SBM OFFSHORE

ENERGY. COMMITTED.

ANNUAL REPORT 2019

4.3.5 EXPENSES BY NATURE

The table below sets out expenses by nature for all items included in EBIT for the years 2019 and 2018:

	Note	2019	2018
Expenses on construction contracts		(1,319)	(469)
Employee benefit expenses	4.3.6	(575)	(519)
Vessels operating costs		(312)	(289)
Depreciation, amortization and impairment		(268)	(235)
Selling expenses		(30)	(22)
Other costs		(153)	(142)
Total expenses		**(2,657)**	**(1,676)**

Year-on-year, expenses on construction contracts increased mainly as a result of higher activity on Turnkey projects. The main projects responsible for the increase of expenses are: 2019 awards of FPSO *Liza Unity* and FPSO *Sepetiba* and the initial limited scope awarded for the FPSO *Prosperity* project.

In 2019, depreciation, amortization and impairment was impacted by a US$16 million impairment of semi-submersible production facility Thunder Hawk and a US$9 million impairment of Deep Panuke MOPU.

Expenses related to short-term leases and leases of low value assets amounted to US$6 million in 2019 (2018: US$4 million).

4.3.6 EMPLOYEE BENEFIT EXPENSES

Information with respect to employee benefits expenses are detailed as follows:

	Note	2019	2018
Wages and salaries		(329)	(308)
Social security costs		(54)	(51)
Contributions to defined contribution plans		(33)	(31)
Contributions to defined benefit plans		(3)	(1)
Share-based payment cost		(17)	(17)
Contractors costs		(88)	(64)
Other employee benefits		(51)	(47)
Total employee benefits	4.3.5	**(575)**	**(519)**

Contractors costs include expenses related to contractor staff not on the Company's payroll. Other employee benefits mainly include commuting, training, expatriate and other non-wage compensation costs.

DEFINED CONTRIBUTION PLAN

The contributions to defined contribution plans includes the Company participation in the Merchant Navy Officers Pension Fund (MNOPF). The MNOPF is a defined benefit multi-employer plan which is closed to new members. The fund is managed by a corporate Trustee, MNOPF Trustees Limited, and provides defined benefits for nearly 25,688 Merchant Navy Officers and their dependents out of which approximately 90 are SBM Offshore former employees.

The Trustee apportions its funding deficit between Participating Employers, based on the portions of the Fund's liabilities which were originally accrued by members in service with each employer. When the Trustee determines that contributions are unlikely to be recovered from a Participating Employer, it can re-apportion the deficit contributions to other Participating Employers.

Entities participating in the MNOPF are exposed to the actuarial risk associated with the current and former employees of other entities through exposure to their share of the deficit those other entities default. As there is only a notional allocation of assets and liabilities to any employer, the Company is accounting for the MNOPF in its financial statements as if it was a defined contribution scheme. There are no contributions to the plan agreed at present.

DEFINED BENEFIT PLANS AND OTHER LONG-TERM BENEFITS

The employee benefits provisions recognized in accordance with accounting principles, relate to:

	Note	2019	2018
Pension plan		6	5
Lump sums on retirement		7	6
Defined benefit plans		**13**	**11**
Long-service awards		14	13
Other long-term benefits		**14**	**13**
Employee benefits provisions	*4.3.26*	**28**	**24**

The defined benefit plan provision is partially funded as follows:

Benefit asset/liability included in the statement of financial position

	31 December 2019			31 December 2018		
	Pension plans	Lump sums on retirement	Total	Pension plans	Lump sums on retirement	Total
Defined benefit obligation	38	7	45	38	6	**44**
Fair value of plan assets	(32)	-	(32)	(32)	-	**(32)**
Benefit (asset)/liability	**6**	**7**	**13**	**5**	**6**	**11**

The main assumptions used in determining employee benefit obligations for the Company's plans are shown below:

Main assumptions used in determining employee benefit obligations

in %	2019	2018
Discount rate	0.25 - 2.00	0.75 - 2.00
Inflation rate	1.00 - 1.75	1.00 - 1.75
Discount rate of return on plan assets during financial year	0.50	0.50
Future salary increases	1.00 - 3.00	1.00 - 3.00
Future pension increases	-	-

The overall expected rate of return on assets is determined on the market prices prevailing on that date, applicable to the period over which the obligation is to be settled.

REMUNERATION OF THE KEY MANAGEMENT PERSONNEL OF THE COMPANY

The remuneration of key management personnel of the Company paid during the year, including pension costs and performance related Short-Term Incentives (STI), amounted to US$19 million (2018: US$23 million).

