



## Risk management and sensitivities

Prosafe operates on several continents and in various segments of the international oil and gas industry. The company's activities and business development are subject to several categories of risk.

Prosafe currently assesses the group's total risk in four main categories: strategic, operational, financial and insurance-related. These are integrated into a tool applied to monitor total risk exposure and risks arising from individual projects.

### STRATEGIC RISK

Unlike risk related to operations, finance and insurance, where the company seeks to reduce exposure as far as possible, strategic risk is the only category that the company actively accepts in order to generate a return for shareholders. Prosafe will create shareholder value by allocating capital and resources to the commercial opportunities that yield the best return in relation to the risks involved within its specified strategic direction.

### Prosafe's position in the value chain

The bulk of the company's activities is centred around the production and maintenance phase of the life cycle of oil fields. Traditionally, this represents

the part of the value chain that is most robust to oil price variations and associated fluctuations in the pace of oil companies' investments and development.

Prosafe's strategic focus secures the company a stable revenue flow combined with growth opportunities, even at times of volatile oil prices. Moreover, the company will at all times seek to have a portfolio comprising long, medium-term and short contracts, which confers stability and predictability, and potentials for increased earnings through market fluctuations and new growth. Prosafe operates in all important offshore regions of the world, which means the company's risk is substantially diversified in geographical terms.

### Competitive position

The competitive position, through changes in demand and supply, is the most important factor affecting company results. Prosafe competes in the global market for accommodation/service rigs, where it faces competition from jack-ups, monohulls and barges in shallow and calm waters. In harsh and semi-harsh environments its vessels are leaders because of their superior technology and better



safety. Demand for its rigs has become global, and comes from areas such as the US Gulf, Africa, Brazil, Asia, Russia and Australia, in addition to the traditional North Sea and Mexican markets.

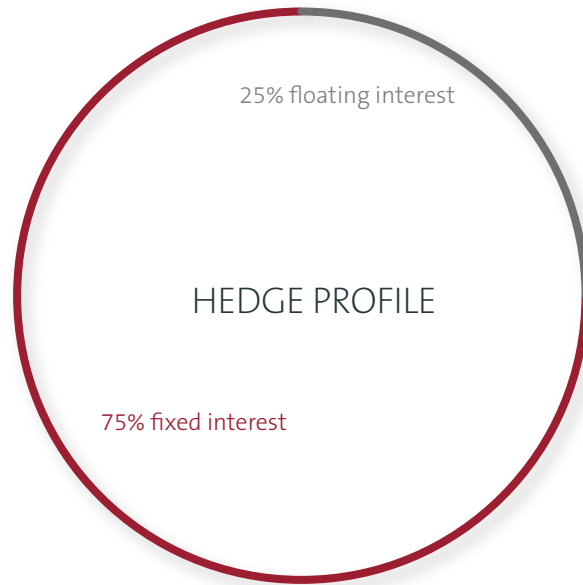
Demand for accommodation and services has risen in line with an increased pace in the development of new oil discoveries and extension of the production life of existing fields. Entry barriers in this segment are substantial owing to the high cost and long delivery time of newbuilds, and the limited availability of rigs which can be converted into accommodation/service units. These barriers are likely to be highest for the upper end of the market, with dynamically positioned rigs which face demanding weather conditions, while moored units in calm waters could be more readily available.

Aiming for optimal combination of day rates and utilisation, and allocating the vessels between harsh and benign environments within its specified strategic direction, Prosafe is working continuously to secure the highest possible short- and long-term contribution from its vessels.

*Sensitivity:* Prosafe's business is based largely on fixed day rate contracts, where compensation is independent of oil prices and production volumes. Day rates for accommodation/service rigs are primarily denominated in USD. An increase of USD 10 000 in the day rate for one accommodation/service rig operated by Prosafe would increase annual operating profit by USD 2.9 million (1.3 cents per share), assuming 80 per cent rig utilisation. Similarly, a ten per cent increase in utilisation for one rig, including saved lay-up costs and assuming an EBITDA contribution of USD 150 000 per day, would increase annual operating profit by USD 5.5 million (2.4 cents per share).

