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FrontRunner
Under the skin of Subsea, Engineering and Construction Contracting

STRATEGIC OFFSHORE RESEARCH

Money seems on a one-way street

The more things change, the more they stay the same. High oil and gas prices and bumper operator profits should mean everyone is experiencing good times? But that's seldom how the offshore market works.

While so many in the world like to worship fairness like it was some blinding new truth religion, business - and the offshore market in particular – is seldom fair. Just look at who actually makes money in the market, and not just any money, real money.

So, new record quarterly profits for oil companies, and the baying masses calling for windfall taxes in another strange application of "fairness", does not mean the supply-chain is rolling in money. Traditionally there's only one part of the offshore market that makes money, and that's the end client oil companies.

Of course, time lag effects mean the supply-chain is out of sync with oil company numbers, but that only partly explains it. The tone of the market, plus the reported numbers and comments from contractors show what's really happening, at least for now.

Oceaneering is still the dominant ROV drill market force, with 58% of the current market. So should see changes in immediate trading conditions quicker than most. Drilling is after all the lead indicator for almost all parts of the market. Yet, Oceaneering second quarter numbers were down. Revenues were up, but profit was down. The new numbers were a $3.7 million profit on $524 million revenues compared against last year's $6.2 million profit on $498.2 million revenues. Pressure on the supply-chain is clearly still there.

Oceaneering has a 250 vehicle ROV fleet and expects as the year goes on that overall utilisation will improve in the high 60%s range or low 70%s. However, Oceaneering says "rates are harder to move" even when costs are increasing "because of the contract lengths" which means changes "take longer to walk off in both up and down cycles".

That's enough for Oceaneering to increase the full year 2022 EBITDA guidance to a range of $210 million to $240 million. The contractor does have 2024 maturing debt and preparation to deal with that has already commenced.

What's of real note is that Oceaneering is expressing "concern to see clients extending payment terms". This is very real and started during the last price crash which quickly moved into the start of the Covid pandemic.

That's the sort of change the clients bring in rapidly when times are tougher but are much slower to change when conditions change. Or they simply don't change them at all. Once they change, even if those measures are said to be temporary, they seldom ever revert back.

Again, this shows that money in the market really only flows one way and just because the end client is making more money does not mean that everything gets better for those further down the chain, at least not straight away.

Somehow others want to believe otherwise, for whatever reason. TechnipFMC top brass remain evangelical on the benefits of integrated contracting, like a self-affirmation self-help course in overdrive. In its recent results release, TechnipFMC is presenting an interesting stance on how its going to produce better returns than its peers.

TechnipFMC seems to suggest the main benefit of the integrated format is quicker project deliveries "ahead of anyone else" and "better project returns" in general. TechnipFMC now wants to "capture a greater share of the economic value given to clients" and even believes "they are more than pleased to share that with TechnipFMC".

That would be believable if we all lived in some utopian wonderland. That's not really how the real world or the offshore market works. If you make more money for someone else, they don't feel motivated to put that extra cash in someone else's wallet not their own.

Spreading around money and equitable sharing is not a feature of the offshore market. Those at the top of the tree will always take and keep as much as possible for their own and their shareholders' benefit. That's how business works. Even more so when oil companies are

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TechnipFMC still thinking big

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under increased pressure and scrutiny while having to compete with companies that have huge values despite never making profits and being valued on the basis of what they might do at some unknown point in the future.

Despite the pumping up of integrated contracting, it's very interesting that in financial presentations, TechnipFMC has gone back to putting lots of emphasis just on the straight number of wellhead orders and wellhead deliveries. That's right back to what the then FMC would only highlight before it got together with Technip. However, TechnipFMC now sees a "market in full growth mode" but says things are going to be different this time.

Different in that the contractor thinks that normally in this point of a new cycle, and TechnipFMC is calling it a "super cycle", everyone would be looking at big capital expenditure. But it's not. Despite having spent so long building an integrated capacity, TechnipFMC seems to think that manufacturing is the most important element. As anyone who's been around the market for long enough will know, the manufacturing side tends to be more about growing volumetrically rather than suddenly accessing much higher margins.

However, TechnipFMC seems to have covered the volume element by adopting a Configure-To-Order manufacturing concept which is claimed to "double wellhead throughput" without increasing "manufacturing roofline". That is without increasing plant sizes.

With its usual bombast, TechnipFMC thinks that "much of our market is propriety" thanks to integrated contracting and early engagement. That's a nice idea, but just because a project is integrated does not mean there isn't competition and certainly does not mean it is TechnipFMC's automatically. Far from it. Of course there are some clients that display a degree of demarcation, but the biggest projects will always somehow be exposed to a competitive process and it's the Subsea 7/Schlumberger alliance that has been winning the biggest projects, no matter how much that must stick in the TechnipFMC craw.

Despite having so much installation capacity of its own, TechnipFMC thinks that alleged propriety control of projects means "others can get their floating assets working on projects via TechnipFMC".

