Directors' report

Petoro manages the State's Direct Financial Interest (SDFI), which represents about one-third of Norway's overall oil and gas reserves. The company's objective is to create the greatest possible value and achieve the highest possible revenue for the State from SDFI.

The SDFI scheme was established in 1985. Under this arrangement, the state participates as a direct investor in petroleum activities on the Norwegian continental shelf (NCS), so that the state receives revenues and incurs expenses associated with SDFI's ownership interests. Petoro acts as licensee for the state's ownership interests in production licences, fields, pipelines and terminals. As SDFI manager, Petoro contributed a cash flow of NOK 96 billion in 2019, which represents an estimated 36 per cent of the state's total revenues from petroleum activities.

External trends

This year is the 50th anniversary of the Ekofisk discovery and Norway becoming an oil nation. Since then, oil and gas activities have generated substantial values that have benefited society as a whole.

The Norwegian oil and gas industry operates in a global arena with strong competition for capital and competence. Several years of transition and efficiency measures have contributed to lower costs, which helped bolster the competitiveness of the NCS. New developments and multiple field upgrades in 2019 have resulted in a high activity level and considerable ripple effects and provide a basis for substantial revenues moving forward.

There is still a need for efficiency measures on the Norwegian Shelf through transition and improvement measures. With today's high level of activity, there is a risk of costs rising and again challenging the competitiveness of the shelf.

Further efficiency measures will require new initiatives and new ways of working. Recent years have seen a strong and rapid development in digital technologies, and on a global basis, digitalisation is among the most important strategic instruments for most oil and supplier companies to streamline work processes and further reduce costs. The main challenge in realising the potential of digitalisation is not primarily technology, but rather achieving the required changes in the way we work. Management, culture and work processes are therefore the most important factors. Operators and suppliers are working actively on digitalisation in areas of significant commercial importance within both reservoir, drilling and operations.

The Government recently presented the white paper "The state's direct ownership of companies — sustainable value creation". This white paper reinforces the state's expectation that the companies with direct state ownership have an overall plan for sustainable value creation. This means that the companies must prove that they can balance finances, corporate social responsibility and the environment in a way that contributes to long-term value creation.

A unified Norwegian oil and gas industry has launched a new climate roadmap and new climate targets. Through this, the industry is clearly signalling that it is taking the climate challenge and the Paris Agreement seriously. The oil and gas industry will reduce its greenhouse gas emissions by 40 percent in 2030 compared with 2005, and further reduce emissions to near-zero in 2050. This will require large investments, technology development and industrial expertise. At the same time, it will presume considerable efforts from all industry players. Petoro wants to be a driving force to ensure that the Norwegian shelf leads the world in tackling the climate challenges and is already working closely with operators and partners in the licenses to investigate which opportunities should be pursued.

Several oil and gas companies are reorienting their strategy in a more sustainable direction and have committed to contributing toward the transition to a low-carbon society. On the Norwegian shelf, electrification, renewable energy and carbon capture and storage (CCS) are emerging as important areas, and considerable activity is already under way here.

Electrification of the platforms, from land or from offshore wind, is a measure that could contribute to considerable reductions in CO_2 emissions from production. While new field developments were previously the most relevant candidates for electrification, work is currently also under way on concrete plans to electrify a number of fields already in operation with power from shore. The decision was made to develop Hywind Tampen in 2019. This wind farm will reduce the need for power from gas turbines and provide renewable power to the Snorre and Gullfaks fields. Hywind Tampen is pioneering work and an example of how expertise in the oil and gas industry can be utilised within new industrial areas.

CCS is also a measure that could play an important role in reaching climate goals. Through the "Northern Lights" project, Equinor, Shell and Total are cooperating on the transport and storage part of CO_2 from the state's demonstration project "Full-scale CCS chain in Norway". On behalf of the partners in the "Northern

Lights" project, Equinor recently signed a letter of intent with seven European companies to develop value chains within this area. Petoro believes it is important to seek to realise CCS as a measure to reduce the industry's carbon footprint and ensure long-term sustainable resource management on the Norwegian Shelf. This could also open up the opportunity to produce hydrogen from Norwegian natural gas.

Historically, gas as a replacement for coal has considerably reduced the carbon footprint and will continue to do so. Cost-effective fields and reliable infrastructure make Norwegian gas highly competitive. Stronger exploration for gas could help maintain high gas deliveries from the Norwegian Shelf over the long term as well, and thus replace declining self-production in the EU.

