



OFFSHORE

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ANNUAL REPORT 2020

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LOSS ALLOWANCE ON FINANCIAL ASSETS AND CONSTRUCTION WORK-IN-PROGRESS

The movement of loss allowance during the year 2020 is summarized as follows:

	Finance lease receivable		Construction work-in-progress		Trade receivables		Other financial assets	
	2020	2019	2020	2019	2020	2019	2020	2019
Opening loss allowance as at 1 January	0	0	(0)	(1)	(4)	(7)	(99)	(99)
Increase in loss allowance recognized in profit or loss during the year	(1)	-	(4)	(0)	(3)	(1)	(15)	-
Receivables written off during the year as uncollectible	-	-	-	-	2	-	-	-
Unused amount reversed	0	-	0	1	2	4	0	-
At 31 December	(1)	0	(4)	(0)	(3)	(4)	(114)	(99)

FINANCIAL RISK MANAGEMENT

The Company's activities expose it to a variety of financial risks, market risks (including currency risk, interest rate risk and commodity risk), credit risk and liquidity risk. The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance. The Company uses derivative financial instruments to hedge certain risk exposures. The Company buys and sells derivatives in the ordinary course of business and also incurs financial liabilities in order to manage market risks. All such transactions are carried out within the guidelines set in the Company policy. Generally, the Company seeks to apply hedge accounting in order to manage volatility in the income statement and statement of comprehensive income. The purpose is to manage the interest rate and currency risk arising from the Company's operations and its sources of finance. Derivatives are only used to hedge closely correlated underlying business transactions.

The Company's principal financial instruments, other than derivatives, comprise trade debtors and creditors, bank loans and overdrafts, cash and cash equivalents (including short-term deposits) and financial guarantees. The main purpose of these financial instruments is to finance the Company's operations. Trade debtors and creditors result directly from the business operations of the Company.

Financial risk management is carried out by a central treasury department under policies approved by the Management Board. Treasury identifies, evaluates and hedges financial risks in close co-operation with the subsidiaries and the Chief Financial Officer (CFO) during the quarterly Asset and Liability Committee. The Management Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity. It is, and has been throughout the year under review, the Company's policy that no speculation in financial instruments shall be undertaken. The main risks arising from the Company's financial instruments are market risk, liquidity risk and credit risk.

During the year of 2020, the COVID-19 pandemic caused crises in many aspects of the worldwide economy. This, combined with demand and supply crises in the oil and gas market has required the Company to evolve and adapt to uncertain market conditions. In the light of this situation, the Company reviewed its financial risk management program and concluded that the existing procedures adequately addressed this challenging situation.

In the context of the COVID-19 pandemic and low oil price environment, the Company especially focused on liquidity, credit and counterparty risks:

- The Company conducted various liquidity scenarios, financial stress tests and sensitivity analyses. The conclusion was that the Company's lease portfolio and the existing financing facilities are sufficient to ensure that the Company will continue as a going concern in the foreseeable future and it can sustain future growth plans;
- The Company performed analyses on the credit and counterparty risks of its clients and financial partners. The analysis resulted in no material impact (refer to note 4.3.8 Net Impairment Gains/(Losses) on Financial and Contract Assets); and
- The Company applied its policy on derivative financial instruments and cash and cash equivalents counterparty credit risk. Credit limits per individual counterparty were not exceeded during 2020.

In terms of hedging policy which addressed interest rates and foreign exchanges rates risks, the hedging instrument in place are effective with no material ineffectiveness (refer to note 4.3.9 Net Financing Costs). The Company did not identify a need to hedge any other financial risks in the COVID-19 context.

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the Company's income or the value of its holding of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

Foreign exchange risk

The Company operates internationally and is exposed to foreign exchange risk arising from transactional currency exposures, primarily with respect to the euro, Singapore dollar, and Brazilian real. The exposure arises from sales or purchases in currencies other than the Company's functional currency. The Company uses forward currency contracts to eliminate the currency exposure once the Company has entered into a firm commitment of a project contract.

For foreign currency risk, the principle terms of the forward currency contract (notional and settlement date) and the future expense or revenue (notional and expected cash flow date) are identical. The Company has established a hedge ratio of 1:1 for all its hedging relationships.