Again, that might sound fair enough if the contractor did not have its own fleet for most tasks. Unless it doesn't want to have that in-house anymore. There are existing relationships with Allseas and Saipem for large diameter and J-lay pipelay, but they still look more like box-ticking exercises, and in the case of Allseas have barely produced any work, and in the case of Saipem has produced nothing. Why TechnipFMC even would highlight using others' equipment isn't very obvious, unless installation is something it has an eye on later outsourcing. And that's despite the combination being one of the reasons for the formation of TechnipFMC in the first place.

How does installation fit?

TechnipFMC likes its own prospects and seems slighted by the current share price. In those prospects, TechnipFMC thinks by 2025 the company can be producing $1 billion of annual EBITDA margin for the Subsea division alone, although the onshore/surface wellhead division is much, much smaller anyway.

On the share price, TechnipFMC believes it is priced at a "significant discount" compared to peers. So much so, that the contractor now has authorisation for a big new share repurchase programme. The authority covers a substantial $400 million spend. At current "undervalued" share prices that would cover a 14% stake in the company. TechnipFMC also reaffirms an intention in the second half of 2023 to resume quarterly dividend payments.

With all that said, it's just as well the TechnipFMC second quarter results are much better than last year. The second quarter saw a $2.1 million profit on $1.7 million revenues with $1.4 billion of that from the dominant Subsea division. That's still a pretty slim margin, although the latest period did include $7.1 million of restructuring and other charges plus a $29.8 million loss on early debt settlement. Last year has seen a second quarter loss of $174.7 million on $1.67 billion revenues.

Subsea 7 too reported a "strong second quarter performance" but the profit is still a small fraction of turnover and still thinks it will be the "second half of 2023" before profitability really starts to improve and the industry can "head back to normal margins".

Subsea 7 notes the backlog for the period has already been brought in and the company does see "improving pricing in both our core markets" which are oil and gas plus renewables. Note that's "improving" not improved, and cost inflation is still a big factor for contractors to deal with. Subsea 7 does say the supply-chain has "stabilised" but is still at much higher levels. At least the contractor sees more assurance on delivery timings although the "costs are still up" and some degree of index-linking has been accepted by some clients.

Subsea 7 also sees the reel-lay market looking significantly "tighter" in 2024 "driving an improvement in pricing". In the meantime, share buy-backs continue steadily with $45 million of a $75 million authorisation already spent.

The Subsea 7 second quarter result for Subsea 7 was $22 million of profit on $1.25 billion revenues. The year earlier had seen a $13 million loss on $1.2 bil-

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Subsea 7 still winning as Saipem talks things up

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lion revenues. However, making money from wind-farms is still an issue. The Seaway 7 renewables division did have a $71 million operating loss in the quarter which was included in the Subsea 7 numbers. The Fomosa-2 project in Taiwan is thought to have lost $33 million alone in the quarter.

Subsea 7 does add "payment terms are gradually improving, particularly in fixed offshore wind", though any contractor producing wind-farm profits is still hard to find.

Subsea 7 keeps adding to backlog and has muscled in on Saipem's territory in Guyana. A consortium of Subsea 7 and Van Oord has ExxonMobil's award for the Guyana Gas to Energy project which requires a 190km line starting in 1,450 msw from the Stabroek block running to shore. The end of 2024 is due to see the project on stream. Van Oord will handle the shallow section and landfall. The contract value is in a $150 million to $300 million range. Schlumberger also reports an EPIC award to OneSubsea with alliance partner Subsea 7 from Kosmos for a multiphase booster on the Odd Job field in the Gulf of Mexico. Subsea 7 will handle the offshore installation that includes a 26km integrated power and control umbilical. Mid-2024 is due to see the offshore work complete.

Seaway 7 also has a new award for US East wind-farm inner-array cables. The project still requires financial closing but covers 160km of cable and could be for the Orsted/Eversource Sunrise project.

Saipem is another talking very positively. And that's despite being through an emergency refinancing programme where the bank underwriters had to step in after a lack of market interest and have ended up with a 29% ownership stake in Saipem. Clearly the banks don't want to hold on to those shares and will offload them. Saipem says the banks have indicated an intention for a planned "orderly disposal" of 70% of the shares held though there is "no coordination with the company".

Saipem is also calling a " new super cycle" driven by "momentum in drilling" where Saipem says "very significantly" rig contracts are "going back to being long-term". Not long ago Saipem wanted to offload the drilling division altogether, now it seems to be the lynchpin in the company's recovery programme.

There's still some way to go though. The second quarter saw a €32 million loss on €2.4 billion revenues. At least that's better than last year when the loss was as much as €659 million on €1.5 billion revenues. The Offshore Engineering and Construction division had a €17 million operating profit on €1.2 billion revenues compared to a €343 million loss last year and revenues that were right down to €475 million. The result excludes the onshore drilling division being sold to KCA and later this year completing.

