Directors' report 2020

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 59 billion in 2020, which represents an estimated 50 per cent of the state's total revenues from the petroleum activities in 2020.

External trends

The oil and gas industry was strongly affected by the global Covid-19 pandemic in 2020. Measures to limit the spread of contagion significantly reduced global economic activity and resulted in a substantial drop in prices for oil and gas, which posed vast operational and financial challenges for the industry. Oil and gas companies on the Norwegian shelf have so far weathered the crisis well and maintained safe, stable operations throughout the year. Nevertheless, outbreaks and infection control measures have resulted in certain postponements of planned activity within development and production drilling, as well as exploration and maintenance.

The demand for oil experienced a historic drop in the second quarter of 2020. In the lead-up to this, Saudi Arabia and Russia had started a competition for market shares, which amplified the market imbalance. In order to handle the situation, OPEC and Russia agreed early on to cut their own production significantly, and several other countries, including Norway, followed suit. These cuts and eventual rise in demand helped balance the markets, which led to rising prices toward the summer and until the end of the year. The gas market was also affected by Covid-19, and in the summer of 2020 we saw the lowest gas prices of the century in both Europe and Asia. The winter of 2019-2020 was relatively mild, and global gas storage was full when the pandemic hit the global economy. The gas market eventually balanced out when the US produced less LNG, and both Norway and Russia reduced their gas deliveries to the European market. Toward the end of the year, it was particularly cold in Asia and Europe, which led to a significant increase in gas prices, particularly in Asia, where LNG prices rose to record levels.

The decline in demand for oil in the second quarter meant that many projects in the planning phase on the Norwegian shelf were put on hold and contributed to significant uncertainty associated with the future activity level and employment. The authorities' temporary change in the petroleum tax has stimulated project maturation and activity. At the end of the year, there was a record-high number of development and electrification projects in the planning phase in the SDFI portfolio. These are projects that, overall, will contribute to increased production and considerable reductions in greenhouse gas emissions. The authorities' stimulus package for the oil and gas industry thus also contributes to secure important activity for the supplier industry moving forward.

The industry has not succeeded in living up to the expectations of continuous improvement in safety on the Norwegian shelf during 2020. The number of serious incidents is still too high, and falling objects dominate the range of incidents. The Petroleum Safety Authority has expressed concern regarding the safety level, as well as the consequences of postponed maintenance as a result of Covid-19. The most serious incident last year was the fire on Melkøya, which also resulted in a lengthy shutdown. It is important for the industry to work together to improve safety on the shelf. This will require increased follow-up from Petoro as well.

A number of countries adopted ambitious climate targets in 2020 and laid plans for how to reach them. Many have established net-zero emission targets by the middle of this century and increased their goals for intermediate years 2030 and 2040. Several oil and gas companies also set ambitious climate targets last year and made plans to reduce their emissions of greenhouse gases, not only from the production of oil and gas, but also from consumption.

In 2020, a unified Norwegian oil and gas industry launched a new climate roadmap and new climate targets with the aim of reducing emissions from production on the Norwegian shelf by 40 per cent in 2030, and near-zero in 2050, compared with reference year 2005. As part of its work on the stimulus package, the Storting requested a plan for a more ambitious goal of a 50-per cent reduction by 2030. The industry also wants to gradually shift the sector toward a future low-carbon society. This includes the industry focusing on offshore wind, hydrogen, as well as carbon capture and storage, which will facilitate vast emission cuts in Norway, Europe and the rest of the world.

The most important measure to achieve a considerable reduction in CO_2 emissions from production on the Norwegian shelf is electrifying installations. The industry has started a number of initiatives to identify and mature electrification projects. Realising these projects will yield considerable reductions in greenhouse gas emissions, but will also require substantial investments moving forward.

The Government presented the white paper "Climate Plan for 2021-2030", which shows how it aims to reduce greenhouse gas emissions during the 2021-2030 period in line with Norway's climate targets in collaboration with the EU. Here it proposes a gradual escalation of the CO_2 tax, leading to a considerable increase in the overall price of emissions moving forward to 2030. In spring 2021 the Government also announced a white paper on long-term value creation from Norwegian energy resources. In addition to value creation and industrialisation associated with natural resources on the Norwegian shelf, the report will cover the Norwegian power system and access to renewable energy. The white paper will also be the Government's follow up of the Storting's request for a plan for how emissions from oil and gas production can be reduced by 50 per cent by 2030.