Greenhouse gas emissions from the Norwegian shelf are low in an international context. This could provide a competitive advantage if the markets in the future take into account emissions from production and transport in the purchase of fossil fuels. This is particularly important for SDFI, as the gas makes up a significant share of overall production, and the gas is sold primarily in Europe, which has very high ambitions to reduce emissions of greenhouse gases. Improving the Norwegian Shelf's competitiveness therefore requires both additional efficiency measures and further reductions in emissions of greenhouse gases.

The giant Johan Sverdrup field has started production and this development is leading the way in both the use of digitalisation, record-low emissions with the aid of electrification and good project execution. Greenhouse gas emissions from the field are record-low, both on a Norwegian and international scale, and future-oriented choices have been made as regards digital solutions that can also be implemented elsewhere in the portfolio. The area solution for power from shore to the Sverdrup field and the surrounding area means that as many as ten fields on the Utsira High in the North Sea will now receive power from shore.

The major international oil companies' sell-down on the Norwegian Shelf continued last year. This, along with a considerable extent of player consolidation, has led to strengthened positions for several medium-sized companies. While the emergence of these medium-sized companies contributes positively to further development of the Norwegian Shelf, this development leads to reduced access to valuable international experience and expertise in the joint ventures. In this scenario, Petoro, with its broad portfolio and long-term perspective, will play an important role in continuing to contribute toward active joint ventures on the Norwegian Shelf.

There are still large opportunities for values and employment associated with oil and gas activities on the Norwegian Shelf. Projections from the Norwegian Petroleum Directorate show that barely one-half of recoverable resources have been produced and sold so far. About 25 per cent has been proven and could potentially be recovered. Of these resources, 85 per cent are in existing fields and 15 per cent in discoveries yet to be developed. The last 25 per cent are projections for what could be discovered through future exploration activity. This shows that the Norwegian Shelf still has considerable potential.

There is still significant interest in exploration acreage on the Norwegian Shelf and 83 production licences were awarded in 2019 in Awards in Pre-defined Areas (APA 2018), which is historically high. Exploration activity in 2019 was also high with a total of 57 spudded exploration wells, which is on par with 2018. Oil and gas are still being discovered on the Norwegian Shelf, but results from the Barents Sea have so far been disappointing.

Summary of SDFI results

Net cash flow to the state from SDFI was NOK 96 billion in 2019, NOK 23 billion lower than in 2018. The decline is mainly caused by lower sales and prices, as well as increased investments.

Total production amounted to 964 thousand barrels of oil equivalent (boe) per day, just over 11 per cent lower than in 2018.

Gas production totalled 98 million standard cubic metres (mill. scm) per day in 2019, down 14 per cent from a record-high level of 113 million scm per day last year. The decline in production alongside low gas prices resulted in revenues from equity produced gas of NOK 68 billion, about NOK 21 billion lower than the previous year. The reduction in gas volume was generally associated with use of flexible gas extraction for price optimisation on Troll, as well as production decline due to operational challenges associated with compression on Ormen Lange.

Production of liquids amounted to 349 thousand boe per day, 6 per cent lower than in 2018. This decline was mainly caused by natural production decline, as well as lower production as a result of problems with risers on Snorre. The decline in liquids production was partially offset by the start-up of Johan Sverdrup in October 2019.

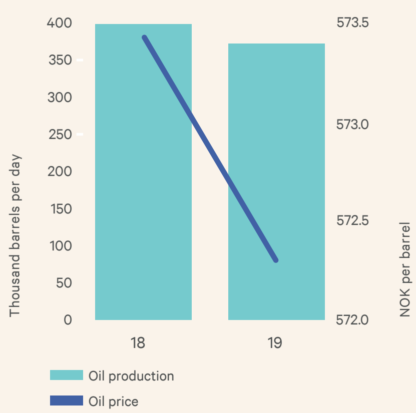
Costs incurred for investment totalled NOK 27 billion, about NOK 4 billion higher than the year before. The increase in investment was primarily caused by increased activity within field development associated with Johan Castberg, Troll Phase 3, Snøhvit and Martin Linge, as well as increased costs for production drilling on multiple fields.

The financial result for 2019 was a net income of NOK 96 billion, NOK 19 billion lower than the previous year. The decline in net income was mainly caused by reduced revenues, in part offset by lower depreciation due to lower sales volume, as well as a reduction in production expenses. The book value of Martin Linge was written down by NOK 1.4 billion in 2019 as a result of cost overruns and postponed start-up.

