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FrontRunner
Under the skin of Subsea, Engineering and Construction Contracting

STRATEGIC OFFSHORE RESEARCH

Belief in comeback starts to spread

Everyone loves a good comeback story. The old hero coming back from the sporting wilderness to recapture past glories, even if only briefly, is a story that can stir hearts and inspire.

Financial markets love a comeback hero as well. Some aspects of the financial community always seem to be looking for one of those, especially if they've been through a really bad period and stock prices are very low. That presents an opportunity for people to make money, or at least have the chance to think that they might be on to a good thing.

Some stock analysts are already breaking cover and calling the offshore services sector a new comeback kid, though old-stager might be more accurate. One UK bank is getting excited and is suggesting it "cannot think of another period in the past 15 years when all subsections were showing positive signals".

That's right from seismic through to downstream and petrochemicals. As long as there's not another oil price crash, the bank thinks it "hard not to believe that order books are set to rebound". So much so that "it could be seen as irresponsible of the industry to not take advantage of bargain basement pricing" though "capital discipline and rising capex in moderation can co-exist".

FrontRunner agrees that logical, but oil companies seldom move quickly enough to take advantage of market softness. They take much longer to react, and all end up moving at the same time.

Equipment rates are as low as they've been in 40 years. Operators can't keep expecting the contracting supply -chain to keep on reducing costs. The pips have already been squeezed. Clients will now have to be thoughtful about how they deal with the supply chain. Going with the cheapest rate may not always work out if the contractor involved takes longer to do the work, or can't even survive long enough to start the job. Efficiency has to be gauged as well.

So, the bank thinks the market can expect a "two stage recovery". Initially with modest increases in capex making "activity levels jump at current pricing driving utilisation before pricing moves". Dampening things down the bank thinks the impact of the cycle won't be seen to 2022 even if backlogs are restocked before that.

Again, that's not mad, spending will go up. Activity will increase slowly, but it's very hard to see the emergence of some trigger point that's suddenly going to allow pricing to go back up and margins to really grow.

Oil companies are certainly talking about getting more work done or moving, but they absolutely do not want prices to rise. And as long as contractors are hungry or under pressure, someone will be keeping rates down. Even though subsea is very late -cycle, the same bank has Subsea 7 as its "top pick".

The UK bank may be calling things a little early, but its heart is in the right place. Others are more reserved. One major Norwegian bank thinks the cycle can be summed up in two words: "patience needed". That's because spending is still down in 2018 and in 2019 is likely flat. So much so that there would be a "slow recovery with a risk to consensus earnings". Though more reassuringly that bank thinks "offshore has regained competitiveness". That same bank is also not so gung-ho on Subsea 7 seeing a "lost year(s) ahead".

Subsea 7 has already said 2019 will be the trough of the market cycle, but the Norwegian bank has concerns that "2020 will be another lost year from an earnings perspective", just because big contract awards are slow to emerge and won't go into their installation phases until much later.

That backlogs might be recharged is obviously good news, but rates and margins are still the issue. Even though the market's been through a downer, there's more competition in most segments. Limited opportunities keep rates very low.

Integrated well equipment and subsea installation contracts are a way for contractors to try and recover margin by other means, but some major oil companies appear to be saying the concept does not bring them any cost savings, even if they are giving the contracting method a go. Getting prices back up again still looks a very, very difficult task. ⏮

Fugro ready for fresh push

No company exists to get smaller. No company exists to not make or increase profits. Despite that, and probably because there's been another change at the top of the corporate tree, Fugro has felt the need to present a plan detailing a "path to profitable growth".

Then again, Fugro probably does need to prove to the financial markets that the company has sorted itself out. That it's streamlined back to a new core, got rid of divisions that hadn't been great acquisitions or the then Fugro management didn't fully understand.

Fugro sees this return to growth with profits coming from an upturn in energy and infrastructure markets, increased digital solution offerings, and a "leverage of core expertise in new growth markets". All of that makes sense, even if it does sound a little vague.

The priority for Fugro capital allocation is "organic growth and deleveraging". That sounds most like doing more of what the company already does with the aim of paying back debt as well. The mid-term, as in 2021 to 2023, target is 8% to 12% EBIT margin with free cash flow of 4% to 7% expected from €2 billion to €2.5 billion revenues. The aim for return on capital employed is as much as 10% to 15%.

Fugro is still seeking a partner, or even outright buyer. For the Seabed GeoSolutions division which is a joint operation with CGG. The French geophysical company under restructuring has just announced an intention to pull out of vessel operations and even many aspects of data acquisition in preference for interpretation services.

Meanwhile the Fugro ROV fleet has been reduced by some 20% down to 112 systems. That's understandable with demand right down and market leader Oceaneering also being very active on removing systems from service. Up time on the ROVs when working is said to be very high, though in a softer market it's the newer, most reliable vehicles that get used in any case.

Fugro's very realistic about how the future market will develop. The Dutch contractor thinks there will be much more of a "battle to get prices up again, than there was five or 10 years ago". However, Fugro does suggest prices are already up 5% to 10% in the marine site characterisation segment of the business.