#### **OPERATIONAL RISK**

Prosafe's offshore operations involve risks of injury to personnel, damage to equipment and accidental discharges/emissions to the natural environment. Avoiding harm to personnel and equipment as well as accidental discharges/emissions represents a clear target. Potential incidents are reported immediately and followed up to limit possible harm and prevent repetition. Prosafe works proactively and constructively with customers and suppliers on setting in-house goals, making continuous



improvements to own routines. Efforts are also made to shape attitudes in order to protect personnel and equipment from harm, and the natural environment from pollution caused by own operations and those of its partners.

In line with industry practice, a contract normally contains clauses which give the customer an opportunity for early cancellation under specified conditions. Providing Prosafe has not acted negligently, however, the effect on results in such cases will normally be wholly or partly offset by a financial settlement in the company's favour.



The Gulf of Mexico contracts contain a cancellation clause allowing the ultimate customer, Pemex, to cancel the agreement with 30 days notice without compensation, if the Mexican authorities annul financing of the project. These clauses reflect the crisis that Mexico saw during the 1980s. The

company takes the view that a cancellation on this basis is only likely if the Mexican economy suffers another deep and lengthy crisis. Prosafe does not regard this as a realistic scenario, given the high present and planned levels of activity in the Gulf of Mexico, and the importance of oil production to Mexico's economic development.

**FINANCIAL RISK**

**Interest rate risk**

Prosafe's interest-bearing debt totalled about USD 960 million at 31 December 2008. Unsecured bond loans accounted for USD 110 million of this total and bank loans secured by mortgages for USD 850 million.

Interest on debt is in principle floating, but has been hedged to reduce the variability of cash flows in the interest payments through the use of interest rate swap agreements. Prosafe's hedging agreements totalled about USD 720 million as of 31 December 2008.

Prosafe evaluates the hedge profile in relation to the repayment schedule of its loans, the company's portfolio of contracts, cash flow and cash in hand.



The proportion hedged will normally lie between 50 and 75 per cent for all loan terms. Without taking into account the interest rate hedges, the average interest cost in 2008 was 5 per cent as opposed to 6 per cent in 2007.

*Sensitivity:* Assuming an average interest-bearing debt of USD 1 billion and a hedged proportion of 60 per cent, a rise of one percentage point in interest rates would increase annual interest expenses by USD 4 million. In addition, assuming a four-year duration at the beginning of the year and applying a flat discount rate of 3 per cent throughout the period, the net present value (NPV) of the interest swap at the end of the year would have increased by about USD 17 million. The interest hedging is regarded as highly effective in achieving offsetting changes in cash flows attributable to the hedged risk during the period of which the hedge is designated. Therefore, the NPV would be recognised

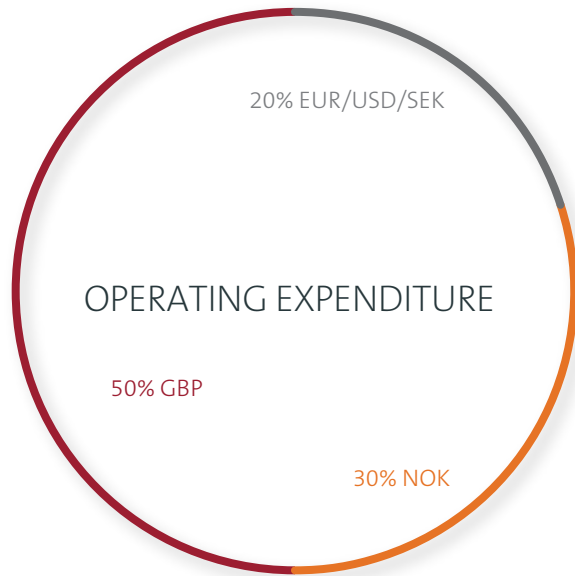
in the balance sheet (equity) and not in the income statement (hedge accounting).

#### Currency risk

Prosafe is exposed to several currencies. The bulk of revenues are in USD and rigs owned by the company are valued and financed in USD. Accounts are therefore compiled in USD. During certain periods, however, depending on the country of operation, the company will have contracts that yield EUR, GBP and NOK revenues, with a consequent reduction in net currency exposure.