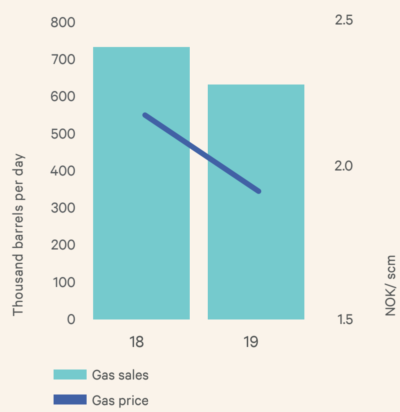
Production costs were NOK 4 billion lower than the previous year. Adjusted for provision associated with a judgement in the trial concerning Troll in 2018 and subsequent settlement in 2019, production costs were on par with the previous year.

The book value of assets at 31 December 2019 was NOK 251 billion. The assets mainly consist of fixed assets related to field installations, pipelines and onshore plants, as well as current debtors. Equity at year-end was NOK 162 billion. Overall debt amounted to NOK 89 billion, of which 70 billion was related to estimated future removal obligations.

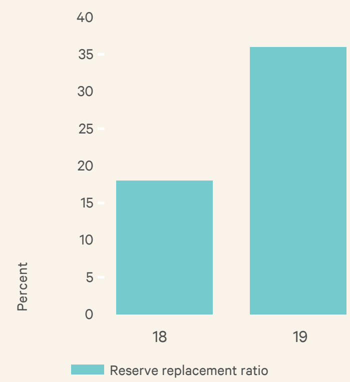
Oil production / - price



Gas sale / -price



Reserve replacement ratio



Health, safety and the environment (HSE)

The objective that the Norwegian petroleum activities shall be world-leading in health, safety and the environment remains firm. This means that the industry must continue working to continuously improve the safety level. In 2019, Petoro has been concerned with putting safety first and has clearly communicated the company's expectations as regards HSE management and HSE culture. At the same time, Petoro has been engaged on learning across the portfolio and quality in risk assessments in a major accident perspective. Petoro also conducted a number of management visits in 2019, focusing on health, safety and the environment on selected fields and onshore plants.

HSE results for 2019 show no incidents with major accident potential. The serious incident frequency, defined as the number of actual and potential serious near-miss incidents per million hours worked, is still too high. The frequency in 2019 was 0.9, compared with 0.7 in 2018. Most incidents were associated with falling objects and the industry increased its efforts in 2019 to prevent such incidents. The personal injury frequency, i.e. the number of personal injuries per million hours worked, increased from 3.8 in 2018 to 3.9 in 2019. No serious discharges to sea were recorded in 2019.

Principal activities in 2019

As of the end of 2019, the portfolio consisted of 200 interests in production licences, 2 more than at the beginning of the year. In January 2020, the Ministry of Petroleum and Energy completed its Awards in Pre-defined Areas (APA 2019), where an additional 14 production licenses were awarded with SDFI participation.

At the end of the year, the portfolio consisted of 35 fields in production. The portfolio contains a total of 39 fields. Decisions have been made to develop four fields, Martin Linge, Johan Castberg, Tor II and Dvalin, but they have yet to come on stream.

In 2019, Plans for Development and Operation (PDOs) were submitted for the Gjøa P1 project which will extract additional resources from the Gjøa field, Tor II which is a further development of the previously shut down Tor field, as well as for the Hywind Tampen offshore wind farm which will supply the Snorre and Gullfaks fields with electricity.

The authorities approved the Plan for Development and Operation (PDO) for Johan Sverdrup Phase 2 in 2019, which also included the Plan for Installation and Operation of the area solution for power from shore for the Johan Sverdrup, Edvard Grieg, Ivar Aasen and Gina Krog fields. The authorities also approved the second phase of extraction of the Shetland/Lista formation on Gullfaks and the above-mentioned P1 project on Gjøa.

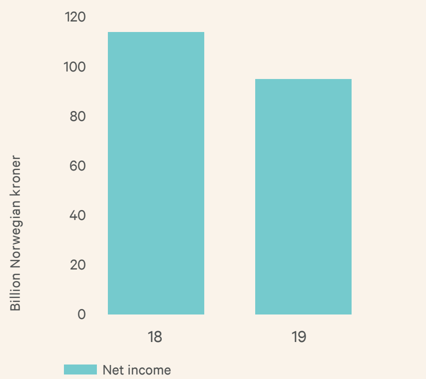
Production from mature oil fields continues to dominate liquids production from the SDFI portfolio. The Troll, Oseberg, Åsgard, Heidrun, Gullfaks and Grane fields accounted for 64 per cent of total liquids production in 2019. In 2019, gas accounted for 64 per cent of overall production measured in oil equivalent. Approximately 70 per cent of the gas production came from Troll, Ormen Lange and Åsgard.

