



# **DIRECTORS' REPORT 2013**

**PETORO AS AND THE SDFI PORTFOLIO**

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

## INCOME, REVENUES, COSTS AND RESERVES

Net income in 2013<sup>1</sup> came to NOK 132.8 billion, compared with NOK 150 billion the year before. Total operating revenue was NOK 194.3 billion, compared with NOK 213.9 billion in 2012. This yielded a cash flow to the government of NOK 124.8 billion as against NOK 146.9 billion the year before. Total production averaged 1 034 000 barrels of oil equivalent per day (boe/d), which was about nine per cent lower than the 2012 figure.

An income after financial items of NOK 132.8 billion was down by 11 per cent from 2012. This primarily reflected a decline of NOK 16 billion in operating revenue from gas sales owing to a 13 per cent decline in such sales, with prices also down by two per cent, from the record set in 2012. Total operating costs were on a par with the year before. Overall oil and gas sales for 2013 averaged 1 094 000 boe/d, compared with 1 197 000 boe/d in 2012.<sup>2</sup> Liquids output fell by about 10 per cent annually between 2005 and 2010, but the decline has since been smaller. It was only four per cent from 2012 to 2013. The drop in production primarily reflects the maturation of large older oil fields in the portfolio, but is offset by improved recovery measures and contributions from new projects, including new fast-track developments. But the number of wells drilled remains too low compared to the existing recovery potential.

Income before financial items came to NOK 132.5 billion. Net financial income was NOK 0.4 billion.

Revenue for the year from dry gas sales totalled NOK 90.4 billion as against NOK 106.4 billion in 2012. Total gas sold came to 39.1 billion standard cubic metres (scm), including sales of third-party volumes. That corresponds to 674 000 boe/d.<sup>3</sup> The average gas price for the year was NOK 2.31 per scm, down two per cent from 2012.

Total revenue for the year from oil and natural gas liquids (NGL) was NOK 92.6 billion. The sales volume totalled 153.3 million boe, or a daily average of 420 000 boe. The average oil price obtained for the year was NOK 647 per barrel, compared with NOK 657 in 2012. Other revenues, which primarily comprise tariff earnings from Gassled, amounted to NOK 11.2 billion in 2013 and were on a par with 2012.

Investment came to NOK 34.4 billion, up by no less than 34 per cent from 2012. Capital spending on development in 2013 totalled NOK 11 billion, and embraced such new projects as Valemon, Martin Linge, fast-track developments, subsea compression on Åsgard and new compressors on Troll. Investment in production drilling amounted to NOK 16 billion, reflecting a record number of mobile drilling units on SDFI fields. Including capitalised exploration costs, total investment for 2013 was NOK 35.4 billion.

The cost of operating fields, pipelines and land-based facilities was NOK 18.3 billion, up by 11 per cent from 2012. This rise reflects higher environmental taxes and reclassification of tax costs for gas operations related to Statoil Natural Gas LLC (SNG). Expenses related to base operation and maintenance of the fields remained on a par with 2012. Exploration-related costs amounted to NOK 3.3 billion, of which NOK 1 billion was capitalised as investment related to possible and confirmed discoveries, and NOK 2.3 billion was expensed as dry wells. Correspondingly, exploration expenses totalled NOK 1.8 billion in 2012, of which NOK 1.1 billion was expensed. A total of 23 exploration wells were completed during 2013, 12 more than the year before. Eleven of these wells represented new discoveries, which contained recoverable reserves of 101-195 million barrels of oil and 57-94 million boe of gas. By comparison, 470-580 million boe were proven in 2012.

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

<sup>2</sup> Sales of entitlement oil, NGL and gas in 2013 totalled 1 041 000 boe/d compared with 1 129 000 boe/d the year before.

