks and opportunities which Petoro itself can influence through its own action within the frameworks available to it. Petoro is exposed to risk throughout the value chain from exploration activity to the sale of oil and gas in the market. Risk management in Petoro involves identifying, analysing and managing risk along the whole value chain, and supporting the company's strategic development and achievement of targets.

The company worked in 2008 on maturing and developing its risk management process in line with its updated principles for integrated risk management. These principles are based on the internationally recognised Coso/ERM framework for internal control and on in-house expertise.

The board assesses the risk picture and the need for compensatory measures on a continuous basis. It paid particular attention in 2008 to following up risk related to the merger between Statoil and Hydro's oil and gas business. This embraces the risk that

Petoro will be inadequately strengthened to ensure its ability to exert sufficient influence over StatoilHydro, and the risk of an increased threat of HSE incidents on the NCS. A major accident in these waters will have significant consequences for the government's portfolio. Petoro works to increase the weight given to HSE parameters and the use of risk management in decision processes within the licence arena.

As a result of the global financial crisis which began in the second half, and the uncertainty related to further development of and consequences for the NCS, the board will devote great attention in the future to the possible effects of a weakened real economy in Norway and the world on the government's portfolio. Assets in the portfolio as well as activity plans and investment programmes are exposed to the market and to changes in oil and gas prices. Historically, such economic downturns have resulted in stronger capital discipline in the industry, with consequences for the level of activity and employment.

Financial instruments used to hedge future gas sales are related to forward contracts and sale for future delivery managed by StatoilHydro pursuant to the marketing and sale instruction. Petoro continuously monitors StatoilHydro's marketing and sale of petroleum from the SDFI.
Further details of risk management and internal control are provided in a separate presentation of corporate governance in this annual report.

Prospects

Following the merger between Statoil and Hydro's oil and gas business, Petoro has been concerned to secure continued diversity and competitiveness on the NCS. This makes new demands on the other partners, and particularly on Petoro as a substantial licensee in these waters. The board has assessed and adjusted the company's strategy to reflect this position, as shown by a reshaping of resource priorities to strengthen the commitment to commercial negotiations and to increase technical work related to the most important fields. The decision to strengthen technical disciplines, particularly in terms of sub-surface expertise, was followed up in 2008. The commercial team was also reinforced so that the company can accept responsibility for leading selected commercial negotiations where incentives between the players have changed as a result of the merger. However, this strengthening has been implemented with minor increases in available financial resources, and has required a strict prioritisation of assignments. Appropriated funds for 2008 and 2009 permit further cautious growth.

Great uncertainty prevails about the development of the world economy and the consequences for future oil and gas prices. The high level of activity in recent years has contributed to a very high level of costs. A lower level of activity can be expected, with opportunities for reduced costs in the industry.

Oil production from the portfolio is likely to decline in the years to come, while gas output will increase. Viewed overall, total production is expected to remain at today's level over the next few years.

The level of investment will be determined in the future by the projects which the industry succeeds in maturing, but will be affected by price trends in the market for goods and services and by the continued development of the world economy.

A positive effect of recent market developments could be a decline in operating costs. It should also be possible to reduce these through efficiency improvements achieved by operators from the implementation of integrated operation, and through the new operations model for fields operated by StatoilHydro. Petoro will devote great attention to the possible effects on activity from developments in the world economy and the dispositions made by other companies on the NCS.

The board expects oil and gas prices in 2009 to be lower than in 2008. On the demand side, great uncertainty prevails over global economic trends and associated consumption of oil and gas. Where supply is concerned, Opec's adjustment of its production to the level of demand represents the primary source of uncertainty.

Imports of LNG to north-western Europe are expected to increase in 2009, with a substantial expansion in capacity for such purchases compared with earlier years – primarily in the UK. This will tie European gas price trends more closely to the development of global prices. Although declining gas production in European countries is boosting the need for imports, the balance between supply and demand is expected to weaken. In addition to economic developments, the formulation of environmental and climate policies plays a key role for the future competitiveness of gas. Security of gas supply is also expected to attract greater attention following the problems with Russian deliveries through Ukraine.

Petoro AS – share capital and shareholder

The company's share capital at 31 December 2008 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 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 2008 was NOK 242 million, compared with NOK 222 million the year before. This sum includes VAT, so that disposable revenue was NOK 193.6 million as against NOK 177.6 million in 2007. Recorded income, including financial income, for 2008 was NOK 202.1 million, compared with NOK 185.7 million the year before.

Operating expenses were NOK 195.8 million for the year, compared with NOK 185.5 million in 2007. 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 production licences in the SDFI portfolio accounts for a substantial proportion of the company's operating expenses. Attention was devoted by the board in 2008 to the company's overall resource position and the need for greater financial flexible within each budget period.

Net income after net financial income came to NOK 5.4 million. The board proposes that this income be transferred to other equity. The company's equity position is good, and it has little exposure to financial risk. Its non-restricted equity totalled NOK 26.4 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 give 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, 20 February 2009

Gunnar Berge Chair	Hilde Myrberg Deputy chair	Nils-Henrik M von der Fehr Director
Per Arvid Schøyen Director		Mari Thjømøe Director
Arild Stavnem Director*	Kristin Johnsen Director*	Kjell Pedersen President and CEO

*Elected by the employees