The main Company's exposure to foreign currency risk is as follows based on notional amounts:

Foreign exchange risk (summary)

in millions of local currency	31 December 2020			31 December 2019		
	EUR	SGD	BRL	EUR	SGD	BRL
Fixed assets	71	-	93	83	-	516
Current assets	93	6	554	89	1	868
Long-term liabilities	(28)	-	(43)	(48)	-	(235)
Current liabilities	(174)	(16)	(633)	(105)	(20)	(1,169)
Gross balance sheet exposure	(38)	(10)	(29)	18	(19)	(21)
Estimated forecast sales	78	-	-	65	-	-
Estimated forecast purchases	(1,079)	(525)	(1,073)	(1,175)	(276)	(888)
Gross exposure	(1,039)	(535)	(1,102)	(1,092)	(295)	(909)
Forward exchange contracts	1,055	528	1,121	1,086	293	1,111
Net exposure	16	(8)	19	(6)	(1)	202

The decrease of the BRL exposure during 2020 was mainly driven by the decrease of the loans to the Brazilian operations entities.

The estimated forecast purchases relate to project expenditure and overhead expenses for up to three years. The main currency exposures of overhead expenses and Brazilian operations are hedged at 100% for the coming year, between 66% and 100% for the year after, and between 33% and 100% for the subsequent year depending on internal review of the foreign exchange market conditions.

Foreign exchange risk (exchange rates applied)

	2020	2019	2020	2019
	Average rate		Closing rate	
EUR 1	1.1422	1.1195	1.2271	1.1234
SGD 1	0.7254	0.7330	0.7566	0.7434
BRL 1	0.1958	0.2540	0.1925	0.2488

The sensitivity on equity and the income statement resulting from a change of ten percent of the US dollar's value against the following currencies at December 31 would have increased (decreased) profit or loss and equity by the amounts shown

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below. This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis as for 2019.

Foreign exchange risk (sensitivity)

	Profit or loss		Equity	
	10 percent increase	10 percent decrease	10 percent increase	10 percent decrease
31 December 2020				
EUR	(1)	1	(124)	124
SGD	1	(1)	(40)	40
BRL	0	(0)	(21)	21
31 December 2019				
EUR	1	(1)	(125)	125
SGD	0	(0)	(21)	21
BRL	0	(0)	(27)	(27)

As set out above, by managing foreign currency risk the Company aims to reduce the impact of short-term market price fluctuations on the Company's earnings. Over the long-term however, permanent changes in foreign currency rates would have an impact on consolidated earnings.

Interest rate risk

The Company's exposure to risk from changes in market interest rates relates primarily to the Company's long-term debt obligations with a floating interest rate. In respect of controlling interest rate risk, the floating interest rates of long-term loans are hedged by fixed rate swaps for the entire maturity period. The revolving credit facility is intended for the fluctuating needs of construction financing and bears interest at floating rates, which is also swapped for fixed rates when exposure is significant.

For interest rate risk, the principle terms of the interest rate swap (notional amortization, rate-set periods) and the financing (repayment schedule, rate-set periods) are identical. The Company has established a hedge ratio of 1:1, as the hedging layer component matches the nominal amount of the interest rate swap for all its hedging relationships.

Interest rate benchmark reform

The reform and replacement of benchmark interest rates such as USD LIBOR 3M and other interbank offered rates ('IBORs') has become a priority for global regulators. There is currently uncertainty around the timing and precise nature of these changes. To transition existing contracts and agreements that reference USD LIBOR to Secured Overnight Financing Rate ('SOFR') as benchmark for US\$ denominated derivatives and loans, adjustments for term differences and credit differences might need to be applied to SOFR, to enable the two benchmark rates to be economically equivalent on transition.

The Company's treasury department is managing SBM Offshore's IBOR transition plan with the support of the Company's Legal department. The greatest change will be amendments to the contractual terms of the USD LIBOR-referenced floating-rate debt and the associated interest rate swaps and the corresponding update of the hedge designation. However, the changed reference rate may also affect other systems, processes, risk and valuation models.

Relief applied

The Company has applied the following reliefs that were introduced by the amendments made to IFRS 9 Financial Instruments in September 2019:

- When considering the 'highly probable' requirement, the Company has assumed that the USD LIBOR 3M interest rate on which the Company's hedged debt is based does not change as a result of IBOR reform.
- In assessing whether the hedge is expected to be highly effective on a forward-looking basis the Company has assumed that the USD LIBOR interest rate on which the cash flows of the hedged debt and the interest rate swap that hedges it are based is not altered by LIBOR reform.
- The Company has not recycled the cash flow hedge reserve relating to the period after the reforms are expected to take effect.