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

At 31 December 2013, the portfolio's expected remaining oil, condensate, NGL and gas reserves comprised 6 423 million boe – down by 200 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 288 million boe were added to the SDFI in 2013. At the same time, reserves were downgraded for certain fields, making the net increase 177 million boe. About half of this figure derived from mature fields. The biggest contributions to the increase in reserves were the decision on carbon injection in Snøhvit, the improved recovery project on Åsgard and the Delta 2 fast-track project in Oseberg. The net reserve replacement rate for 2013 was 47 per cent, compared with 67 per cent the year before, and the average replacement rate for the portfolio over the past three years came to 91 per cent. The corresponding figure for 2010-12 was 87 per cent. The reserve replacement rate will vary from year to year, and was particularly high in 2011, at 160 per cent, as a result of the decision on new compressors for Troll.

Petoro Iceland AS was established in December 2012 as a wholly owned subsidiary of Petoro AS. See further details below.

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

The book value of assets totalled NOK 234.9 billion at 31 December 2013. 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 162.9 billion. Future removal liabilities were NOK 52.6 billion. 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 17.2 billion at 31 December.

From the establishment of Petoro in 2001 and until 31 December 2013, the number of production licences in the SDFI portfolio rose from 80 to 179. At 31 December 2013, Petoro also participated in 15 joint ventures for pipelines and terminals.

#### **STRATEGY FOR PETORO**

The company's strategy was revised in 2013. Its new strategy retains mature fields as a main priority. This is because such fields represent

a large proportion of Petoro's portfolio, and because investment decisions which secure the recovery of their remaining resources, and thereby their value, are time-critical.

Field development has also been elevated as a separate principal strategic topic. The background for this is Petoro's participation in large new projects such as Johan Sverdrup as well as the insight and experience which the company has acquired from its work on mature fields and which can be applied to securing long-term and flexible solutions for new field developments.

The far north has been chosen as third main topic in the strategy. Petoro has a broad involvement in the Barents Sea through participation in a substantial number of production licences in the exploration phase and in the Snøhvit field and Johan Castberg development, where substantial value could be secured through good and forward-looking area solutions.

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

Output from a few large oil fields in a mature phase dominates liquids production in the SDFI portfolio. Remaining reserves are substantial, but realising these volumes assumes continuous drilling of production wells. However, Petoro sees that the pace of drilling and the number of new wells have declined compared with earlier years – from three per drilling rig to less than half. In addition, the remaining number of necessary wells appears to have been underestimated.

This increases the risk that the producing life of mature fields will be reduced, which will limit the number of remaining profitable drilling targets. More wells per year can be achieved through increased drilling efficiency from existing facilities, greater capacity in the form of new installations (such as wellhead platforms) or more subsea wells. Reduced uncertainty through detailed mapping of the remaining resource potential and good solutions for field development are necessary for realising reserves and resources. Work to increase the pace of drilling has and will continue to characterise Petoro's commitment to mature fields.

Record investment characterised 2013. Activity increased on the Norwegian continental shelf (NCS), mainly because of more new drilling rigs and a larger number of wells as well as major development projects. This is a result of business opportunities matured to the point

of decision, and will generate greater future revenues. But part of this investment growth also reflects high price rises and reduced productivity. The growth in costs challenges the profitability of new projects and must be tackled through cost cuts/productivity improvements.

One area where Petoro sees a need for improvement is drilling of production wells. The drilling rate – the number of new wells per year – must be increased. Several measures are available to achieve this, and Petoro has made a strong commitment in recent years to securing more mobile drilling rigs for the NCS. That has contributed to a doubling of rig-years from mobile units over the past two years. The number of production wells completed on SDFI fields in 2013 was up by 25 from the year before. Mobile units accounted for 23 of this increased number, primarily on Ekofisk, Troll and the new fast-track developments.

No rise in the drilling pace is seen from fixed installations on mature fields, despite initiatives to boost productivity. Petoro will increase its future commitment in this area. On some of the mature oil fields, the company has challenged the operator and partners to assess wellhead platforms as another measure to speed up the pace of drilling.

Together with Statoil, Petoro has also worked for licences which have a long-term need to drill many wells to consider owning mobile rigs themselves. The partners in Gullfaks and Oseberg resolved in 2013 to order such units for their fields. These decisions represent an important milestone in securing the big remaining assets in these mature fields.