On the construction side, Saipem thinks next year will see full utilisation and good order intake is seen from West Africa, Guyana and Brazil. The contractor thinks we are on the way to a "growing market with less capacity" as some assets - even the Saipem 7000 - are seen as permanently joining the wind-farm side of the industry.

Saipem also says its half way through a "valorisation" programme. The use of that word might leave most non-plussed, but what Saipem is talking about is a glorious plan to raise money by selling assets but somehow keeping their control. Ownership of the assets involved would move to a "dedicated vehicle" which can "become non-consolidated and where our share would no longer be 100%". Particularly highlighted is the "deepwater offshore fleet" which is now seen as "getting every single day a higher value considering the market in which those ships are nowadays operating".

Really that's just financial engineering as a means to raise more money in the short-term. The value of those ships could only be realised if there was a legitimate buyer and selling would damage Saipem's business prospects. Though Saipem doesn't quite have the right assets for some of the key parts of the forward market, and who ever owns them won't change that.

Further down the food-chain, things look a little better. Especially if the company has decent market share and diverse revenue streams.

Fugro's back to basics works

Fugro's multi-year turnaround continues and for the first half of the year a €29.4 million profit on €833 million revenues is reported. That's a good improvement on 2021 when the profit number was €17.2 million and revenues were at the €673.3 million mark. The turnaround programme for Fugro has been all about getting back to core business and what it does best. It's taken time, but Fugro seems to have just about got there with only an interest in ex Global cable business in China to still sell and the Finder operation which has interests in a couple of offshore blocks left to go.

Fugro sees "ongoing growth" particularly from renewables while the results improved "despite inflationary and supply chain pressures". Full year 2022 Fugro expects "continued revenue growth and further margin expansion".

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Better get a bigger gun

Remember what good news is? In the offshore market the words almost feel incongruous.

Yet, reports of the offshore market's death have been greatly exaggerated. The offshore market is certainly not dead yet, and if someone wants to kill it off, they had better get a much bigger gun.

The market is turning. The cycle profile might be different, but we're out of the bottom of the trough. Much better times are ahead thanks to a stronger commodity price and concerns about both energy supply and security.

That's going to lead to stronger demand just as the subsea industry is finally getting a handle on the need to reduce vessel supply. Demand out to 2028 is going to get better year on year and the balance of the market will keep on improving as well.

The future ain't exactly what it used to be. There are new factors in play as well. The industry does not have to be scared of the word "transition". Moves to try and move away from fossil fuels completely are well intentioned but rather half-baked and naive. Energy transition will still generate work for subsea support vessels both on the renewables side but also from work to make oil and gas production much less carbon intensive. Decommissioning work is finally becoming consistent and adds another slice of demand on top of the industry as well.

Suddenly, the subsea market's look ahead is much more positive than it has been in a long time. Both the market players and end clients will have to sit up and take real notice.

The new report runs through a forecast horizon of 2028 because the market drivers are that long-term. All aspects of what's going to happen are closely examined in a thought-provoking and direct fashion.

People need things distilled right down to the brass tacks of what it will mean to their business and their market, and that's what this report does every time. And there's no shying away from some inconvenient truths that are thrown up too. For further details contact Jo Slade at jslade@strategicoffshore.com, visit this page, or call +44 (0) 1224 498023. ⏮

Fugro refinances now before costs go up

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Despite the profit numbers, Fugro has also moved quickly on a new refinancing deal. Initially, €116 million has been raised through an accelerated bookbuild offering with 10.32 million new shares issued though Fugro admits equity is the most expensive refinance route. That increased the share capital by 10%.

On top of that Fugro has a new €200 million revolving credit facility and a new €200 million three-year term loan. Those two replace a €250 million revolver and a €188 million term loan which next year was due to mature. Fugro thinks it "prudent" to have refinanced now ahead of increasing interest rates. The new deals also have "sustainability measures" built in which "can cut interest costs by 10 basis points". Those measures are a by 2025 20% cut in vessel CO_2 emissions, 50% revenue growth from renewables, and a 2025 target of 25% senior posts held by woman.

Some of the proceeds will be used to cover a potential put option for a 2024 maturing convertible bond. Mid-August to mid-September this year appears as an exercise period. The conversion price is at €19.50 per share when the open market price is currently €11.45. Fugro also recently bought back €9 million of that bond.

On cost inflation, Fugro says the cost increases are "unprecedented". As a reaction Fugro is limiting bid validity periods, reducing fuel price risk on new contracts, and finding ways to include escalation clauses. European fuel costs are reported to have doubled.

For the full year Fugro expects continue revenue growth and "further margin expansion". That's expected to help reach 2023/2024 mid-term targets of 8% to 12% EBIT margin. 4% to 7% of revenues free cash flow, and a 10% to 15% return on capital employed. Current offshore EBITDA margins are put at 10% to 13% but Onshore is lower at 6% to 9%. ⏮