Production from Johan Sverdrup Phase 1 started on 5 October – more than two months ahead of the original schedule. The project was delivered at a cost considerably lower than budgeted. Along with Phase 2, which starts up in 2022, the field will provide a considerable contribution to production on the Norwegian Shelf for decades to come. At plateau, Johan Sverdrup Phase 1 and 2 will produce up to 660,000 bbls per day. As a result of the decision to use power from shore, CO_2 emissions are at a record-low level with only 0.7 kg per bbl. Petoro is a licensee with a 17.36 per cent interest in the field.

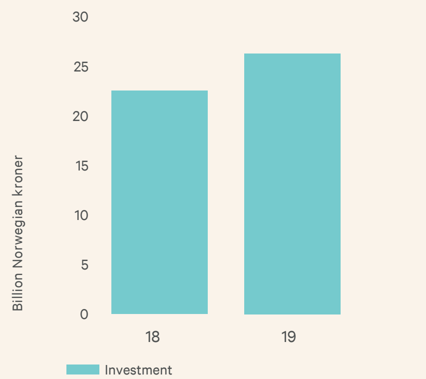
Petoro's strategy has three main areas: competitiveness, mature fields and wells. The areas are supported by four priorities: Optimise recovery strategy, field and further development, maturing wells and efficient drilling and efficient operations. The company works to seize the opportunities created by digitalisation within each priority. Climate and safety requirements make an important framework for the strategy.

Through focused follow-up, supported by in-depth professional commitment, Petoro works to reinforce value creation opportunities with emphasis on long-term business development. The

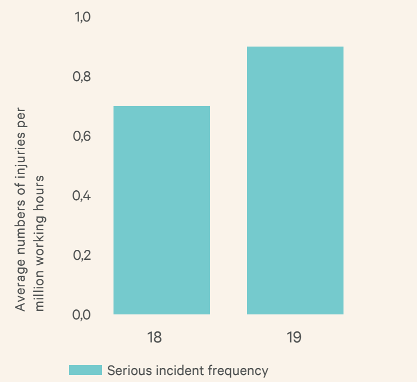
Net income



Investment



Serious incident frequency



company's climate policy emphasises that Petoro shall act as a driving force to ensure that the oil and gas industry on the Norwegian shelf is at the forefront as regards addressing the climate challenges.

In line with this strategy, Petoro in 2019 focused special efforts toward the Heidrun, Maria, Åsgard, Oseberg and Grane fields. Well maturation and digitalisation have also been addressed as special topics for the entire field portfolio. Within digitalisation, the company has employed strategic collaboration with one supplier, aimed special efforts toward improving quality and streamlining work processes in reservoir modelling.

On Heidrun, where Petoro has an interest of 57.7 per cent, the company carried out its own simulation studies of the field's northern part in 2019. Through this work, Petoro identified a potential for drilling several new wells and associated development of new infrastructure. Petoro has also studied various gas management solutions for Heidrun, which revealed a potential for increased oil reserves through gas injection in deeper reservoir layers.

On Åsgard, where Petoro has an interest of 35.69 per cent, the company used its own studies in 2019 to identify and specify projects that could contribute to increase the recovery rate to the field's target recovery rate of 60 per cent.

On Oseberg, where Petoro has an interest of 33.6 per cent, the company conducted a study to map the effect of increased gas export from the field's main structure. Petoro has identified seven new profitable drilling targets and the study supports the licence's strategy with a stepwise escalation of gas export leading up to 2022. In connection with increased gas exports, it will be necessary to upgrade gas capacity at the Oseberg Field Centre. Petoro has been a driving force to maximise the value of the project by early phase-in of pre-compression. The concept choice was made in December, and the plan is to start pre-compression in 2024.

On Grane, where Petoro has an interest of 28,91 per cent, the company prepared a technical basis for developing the Breidablikk deposit through a joint simulation model for the Grane and Breidablikk reservoirs. The purpose of the Breidablikk project is to develop resources north of the Grane unit by utilising the capacity in existing infrastructure, which will also contribute to extend the field's production lifetime.

A concept choice was made in 2019 to improve the recovery of gas on the important gas fields Ormen Lange and Snøhvit. The solution involving lowering wellhead pressure while simultaneously installing increased gas compression capacity will yield increased reserves at a low break-even price.