Special attention was devoted during the past year to Snorre, which has the largest remaining oil reserves among producing oil fields on the NCS after Ekofisk. The concept for the Snorre 2040 project was chosen in November 2013, with the partners resolving to continue with Petoro's preferred solution of a platform which will help to realise the 100 remaining identified drilling targets. According to Petoro's calculations, this will yield 240 million barrels of extra crude – substantially more than the oil in the Goliat field soon to come on stream in the Barents Sea. A new platform for Snorre 2040 represents a demanding decision.

Other mature fields given priority by Petoro in 2013 include the big Heidrun and Oseberg oil producers. As with Snorre, the main effort has related to identifying new drilling targets in order to secure a better picture of the total

remaining need for wells and thereby create greater confidence in the reserve base. This is fundamental for the discussion of future development.

Petoro's commitment on Heidrun since 2010 has convinced the partnership to carry out detailed work to realise the reserve potential. The company has played a key role in the partnership's establishment of a project intended to produce a long-term and coherent plan for continued development of the field. Petoro's commitment has related to changes in work processes for reservoir management, identification of new well targets and measures to boost the pace of drilling. The licence is due to decide in June 2014 whether the basis exists for starting conceptual studies. Petoro will conduct its own studies to support this process.

The commitment on Johan Sverdrup in 2013 related to promoting a coherent development of the field up to a choice of concept in February 2014. This work includes independent analyses of the sub-surface. Petoro's field development commitment has concentrated particularly on solutions which maximise long-term value creation, including a single field centre, provision for water and gas injection, many well slots, an integrated drilling facility, enhanced oil recovery (EOR) and the provision of spare space for future phases. This is in line with the company's strategy of shaping field development for future opportunities and manifesting the potential for EOR.

Petoro has received a supplementary appropriation from its owner related to unitisation negotiations for the Johan Sverdrup discovery between PLs 265, 501 and 502. Work on this was pursued in 2013 and will continue in the direction of negotiations in 2014.

Two plans for development and operation (PDO) were approved in the SDFI portfolio in 2013, covering Oseberg Delta 2 and Fram H North respectively. The first of these is one of Statoil's fast-track projects, which aim to reduce the time from discovery to production and the cost of small developments close to existing fields. Three of these fast-track projects where Petoro is a licensee – Skuld/Norne, Stjerne/Oseberg and Vigdis North-East/Tordis/Vigdis – came on stream during 2013. Another five are due to begin production in coming years.

## **EXPLORATION ACTIVITY**

Petoro was involved in 23 of 59 completed wildcat and appraisal wells. A total of 20 new discoveries were made - five in the Barents Sea,

eight in the Norwegian Sea and seven in North Sea, and Petoro was a participant in 11 of these.

Much of the exploration activity was directed at understanding the resource potential of Johan Sverdrup and ensuring the best possible development solution for this field. A total of 11 exploration wells were drilled in the two main licences, PLs 265 and 501, during 2013. In addition, an exploration well was drilled in PL 502.

A very promising discovery, Wisting Central, was made in the Hoop area of the Barents Sea. This opens a number of new exploration opportunities in the central and north-western parts of this region.

Three exploration wells were drilled in the area around Johan Castberg, resulting in two small gas discoveries and one minor oil find. These will be viewed in relation to the Skrugard and Havis discoveries in connection with the choice of concept for Johan Castberg in 2014. Before this choice, two new exploration wells will be drilled in 2014.

Allocations in the awards in predefined areas (APA) and the regular 22nd licensing round in 2013 added interests in 25 new production licences to the SDFI portfolio. A large proportion of these are in the Barents Sea.

## MARKETING AND SALE OF THE PRODUCTS

All oil and NGL from the SDFI portfolio is sold to Statoil. The latter is responsible for marketing all the SDFI's natural gas together with its own gas as a single portfolio, but at the government's expense and risk. Petoro is responsible for monitoring that Statoil's sales of the SDFI's petroleum achieve the highest possible overall value, and for ensuring an equitable division of total value creation. Petoro concentrates in this work on Statoil's marketing and sales strategy, issues of great significance in value terms, matters of principle and questions relating to incentives.