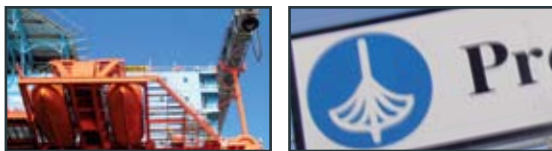
Operating expenses are mainly denominated in GBP and NOK, but depending on the country of operation and nationality of the crew, operating expenses can also be in EUR, USD and SEK. Net cash flow from operations is typically currency-hedged using forward contracts within a time horizon of nine to twelve months.

Capital expenditure in terms of general maintenance will typically be denominated in GBP and NOK. Value enhancing investments, such as upgrades and/or refurbishment programmes, will, depending on the origin of equipment and the location of the yard,



tend to be in USD and EUR. To the extent that such investment is denominated in currencies other than USD, the cash flow will be hedged with the aid of currency forward contracts.

Debt and interest expenses in currencies other than USD are currency-hedged on a continuous basis against the USD, so that this effectively functions as USD financing. The hedging takes the form of liquidity reserves and financial instruments.



Factors such as currency exposure in the balance sheet and tax calculations will also be taken into account to the extent that they are affected by exchange rate changes.

*Sensitivity:* Assuming a net annual requirement for EUR, GBP and NOK corresponding to USD 100 million, a 10 per cent weakening of the USD against the EUR, GBP and NOK would increase operating expenses by USD 10 million before the

effect of currency-hedging is taken into account. In addition, assuming that 75 per cent of the currency requirement is hedged against the USD, the realised gain on currency forward contracts would amount to USD 7.5 million. Any currency gain/loss would be recognised in the income statement (not hedge accounting).

#### Liquidity risk

Under existing credit agreements, Prosafe is required to maintain a minimum liquidity reserve of USD 65 million. Prosafe makes active use of a system for planning and forecasting the development of its liquidity, and utilises scenario analyses to secure stable and sound development.

#### Oil price risk

Largely dictated by oil price trends, the level of activity in the oil and gas industry has historically been cyclical. Activity levels at Prosafe have traditionally been relatively robust in relation to oil price fluctuations because company operations generally focus on the production and maintenance phase of oil fields, in combination with day rate charters, often of long duration. However, in the long term the company might be affected by a persistently low oil price, as this could lead to field developments being postponed, thereby affecting

the demand for accommodation and service rigs needed to carry out installation, hook-up and maintenance work.

#### INSURANCE-RELATED RISK

The company primarily aims to cover insurance-related risk as fully as possible through insurance policies, to the extent that such cover is available and reasonably priced.

Prosafe's insurance policies provide cover against injury to crew, damage to its vessels, loss of revenue, third-party liability – including oil spill, employer's and director's liability – and personal cover for employees relating to accident, death, disability and pension.

Cover under hull and machinery and loss-of-hire policies for vessel loss or damage is related to the vessel's estimated market value and the value of the individual charter respectively, so that the impact of a possible loss on results is minimised. Prosafe has also taken out war risk insurance to cover physical damage and liability arising from war and terrorist actions.

#### PROJECT RISK

The four above-mentioned risk categories are integrated into a tool that monitors total risk exposure and risks arising from individual projects. In addition, the company carries out a particular assessment of four risk factors when planning value enhancing investments such as upgrades and/or refurbishment programmes.

- Technical risk
- Project profitability
- Construction risk
- Credit assessment

Technical risk analysis involves an assessment of three critical factors. Firstly, a thorough market analysis is conducted to provide guidance in terms of future demand for certain technical specifications. Secondly, the yard's ability to deliver in line with these specifications is evaluated. Thirdly, the project's fit with the overall business plan and strategic direction of the company is established.

Project profitability is essential to the undertaking and is assessed on the basis of cost-effectiveness. Both incremental costs and effects are analysed in detail, while sensitivity analysis is applied to identify particular success factors and for justifying further research to reduce project uncertainty.

Construction risk embraces the possibility of cost overruns and delays. Continuous improvement of systems and work processes is vital to obtain adequate management of this type of risk. So is a focus on securing continuity in the organisation and key positions, and maintaining relations with sub-contractors and equipment suppliers.

Credit assessment of yards, sub-contractors and equipment suppliers is part of Prosafe's project evaluations and risk analyses. It attempts as far as possible to reduce credit risk via parent company or bank guarantees.

An overall understanding and management of the above-mentioned risk factors is important in order to ensure stable value creation for Prosafe's shareholders.