In many countries, authorities and the private sector have focused on hydrogen as an important piece of the puzzle in reaching ambitious climate targets. The Government published a dedicated hydrogen strategy for Norway in summer 2020, and will elaborate on this in a separate hydrogen roadmap in spring 2021. Decarbonised natural gas with carbon capture and storage (CCS) can contribute to cover an anticipated increase in demand for hydrogen in both Norway and Europe. The development of CCS reached a milestone in 2020 when the authorities decided to invest in the "Longship" project. This is a demonstration project for full-scale CCS which can contribute to developing measures that are crucial in order to reach the global climate targets. It could also open the door for producing hydrogen from Norwegian natural gas while building on experiences with CO_2 injection on the Norwegian shelf. Petoro wants to be an active contributor in this effort and updated its strategy as regards sustainability and climate in 2020. In its further work, the company will consider which opportunities this presents for the SDFI portfolio.

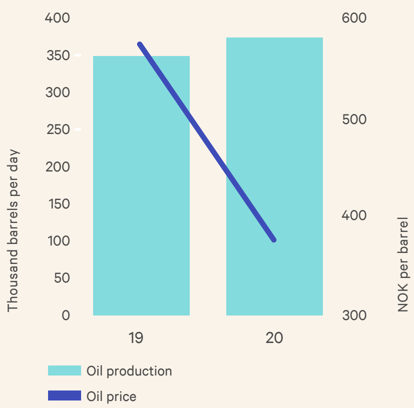
The Norwegian shelf competes for capital and competence on a global market. In order to secure and increase the value of remaining reserves and resources, it will be important to maintain the shelf's competitiveness. Konkraft's report "Competitiveness 2020" confirms that the Norwegian shelf is still competitive within important indicators such as break-even price, operating costs and CO_2 emissions per barrel. The authorities' temporary changes in the petroleum tax have also improved the shelf's competitiveness over the short term.

At the same time, additional efficiency measures are still needed on the shelf through transition and improvement measures. The development in important key indicators such as operating costs per barrel and production efficiency shows that the pace of improvement has flattened.

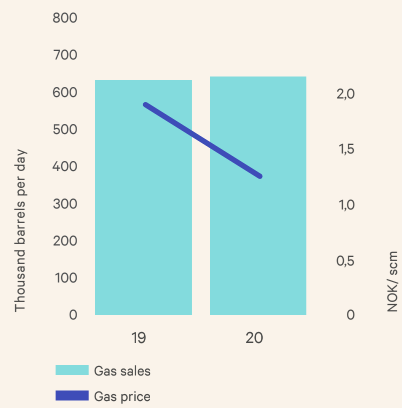
Digitalisation is an important tool to increase competitiveness. Operators and suppliers are working actively on digitalisation in areas of significant commercial importance within both reservoir, drilling and operations. New solutions are constantly being developed, and individual projects are demonstrating positive effects. However, the gains in form of significant changes in efficiency and cost level across the SDFI portfolio are not yet materialising. Broad implementation and use of new solutions across fields and the companies' portfolios, as well as extensive sharing of data, are preconditions in order for digitalisation to contribute to increased competitiveness. In this context, the focus on improvement and change management, as well as transparency and cooperation, will be the most important success factors.

The awards in pre-defined areas (APA 2020) comprised a total of 61 production licences. 30 companies were offered new exploration acreage, on par with the last four years. Interest in the North Sea and Norwegian Sea is still significant, particularly in areas near existing

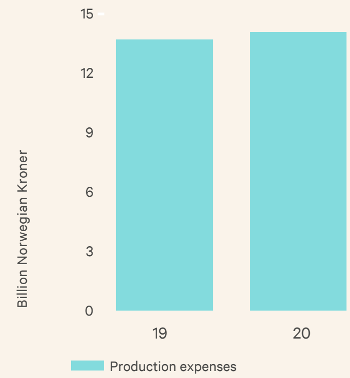
Oil production / - price



Gas sale / -price



Production expenses



infrastructure. However, interest in the Barents Sea reached a record-low and only 3 licenses were awarded. The APA round confirms the impression that medium-sized companies will be increasingly important on the Norwegian shelf in the time ahead.