Oil prices were particularly influenced by several factors during 2013 – continued weak growth in important economies, unrest in important supplier countries and the emergence of new oil sources. Weaker economic growth meant that demand for crude rose more slowly than the historical trend during 2013. However, the expansion in global oil demand staged a recovery towards the end of the year. Daily oil consumption accordingly averaged 91 million barrels per day during November/December, up by two per cent from the same period of 2012.

On the other hand, continued geopolitical tensions have reduced oil output from such countries as Libya, Iraq, Syria, Sudan/South Sudan and Nigeria. Production from oil shales and sands in the USA and Canada has contributed new volumes to the market, reduced US import requirements and thereby moderated oil prices. Overall, developments in supply and demand left oil prices at roughly the same level as in 2012.

Oil prices obtained for the SDFI moved within a band of USD 100-120 per barrel. The average figure for 2013 was USD 110 per barrel compared with USD 113 in 2012.

European demand for gas is showing a falling trend. Weak economic development and increased competition from renewable energy and coal are important reasons for the reduction. However, preliminary figures indicate that the decline in 2013 was smaller than expected, at around 0.7 per cent. The main reason was an unusually long period of cold weather during the winter of 2012-13, which led to a sharp rise in gas demand. However, demand fell again over the year compared with 2012, particularly in important countries such as Germany and the UK. The decline in European gas demand is expected to continue during 2014.

Norwegian gas exports fell by five per cent from a record 2012 level. High gas prices in Asia during 2013 again meant that liquefied natural gas (LNG) originally intended for the European market was sent instead to eastern markets. Russia functioned as the swing producer for Europe, and increased its gas deliveries there by roughly 16 per cent in 2013. Part of the gas volume sold to Europe is priced in accordance with market quotations which reflect the balance between supply and demand (spot pricing). Prices in the European gas market were somewhat lower than in 2012, but still move at a relatively high level.

The average gas price for the SDFI portfolio in 2013 was NOK 2.31 per scm, compared with NOK 2.35 the year before.

Petoro has worked to ensure maximum value creation for the gas portfolio. The company is concerned to ensure that available gas is sold in the market at the highest possible price, and that the flexibility of production plants and transport capacity is exploited to optimise deliveries.

Petoro also monitored and assured itself that

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

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

HSE results for facilities in the portfolio have been improving over a number of years. The serious incident frequency (SIF) per million working hours was 0.9 for 2013, an improvement from the year before. This is based on 39 serious incidents registered on the 18 fields included in the statistics, compared with 47 incidents in 2012. No fatalities were suffered in Petoro's portfolio during 2013. Dropped objects and incidents related to mechanical handling continued to dominate the statistics, despite big improvements in these categories over the past three years. The personal injury frequency per million working hours came to 4.4 in 2013, an improvement of almost 20 per cent.

Petoro has focused particular attention in recent years on measures to reduce the risk of major accidents. To identify risk elements in the licences, efforts were made to establish best practice for preventing such incidents through a collaboration project with ConocoPhillips, ExxonMobil and Total. Brainstorming sessions were conducted in 12 Statoil-operated licences during 2013 to identify risk elements with a major accident potential. This work will continue in 2014 with the goal of further operationalising the process. The project has received positive responses from the Petroleum Safety Authority Norway.

The company participated in several HSE management inspections on selected fields and installations during 2013.

Petoro reports on emissions to the air and discharges to water from the portfolio in a separate section on the environment in the annual report. It is concerned to ensure that the industry takes account of the environment and would point in that context to the fact that emissions/discharges on the NCS have been low in an international context for many years. No big individual discharges to the sea or on land occurred in the SDFI portfolio during 2013. The final figures will be reported in the external annual report as soon as they are available.

**ATTRACTIVE WORKING ENVIRONMENT AND EXPERTISE**

Petoro's human resources policy aims to ensure diversity and equal opportunities,

develop expertise and facilitate a good working environment.

The individual Petoro employee is crucial to the company's deliveries and success, and the board gives emphasis to ensuring that the company offers a stimulating working environment which attracts people with the right expertise and positive attitudes.

Opportunities for professional and personal development will help to retain, develop and attract able personnel.

