Petoro AS and the SDFI portfolio

Directors' report 2010

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 for the portfolio in 2010[1] came to NOK 105.4 billion, compared with NOK 100.7 billion the year before. Total operating revenue was NOK 159.3 billion, compared with NOK 154.2 billion in 2009. This yielded a cash flow to the government of NOK 103.6 billion as against NOK 97 billion the year before. Total production averaged 1 080 000 barrels of oil equivalent per day (boe/d), which was somewhat higher than the 2009 figure of 1 074 000 boe/d.

Income, revenues, costs and reserves

The main reason why net income for 2010 grew by five per cent from the year before was an increase in oil prices, while reduced oil production offset the positive effect to some extent. Overall oil and gas sales for the year averaged 1 159 000 boe/d, compared with 1 147 000 boe/d in 2009.[2] Further maturation of the portfolio meant that oil production in 2010 declined by 12 per cent from the year before. Gas output rose by 15 per cent from 2009.

Income before financial items came to NOK 107.2 billion. Net financial expenses of NOK 1.8 billion consisted mainly of calculated interest expenses on future removal liabilities for the SDFI.

Revenue for the year from dry gas sales totalled NOK 68 billion as against NOK 70.3 billion in 2009. Total gas sold rose by 15 per cent from 2009 to 39.5 billion standard cubic metres (scm), including sales of third-party volumes. That corresponds to 681 000 boe/d.[3] Troll alone accounted for 40 per cent of total gas revenue. The average gas price for the year was NOK 1.76 per scm, down 10 per cent from 2009.

Total revenue for the year from oil and natural gas liquids (NGL) was NOK 81 billion, compared with NOK 73.7 billion the year before. The sales volume totalled 175 million barrels, or a daily average of 479 000 barrels. The decline in production was rather larger than expected, and reflected reduced output from the mature oil fields. The average oil price for the year for the SDFI portfolio was NOK 482 per barrel, compared with NOK 380 the year before. In US dollars, the oil price averaged USD 79.38 per barrel, up 27 per cent from 2009.

Other revenues, which primarily comprise tariff earnings from Gassled, amounted in 2010 to NOK 10.3 billion and were on a par with the year before.

Total investment in 2010 was NOK 19.5 billion as against NOK 22.2 billion the year before. The biggest spending in 2010 related to Troll, with a high level of drilling activity as the most important factor. The overall decline in investment activity reflected the completion of the Gjøa/Vega development, reinforced because few new projects were initiated during the year.

The cost of operating fields, pipelines and land-based facilities was NOK 15.9 billion, up four per cent from 2009. Operating costs for fields and plants represented about 70 per cent of these expenses, and accounted for the entire increase of just over NOK 0.5 billion.

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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 2009 totalled 1 088 000 boe/d compared with 1 091 000 boe/d the year before.

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

Exploration-related costs amounted to NOK 2 billion, of which NOK 0.8 billion was capitalised as investment related to possible and confirmed discoveries, and NOK 1.2 billion was expensed as exploration costs for dry wells. Correspondingly, exploration expenses totalled NOK 2.2 billion in 2009, of which NOK 1.1 billion was expensed. A total of 12 exploration wells were completed during 2010, compared with 23 the year before. Hydrocarbons totalling about 30 million boe were proven in eight wells. That represented a substantial reduction from 2009, when more than 100 million boe in new reserves were proven.

At 31 December 2010, the portfolio's expected remaining oil, condensate, NGL and gas reserves comprised 6 539 million boe – a decrease of 246 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 204 million boe were added to the SDFI in 2010. The biggest contributions came from the decision to develop the Valemon discovery and the sanctioning of low-pressure production on Kvitebjørn. At the same time, reserves were downgraded for certain fields, which meant that the net increase in reserves was 187 million boe. That does not include a correction of 40 million boe to earlier reserve estimates which resulted from a reconciliation with official production figures from the NPD.

The net reserve replacement rate for 2010 was thereby 37 per cent, compared with a negative 45 per cent the year before, and the average replacement rate for the portfolio over the past three years came to one per cent. The corresponding rate for 2007-09 was a negative three per cent.

Book assets and equity

The book value of assets totalled NOK 207.4 billion at 31 December 2010. 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 146.5 billion. Long-term liabilities totalled NOK 47 billion, of which NOK 45.2 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 13.9 billion at 31 December.

