SBM OFFSHORE

ENERGY. COMMITTED.

ANNUAL REPORT 2021

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

The movement of loss allowance during the year 2021 is summarized as follows:

	Finance lease receivable		Construction work-in-progress		Trade receivables		Other financial assets	
	2021	2020	**2021**	2020	**2021**	2020	**2021**	2020
Opening loss allowance as at 1 January	**(1)**	**0**	**(4)**	**(0)**	**(3)**	**(4)**	**(114)**	**(99)**
Increase in loss allowance recognized in profit or loss during the year	(0)	(1)	(2)	(4)	(4)	(3)	(3)	(15)
Receivables written off during the year as uncollectible	-	-	-	-	-	2	-	-
Unused amount reversed	1	0	5	0	4	2	9	0
At 31 December	**(0)**	**(1)**	**(1)**	**(4)**	**(3)**	**(3)**	**(108)**	**(114)**

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.

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)

	31 December 2021			31 December 2020		
in millions of local currency	EUR	SGD	BRL	EUR	SGD	BRL
Fixed assets	57	-	84	71	-	93
Current assets	82	3	398	93	6	554
Long-term liabilities	(19)	-	(577)	(28)	-	(43)
Current liabilities	(166)	(6)	(743)	(174)	(16)	(633)
Gross balance sheet exposure	**(46)**	**(3)**	**(837)**	**(38)**	**(10)**	**(29)**
Estimated forecast sales	40	-	-	78	-	-
Estimated forecast purchases	(977)	(237)	(2,542)	(1,079)	(525)	(1,073)
Gross exposure	**(983)**	**(240)**	**(3,379)**	**(1,039)**	**(535)**	**(1,102)**
Forward exchange contracts	1,000	241	3,281	1,055	528	1,121
Net exposure	**17**	**1**	**(97)**	**16**	**(8)**	**19**

The increase of the BRL exposure results from *FPSO Sepetiba*, *FPSO Almirante Tamandaré* and *FPSO Alexandre de Gusmão* under construction in 2021.

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)

	2021	2020	2021	2020
	Average rate		Closing rate	
EUR 1	1.1827	1.1422	1.1326	1.2271
SGD 1	0.7442	0.7254	0.7413	0.7566
BRL 1	0.1856	0.1958	0.1795	0.1925

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 below. This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis as for 2020.

Foreign exchange risk (sensitivity)

	Profit or loss		Equity	
	10 percent increase	10 percent decrease	10 percent increase	10 percent decrease
31 December 2021				
EUR	0	(0)	(108)	108
SGD	(0)	0	(18)	18
BRL	(0)	0	(43)	43
31 December 2020				
EUR	(1)	1	(124)	124
SGD	1	(1)	(40)	40
BRL	0	(0)	(21)	21

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. On 5 March 2021, LIBOR's administrator (IBA) set out clear end-dates for new use of USD LIBOR and its cessation as a representative rate:

- December 31, 2021: Cessation of USD LIBOR 1W and 2M tenors; deadline for most of new contract to use USD LIBOR as sole reference;
- June 30, 2023: Cessation of remaining USD LIBOR tenors.

To transition existing contracts and agreements that reference USD LIBOR to Secured Overnight Financing Rate ('SOFR') as the 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.

Any contract referring to USD LIBOR 1W and 2M tenors has been successfully amended by the Company prior to December 31, 2021 in order to no longer use these LIBOR settings. These amendments did not have material impact on the consolidated financial statements.

In addition, in 2021 the Company has started hedging future debt interest rate risk with SOFR interest rate derivatives. For the Prosperity financing (maturing beyond 30 June 2023), IBOR transition to SOFR principles have been agreed with lenders.

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)

	2021	2020
Fixed rate instruments		
Financial assets	6,233	6,573
Financial liabilities	(1,058)	(347)
Total	**5,174**	**6,226**
Variable rate instruments (USD LIBOR 3 Months)		
Financial assets	51	46
Financial liabilities (USD LIBOR 3 Months)	(6,793)	(5,229)
Financial liabilities (future) (USD LIBOR 3 Months)	(1,788)	(1,271)
Financial liabilities (future) (SOFR)	(730)	-
Total	**(9,259)**	**(6,454)**

Interest rate risk (exposure)

	2021	2020
Variable rate instruments (USD LIBOR 3 Months)	(8,529)	(6,454)
Variable rate instruments (SOFR)	(730)	-
Less: Reimbursable items (USD LIBOR 3 Months)	1,746	668
Less: IRS contracts (USD LIBOR 3 Months)	4,985	5,649
Less: IRS contracts (SOFR)	730	-
Exposure	**(1,798)**	**(136)**