Petoro had 64 employees at 31 December 2013, compared with 65 a year earlier. Twelve staff left or retired during 2013. Replacing them has been challenging in a tight labour market with strong competition over terms and conditions of employment.

Women accounted for 36 per cent of the total workforce in 2013, similar to the year before, and for 42 and 25 per cent of the company's directors and executive management respectively. Petoro gives weight to equality between the genders in terms of opportunities for professional and personal development as well as pay. 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. It customises working conditions so that people with disabilities can also work for Petoro.

Sickness absence came to 1.2 per cent, compared with 2.35 per cent in 2012. Long-term sick leave was particularly reduced in 2013. Petoro has an inclusive workplace (IA) agreement, and gives weight to close follow-up and dialogue as well as to making arrangements which can ensure that such absences are as short as possible.

Collaboration with the company's working environment committee (AMU) and works council (Samu) lays an important basis for achieving a good working environment in the company. Work in these bodies again functioned well in 2013.

**CORPORATE SOCIAL RESPONSIBILITY (CSR)**

Petoro's management of substantial assets on behalf of the Norwegian government calls for good corporate governance which fulfils the expectations of its stakeholders and society at large. The presentation of CSR by the company builds on the guidelines for its exercise adopted in 2012, which are tailored

to its activities as a licensee on the NCS. CSR embraces the activities voluntarily pursued by the company over and above existing legal and regulatory obligations. Funding for discharging its management duties and for running the company is provided through appropriations from the government, and Petoro has no mandate to provide monetary support for social purposes.

Measures which ensure that Petoro discharges its CSR include ethical guidelines, openness on money flows and anti-corruption work, the HSE declaration, and diversity and equal opportunities. The board provides a more detailed presentation of the exercise of CSR in a separate section of the annual report.

### RESEARCH AND DEVELOPMENT

The oil companies devote some NOK 3 billion per year to petroleum-related research and development (R&D), and the supplies industry spends about NOK 1 billion. Through its interests in production licences, Petoro contributes to R&D through the SDFI meeting its share of these costs, with the funds managed by the respective operators. This amounts to more than NOK 500 million per annum. Petoro does not have the opportunity to initiate its own technology development and research projects.

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

The company has been a driving force over a number of years for maturing EOR measures. An extensive test with silicate injection was implemented on Snorre in 2013. Although the project was completed during the year, it will take time for a possible response to be measured in the production wells.

### CORPORATE GOVERNANCE

The board gives weight to good governance to ensure that the SDFI portfolio is managed in a way which maximises long-term value

creation. Requirements for governance in the public sector are specified in the government's financial regulations and standards for good corporate governance. The board observes those sections of the Norwegian code of practice for corporate governance regarded as relevant to Petoro's business and the frameworks established by its form of organisation and ownership.

The internal audit function conducted a review in 2013 of Petoro's compliance with the Norwegian code of practice for corporate governance as well as supplementary requirements and best practice. It concluded that the company's is very compliant with these provisions, and found no significant recommendations/requirements which were not observed and no significant nonconformities with best practice. The management system is tailored to Petoro's special character, and has been further developed in line with organisational changes during the year. See the separate section in the annual report for further details.

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

### WORK OF THE BOARD

The board held 12 meetings in 2013. An annual meeting and work plan has been established for the board, with the emphasis on the consideration of strategy, goals, budgets and interim results. The board is concerned with overall value creation from the total portfolio, and with ensuring that the state receives its rightful share and does not get charged a larger proportion of costs than is warranted. Balanced scorecards are a key instrument used by the board in following up the company's results, and it measures the results achieved against established commercial and organisational goals.

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

The board has maintained the practice of allocating preparatory work related to compensation arrangements to a sub-committee. Conflicts of interest are a fixed item on the agenda at board meetings, and directors

with such a conflict withdraw from the board's consideration of the relevant issue. The board conducts an annual evaluation of its own work. That also includes the company's guidelines on business ethics and CSR, and the instructions for the board.

