

NKT Teleconference 30 May 2011

Petrobras Frame Agreement

Welcome to this teleconference we have called for today. My name is Thomas Hofman-Bang; I am CEO of NKT Holding. I am seconded today by Michael Hjort CEO in NKT Flexibles and Michael Lyng, CFO of NKT Holding. The purpose of today's meeting is to elaborate on the frame agreement that NKT Flexibles has been awarded by Petrobras that we announced this morning and which is a cornerstone in the development of not only NKT Flexibles but also the overall NKT and a crucial part of our strategy towards our 2015 targets and goals. The way we have organised today's session is that I will give a short introduction with an NKT holding perspective, then I will hand over to Michael Hjort who will then give an NKT Flexibles perspective, give further flavour and detail to the agreement that we have achieved and then afterwards we will have a Q&A session where we will take questions from the audience here, then afterwards we will take questions from the teleconference with the participants watching on the web dialling in.

If we start out taking a perspective on the importance for the NKT Group as such with today's announcement it is obviously a cornerstone and a very important step towards the targets we have defined for 2015. The overall frame agreement has a size of DKK 9.7 billion and half of that is guaranteed and in terms of volume we are talking about approximately 700 km of pipe so a sizeable frame agreement and we are thereby entering territory where we have never been before, neither NKT Flexibles, nor NKT as a group.

The headlines of today's agreement are the amount, as we talked about, and it follows the previous framework agreement that we achieved a couple of years ago where we had a DKK 1.4 billion frame agreement with Petrobras and we have been delivering on that frame agreement the last couple of years out of the Danish facility and the natural next step is the frame agreement that we have announced this morning where as a part of that we have agreed with Petrobras that we will of course erect a factory in Brazil and therefore comply with the local content regulations in Brazil. Michael will go into further details about that part. And if we turn to the strategic perspective from an NKT Holding level, then on the slide here is a repetition of the targets for the overall strategy for the NKT Group that we announced in March this year and singled out NKT Flexibles is part of that strategy with an ambition of achieving an EBITDA margin of 20-25 %. And the message today is that by securing the agreement today with the profitability that is industry norm in that agreement we are now on a good track to achieve the possibility that we have set out as part of our strategy plan.

So therefore with this agreement in place and, knock on wood, hopefully successful execution over the next couple of years in terms of erecting the factory in time and delivering the products and qualifying further products for a water depth down to 2,000 metres and also work with Petrobras about solutions for down to 2,500 metres of water depth we now have all the stones in place to achieve the targets for NKT Flexibles.

And on this slide is basically the same message. That is also a slide that we used when we announced the strategy in March where you can see the journey we have been on with NKT Flexibles coming from the period 2008-2011 where we developed the first frame agreement. We qualified products down to 2,000 metres for 6 inches and 8 inches and we have been delivering and we are still delivering on that frame agreement that Petrobras exhausted 100 % and it was also

pointed out when announcing the strategy that the most crucial part for the strategy to 2015 was to cement our position in Brazil and that is indeed what we have done today with the announcement. And therefore I am a very happy man heading the NKT Group with today's announcement but the person who really deserves the limelight today is maybe Michael Hjort and that is why we have Michael on the stand now so Michael will then dig into further details and then we will come to the Q&A so the floor is yours, Michael.

4.53

Michael Hjort

Thank you, Thomas. Good morning everybody. My name is Michael Hjort. And I am the CEO of NKT Flexibles and just to follow up on what Thomas said he is a happy man. I can guarantee you there are at least two happy men in the company now. A lot more. I just broke the news this morning to all the employees in NKT Flexibles both here in Copenhagen and in Kalundborg, and everybody is really enthusiastic about this.

Just to give you a little bit of perspective on this, of course this is a massive order. It will definitely introduce a new regime for the company. But before we go into the details, I would like to just share a little bit of the perspective with you. What we see up here is the development of the oil price, that is the upper left part you can see and there has been quite a remarkable increase in the price during the last few years. Then we had the drop which was driven by the financial crisis in 2008 and 2009 and what we can see now is that the oil price is heading north again, basically following the same pattern as we saw in 2006, 2007 and 2008 so why is that? If we look at the lower right corner we can see a prediction. It is one prediction but it is a prediction that we do share where the purple band seems to be the consensus band on the expected growth in consumption of oil and gas and the yellow band you see heading down is the consensus band for what most people think is going to be the available production capacity unless some serious investments are made to reinvigorate the production and as you can see the two consensus bands are parting, which means there will be a deficit of oil and gas in the future unless the oil companies really start an investment spree. On the left-hand side in the lower corner, it is very difficult to see but it is actually a floating production unit and the reason why I took this illustration is to confirm to you that the future, the way you actually fill up this gap is going by and large to be made by floating production systems and the good thing for us in floating production systems is that you will need a lot of flexible pipe. So this is a kind of perspective we need to look at. If we take NKT Flexibles as a company and put into that perspective the company was started really in 1995 when we completed the building of the Kalundborg factory. As you can see, in the late 1990s and the beginning of this century the oil price was not that high and it was pretty challenging for NKT Flexibles but we experienced our first growth cycle from 2005 to 2008 where the turnover in the company grew quite dramatically and it followed the oil price up. We then managed to secure a fairly large backlog which we have lived from over the past couple of years but now with this new frame agreement from Petrobras we are ready for the second growth cycle and the second growth cycle we think is really going to kick off from 2013 and onwards, at which point in time we will have Kalundborg fully operational and the Brazil factory fully operational.