Assumptions made

The counterparties to the Company's interest rate swaps are also counterparties to the floating loan they are hedging. It is then assumed that the result of the negotiations with external banks and the implementation of SOFR will not have material impacts on the Company's future financial results.

At the reporting date, the interest rate profile of the Company's interest-bearing financial instruments (excluding transaction costs) was:

Interest rate risk (summary)

	2020	2019
Fixed rate instruments		
Financial assets	6,573	6,770
Financial liabilities	(347)	(448)
Total	6,226	6,322
Variable rate instruments (USD LIBOR 3 Months)		
Financial assets	46	55
Financial liabilities	(5,229)	(4,382)
Financial liabilities (future)	(1,271)	(1,879)
Total	(6,454)	(6,206)

Interest rate risk (exposure)

	2020	2019
Variable rate instruments (USD LIBOR 3 Months)	(6,454)	(6,206)
Less: Reimbursable items (USD LIBOR 3 Months)	668	565
Less: IRS contracts (USD LIBOR 3 Months)	5,649	5,481
Exposure	(136)	(160)

Interest rate risk (sensitivity)

	Profit or loss		Equity	
	100 bp increase	100 bp decrease	100 bp increase	100 bp decrease
31 December 2020				
Variable rate instruments (USD LIBOR 3 Months)	(1)	1	-	-
Interest rate swap	-	-	226	(226)
Sensitivity (net)	(1)	1	226	(226)
31 December 2019				
Variable rate instruments (USD LIBOR 3 Months)	(1)	1	-	-
Interest rate swap (USD LIBOR 3 Months)	0	(0)	240	(240)
Sensitivity (net)	(1)	1	240	(240)

The sensitivity on equity and the income statement resulting from a change of 100 basis points in interest rates at the reporting date would have increased (decreased) equity and profit or loss by the amounts shown above. This analysis assumes that all other variables, in particular foreign currency rates, remain constant. The analysis is performed on the same basis as for 2019.

At December 31, 2020, it is estimated that a general increase of 100 basis points in interest rates would decrease the Company's profit before tax for the year by approximately US\$1 million (2019: decrease of US\$1 million) mainly related to residual exposure on un-hedged financial liabilities.

As set out above, the Company aims to reduce the impact of short-term market price fluctuations on the Company's earnings. Over the long-term however, permanent changes in interest rates could have an impact on consolidated earnings.

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Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's other financial assets, trade and other receivables (including committed transactions), derivative financial instruments and cash and cash equivalents.

Credit risk

Rating	2020		2019	
	Assets	Liabilities	Assets	Liabilities
AA	0	(10)	-	(4)
AA-	67	(171)	21	(89)
A+	66	(205)	20	(147)
A	3	(24)	-	(1)
BBB	-	(1)	1	-
Non-investment grade	-	-	1	-
Derivative financial instruments	136	(411)	43	(241)
AAA	111	-	120	-
AA	10	-	27	-
AA-	217	-	183	-
A+	53	-	131	-
A	3	-	11	-
A-	0	-	0	-
Non-investment grade	20	-	34	-
Cash and cash equivalents and bank overdrafts	414	-	506	-

The Company maintains and reviews its policy on cash investments and limits per individual counterparty are set to:

- BBB- to BBB+ rating: US\$25 million or 10% of cash available.
- A- to A+ rating: US\$75 million or 20% of cash available.
- AA- to AA+ rating: US\$100 million or 20% of cash available.
- Above AA+ rating: no limit.

As per December 31, 2020, cash investments above AA+ rating do not exceed US\$100 million per individual counterparty.

Cash held in banks rated AA- is mainly linked to cash pledged to loan reimbursements to those same banks. Cash held in banks rated below A- is mainly related to the Company's activities in Angola (US\$13 million) and decreased since 2019 following cash repatriation.

For trade debtors the credit quality of each customer is assessed, taking into account its financial position, past experience and other factors. Bank or parent company guarantees are negotiated with customers. Individual risk limits are set based on internal or external ratings in accordance with limits set by the Management Board. At the date of the financial statements, there are no customers that have an outstanding balance with a percentage over 10% of the total of trade and other receivables. Reference is made to note 4.3.19 Trade and Other Receivables for information on the distribution of the receivables by country and an analysis of the ageing of the receivables. Furthermore, limited recourse project financing removes a significant portion of the credit risk on finance lease receivables.

For other financial assets, the credit quality of each counterpart is assessed taking into account its credit agency rating when available or a comparable proxy.