Petoro served at 31 December as the licensee for the government's interests in 146 production licences and 14 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 revised the strategy for its business operations during 2010. In this work, the board concentrated attention on the value potential of the SDFI portfolio and areas where Petoro has the greatest ability to exercise influence.

A three-point strategy was adopted.

1. Realise the potential in and close to large mature fields.
2. Integrated and timely development of the gas value chain.
3. Seek commercial opportunities on Vøring and in Barents Sea South.

This strategy is directed particularly at playing an active role on mature fields, both because of their value in the portfolio and as a consequence of fairly limited attention being paid to them by other licensees in these fields.

Petoro's contribution to realising the potential on and close to large fields will be directed at improving recovery from and extending the production life of priority installations through the choice of technology, efficient drainage methods and the completion of more production wells per year. The company will also work to prioritise selected installations for use as field centres and to achieve a timely phasing-in of discoveries.

Developments in the global market for natural gas in the time to come and an understanding of these will be highly significant for opportunities to realise the portfolio's value potential. Activities related to supporting the value of the existing portfolio of contracts, identifying the best future sales and facilitating greater flexibility in the gas value chain will become more extensive and will represent important areas of work for Petoro in the time to come.

Barents Sea South and Vøring are the most important immature areas in the portfolio. Petoro's commitment will be to contribute to continued exploration activity and maturing of resources through setting priorities for drilling rigs while also ensuring that developments in these areas safeguard the owner's interests.

To give force to the new strategy, the company restructured its organisation with effect from February 2011. The board feels that this will provide a good basis for realising the strategy and protecting the value of the company's assets in a positive manner.

Petoro's contribution to added value

Petoro contributes to safeguarding asset value and to creating added value for the SDFI. Results of the company's work are reflected in a wide range of activities, such as analyses which influence important investment decisions on fields in which Petoro is a licensee.

An annual assessment is conducted of the results achieved by Petoro's work. The submission of a plan for development and operation for the Valemon discovery was one of the company's most important projects in 2010. Through its expertise, Petoro contributed to achieving the most optimum development of this field in financial terms.

Business areas in the SDFI portfolio

Management of the SDFI portfolio in 2010 was 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 treated as a separate area.

The Troll business area embraces the producing Troll, Kvitebjørn Visund, Gjøa, Vega, Ekofisk and Jotun fields, the Valemon development and a number of production licences in the exploration phase.

Total production from the business area in 2010 averaged 423 000 boe/d, up by 14 per cent from the year before. Output from Troll made a substantial contribution to both gas and liquids production from the area. The Gjøa and Vega fields came on stream as planned towards the end of the year, and will make an important contribution in volume terms during the years to come.

The reserve addition for the area was high in 2010, corresponding to 117 million boe. The biggest contributions related to the decisions on the Valemon development and low-pressure production on Kvitebjørn.

Expenses for operating fields and facilities in the area came to NOK 2.3 billion, which represented a small increase from 2009. This rise related primarily to operation and maintenance of Troll and to the start-up of Gjøa in November 2010.

Capital spending in the Troll area amounted to NOK 7.1 billion in 2010, a substantial reduction from the year before. That primarily reflected the completion of the Gjøa development.

Petoro is concerned to secure optimum value creation from Troll by ensuring a good balance between oil and gas reserves. This is in line with the harmonisation work which has long been underway in the partnership, where the desire is to establish a long-term plan for improved oil recovery (IOR) from the field and to facilitate maximum value creation from the gas.

In addition to the development and completion of Valemon, timely decisions concerning discoveries on Visund and development projects at the southern end of the Norwegian continental shelf (NCS) are important for long-term value creation from the business area.

Two wells were drilled in the area in 2010, which both proved non-commercial. Even though a well is non-commercial or completely dry, however, valuable knowledge of the geology in the area can be obtained.

The Tampen/Oseberg business area embraces 22 producing fields, and is dominated by four large ones: Gullfaks, Snorre, Oseberg and Grane.

Production from the area in 2010 averaged 254 000 boe/d, about nine per cent lower than the year before. Liquids accounted for 78 per cent of this total. The most important gas producers were Gullfaks and Oseberg, and the level of gas offtake was governed by the value potential of injection for IOR.

Expenses for operating fields and facilities in the area came to NOK 6.1 billion in 2010, an increase of NOK 0.8 billion from the year before. That reflected higher costs for well maintenance and the purchase of injection gas for Grane.