On Maria, where Petoro has an interest of 30 per cent, the company has taken an active role in identifying measures to increase production in light of disappointing production after start-up. One key instrument will be a new injection well, where results from Petoro's own reservoir studies are used as a basis for well placement. Petoro has worked to define a long-term solution to develop the field which will contribute to increase reserves.

As regards new fields in the portfolio, Petoro's efforts are associated with assessing various development solutions leading up to a concept choice. Petoro emphasises the selection of development solutions with the capacity and expansion opportunities to realise the field's full value potential.

In 2019, Petoro has followed up a substantial portfolio of major development projects: Johan Sverdrup Phase 1 and 2, Johan Castberg, Snorre Expansion Project, Martin Linge, Dvalin and Troll Phase 3. The follow-up has been focused on factors that affect HSE, climate and implementation risk as well as ensuring sound preparations for operations. While project implementation generally has been good, the Martin Linge project has been characterised by multiple significant delays, but operations are expected to start in 2020. Petoro maintained substantial focus on the project last year as well, with primary focus on achieving a safe and good field start-up.

New wells account for about 50 per cent of the potential to add new production to the SDFI portfolio. There is a need for goal-oriented efforts to mature new well targets and thereby increase the likelihood of realising the reserve potential and secure utilisation of contracted rig capacity. In an effort to increase the range of wells in the portfolio and supplement the operators' work, Petoro matured new proposed drilling targets in 2019 on selected fields such as Oseberg, Åsgard, and Heidrun.

Petoro has followed up drilling efficiency on 10 of the fixed drilling facilities on the mature fields in the portfolio since 2002. After remaining stable since 2015, the average drilling cost per well increased from 2018 to 2019. In order to realise reserves in the mature fields and increase the recovery rate, the cost must be reduced through further efficiency measures.

Digitalisation as an instrument to improve and increase competitiveness is high on the strategic agenda of most oil and gas companies and suppliers. Efforts are characterised by a strong desire to develop new solutions and new good examples of commercial value are continuously emerging. The challenge moving forward is to reinforce the operative units' drive to improve and thereby stimulate testing of new solutions, as well as changing work processes. There is also a need for greater transparency between players to enable sharing of data. Within drilling, the company has identified concrete improvement opportunities in selected licenses and has proposed them in the joint ventures. Petoro also actively participates in selected industry forums with particular emphasis on sharing data.

In 2019, Petoro has seen significant activity associated with maturing electrification measures that could contribute to considerable reductions in greenhouse gas emissions from the SDFI portfolio. Several of the fields in the portfolio, such as Troll A/Kollsnes, Gjøa and Ormen Lange/Nyhamna, have already been electrified with power from shore. New adopted developments such as Johan Sverdrup and Martin Linge will also be fully electrified at start-up. When Johan Sverdrup Phase 2 and Martin Linge are on stream, 50 per cent of SDFI's oil and gas production will be electrified. In the planning of Johan Castberg, Petoro has emphasised the facilitation of possible future partial electrification.

Ongoing project development on several of the company's mature fields could also provide further reductions in the carbon footprint from the SDFI portfolio in the future. In 2019, the licensees in the Snorre and Gullfaks licenses decided to develop the Hywind Tampen offshore wind farm. This wind farm will provide renewable power to fields and contribute to reducing emissions of CO_2 from the Norwegian shelf by 200,000 tonnes annually. Petoro is a licensee with a 30 per cent interest in both licences.

Electrification of mature fields is a time-critical measure as the projects' income potential is reduced when the remaining operating period is curtailed. Petoro therefore actively works with operators and partnerships to maintain progress on these projects. If ongoing planned electrification projects can be realised, they could, alongside Hywind Tampen, overall contribute to ensure that 60 per cent of SDFI production is electrified leading up to 2030 and provide average CO_2 emissions per bbl of oil equivalent of about 6-7 kg from the SDFI portfolio.

In 2019, Petoro was a participant in 19 exploration wells, 18 of which were wildcat wells which resulted in six minor discoveries; one gas discovery and five oil discoveries. Only two of the discoveries, Ragnfrid Nord and Telesto, are presumed to be commercial, as they can be tied into existing infrastructure. The exploration wells with medium to considerable volume potential were all dry or proved only minor volumes.

The portfolio's estimated remaining reserves totalled 5,335 million boe at the end of the year, down by 210 million boe from the year before. Reserve growth totalled 142 million boe and was mainly caused by increased gas reserves on Gullfaks, as well as a lifetime extension for Draugen. With a production of 352 million boe, this yielded a reserve replacement rate of 40 per cent in 2019.