Summary of SDFI results

Net cash flow to the state from SDFI totalled NOK 59 billion in 2020, NOK 37 billion lower than in 2019. This decline was mainly caused by lower prices for gas and liquids, in part offset by increased liquids production as a result of Johan Sverdrup phase 1 starting up in October 2019, as well as a positive change in working capital.

Total production reached 988 thousand barrels of oil equivalent per day (kboed), an increase of 24 kboed compared with the previous year.

Gas production amounted to 98 million standard cubic metres (mill. Sm^3) per day, which is on par with the previous year. Gas extraction was higher on Troll than in 2019 due to price optimisation, but this was offset by lower production, particularly from Snøhvit as a result of the fire in late September, as well as from Åsgard. The average realised gas price was NOK 1.25, compared with NOK 1.92 per Sm^3 the previous year.

Liquids production came to 374 kboed, 24 kboed (7%) higher than the previous year. This increase was caused by Johan Sverdrup starting up at the end of 2019. Excluding production from Johan Sverdrup, production declined by 51 kboed (14%), mainly as a result of natural production decline on multiple fields, as well as reduced production on the fields included in the Government's revised production permits. The average realised oil price was USD 40, compared with USD 65 per barrel the previous year. The price drop in USD was somewhat offset by a weaker NOK, meaning that the achieved oil price measured in NOK was 376, compared with NOK 572 per barrel last year.

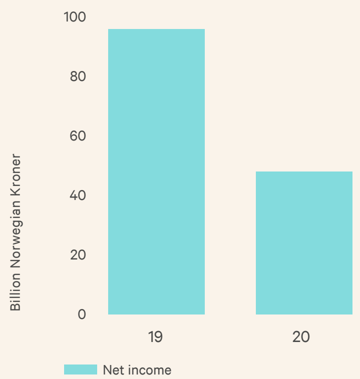
Costs incurred for investment totalled NOK 28 billion, just under NOK 1 billion higher than the year before. The increase in investment was mainly caused by higher drilling activity on multiple fields compared with the previous year. Development investments have been reduced due to the completion of Johan Sverdrup phase 1 in 2019.

The financial result for 2020 was a net income of NOK 48 billion, NOK 49 billion lower than the previous year. This decline was mainly caused by lower revenue as a result of reduced prices for oil and gas, and impairment on fixed assets in the first and fourth quarters. The reduction was partially offset by increased oil production from Johan Sverdrup.

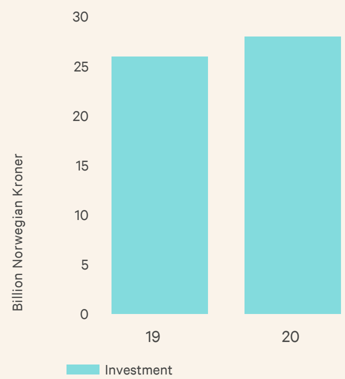
Production costs ended at NOK 14 billion, 0.3 billion higher than the previous year. However, production costs in 2019 were reduced by 1.3 billion as a result of the final settlement in the COSL case. This means that costs in 2020 compared with 2019 were actually reduced by NOK 0.9 billion. The decline was mainly caused by reduced electricity costs, as well as somewhat lower maintenance expenses in connection with prioritisations made as a result of Covid-19.

The book value of assets at 31 December 2020 was NOK 256 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 came to NOK 151 billion. Overall debt amounted to NOK 105 billion, of which 84 billion was related to estimated future removal obligations.

Net income



Investment



Serious incident frequency

Health, safety and the environment (HSE)

The most serious incident in 2020 was the fire on Melkøya in September. Follow-up with the licence and management, as well as learning from the incident, will be a major priority in 2021. The Covid-19 pandemic has led to considerable challenges, but the operators have been able to maintain stable and safe operations throughout the year. The pandemic has resulted in certain planned maintenance being postponed. This is a risk that will be followed up in 2021.

There was a total of 26 serious incidents in the SDFI portfolio in 2020, which yields a serious incident frequency of 0.9, about on par with 2019. Falling objects dominate the range of incidents in raw numbers. The personal injury frequency in 2020 was 3.6.