Chief executive Kjell Pedersen retired on 11 June 2013. Grethe K Moen was appointed to succeed him as president and CEO, and took office on 12 June. Gunn Wærsted joined the board and Mari Thjømøe stepped down as a director during 2013.

Each director and the board as a collective body seek to strengthen their expertise in various ways. These include participation in courses and conferences and generally following developments in the area. The board conducted two strategy meetings in 2013.

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

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

The board conducted an assessment of the risk picture in 2013 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 through the frameworks available to it.

Several internal audit projects are approved and implemented every year. These are summed up in a report to the board and describe the checks undertaken, the findings made and measures proposed and implemented. Petoro's internal audit function is outsourced to Deloitte, which also undertakes the internal financial audit for the SDFI.

### **PROSPECTS**

The board expects economic growth to remain strong in Asia and to strengthen again in the USA and Europe. However, growth prospects for several non-OECD countries look more uncertain. Viewed overall, nevertheless, the outlook for the world economy looks better than it was a year ago. Improved economic prospects will have a positive influence on demand for oil. Unrest in the Middle East means continued uncertainty about oil supplies from countries such as Libya, Syria and Iraq. On the other

hand, Opec has spare production capacity and a further increase in shale oil output is also expected in the USA. Viewed overall, the board expects oil prices to remain relatively high in 2014 although at a somewhat lower level than in 2013.

Global gas demand is expected to rise in the years to come. Growth in Asian demand for gas is likely to continue and will attract a substantial proportion of the world's LNG volumes. Large volumes of shale gas are being produced in the USA, which has resulted in low gas prices. Some US gas is likely to be exported as LNG, with Europe as a possible market.

Demand for gas is expected to decline in the European market, even if the economic outlook shows signs of improvement. Gas is increasingly competing with renewable energy and coal, particularly for electricity generation. Energy efficiency gains are also reducing the need for gas. Europe's own gas production is declining, and the need for gas imports will rise. Russian deliveries and LNG are the main competitors for Norwegian gas. Gas prices in 2014 are expected to remain unchanged from the year before.

Oil and gas production from the SDFI portfolio is expected to remain at a level of just over a million boe/d in the years to come, with a fairly stable division between liquids and gas. Total output in 2020 is likely to be roughly unchanged from 2013, with the difference that the portfolio will contain a substantially larger number of fields and that production from large mature fields will be lower. Maintaining this stable level of output will be a challenge, and will call for an independent technical and commercial commitment by Petoro both to safeguard expected output from fields already covered by development decisions and to mature new projects.

Petoro manages large holdings in the big mature fields on the NCS. Its strategy calls for investment both to safeguard the production of existing reserves and to improve recovery from such fields. This will be an ever more demanding job, both because the simplest and cheapest volumes were produced first and because a high level of growth in costs combined with a stable oil and gas prices puts pressure on project profitability.

The big operators have communicated a need to set stronger priorities for projects in the light of capital requirements, cost increases and declining returns. This could lead to projects being postponed and to the priority of profitable



Norwegian projects being downgraded to the benefit of developments in other countries. A danger accordingly exists that necessary and time-critical investments in mature fields fail to be implemented.

The board would emphasise the significance of the company's strategy for the mature fields in the SDFI portfolio. Important jobs for maximising the value of the fields include increasing the number of production wells, ensuring that technical integrity provides scope for extending producing lives, and generally enhancing the efficiency of work processes.

At the same time, Petoro also has substantial assignments associated with developing new discoveries such as Johan Sverdrup and Johan Castberg. The company will contribute to ensuring the best possible developments, not least with a view to future opportunities in such fields. It will also look after the government's commercial interests in the unitisation of the licences which make up Johan Sverdrup.

A large proportion of Norway's undiscovered resources are located in the far north. The discovery of Johan Castberg has created new faith in the opportunities on the northern NCS, and a high level of exploration activity is planned for the next few years. Petoro is involved in a number of important licences in the far north where exploration activity is being pursued, including the promising Hoop area.