Regarding loans to joint ventures and associates, the maximum exposure to credit risk is the carrying amount of these instruments. As the counterparties of these instruments are joint ventures, the Company has visibility over the expected cash flows and can monitor and manage credit risk that mainly arises from the joint venture's final client.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities

when due, under both normal and abnormal conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

The Company conducted various liquidity scenarios, financial stress tests and sensitivity analyses. The conclusion was that the Company's lease portfolio and the existing financing facilities are sufficient to ensure that the Company will continue as a going concern in the foreseeable future and it can sustain future growth plans. Furthermore, under its Lease and Operate contractual arrangements with clients the Company has considerable time under charters in which to deal with disruptions from events outside the Company's control, thus providing it with considerable financial protection. To date, the Company has been able to manage the COVID-19 situation without the need to use such protection.

Liquidity is monitored using rolling forecasts of the Company's liquidity reserves based on expected cash flows. Flexibility is secured by maintaining availability under committed credit lines.

The table below analyses the Company's non-derivative financial liabilities, derivative financial liabilities and derivative financial assets into relevant maturity groupings based on the remaining period at the statement of financial position date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. The future interest cash flows for borrowings and derivative financial instruments are based on the USD LIBOR 3-month rates as at the reporting date.

Liquidity risk 2020

	Note	Less than 1 year	Between 1 and 5 years	Over 5 years	Total
31 December 2020					
Borrowings		1,336	3,148 ¹	1,522	5,995
Lease liabilities		20	45	6	71
Derivative financial liabilities		133	193	111	437
Derivative financial assets		(97)	(33)	-	(130)
Trade and other payables	4.3.27	1,033	-	-	1,033
Total		2,424	3,354	1,639	7,406

¹ includes the Liza Unity Project finance facility as disclosed in 4.3.24 Borrowings and Lease liabilities.

Liquidity risk 2019

	Note	Less than 1 year	Between 1 and 5 years	Over 5 years	Total
31 December 2019					
Borrowings		766	3,043	1,944	5,753
Lease liabilities		32	102	39	173
Derivative financial liabilities		89	105	29	223
Derivative financial assets		(25)	(3)	-	(29)
Trade and other payables	4.3.27	911	-	-	911
Total		1,772	3,246	2,012	7,030

Capital risk management

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders, benefits for other stakeholders and to maintain a capital structure which optimizes the Company's cost of capital while at the same time, ensures diversification of sources of external funds.

The Company generally uses its corporate revolving credit facility (RCF, US\$1 billion) to bridge financing requirements on projects under construction prior to putting a dedicated project finance facility in place. When a project finance facility is arranged and draw-downs have started, the RCF is repaid and a corporate guarantee from the Company is put in place for the construction period. When the project facility is drawn in full and the associated FPSO is producing, the corporate guarantee is relinquished and the project finance becomes non-recourse debt.

As per December 31, 2020, all the debt associated with operating FPSOs is non-recourse.

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The Company has limited appetite to decrease the existing debt in its structure, as this would involve breakage cost, through winding down the hedges and it would decrease the Company's return on equity. From time to time, it may decide to refinance existing facilities in order to increase and/or extend the tenor of leverage subject to sufficient charter tenor and income.

Given the non-recourse nature of a large part of its debt, the Company monitors its capital risk based on the Lease Backlog Cover Ratio, which is also used by the bank consortium supporting the Company's RCF. Generally, this ratio is calculated as the present value of the projected future net charter income, after deducting the project finance debt and interest payments, of a selected group of FPSO owning entities divided by the Company's corporate debt level (see note 4.3.24 Borrowings and Lease Liabilities).

The gearing ratios at December 31, 2020 and 2019 were as follows:

Capital risk management

	2020	2019
Total borrowings and lease liabilities	5,623	4,922
Less: net cash and cash equivalents	414	506
Net debt	5,209	4,416
Total equity	3,462	3,613
Total capital	8,670	8,029
Gearing ratio	60.1%	55.0%

Other risks

In respect of controlling political risk, the Company has a policy of thoroughly reviewing risks associated with contracts, whether Turnkey or long-term leases. Where political risk cover is deemed necessary and available in the market, insurance is obtained.

4.3.30 LIST OF GROUP COMPANIES

In accordance with legal requirements a list of the Company's entities that are included in the consolidated financial statements of SBM Offshore N.V. has been deposited at the Chamber of Commerce in Amsterdam.