Interest rate risk (sensitivity)

	Profit or loss		Equity	
	100 bp increase	100 bp decrease	100 bp increase	100 bp decrease
31 December 2021				
Variable rate instruments (USD LIBOR 3 Months)	(18)	18	-	-
Variable rate instruments (SOFR)	-	-	-	-
Interest rate swap (USD LIBOR 3 Months)	-	-	270	(270)
Interest rate swap (SOFR)	-	-	54	(54)
Sensitivity (net)	**(18)**	**18**	**324**	**(324)**
31 December 2020				
Variable rate instruments (USD LIBOR 3 Months)	(1)	1	-	-
Interest rate swap (USD LIBOR 3 Months)	-	-	226	(226)
Sensitivity (net)	**(1)**	**1**	**226**	**(226)**

The exposure of US$1,798 million is primarily related to un-hedged current financial liabilities, namely the bridge loan facilities for *FPSO Almirante Tamandaré* and *FPSO Alexandre de Gusmão* secured in 2021. The interest rate exposure arising from the bridge loans is mainly offset by the Cash and Cash Equivalent at December 31, 2021.

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 2020.

At December 31, 2021, 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$18 million (2020: decrease of US$1 million) mainly related to the exposure on the bridge loan facilities for *FPSO Almirante Tamandaré* and *FPSO Alexandre de Gusmão* and the 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.

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

	2021		2020	
Rating	Assets	Liabilities	Assets	Liabilities
AA	2	(33)	0	(10)
AA-	21	(95)	67	(171)
A+	16	(142)	66	(205)
A	2	(13)	3	(24)
BBB	-	(1)	-	(1)
Non-investment grade	0	(0)	-	-
Derivative financial instruments	**40**	**(283)**	**136**	**(411)**
AAA	223		111	-
AA	5		10	-
AA-	187		217	-
A+	534		53	-
A	50		3	-
A-	0		0	-
Non-investment grade	22		20	-
Cash and cash equivalents and bank overdrafts	**1,020**	**-**	**414**	**-**

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, 2021, cash investments above AA+ rating do not exceed US$100 million per individual counterparty. Cash held in banks rated A+ has been diversified in cash investments above AA+ rating since year-end.

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 and Brazil (US$16 million) and has decreased since 2020 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 two 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.

In 2021 the Company again conducted various liquidity scenarios, financial stress tests and sensitivity analyses. The conclusion remained that the Company's lease portfolio and the existing financing facilities and overall financing capacity 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/SOFR 3-month rates as at the reporting date.

Liquidity risk 2021

	Note	Less than 1 year	Between 1 and 5 years	Over 5 years	Total
31 December 2021					
Borrowings		1,017	4,648	3,156	8,821
Lease liabilities		19	34	4	56
Derivative financial liabilities		121	107	40	268
Derivative financial assets		(34)	(16)		(50)
Trade and other payables	*4.3.26*	1,111	-	-	1,111
Total		**2,234**	**4,772**	**3,200**	**10,207**

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	*4.3.26*	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.

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 ensuring 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 recovered and the project finance becomes non-recourse debt.

As per December 31, 2021, all the debt associated with operating FPSOs is non-recourse.

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, 2021 and 2020 were as follows:

Capital risk management

	2021	2020
Total borrowings and lease liabilities	7,701	5,623
Less: net cash and cash equivalents	1,021	414
Net debt	**6,681**	**5,209**
Total equity	3,537	3,462
Total capital	**10,217**	**8,670**
Gearing ratio	65.4%	60.1%

Climate related risks

The Company has adopted two climate change scenarios to future-proof current strategy and take appropriate action. The scenarios are based on the International Energy Agency (IEA) and the Intergovernmental Panel on Climate Change (IPCC) data, as explained in section 5.1.4 Taskforce for Climate-related Disclosure (TCFD):

- A Steady Climate Change Scenario with a positive impact on climate change, but which falls short of meeting the Paris Agreement goals.
- A Bold Climate Action Scenario providing for strong commitment towards targets, as per the Paris Agreement.

Through its strategy process the Company tests the resilience of its portfolio and business model against each of these scenarios. Refer to section 1.4.3 Climate Change Risk & Opportunity for a detailed presentation of these scenarios and the risks associated to each of them.

Although climate related risks are key drivers of the Company strategy, budgeting exercise, capital allocation and prospects selection, the Company did not experience any impact on the financial result of the period. The risks will however remain key points of attention for areas such as impairment testing, estimation of remaining useful life, expected credit losses and provisions for future periods.

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.

4.3.29 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.