The number of serious incidents is at the same level as the previous year and remains too high. Efforts to reduce this must be prioritised. Petoro puts safety first and has clearly communicated the company's expectations for HSE management and HSE culture in the licences. In a major accident perspective, Petoro is concerned with learning across the portfolio, as well as the quality of risk assessments. Over the course of the year, Petoro has carried out multiple digital management visits at selected fields and onshore facilities with a focus on HSE.

Principal activities in 2020

As of the end of 2020, the portfolio consisted of 194 interests in production licences, 6 fewer than at the beginning of the year. In January 2021, the Ministry of Petroleum and Energy completed its awards in pre-defined areas, where an additional 10 production licenses were awarded with SDFI participation. As a major player on the Norwegian shelf, Petoro can contribute to value creation by identifying opportunities and contributing to learning across the portfolio.

At the end of the year, the portfolio consisted of 39 fields, 36 of which are in production. Martin Linge and Johan Castberg are under development. As regards the Dvalin field, which should have started up in late 2020, commercial production has been postponed as a result of a higher than allowed content of mercury in the gas stream. Tor II started production in December and is the first field on the Norwegian shelf to be reopened after having been permanently shut down.

A plan for development and operation (PDO) was submitted for Breidablikk in 2020. The project is a major subsea development with 4 seabed templates tied into the Grane platform. The development is time-critical, as a loss of reservoir pressure could create challenges for the drilling of wells in the future. At the same time, the development is scalable and robust in the face of both an upside and downside in the reserve base.

Production from mature oil fields continues to dominate liquids production from the SDFI portfolio, despite the fact that Johan Sverdrup accounted for 20 per cent of production in 2020. The Troll, Oseberg, Åsgard, Heidrun, Gullfaks and Grane fields accounted for 52 per cent of total liquids production. In 2020, gas accounted for two-thirds of overall production measured in oil equivalent. More than 70 per cent of gas output came from Troll, Ormen Lange and Åsgard.

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, drilling efficiency and efficient operations. The company works to seize the opportunities created by digitalisation within each and every priority. Climate and safety requirements are 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 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, the company has paid special attention to the Breidablikk, Heidrun, Maria, Snorre, Åsgard, Gullfaks and Grosbeak fields. Drilling efficiency has also been addressed as a special topic for the entire field portfolio.

Petoro carried out its own studies in connection with the Breidablikk development project, in which the company addressed resources in place and recovery potential for different parts of the field.

Petoro has conducted its own in-depth work on the Heidrun subsurface for a number of years. Dedicated simulation studies were undertaken in 2020 for the field's northern section based on new reservoir models. Through this work, Petoro identified an alternative drainage strategy that could yield higher recovery.

On Åsgard, the company used its own studies in 2020 to identify and specify projects that could help improve the recovery rate to the field's target of 60 per cent.

In light of disappointing production after start-up on Maria, Petoro has taken an active role in identifying measures to increase production. Petoro has worked to define a long-term solution to develop the field which will contribute to increase reserves.

On Gullfaks and Snorre, the company carried out its own studies to assess the well potential with an option for additional well slots, which could improve recovery.

Petoro also carried out its own studies on Troll to assess how increased gas production would affect oil production.

As regards new fields in the portfolio, the company'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 full value potential of each field.

The company conducted its own assessments for new development projects whose resource potential was associated with significant uncertainty. One example of this is Grosbeak, where Petoro carried out an external study to quality-assure the operator's geological model.

In 2020, the company followed up a substantial portfolio of major development projects in the implementation phase, including Johan Sverdrup phase 2, Johan Castberg, Martin Linge 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 has generally been good, the Martin Linge project has suffered multiple significant delays. There have also been challenges associated with well integrity in pre-drilled wells. Petoro led a project team where the company assessed well integrity on Martin Linge alongside the operator, which resulted in the drilling of multiple new wells. Petoro has furthermore kept a close eye on the project, with primary focus linked to safe, prudent start-up of the field.

Early technology adoption and technological advances are important in order to increase competitiveness. The primary technology areas Petoro is focusing on include technology to radically increase the drilling pace, optimising the recovery strategy by using new digital tools, next-generation developments with remote operation and low manning, as well as technology to reduce greenhouse gas emissions.

Petoro has been following up drilling efficiency on 10 of the fixed drilling facilities on the mature fields in the portfolio over a long period of time. 2020 was a weak year for the number of new wells from fixed facilities, and costs per well were at the same level as the previous year. The reason for this was that several drilling rigs were unavailable to drill new wells for large parts of the year. This was in part caused by prioritising other activity, such as larger projects and well maintenance, but was also a consequence of technical challenges. In order to realise resources in the mature fields and improve the recovery rate, the drilling efficiency must be increased and the cost per well reduced.