Fugro also seems to have no intention of adding to the long-term vessel fleet it controls. Rather the contractor expects to use the spot market and short-term charters to cover increased seasonal vessel capacity when it's needed.

Fugro goes back to core

Fugro got into trouble on the back of ill-advised acquisitions that got further away from the core of what Fugro was best at. And it more often than not over-paid as well. Now Fugro is getting back to what it's best at and getting out of market segments it really doesn't understand.

Having a new, internally-promoted CEO that's worked on both the offshore and onshore sides of the survey market should really help that process too.

But one has to wonder if Fugro might go back to taking out direct competitors to protect the company's main survey market strength. Especially when in areas like ROVs, Fugro can offer nothing different from anyone else in the market. Fugro did originally consolidate the survey market very effectively, but then let fresh competition emerge too easily. ⏮

No sunburn at DOF

The third quarter in the North Sea should be the hottest. The seasonal nature of the market makes it the busiest, even in a downcycle. But when prices are right down, that does not mean that there's a guarantee of a glorious pay-day outside of maybe the tier-one contractors. The other layers of the contracting and vessel owner market are still left scrabbling along.

Even at DOF Subsea, the third quarter results were in the red. The loss was pegged at NKr 98 million on NKr 958 million of revenues. The bottom line was down despite a revenues increase. Last year had seen a NKr 138 million profit on NKr 899 million of revenues.

DOF sees the market conditions as "still challenging" but is holding onto an indication that "tendering activity has increased". The latest quarter didn't see much impairments bar a little on "the oldest ships". And, very unusually for DOF and an indicator of the changed market, DOF will soon have no newbuilds in progress. By the end of the year the flexible flowline spread Skandi Olinda will be delivered. February next year will see the vessel start an eight-year Petrobras charter. On that series of newbuilds jointly owned with TechnipFMC, DOF now expects to "enter a harvesting season" with the rates fixed at the peak of the market. Two other jointly owned ships – the Skandi Vitoria and Niteroi – are idle in Brazil.

Outside of Brazil, there seems to be renewed focus at DOF to promote production support services and long-term vessel chartering. Presumably that's to try and help keep construction spreads chartered to third party contractors to stay where they are by completing less with chartering clients.

Like pretty much every vessel owner, DOF has needed some fresh cash. DOF relatively easily and surprisingly quickly has managed to issue a new NKr 900 million unsecured bond. November 2023 is the maturity date. The cash raised is being used to refinance existing bonds and general corporate purposes. Some $30 million of existing bonds have just been bought back as a result. ⏮

Toisa garage sale continues

It's taken a while but more Toisa vessel sales are emerging. A court managed sales process under bankruptcy protection is seldom quick, unless there's some sort of pre-packed deal agreed from when the company originally went down. Notwithstanding that some deals are now done, for almost two years the process has taken vessels out of circulation. And, some had been idle for a year or more before that.

One of the major players has grabbed one of the former Toisa DSVs. Subsea 7 is confirmed as the buyer for the Toisa Pegasus. And the price is a surprisingly high, in so much as it's still a distress sale, $34.3 million.

For some, Subsea 7 emerging as the buyer was a bit of shocker. But the contractor appears to have a defined regional plan for the ship. The intention appears, though not fully confirmed. to be to relocate the ship to South East Asia. Subsea 7 has a gap coming there anyway as the venerable Rockwater-2 is right now heading for scrap.

For that area the Pegasus can work in several roles with a sat dive system, decent crane, and significant deck space. So, it can handle both diving and light construction tasks. However, there's also talk of a long-term contract in the region in the offing as end clients look at much more flexible field support vessels.

Subsea 7 also currently has the Seven Eagle enroute to Singapore. That's much more of an international asset, and even this year did some work in the North Sea. But one can imagine that ship will go wherever Subsea 7 has work for it, while the Pegasus might become more regionally assigned. Then again, when the Eagle's slightly younger effectively sister vessel Seven Discovery has already been sent for scrap, then perhaps the contractor doesn't have that much of a long-term plan mapped out for the Eagle.

For now, the Toisa Pegasus remains idle off Greece with the handover date to Subsea 7 to be confirmed. Before the end of the year is expected, and the sale is on a simple "as is, where is" basis.

Also, just agreed to be sold is the DSV Toisa Paladin. Mexican company ANG is the one buying that ship and appears to have secured the ship at the much more aggressive price of $18.5 million. ANG/NN also earlier agreed to buy the Toisa Perseus, which still has a small deck-mounted sat dive system. Late November is due to see that ship handed over.

While the logical thing would be expecting both the ANG acquired vessels to go to Mexico, that's not a certainty in the process of the company taking a big step-up into vessel ownership. For the Paladin, while a possible long-term charter to Diavaz in Mexico seems conceivable, likewise other work in South East Asia might also be possible. The Paladin is sitting idle in the Canary Islands off Tenerife. At least the Paladin hasn't been idle as long as the other ships- April 2017 was the last time that ship worked in West Africa with Rana as diving contractor on board.