Research and development

Petoro contributes to research and development (R&D) through SDFI covering its share of the operator's costs for general research and development pursuant to the Accounting Agreement. The funds are managed by the respective operators. This amounted to NOK 512 million for SDFI in 2019. Projects aimed at field-specific qualification of new solutions or pilot application of technology in licences, where the costs are charged to the joint ventures, come in addition. Petoro does not initiate its own technology development and research projects.

Marketing and sale of the products

All oil and natural gas liquids (NGL) from the SDFI portfolio are sold to Equinor. Equinor is responsible for marketing all the SDFI's natural gas along with its own gas as a single portfolio, at the state's expense and risk. Petoro's task is to monitor that Equinor's marketing and sale of the state's petroleum together with its own production complies with the marketing and sale instruction issued to Equinor. The objective of the marketing and sale instruction is to achieve the highest possible value for Equinor's and the state's petroleum and ensure rightful distribution of the total value creation. Petoro specifically follows up issues of significant importance, issues of a principle nature and potential conflicts of interest.

In 2019, Petoro prioritised issues within the marketing and sale of oil. In this context, Petoro has maintained particular focus on Equinor's management and follow-up system as regards maximum value creation and equitable distribution.

Petoro is concerned with ensuring that the products are marketed and sold in the markets where the highest price can be achieved, in addition to ensuring that the portfolio's flexibility is used to achieve the highest possible value creation. In this context, optimal further development, regularity, utilisation of capacity and flexibility in production facilities and infrastructure are of significant importance in order to achieve maximum value creation.

Selected verifications have been conducted to ensure that the SDFI receives its rightful share of sales-related costs and revenues. Petoro has maintained a dialogue throughout the year with the Ministry of Petroleum and Energy as regards clarifications related to the marketing and sale instruction.

Working environment and expertise

Petoro's personnel have extensive

experience from the petroleum industry and a high level of expertise. The individual employee is crucial to the company's deliveries and success, and the board places emphasis on ensuring that Petoro offers competitive terms and a stimulating working environment that attracts people with the right expertise. Opportunities for professional and personal development help to retain, develop and attract skilled personnel.

The company's human resources policy shall ensure that Petoro is an attractive workplace for existing and future employees. This includes diversity and equality, competence development and facilitating a good working environment that prevents discrimination due to age and gender, as well as cultural and geographic background. Petoro emphasises equal opportunities for professional and personal development as well as pay. The company facilitates flexible working hours and adaptation of working conditions to ensure that employees with disabilities can also work for Petoro. "Statement on corporate social responsibility" provides a more detailed account of diversity, inclusion and equality. There are no systematic or significant differences between gender and age groups, either as regards wages, wage development, performance evaluations or development opportunities.

At the end of 2019, Petoro had 65 employees, one more than the year before. Three new employees were hired in 2019. The percentage of women in the company was 32 at the end of 2019, 25 per cent in company management and 43 per cent in the company's board.

Absence due to illness was 1.5 per cent, compared with 2.6 per cent the previous year. The company considers this to be low. Petoro emphasises close follow-up and dialogue as described in the 2019-2022 IA agreement to promote health and prevent absence due to illness. No occupational accidents were recorded among Petoro's personnel in 2019. As part of the effort to safeguard a good working environment, the company regularly conducts work environment surveys followed up with measures.

In 2019, the company conducted extensive work associated with organisational development to further develop Petoro as a driving force on the Norwegian shelf. A new organisation structure and executive team has been established and implemented as of 1 January 2020. Implementation of the new organisation will be supported by activities associated with organisational development.

Collaboration in the company's working environment committee (AMU) and works council (SAMU) lays an important foundation for a good working environment. Cooperation in these bodies is considered to be good.

Corporate governance

The board emphasises good governance to ensure that the state's portfolio is managed in a way which maximises financial value creation in a long-term perspective. Requirements for governance in the public sector are specified in "Regulations on Financial Management in Central Government" and in standards for good corporate governance. The Board observes the Norwegian state's principles for sound corporate governance as expressed in Storting Report 8 2019-2020 "The state's direct ownership in companies - sustainable value creation" and those sections of the "Norwegian Code of Practice for Corporate Governance" regarded as relevant to Petoro's activities and the frameworks established by its form of organisation and ownership.

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

The management system is tailored to Petoro's distinctive nature, and enterprise management is based on balanced scorecards, where goals are established to support the company's strategy. Reference is also made to the dedicated chapter on corporate governance in the annual report.