Digitalisation as an instrument to improve and increase competitiveness is high on the strategic agenda of most oil and gas companies and suppliers. Petoro actively uses its role in the joint ventures and on the Norwegian shelf to reinforce the momentum for improvement and contribute to change processes, as well as to facilitate efficient data sharing. Petoro has also employed strategic collaboration with Schlumberger, aimed special efforts toward improving quality and streamlining work processes in reservoir modelling.

In 2020, Petoro has seen significant activity associated with maturing electrification measures that could contribute to considerable reductions in greenhouse gas emissions from the SDFI portfolio. 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. Several large electrification projects on Troll, Oseberg, Snøhvit, Kårstø and Draugen were further matured throughout the year toward planned investment decisions in 2021 and 2022. Equinor has also started a major project to study the possibility of joint electrification of fields on the Halten Bank, including Åsgard and Heidrun. This project is planning to pass a DG1 decision in 2021. If currently planned electrification projects can be realised, they could, along with Hywind Tampen and planned shutdowns and scale-backs on fields, collectively contribute to reducing current emissions from the SDFI portfolio by 30 to 60 per cent leading up to 2030.

In 2020, Petoro was a participant in 12 exploration wells, nine of which were wildcat wells. These resulted in two minor discoveries, the Lomre oil discovery near the Vigdis field and the Swisher oil and gas discovery near the Fram field. Both discoveries are presumed to be commercial, as they can be tied into existing infrastructure.

The portfolio's estimated remaining reserves totalled 5,045 million boe at the end of the year, down by 290 million boe from the year before. Reserve growth totalled 72 million boe, which was mainly caused by the decision to develop Breidablikk. With a production of 362 million boe, this yielded a reserve replacement ratio of 20 per cent, compared with 40 per cent in 2019.

Research and development

Petoro contributes to research and development (R&D) through the SDFI meeting its share of the operator's costs for general research and development pursuant to the Accounting Agreement. The funds are managed by the respective operators. This amounted to NOK 499 million for the SDFI in 2020. This is in addition to 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. 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 instructions issued to Equinor. The objective of the marketing and sale instructions is to achieve the highest possible value for Equinor's and the state's petroleum and ensure fair distribution of the total value creation. Petoro specifically follows up matters of significant value, matters of principle and potential conflicts of interest.

In 2020, Petoro prioritised matters within the marketing and sale of both oil and gas. In this context, the company has maintained particular focus on Equinor's management and follow-up system and models for maximum value creation and fair distribution. The company has also devoted particular attention to challenges related to Covid-19 with subsequent volatile oil and gas prices.

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. Optimal further development, regularity, utilising capacity and flexibility in production facilities and infrastructure will be highly important in this context 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 instructions. The company has also had an extensive dialogue with Equinor associated with monitoring the marketing and sale, including follow-up of new shared goals for value creation.

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.

At the end of 2020, Petoro had 64 employees, one less than the year before. There were four new hires in 2020, one of which had signed their contract in late 2019. One additional employee signed their contract in 2020, with planned start-up in 2021. The percentage of women in the company was 30 at the end of 2020, 43 per cent in company management and 57 per cent on the company's board.

Absence due to illness was 2.1 per cent, compared with 1.5 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 inclusive workplace (IA) agreement to promote health and prevent absence due to illness. No occupational accidents were recorded among Petoro's personnel in 2020. As part of the effort to safeguard a good working environment, the company conducts annual employee surveys, which are followed up with measures.

A new organisational structure was implemented in 2020, featuring team leaders with personnel responsibility and technical supervisors. The company carried out extensive work in 2020 in connection with updating the salary system and employee benefits. As part of this effort, the company updated key HR processes, including performance reviews, rewards and competence 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.

Work to promote equality and prevent discrimination

Petoro does not discriminate on the basis of gender, religion, national or ethnic affiliation, social group or political views. The company emphasises equal opportunities between genders 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" also provides account of diversity, inclusion and equality.

The ratio of women in Petoro has remained above 30 per cent since 2009, and was 30 per cent in 2020 as well. The average age in Petoro is 53; 52 for men and 54 for women.