Capital spending came to NOK 5.6 billion in 2010 and was on a par with the year before. The biggest investments related to drilling and modifications, and were directed in part at IOR. Development costs accounted for about six per cent of the total. Drilling of new wells on Gullfaks suffered big delays because of operational problems with the mobile rig. In addition, all drilling operations on Gullfaks were halted from November 2010 after the serious incident in one of the wells on the C platform. Towards the end of the year, a number of injection wells and producers were also shut in because of injection problems. The various incidents on this field over the past year also call – as discussed below – for special attention on Petoro’s part in the time to come.

The reserve addition for the area was good in 2010, and corresponded to 61 million boe. This increase related primarily to improved recovery measures on Gullfaks.

A number of the mature fields in the area are challenged by declining production and increased costs per barrel. Substantial resources remain in the existing fields, and work is under way to develop measures which can first secure recovery of the estimated reserves and subsequently boost the recovery factor, reduce costs and ensure a longer producing life for aging installations. Timely phasing-in of new discoveries to the existing infrastructure is important. Petoro gave priority in 2010 to work on the Snorre 2040 project, with an optimum long-term solution and reservoir understanding, and further development of Gullfaks. The goal of these projects is to ensure optimum development of the remaining reserves. Two rig upgrades are being implemented on Oseberg. Work is under way on maturing several discoveries, including Hild, Vigdis North-East and Katla.

Although Tampen/Oseberg represents a mature area, substantial exploration activity is being pursued there – particularly close to existing fields. A total of seven exploration and appraisal wells were completed in 2010. These resulted in four discoveries, including two planned for development. Of the three appraisal wells drilled, two confirmed volumes in the Grevling discovery. A test well on Hild was completed in 2010 with positive results.

The Norwegian/Barents Seas business area embraces nine producing fields on the Halten Bank and one in the Barents Sea, plus 28 discoveries which include 18 under evaluation. Exploration activities are being pursued in the Norwegian Sea, both in deep water and close to existing infrastructure, and in parts of the Barents Sea.

Production in 2010 derived primarily from the Åsgard, Ormen Lange, Heidrun, Draugen, Norne, Kristin and Snøhvit fields. Output from the area averaged 403 000 boe/d, down about five per cent from 2009. The general decline in output during 2010 was partly offset by the first year of plateau production from Ormen Lange.

The reserve addition for the area during 2010 was 10 million boe.

Expenses for operating fields and facilities in the area were NOK 5.1 billion, on a par with the year before. At NOK 5.1 billion, capital spending for the area was lower than in 2009 because of postponed or delayed projects and drilling activity.

The declining trend in production from Heidrun continued in 2010. Together with Schlumberger, Petoro has launched a project to assess the drainage strategy for this field.

Despite substantial modifications to the Snøhvit gas liquefaction plant at Melkøya, new problems arose with the cooling plant in December and led to a shutdown.

Low-pressure compression for Kristin with the tie-in of Tyrihans was implemented, with Petoro as lead negotiator for Kristin.

Three exploration and appraisal wells were completed in the area during 2010, two in the Norwegian Sea and one in Barents Sea South. The Norwegian Sea wells yielded discoveries, while the one on the Lunde/Alke prospect in production licence 489 was dry. The discovery on the Fossekall prospect in production licence 128 was the most positive, and will be considered for development through a tie-in to Norne.

Petoro is one of the partners in the *Gassled* joint venture, which comprise gas infrastructure and terminals on or in association with the NCS. Day-to-day operation is handled by Gassco. The SDFI’s revenues from Gassled in 2010 were NOK 11 billion, while capital spending and operating costs came to NOK 1.5 billion and NOK 2 billion respectively. The Gassled partners are 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 98.78 per cent in 2010, compared with 99.6 per cent the year before. Gassled is paying great attention to the level of operating expenses, and Petoro has been a prime mover in achieving lower costs for ordinary operations. A new improvement programme has been defined for 2010-14 with the goal of achieving further cost cuts. This programme will embrace all parts of the transport system, with greater emphasis on risk and regularity.

Petoro is actively involved in planning new projects in order to influence the choice of technical solutions through to concept selection. A priority in 2010 was to ensure good execution of the sanctioned modification and upgrading projects at the Kårstø plant.