There is one industry driver in our market and that is the oil price. The oil price of course is depending on deciding how much investment the oil companies will make and that is driven by the global economy and the expectations of the future demand. What we see is that in order to fill up the demand we will see extraction of oil and gas in deeper and deeper water, which is good news for NKT Flexibles because you need the floating systems and we also see an increased use of subsea

developments, which is also to a large extent using flexible pipe as an enabling asset. Lastly, we see the Flexible pipe solution is often a more flexible, of course, but also a faster way to develop new fields and to do tiebacks of fields to existing infrastructures. If we take that into the perspective and look at the graph just below, we see the red graph and the black graph is demand and supply and you can see the gap opening up, which we talked about before. And if you plot the oil price over time you can see the oil price is going up and up and up and what we see is that the oil companies will have to do something in order to meet that demand which again will be good news for us – hence the investment we are going to make. In the company we have operated with a four-leg strategy over the last few years. The first three are really about the existing organisation, the existing company we have here in Denmark as is and to ensure as efficient load you can see there has been focus on the Brazilian market which of course has been very important for us to secure the load of the Kalundborg plant but the fourth leg, the one with the red text is really the one that we are going to deliver on now and that is to establish ourselves as a true local company in Brazil and become a local supplier, which is a very strategic and important move for us considering the future.

So what is this frame agreement? Thomas mentioned a little bit about the numbers. It is a four-year contract. It is up to 700 km of pipe and we have a minimum guarantee of 50 % of the value so it is going to be between 650 million Euros and up to a massive 1.3 billion Euros if Petrobras decides to fully consume the agreement. The products we are looking at are 4" pipe, 6" pipe and 8" pipe, all of them designed to go down to 2,000 metres of water depth, which is really a challenging part of the market, hence there is also a qualification scope attached to it, this is the same as we had in frame agreement number one and it is very normal for Petrobras, for the way they work. In terms of the minimum guarantee, the 50 % is split so there is a minimum of 86 kilometres of pipe per year and those 86 kilometres at least must represent 12.5 % of the full value, hence the four years will give the 50 %. Of course, we hope that Petrobras will go beyond that but time will tell over the next four years.

Finally, just to give you a visual perception of what we are talking about, we will have two locations from 2013. In order to succeed we will need to focus very much on various issues such as the employees, the products, the sharing of knowledge, the culture and the communication. Brazil is a very different country from Denmark and on both sides we need to reach out for each other. Then by mid-2013 NKT Flexibles in Brazil will be optimised and ready to service Petrobras in the years to come and by mid-2013 we will then have NKT Flexibles in Denmark with the Kalundborg factory ready to service the rest of the world and take that increased activity level which we are all expecting. Okay? That is it.

12.44

Thomas Hofman-Bang

Thank you very much, Michael. And then we are ready to take questions from the audience, I don't know with the cameras, can we sit down, I forgot to ask that before we started, can we sit down, you can still reach us? Then I suppose we sit down and then take questions. And please state your name and organisation before putting forward your question.

13.09 Klaus Ørtoft Madsen, Handelsbanken Markets

My first question relates to the sales capacity when the Brazilian factory is fully up and running, what is the estimated sales capacity based on, industry norms? So that is the first question. Then the second question. Does the minimum or the guaranteed amounts require that you actually qualify on certain of these specified pipes?

13.36 Michael Hjort

Well, the new factory will be designed with a capacity of 250 kilometres of what we call standardised 6" pipe and in that respect it will be quite comparable to the existing plants that are in Brazil. In terms of the qualification programme, the way it works is that Petrobras will call off certain orders from NKT and only in so far that that call of order will contain new designs that we have not yet qualified, then we will have to work on the qualification scope. But in that sense there will be sufficient lag in the projects to complete those qualifications. So it is not a mandatory requirement for the 50 %.

14.30 – Question from the same person, Klaus Ørtoft Madsen, Handelsbanken Markets

Then moving onto the protection or adjustment for raw material price inflation, is that fully covered during the four years of this agreement?

14.39 – Michael Hjort

Yes, when you work with Petrobras in the contracts there is a certain price escalation clause which states a certain date when you freeze your designs and your material prices and then following various indices of the raw materials and cost of labour into a formula you will be compensated for any evolution in your cost price. So we are protected.