SDFI production today is the result of a number of important historical political decisions, including the licensing policy which has been pursued and the decisions taken to sell SDFI interests in the early 2000s. The SDFI accordingly participates in only a small proportion of today's large development projects and has generally received a smaller interest in production licences during recent years than was the case before. Oil operations are very long term, and SDFI production up to 2030 will depend in the same way on the decisions taken by the government over the next few years on maximising state revenues from the petroleum industry – including licensing policy.

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

The company's share capital at 31 December 2013 was NOK 10 million, divided between 10 000 shares. All the shares are owned by the Ministry of Petroleum and Energy on behalf of the Norwegian government. Petoro's business office is in Stavanger.

#### **PETORO ICELAND AS**

Petoro Iceland's purpose is to participate in petroleum operations on that part of the Icelandic continental shelf which falls within the joint Icelandic-Norwegian collaboration area. The company was established in December 2012 as a wholly owned subsidiary of Petoro AS. Its share capital at 31 December 2013 comprised NOK 2 million, divided between 2 000 shares. Petoro Iceland participated during 2013 with 25 per cent interests in two licences, and secured a participatory interest in a third licence on 22 January 2014. The company has no employees and has entered into a management agreement with Petoro, which will handle day-to-day operation of Petoro Iceland's activities and take care of all administrative functions. An agreement on technical support has also been entered into with the Norwegian Petroleum Directorate.

The budget covers management costs for Petoro AS, which is responsible for daily operation and handles all administrative functions, as well as Petoro's share of licence costs in the two first production licences.

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

Petoro AS administers the SDFI portfolio in accordance with 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.

The consolidated accounts embrace the parent company and Petoro Iceland AS. A management agreement has been entered into between the two companies. Amounts related to internal transactions are eliminated in the consolidated accounts. No consolidated accounts were prepared for 2012.

Funds for operating Petoro AS and Petoro Iceland AS are provided by the government, which is directly liable for the commitments

accepted by the companies. The government contribution for ordinary operation of Petoro AS in 2013 was NOK 290.7 million, compared with NOK 281.2 million the year before. Since this sum includes VAT, disposable revenue exclusive of VAT was NOK 232.6 million as against NOK 225 million in 2012. Petoro received an additional appropriation of NOK 28.1 million exclusive of VAT in 2013 to meet costs related to unitisation work for the Johan Sverdrup field. Consolidated recorded operating income for 2013 was NOK 267.7 million and the net financial results was NOK 3.5 million.

Operating expenses for the parent company in 2013 were NOK 270.4 million, compared with NOK 256.7 million the year before. Consolidated operating expenses totalled NOK 271.7 million in 2013. These expenses related primarily to payroll and administration expenses and to the purchase of external services. The purchase of leading-edge expertise relating to supervision of joint ventures in the SDFI portfolio accounts for a substantial proportion of the company's operating expenses. The company gave priority to devoting substantial resources and study funds to mature fields and the work on Johan Sverdrup. This boosted costs for studies and leading-edge expertise by NOK 13.6 million from 2012.

The board again devoted attention in 2013 to the company's overall resource position, and has followed up the organisational and

management changes made in order to equip Petoro even better to tackle the challenges and opportunities faced in managing the SDFI portfolio. The business manager arrangement was not renewed when contracts expired in the autumn of 2013, and Petoro included follow-up of fields during 2013 which were previously handled by business managers. Priority will be given by Petoro to directing resources at the three main topics specified in its strategy. The company's commitment to the strategically important priority areas of mature fields and Johan Sverdrup will depend on available disposable funds.

The net loss after net financial income came to NOK 0.5 million for the group and NOK 0.6 million for Petoro AS. The board proposes that this loss be covered from other equity. Remaining other equity at 31 December was NOK 14.8 million for the group and NOK 12.8 million for Petoro AS. The company's equity position is satisfactory, with low financial risk.

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 on the assumption that the company is a going concern.

Stavanger, 21 February 2014



**Gunnar Berge**  
Chair



**Hilde Myrberg**  
Deputy chair



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



**Per Arvid Schøyen**  
Director




**Gunn Wærsted**  
Director



**Ragnar Sandvik**  
Director\*



**Anniken Teigen Gravem**  
Director\*



**Grethe K. Moen**  
President and CEO

\* Elected by the employees