As mentioned, ANG/NN already agreed to buy the Toisa Perseus. That one's in the process of being handed over in Mobile. The purchase price on the Perseus was $7.4 million and the vessel still has a small deck-mounted sat dive spread on board.

Other Toisa associated ships remain for sale from the bankruptcy court, but also potentially more useful are three vessels from Chinese yards that Toisa had ordered and then walked away from.

Two of those are ROV support ships, one is a DSV. All three are being offered for sale from the yards involved. Bids have just been taken by the CISC yard for the potential purchase of the pretty much complete new ROV support vessels ships originally intended to be the Toisa Resolute and Reveille.

With all such Chinese yard sales which involve some state money, there appears to be severe limitations on how much of a discount, if any, the yard would accept compared to the original order price. Instead, that means that the yard could provide leasing or financing offers to any effective eventual buyer. The yard's preference appears to be for an en-bloc offer for both ships and may even reject offers for single ships.

Incomplete DSV on market too

The ex Toisa newbuild DSV is what was going to be the Toisa Pelagic and is currently under the name "ZMPC Pelagic" – ZMPC in China being the yard building the ship. The ship has even very recently been on sea-trials. However, that's trials for the ship itself not all the equipment on board. There is still a significant amount of work to complete on the ship. Principally the commissioning programme on the Drass-supplied twin-bell sat dive system.

For the Pelagic, mid-2019 is thought the earliest potential delivery date. Market sources say some limited offers have been taken for potential control of the Pelagic. The offers are direct to the yard which may well look at bareboat charter offers on the vessel rather than an outright sale.

Again, part of that is thought to be from limitations on an acceptable price as state-financing is involved with the yard, though that's the case with pretty much all Chinese yards. In any case that makes the asking price as high as the

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FrontRunner also features contributions from our associate, upstream analyst Maarten van Mourik

Ex Toisa newbuilds left homeless

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original order price, perhaps even more. No one's going to pay something like $160 million for the ship in this market, but a bareboat charter could be very cost effective.

Two other more general Toisa OSVs have also been disposed of under the bankruptcy auction process. A deal's done on the Toisa Crest which will go to Maritech of Greece for $0.75 million. The deposit has already been lodged, though the delivery date is to be confirmed. Wells Fargo held the mortgage on the ship and had $5.76 million principle outstanding. Maritech is likely to use the Crest for cable work.

The Crest did start out as an ROV support vessel but has not worked in that mode in a long time. Since 2015 the vessel has been laid-up in Port Elizabeth in South Africa.

Greek interests are also buying the PSV Toisa Invincible. That ship's going to the enigmatically named DP Acquisitions which seems to be related to Prime Tanker Management of Greece. The purchase price on that one was originally intended to be $0.95 million but after further inspection significant recent "storm damage" was identified and the price being paid cut to just $0.5 million. The Invincible is idle in Greece and that ship has always worked in platform supply mode and didn't cross over into a subsea role.

There's still a rump of the Toisa fleet that remains unsold. What happens with them is rather unclear. Clearly the banks owed money want to get something back, but sending the ships for scrap won't net much cash and certainly won't come close to covering the outstanding debt. A further round of auction sale offers might still be possible.

Another recent vessel sale has seen a ship head off outside the oil and gas sphere. Algosaibi has sold the ROV and air diving support vessel Adams Aquanaut. The buyer of that one is Thyssenkrupp in Germany which will use the ship to support submarine construction work and provide rescue cover. The vessel now known as just "Aquanaut", has already been handed over and has arrived in Kiel. The Aquanaut was built in Spain and intended for moderate weather conditions. ⏮

Get off your bottom

All markets turn. The subsea market might be bouncing along the bottom right now, but change is coming. The inflection point when demand can improve again can be seen. Though like that unreliable acquaintance that's the soul of the party, just don't expect it to turn up right now or on time. It's on the way though.

That's an improvement in demand. Sounds good. But that doesn't even mean in the next five years demand will be back to where things were at the most recent peak. And even if it did, the supply side is completely different. Supply has grown so much that, while welcome, modest increases in demand, won't tighten the market that much. Rampant supply will keep the market out of balance. That makes for an industry that's going to be a lot more complicated and a lot trickier.

Immediately things are still tough, but there is light at the end of the tunnel. Understanding how that's going to play out is paramount.

There's already wreckage strewn over the pitch, and more will follow. Realignment, refinancing, consolidation, and all sorts of moves will come with it. Some of it to deal with the huge sums already spent, that now looks like a busted flush. Some of it as smart money moves it to try and take advantage of others' distress and do deals at the bottom of the market.

Strategic Offshore Research's definitive annual **Global Subsea Market to 2022** report tells you what you really need to know about the market. The report is forthright and direct. All the needless noise and wailing of the industry is stripped away for straight to the point answers. What you really need to know. The report gives you the brass-tacks of where the market is and is going. With the market tougher than ever before, being aware of what the issues and risks are has never been more vital.

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