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 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 and expenses. Petoro concentrates in this work on Statoil’s marketing and sales strategy and risks, issues of great significance in value terms, matters of principle and questions relating to incentives.

Energy markets were affected in 2010 by greater stability in world economic development compared with the year before. The Brent Blend oil price strengthened from USD 76.5 per barrel at 1 January to USD 88 at 31 December. This resulted in an average price of roughly USD 79 per barrel. Oil price changes in Norwegian kroner were somewhat higher because the USD exchange rate strengthened during the year from NOK 5.78 per USD to NOK 6.22.

Part of gas sold to Europe is priced in accordance with market quotations which reflect the balance between supply and demand. Following declining prices in the first quarter, the balance strengthened during 2010 and prices increased to a level of NOK 2.10 per scm in the UK.

The average gas price for the SDFI portfolio in 2010 was NOK 1.76 per scm, compared with NOK 1.95 the year before. About 90 per cent of the SDFI’s gas production was sold under long-term contracts at 1 January, 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.

Oil price trends and continued plentiful supplies of gas in the market over the past year helped to maintain a significant differential between oil-indexed contract prices and spot prices for gas. This position led to pressure on the level of prices in the long-term contracts.

Petoro will work 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 see that available gas is sold in the market at the highest price, and that the flexibility in the production plants is exploited to optimise deliveries.

Petoro has also monitored that petroleum sales to Statoil's own facilities are made at their market-based value. In addition, checks have been made to ensure that the SDFI is being charged an equitable share of costs and receives its equitable share of revenues.

Health, safety and the environment (HSE)

HSE results at the facilities in the portfolio showed a clear improvement during 2010. The number of serious incidents per million working hours (SIF) was 1.4, compared with 2.7 in 2009. This is a very positive development, and the lowest registered frequency in the company's history. The figure represents a total of 46 incidents registered as serious, or an average of 1.5 incidents per installation included in the statistics. No fatalities were suffered in 2010, but incidents occurred with the potential to become major accidents. That applies particularly to an incident during the drilling of a well on Gullfaks, where barriers were breached or weakened. This event attracted great attention in Petoro, and has influenced the way the company will follow up critical well operations in the future. It also prompted Statoil to carry out a study in the autumn of 2010 which led to the temporary shutdown of 20 injection and production wells on integrity grounds. As a result, a further 30 production wells were shut down to ensure balanced pressure conditions in the reservoir.

An improvement in the personal injury frequency was also registered in 2010. Dropped objects and incidents related to mechanical handling continued to dominate the statistics.

Petoro participated in HSE management inspections on selected fields and installations during 2010. The company works with the operators and the industry as a whole to achieve a reduction in personal injuries and serious incidents with long-term consequences.

The Petroleum Safety Authority Norway (PSA) audited Petoro in 2010 to check its management of major accident risk from an enterprise management perspective. No report had been received from this audit at 31 December.

No large oil spills were registered from fields in the portfolio during 2010.

Attractive working environment and interesting assignments

The individual Petoro employee is crucial to the company's delivery and success, and the board gives emphasis to the company offering an appealing and stimulating working environment which attracts people with the right expertise and positive attitudes. Helping to ensure that each employee achieves the professional and personal development needed to attain both company goals and personal targets and job satisfaction is a management job.

Petoro's human resources policy aims to ensure diversity and equal opportunities, competence development and good work on HSE.

Over the past two years, the company has strengthened its organisation through new recruitment. Petoro had 69 employees at 31 December 2010, up by four from 2009. No significant increase in the workforce is expected during 2011.

Collaboration with the company's working environment committee (AMU) and works council (Samu) lays an important basis for achieving a good working environment. Work in these bodies functioned well in 2010.

Expertise

Opportunities for professional and personal development will help to attract, develop and retain good employees. Learning and expertise development goals with associated plans are drawn up each year at company and individual level. The company revised its expertise strategy in 2010, and this builds on the competence required by the new corporate strategy.

Sickness absence

Sickness absence in Petoro was 3.76 per cent in 2010, up by almost two per cent from the year before. This reflects higher long-term sick leave. By comparison, sickness absence on a national basis was 7.6 per cent in 2009. Petoro has an inclusive workplace (IA) agreement, and gives weight to close follow-up of and dialogue with employees on sick leave, as well as making arrangements to ensure that such absences are as short as possible.