15.09 – Question from the same person, Klaus Ørtoft Madsen, Handelsbanken Markets

Right. Then just finally on the deeper water depth, 2,500 metres, you are looking for a partner to finalise certain projects here and is that particular partner now Petrobras?

15.25 – Michael Hjort

Well, the frame agreement does not contain any products of 2,500 metres water depth capacity, as I said it is exclusively about 1,500 and 2,000 metre products which is the standard Petrobras consumption today, but it is correct that we think Petrobras would be the ideal partner for NKT Flexibles in the final commercialisation of the 2,500 metre product. We have a design that we are working on today, we have done some tests, it looks promising, but we still need to find the partner that will help us to bring this into full blown production.

16.07 – Question from the same person, Klaus Ørtoft Madsen, Handelsbanken Markets

And are there any indications that they want to co-develop this with you?

16.13 – Michael Hjort

Well, we are talking to them, I think that is the indication I can bring to the table today.

16.18 – Same person, Klaus Ørtoft Madsen, Handelsbanken Markets

Thank you.

16.26 – Klaus Kehl from Nykredit Markets

First of all congratulations with this contract. A couple of questions. Obviously you are quite happy about this contract but what are the main risks related to this, going forward? That is my first question.

16.45 – Michael Hjort

Well, the main risk obviously lies in the fact that we had to erect a factory in Brazil and get an organisation up and running so it is ready to take on orders from Petrobras in two years' time, say from mid-2013. That will be quite an achievement to make that happen but we are quite comfortable that we can do it, we have worked with this inside the company for quite a long time, obviously we have had to keep it very secret, but we have done a lot of preparations and we also did a little bit of a trial with the Kalundborg expansion over the last two years so handling large projects and implementing process lines is something we have good experience with very recently, so we are quite confident we will be able to make it.

17.37 - Klaus Kehl

Okay, and then my second question would be, what would it take for Petrobras to fully consume the entire agreement?

17.47 – Michael Hjort

A few nice big chunky call-off orders would make it, I think, it is a frame and they have the privilege that they can place call-off orders to the extent they like with NKT Flexibles within that frame and the way it works between us and Petrobras is that they will ask us, we have this order with this consumption and we want it delivered here, here and here and then we will confirm as to whether we can deliver in line with that expectation. And basically it is a very close partnership between the two companies in trying to maximise the outcome of the frame agreement.

18.25 – Klaus Kehl

Okay, then my final question. Have you received or will you receive any kind of pre-payments on this contract so you can finance the factory in Brazil?

18.36 – Michael Hjort

No. There will be no pre-payment, Petrobras operates with a very strict set of payment terms and we just have to finance through NKT Flexibles via external financing for the erection of the factory.

18.52 – Klaus Kehl

Okay, thank you.

18.53 – Thomas Hofman-Bang

And there I could add that as it is also stated in today's announcement that NKT Flexibles will finance this, looking at the cash flow coming out of the existing NKT Flexibles and adding the cash flow that is expected out of Brazil, the NKT Flexibles as a financing vehicle can handle the financing itself. Any further questions? There is one more.

19.25 – Question (no name stated)

Yeah, just one or two follow-ups. Are you basically able to use this Brazilian capacity to serve other markets like the Gulf of Mexico, the Asian area when you have fulfilled your obligations towards Petrobras?

19.46 – Michael

Actually I would hope not because that would mean Petrobras will fully consume the capacity in the years following but surely the Flexibles pipe plan itself will be capable of producing Flexibles pipes that can be used in the Gulf of Mexico or West Africa which are the two markets that are logistically closest to the Brazilian area. But the layout of the factory will be optimised to suit

Petrobras type of products and of course the investment in a factory in Brazil is not intended for the four-year contract only, we have big expectations that we will be able to continue to fill up the factory by Petrobras products.

20.27 - Question

Are there any commercial inhibitors in exploiting Brazilian capacity elsewhere like duties, restrictions etc.?

20.37 – Michael Hjort

No, in fact it is probably more challenging to bring things into Brazil than bringing them out of Brazil so we do not see any, at least today we do not see any big hindrances in taking things out of Brazil. But if you look at the Brazilian market in a historical perspective, Petrobras has almost always been able to consume all the production capacity in the country and from our discussions with Petrobras we have a good feeling that they will be able to also consume the capacity of this factory.

21.17 – Thomas Hofman-Bang

Any further questions by the audience here? That does not seem to be the case. Then I will ask the operator if we have anybody on line with a desire to ask a question?

21.26 Operator

Thank you. If you have a question please press star then one on your touch tone phone. Once again, if you have a question please press star then one on your touch tone phone.

21.43 – Thomas Hofman-Bang

That does not seem to be the case. Then if there are no further questions then I will thank everybody for participating in this teleconference and we will be back in August with our Q2 unless we are able to call for an extraordinary TC with other good news. Thank you very much. Bye.