Petoro has had at least 40 per cent women on its board since its inception. The rules for electing employee representatives to the Board require one representative for each gender. The current ratio of women in company management is 43 per cent, compared with 25 per cent in 2019. There is only one woman among six representatives in the AMU and SAMU.

Female representation in the company's various wage groups is in accordance with the ratio of women in the company as a whole. 33 per cent of promotions in 2020 involved women. The company has a number of employees from diverse cultural and ethnic backgrounds. Seven nationalities are represented among the company's employees.

There were three instances of part-time employment in Petoro in 2020, all of which were voluntary, and both genders were represented. Six people took out parental leave over the last three years. These were all men, and they took out an average of 64 days.

Petoro has an external whistleblowing channel.

In the stipulation of salaries and wage settlements, the company is cognisant of treating women and men equally. The annual wage settlement process includes verifying that there are no systematic wage differences between gender and age. An equivalent review is undertaken annually in connection with performance reviews and promotions. There are no systematic or significant differences between gender and age groups, either as regards wages, wage development, performance evaluations or development opportunities.

The company facilitates a flexible customising of working hours. The "Petoro Flex" scheme was adopted in 2020, which entails increased flexibility and a future-oriented form of working. Petoro also provides full pay during maternity and paternity leave and has fully implemented the principles of the inclusive workplace as described in the IA agreement for 2019-2022.

Petoro has systematically focused on age and gender in recruitment processes in recent years, and will reinforce its emphasis on balanced demographics in external recruitment moving forward. The company's job postings are designed with the intent of attracting both women and men, as well as various age groups. When candidates are selected for new hires, the company emphasises both gender and diversity both as regards age and background.

In order to systematically quantify diversity and create a broader consciousness surrounding equality, as well as focus on measures to reach concrete achievements, the company will participate in Ernst & Young's SHE Index starting in 2021.
Annual reporting on equality is presented to the Board and AMU/SAMU.

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 comprehensive 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 No. 8 2019-2020 "The Norwegian 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 management by objectives, under which objectives are established that support the company strategy.

Reference is also made to the dedicated chapter on corporate governance in the annual report.

Corporate social responsibility

Petoro discharges 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 does not have the opportunity to provide monetary support to social causes.

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 instructions.
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 assessed the risk picture in 2020 based on the adopted strategy and stipulated goals for the upcoming year, and the climate risk was clarified in the company's governance over the course of the year. Measures were also identified for reducing the most significant risks which Petoro has an opportunity to influence within the company's established frameworks.

Two internal audit projects were carried out in 2020. 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 were conducted by PwC, which has also been responsible for the internal financial audit of the SDFI for the 2020 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 eight times in 2020.
An annual schedule of meetings has been established for the work of the board, with emphasis on considering topical commercial issues and following up strategies, budgets and interim results. Balanced scorecards are a key instrument used by the Board in following up the company's results.

The Board considers major investment decisions in the portfolio. It also follows up activities in the licences 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 fixed item on the agenda for the Board's meetings and consideration of matters, and any conflict of interest will entail that the director withdraws from the Board's consideration of the matter in question.

The Board conducts an annual self-assessment which includes a review of its own work and form of working, as well as cooperation with company management. The self-assessment for 2020 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. Directors must also disclose other relationships with licensees in petroleum activities on the Norwegian shelf, or with companies that supply licensees.

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

Grethe K. Moen resigned from her position as CEO on 7 September 2020, and Kjell Morisbak Lund was appointed acting CEO as of the same date. Kristin F. Kragseth was hired as the new CEO in December 2020 and will assume this position 1 June 2021.

The Board of Directors of Petoro AS consists of Gunn Wærsted as chair, deputy chair Brian Bjordal, Trude J. H. Fjeldstad, Hugo Sandal and Kristin Skofteland as shareholder-elected directors. Board members May Linda Glesnes and Ragnar Sandvik were elected to represent 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 2020 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).

Petoro AS ceased to exist as a group when the subsidiary Petoro Iceland AS was liquidated in 2020. The company's share capital of NOK 2 million was returned to the Ministry of Petroleum and Energy over the course of the year.

Funds for operating Petoro AS are provided by the state, which is directly responsible for the contractual obligations incurred by the company.