Ethical guidelines

All employees signed the company’s ethical guidelines in 2010, which cover such considerations as the duty of confidentiality, possible conflicts of interest and issues related to the receipt of gifts and services. As an important anti-corruption measure, employees must not accept remuneration from anyone other than Petoro in connection with their work for the company. Its information systems and data are secured against unauthorised access.

Through its HSE declaration, Petoro has a common goal of creating a good physical and mental working environment for all employees. Actions or attitudes which conflict with this goal are not accepted. 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 on to the board. No cases of whistleblowing were recorded in 2010.

Equal opportunities

Women accounted for 33 per cent of the total workforce in 2010, compared with 35 per cent the year before, and for 42 and 22 per cent of the company’s directors and executive management respectively, unchanged from 2009. 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.

Diversity

Petoro took on new employees with differing cultural and ethnic backgrounds in 2010. The company offers language facilitation to new recruits and Norwegian lessons were provided to employees joining the company during the year.

Physical access to Petoro’s offices is good.

Social responsibility/natural environment

Work was pursued by Petoro during 2010 on supplying power from shore to offshore installations. The company followed up this issue in the Åsgard compression and Valemon projects. In addition came efforts under way on Snøhvit to reduce carbon emissions from today’s gas liquefaction plant and a potential new facility of this kind.

Petoro reports emissions to the air and discharges to water from the portfolio in a separate chapter of its external annual report on the natural environment, based on figures obtained from the operators. The company’s values and a more detailed description of its management system, including its guidelines on business ethics, are contained in the statement on corporate governance, which also covers Petoro’s corporate social responsibility (CSR).

Research and development

The oil companies are estimated to devote some NOK 2.7 billion per year to research and development (R&D), with the supplies industry spending 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 respective production licences, where the funds are managed by the respective operators. This contribution comes to more than NOK 500 million per annum, or an average of 30 per cent of R&D expenses in the production licences where Petoro is a licensee.

In addition to the above-mentioned R&D commitment, a great deal of technology development and qualification is done directly through projects and in day-to-day operations. The cost of this work is charged as part of the development projects – through construction or drilling of wells, for instance. Experience indicates that qualifying and adopting new technology represents a major challenge for the oil industry, including on the NCS.

Petoro has worked for a number of years to secure faster adoption of technological opportunities. Its commitment in 2010 focused particularly on the company's own specialist work and active efforts to achieve a decision on a pilot project for advanced water injection on Heidrun.

The company also contributed during 2010 to the choice of subsea compression on Åsgard, the first field to adopt such technology. This is the result of five years of purposeful technological development in the Åsgard and Ormen Lange joint ventures.

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. That includes following up wider social considerations relating to such issues as ethics and HSE as specified in White Paper no 13 (2006-2007) on active and long-term state ownership. The company'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 2010, the management system contributes to maximising value creation for the state by concentrating attention at all times on the attainment of targets by the company and on the risk picture.

Petoro seeks a corporate culture characterised by commitment and vigour within a good internal control regime. The company's values base and ethical code were revised in 2010 together with its strategy. Its values base and ethics are embedded in its guidelines on business ethics.

Work of the board

The board held 11 meetings in 2010. An annual meeting and work plan has been established for the board's work, with the emphasis on the consideration of strategy, goals, budgets and interim results. The board is continuously concerned with the 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. 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 Statoil's duties under the marketing and sales 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. Instructions issued by the board for its own work and that of the chief executive include taking care of CSR in relation to the company's duties and mandate. The board has chosen to organise preparatory work related to compensation arrangements in 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, and employed an external consultant in 2010 to facilitate this self-assessment.

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 also conducts a study trip during the year, either in Norway or in a country relevant to Petoro as a petroleum producer.

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 Line Geheb and Erik Aarrestad as directors elected by and from among the employees in 2010.

Risk management and internal control

The board conducted an assessment of the risk picture in 2010 on the basis of the new strategy. Compensatory measures were identified for the biggest risks Petoro has an opportunity to influence through the frameworks available to it. The greatest potential for maturing reserve in the SDFI portfolio lies in the large mature fields, where Statoil is the dominant operator. The most important risk for Petoro in the time to come relate to development of and production from the big mature fields, well integrity, and technical integrity related to aging installations on fields and in the infrastructure.