Corporate social responsibility

Petoro safeguards its corporate social responsibility in line with the relevant guidelines, which are tailored to the company's role. Petoro's funding for performing its management duties and for running the company is provided through appropriations from the government. Petoro is not permitted to provide monetary support for socialpurposes.

Measures which ensure that Petoro discharges its CSR include business ethics guidelines, the HSE declaration, climate policy and an HR policy that ensures diversity and equal opportunity. Petoro has no activity outside Norway but participates indirectly in certain foreign activities as licensee and through the marketing and sale instruction. The board provides a more detailed presentation of the exercise of CSR in a separate section of the annual report.

Risk management and internal control

The board conducted an assessment of the risk scenario in 2019 on the basis of the approved strategy and set targets for the coming year. Measures were identified for reducing the most significant risks which Petoro has an opportunity to influence within the company's established frameworks.

Three internal audit projects were carried out in 2019. The results were summarised in a report to the board describing the audit actions undertaken, findings, as well as proposed and implemented measures for the internal audit projects.

The internal audit projects in 2019 were conducted by PwC, which has also been responsible for the internal financial audit of the SDFI for the 2019 accounting year.

Work of the board

The board has overall responsibility for the management of Petoro, including ensuring that appropriate management and control systems are in place, and for exercising supervision of the day-to-day conduct of the company's business. The board met 8 times in 2019. An annual schedule of meetings has been established for the work of the board, with the emphasis on considering topical commercial issues and following up strategies, budgets and interim results. Balanced scorecard is a key instrument used by the board in following up the company's results.

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

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

Conflicts of interest are a regular item on the agenda for the board's meetings and potential conflicts of interest entail that the board member withdraws from the board's consideration of the relevant issue.

An annual self-assessment is conducted by the board, which encompasses an evaluation of its own work and mode of working, as well as its collaboration with company management. The self-assessment for 2019 is complete.

The work of the board is based on the "Board Instructions", which describe its responsibilities and mode of working. As an appendix to the Instructions, the board has adopted supplementary provisions for matters which it will consider. The board also reviews the company guidelines on business ethics and CSR, as well as the Board Instructions. Directors must routinely report their ownership of shares or similar interest in other companies which could constitute, or which could be perceived as constituting, a conflict of interest with their position. They are furthermore required to report other relationships with licensees involved in petroleum activities on the NCS or with companies that supply goods or services to licensees.

Each director and the board as a collective body seek to strengthen their expertise in various ways. These include participation in courses and conferences and generally following developments within the business area.

Petoro's board comprises Gunn Wærsted as chair, Brian Bjordal as deputy chair, Per Arvid Schøyen, Trude J. H. Fjeldstad and Hugo Sandal as shareholder-elected directors. Board members Anne-Cathrine Nilsen and Ragnar Sandvik are elected by the employees.

Petoro AS

Share capital and shareholder

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

Petoro's share capital at 31 December 2019 was NOK 10 million, distributed among 10,000 shares owned by the Ministry of Petroleum and Energy on behalf of the Norwegian state. Petoro's business office is in Stavanger.

Net income and allocations

Petoro AS maintains separate accounts for all transactions relating to participating interests in the joint ventures. Revenue and expenses from the SDFI portfolio are kept separate from day-to-day operation of the company. Cash flow from the portfolio is transferred to the central government's own accounts with Norges Bank. Accounts for the portfolio are presented both on the cash basis used by the government and in accordance with the Norwegian Accounting Act and Norwegian generally-accepted accounting principles (NGAAP).

In 2019, Petoro AS was the parent company of Petoro Iceland AS, which is planned liquidated in 2020. The subsidiary was established in December 2012 and, as a branch, acted as licensee in production licences where the Norwegian state chose to participate. The subsidiary had no activity in 2019. The company's share capital at 31 December 2019 comprised NOK 2 million, distributed among 2,000 shares.

Funds for operating Petoro AS are provided by the state, which is directly liable for the contractual obligations incurred by the companies. NOK 358.7 million was appropriated for ordinary operation of Petoro AS in 2019.

Total expenses in 2019 were in accordance with the board's approved budget, the company's appropriation and allocation letter. The financial result for Petoro AS totalled NOK 975,000. The board proposes that the profit in Petoro AS be transferred to other equity. Net income for the year increased other equity to NOK 14 million as of 31 December 2019.

Pursuant to Sections 3-3 and 3-2a of the Norwegian Accounting Act, the board affirms that the annual accounts for the portfolio and the company provide a true and fair picture of the company's assets and obligations, financial position and results of the business, and that the annual accounts have been prepared under the assumption that the company is a going concern. The company has satisfactory equity and low financial risk.