NOK 360 million was appropriated for ordinary operation of Petoro AS in 2020 compared with NOK 359 million in 2019.

Total expenses in 2020 were within the framework of the Board's approved budget, the company's appropriation and letter of assignment. Net income for Petoro AS was NOK 4 million. The Board proposes that the profit in Petoro AS be transferred to other equity. Including net income for the year, other equity amounted to NOK 18 million as of 31 December 2020.

Pursuant to Section 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 view 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

Over the course of last year, the oil and gas market experienced a significant drop in demand and a situation with highly volatile prices. When and how quickly the demand will rebound will depend on how the pandemic develops and the necessity of continued measures to limit the spread of infection, as well as the effect this will have on the global economy. Global demand for gas could return to 2019 levels as early as 2021, while this is expected to take more time for the demand for oil. At the same time, the prices of both oil and gas are currently on par with the time leading up to the outbreak of the pandemic. In a turbulent market, the SDFI portfolio has emerged as highly resilient and contributed considerable revenues to the state in 2020.

It is difficult to say how extensive the effect of the pandemic will be on economic growth, energy consumption and greenhouse gas emissions, or how long this effect will last. The UN Sustainable Development Goals and the Paris Agreement will entail a substantial transition to clean energy. This is expected to challenge fossil energy sources such as coal, oil and gas. The energy transition is already under way, but the world's energy systems are complex, and will take time to change. It is highly uncertain how rapidly the development will take place and projections indicate that current policies will not be sufficient in order to achieve the target in the Paris Agreement.

Last year, the EU bolstered its climate target for 2030 and has announced more stringent policy instruments in its follow-up of the "European Green Deal". This could impact the oil and gas industry by influencing both demand and prices. In turn, this could affect prevailing regulation of the industry in Norway, since EU climate policy establishes a framework for Norwegian policy in the area.

Nevertheless, the world needs energy, and oil and gas are expected to remain an important part of the energy mix for many years to come. Demand is expected to develop differently in different regions, where emerging economies in particular will account for the greatest growth, while the demand for fossil energy is on the decline in Europe and other mature economies.

Declining own production of gas in Europe could allow the Norwegian gas to retain a key position. Norwegian gas has a number of competitive advantages, such as reliability of supply, low costs, low greenhouse gas emissions from the production and well-developed infrastructure. Market-related climate risk will increase over the longer term as a result of ambitious climate targets. Further climate measures are planned and will contribute to considerable cuts in emissions from production. These types of measures are important not only to demonstrate that the oil and gas industry is taking responsibility for the climate challenge, but also because this could yield a competitive advantage in a future low-emission society.

Over the next few years, Petoro will contribute to identify and mature a number of electrification projects, ensure quality in the basis for decisions, and that the projects achieve sufficient profitability to be approved in the joint ventures. Robust power supply will be decisive for these decisions. The Government's plan to raise the carbon price toward 2030 sets the direction for working with climate measures in the joint ventures. Furthermore, Petoro will work to obtain data to document the SDFI portfolio's low carbon footprint from production and transport, and also assess opportunities for the SDFI in any future decarbonised value chains.

There is still a considerable potential for long-term value creation, activity and employment associated with oil and gas activities on the Norwegian shelf. The mature fields make up the backbone of the Norwegian shelf in general and in the SDFI portfolio in particular. There are still considerable value creation opportunities associated with these fields and utilisation of the infrastructure represented by the mature fields. Petoro is a driving force for improving recovery rates and accelerating production. This presumes the drilling of a considerable number of new wells, high drilling efficiency, optimising recovery strategies and efficient operations.

The SDFI portfolio is characterised by relatively low costs and low greenhouse gas emissions. Profitable activity can therefore be maintained even in a future with uncertainty and volatility in prices and potentially tighter regulations, including higher prices for greenhouse gas emissions. However, in order to safeguard this competitive position, it is important for the industry to continue the efforts that are under way for further improvement and efficiency measures, including digitalisation of work processes and reductions in the carbon footprint.

Stavanger, 4 March 2021

Gunn Wærsted
Chair

Brian Bjordal
Deputy chair

Trude J. H. Fjeldstad
Director

Kristin Skofteland
Director

Hugo Sandal
Director

Ragnar Sandvik
Director,
elected by the employees

May Linda Glesnes
Director,
elected by the employees

Kjell Morisbak Lund
Acting CEO