Operational risk is mainly managed at field level within the various business areas and within the joint ventures. The biggest risk within the marketing and sales area is a weak gas market with low and volatile prices. Statoil has identified compensatory measures for risk in relation to the marketing and sale instruction, which are followed up as part of Petoro's monitoring of the sale of SDFI production. Financial instruments used to hedge future gas sales are related to forward contracts and sales for future delivery managed by Statoil pursuant to the marketing and sale instruction.

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 developments for the mature oil fields and the gas business, and on access to new exploration acreage. Discoveries in recent years have been small, and continued operation of the big fields is crucial for the profitable development of many minor finds.

Increased reserves and new technology have extended the production life of several large mature fields. But oil output is declining faster than earlier expected. At the same time, production costs have risen considerably. So few production wells are now being drilled that it could be difficult to achieve planned recovery before fields must be shut in. A substantial commitment is needed from both companies and government to implement the necessary changes on mature fields. The board would emphasise the importance of Petoro's efforts to ensure that the operators and other partners give priority to reserves in as well as work on and investment in the mature fields on the NCS.

Statoil is the dominant player on the NCS and operates about 90 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.

Pressure on margins highlights the need to adapt to a development characterised by many small discoveries combined with mature fields where production is declining. Exploiting tested technology and standardised solutions will be important in achieving profitable development of these small finds. Given its position and substantial portfolio, Petoro will act as driver on the NCS and play an important role in the process of identifying good solutions to these challenges within the framework of the company's resources as determined by the owner.

Petoro has ambitious goals for its role as a partner and manager of the SDFI portfolio on the NCS. It aims to contribute to enhanced value creation and gives priority to work on the areas when 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 must safeguard the government's interests in competition with the priorities of other companies. It fulfils this role through a purposeful build-up of its own expertise and capacity, and by setting good priorities. In the board's view, the changes to the organisational structure will help to focus greater attention on the new strategy and give vigour to the company.

Environmental challenges on the NCS and what these will mean for the development of the portfolio are a matter of concern for the board. Great uncertainty exists over which climate policy instruments will be applied to the petroleum sector and the consequences these will have for the SDFI portfolio.

The board expects oil prices to be stable at a high level during 2011, primarily because of increased demand for crude as a result of the recovery in the global economy. Uncertainty over political developments in a number of north African and Middle Eastern countries are also helping to strengthen oil prices. Output from the SDFI's portfolio is not expected to increase in coming years, but the shift from oil to gas will continue.

Structural market changes have reduced the level of prices for gas relative to those for oil. The board nevertheless expects a gradual strengthening in the market balance for gas in Europe over the next few years. However, this development is highly uncertain. An important source of such uncertainty is the progress of the world economy. Current discussion within the European Union on energy and climate policies also contributed to increased uncertainty about the role of gas in tomorrow's energy picture.

Petoro AS – share capital and shareholder

The company's share capital at 31 December 2010 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 2010 was NOK 260 million, compared with NOK 252 million the year before. Since this sum includes VAT, disposable revenue was NOK 208 million as against NOK 201.6 million in 2009. Recorded income, including financial income, for 2010 was NOK 216.6 million, compared with NOK 208.1 million the year before.

Operating expenses were NOK 216.5 million for the year, compared with NOK 207.2 million in 2009. 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. Petoro's payroll expenses were on a par with 2009. Costs related to ICT and accounting services were reduced in 2010 compared with the year before, reflecting fewer ICT projects and enhancements in accounting efficiency. The company carried out in-depth studies of priority fields and purchased external services in this connection, and these were reflected in increased costs for technical studies and leading-edge expertise. The board devoted attention in 2010 to the company's overall resource position and priority areas, and implemented a cautious strengthening of Petoro's own resources in critical disciplines. Further use of resources directed at mature fields and critical activities will be given priority, but kept within available disposal funds.

The net loss after net financial income came to NOK 0.4 million. The board proposes that this loss be covered from other equity. The company's equity position is good, and it has little exposure to financial risk. Its non-restricted equity totalled NOK 24.1 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, 18 February 2011

Gunnar Berge — Chair
Hilde Myrberg — Deputy chair
Nils-Henrik M von der Fehr — Director

Per Arvid Schøyen — Director
Mari Thjømøe — Director

Erik Aarrestad — Director*
Line Geheb — Director*
Kjell Pedersen — President and CEO

**Elected by the employees*