Outlook

The world is facing substantial challenges in order to reach the UN's Sustainable Development Goal and the ambitions of the Paris Agreement. This has contributed to increased pressure on the oil and gas industry. Today, fossil energy sources account for 80 per cent of global energy consumption. Energy systems are highly complex and will take long time to change. The industry takes this challenge seriously and several leading companies have recently changed their strategy to develop their activities in the face of tackling a low-carbon future.

The international and national climate debate has been further intensified and more and more people are questioning the legitimacy of the oil and gas industry in a climate perspective. Many are advocating a cessation date for oil and gas activities on the Norwegian shelf. Climate risk, associated with physical changes and transitioning to a low-carbon society, is high on the agenda of the oil and gas industry. It is particularly important to understand how the climate challenge could affect prices and demand for various energy sources, as well as which requirements will be set for industry's carbon footprint.

Mature fields on the Norwegian shelf are the backbone of the Norwegian petroleum industry in general and the SDFI portfolio in particular. These fields are associated with considerable value creation opportunities. There is still a considerable potential to increase the recovery rate; this presumes the drilling of a considerable number of new wells, high drilling efficiency, optimisation of recovery strategies and efficient operations.

CO_2 emissions per produced unit will increase along with declining production from mature fields. Moving forward, Petoro will expend considerable efforts to reduce greenhouse gas emissions and electrification is included as part of a comprehensive further development of the mature fields. Electrification often takes place alongside a license's desire for extended lifetime for installations, or a need for more power for e.g. gas compression, in both instances to increase recovery and value. Petoro will continue to work actively to mature measures to reduce emissions of greenhouse gases, as well as ensure good technical and cost-effective solutions.

The start-up of Johan Sverdrup Phase 1 was an important milestone for the Norwegian Shelf and over the next few years, other major projects such as Troll Phase 3, Johan Castberg, Johan Sverdrup Phase 2, Snorre Expansion Project and Martin Linge will be completed. Without new major oil and gas discoveries, production from the Norwegian Shelf will decline rapidly in the last half of the 2020s. This will entail available capacity in fields and infrastructure. There is a certain potential in utilising this vacant capacity. Increased exploration in surrounding areas is key in order to discover more profitable gas and oil resources that can be developed quickly by utilising the competitiveness inherent in the existing infrastructure. Maintaining exploration activity on the Norwegian Shelf and access to attractive exploration acreage in the areas the authorities open for petroleum activities is therefore important.

Recruitment to the petroleum industry is expected to be challenging moving forward. The trend for several years has been that fewer and fewer young people are choosing educations aimed at the petroleum industry. Strengthening the industry's focus on transition and measures to reduce its carbon footprint, as well as digitalisation, are considered to be important recruitment instruments for the industry.

The SDFI portfolio is highly robust, even with low oil and gas prices. However, future revenues from the activities will be highly dependent on price developments. Price insecurity is still high going forward, both for oil and gas. The development in the oil market moving forward will primarily be determined by the development in the supply of oil, particularly from OPEC and shale oil. Demand is expected to continue to increase in the years to come, but over the longer term, it could decline somewhat depending on e.g. economic growth and climate policy. Protectionism and trade wars increase the fear of reduced economic growth. This is an important factor for further developments in the demand for oil. The demand for gas increases every year. In Europe, this is primarily taking place at the expense of coal, which results in considerable reductions in greenhouse gas emissions. With declining self-production in the EU, Norway will keep its key position as a supplier of gas to Europe. Norwegian gas is competitive, well-supported by a cost-effective and reliable infrastructure as well as low emissions. However, increased deliveries of both pipeline gas from Russia and LNG from the US result in particular price pressure for gas. With a further increase in global LNG capacity, one can expect continued pressure on gas prices, unless Asia increases LNG imports to a considerable extent.

The oil and gas industry is facing substantial challenges in light of the expected energy transition. Climate policy will continue to challenge fossil fuels, which will face increased competition from renewable energy. The role of gas in Europe's future energy supply is a topic of considerable interest. An extensive development of renewable energy is needed in order to reach the EU's long-term climate targets. It will also be necessary to develop new technology to reduce greenhouse gas emissions, e.g. through CCS or by de-carbonising natural gas to hydrogen with CO2 storage. In the meantime, Norwegian gas will play an important role in climate policy by replacing coal.

The oil and gas industry wants to be part of the solution to the climate challenge. With leading technology expertise, a global presence and financial resources, the industry can contribute both low-emission production and the development of new profitable de-carbonised value chains.

Stavanger, 5 March 2020

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