The performance-related part of the remuneration, comprising LTI, Value Creation Stake and STI components, was 60% (2018: 66%). The remuneration (including the Management Board's remuneration which is euro denominated) decreased in 2019 versus 2018, explained by the yearly portion of two LTI schemes being expensed in 2018 (as part of the RP 2015) versus only one yearly portion (i.e. the last one under RP 2015) being expensed in 2019.

The total remuneration and associated costs of the Management Board and other key management personnel (members of the Executive Committee) is specified as follows:

Remuneration key management personnel

in thousands of US$	Base salary	STI[1]	Sharebased compensation[2]	Other[3]	Pensions[4]	Total remuneration
Management Board Members[5]						
2019	2,651	2,532	6,513	440	712	12,848
2018	2,657	3,245	9,472	460	719	16,553
Other key personnel[6]						
2019	2,254	1,028	1,170	1,358	130	5,940
2018	2,482	1,478	808	1,353	151	6,272
Total 2019	**4,905**	**3,560**	**7,683**	**1,798**	**842**	**18,788**
Total 2018	**5,139**	**4,723**	**10,280**	**1,813**	**870**	**22,826**

1 For the Management Board this represents the actual STI approved by the Supervisory Board, which has been accrued over the calendar year, payment of which will be made in the following year.

2 This amount represents the period allocation to the calendar year of vesting costs of all unvested share-based incentives (notably Long Term Incentive shares (performance shares and Value Creation Stake under Remuneration Policy 2018), matching 'STI' shares, and RSUs COO and CFO), in accordance with IFRS2 rules. The shares of the Value Creation Stake vest immediately.

3 Consisting of social charges, lease car expenses, and other allowances, a.o. in connection with the headquarter move, such as housing allowance, settling-in allowance.

4 This represents company contributions to pensions; in the absence of a qualifying pension scheme such contribution is paid gross, withholding wage tax at source borne by the individuals.

5 For sharebased compensation, this includes the former CFO.

6 The definition of 'Other key personnel' has been amended to align with the Executive Committee, as disclosed on the Company's website.

The table above represents the total remuneration in US dollar, being the reporting currency of the Company.

The following table represents the movements during 2019 of all unvested shares (the total number of vested shares held by (former) Management Board members are reported in note 4.3.23 Equity Attributable to Shareholders). Unvested LTI shares in the columns Outstanding at the beginning and/or end of the year, are reported at the Target LTI numbers. The actual vesting hereof in the year is shown for the actual number as per the outcome of the performance criteria as per the Remuneration Policy. As at December 31, 2019 the following share-based incentives are outstanding:

Shared-based incentives	Outstanding at the beginning of 2019	Granted	Vested	Outstanding at the end of 2019
Total 2019	**574,062**	**-**	**326,373**	**247,689**

SHORT-TERM INCENTIVE PROGRAM OF THE MANAGEMENT BOARD

The Short-Term Incentive Program is based upon the short-term operational performance, which includes three sets of Performance Indicators as noted below:

- Profitability;
- Growth;
- Health, Safety, Social and Environment (HSSE).

The Supervisory Board may adjust the outcome of the STI down by 10% (2018: 10% up as well as down). Any such adjustment will be explained in the Remuneration Report.

For 2019 (equal to 2018), the Supervisory Board concluded that the Company's performance indicators had outcomes ranging from below threshold to maximum. For the year 2019 a total of seven performance indicators were established (2018: seven). The Company's performance resulted in performance of 115% (2018: 146%) of salary for the CEO and 86% (2018: 106%) for the other Management Board members.

VALUE CREATION STAKE AND LONG-TERM INCENTIVE SHARES OF THE MANAGEMENT BOARD

Under the Remuneration Policy 2018, the members of the Management Board are entitled to a Value Creation Stake, being a number of shares determined by a four-year average share price (volume weighted). These shares vest immediately upon the award date, and must be retained for five years from the vesting date, or – in the event of retirement or termination – two years after such event.

Number of issued shares	2019	2018
Total 2019	**320,330**	319,198

The number of shares granted is based upon 175% of the individual's base salary and determined by the 4-year average volume-weighed share price (VWAP) over the years 2015 through 2018 (2018: 2014 through 2017), being EUR12.92 (2018: EUR12.34). The fair value of these shares upon issue was EUR12.67 (2018: EU13.295) , being the opening share price of January 2, 2019 (2018: January 2, 2018). During 2019 a board member was awarded an additional Value Creation Stake based on the increase in the individual's base salary. As the increase in base salary was awarded on July 1, 2019 the VWAP over the period July 1, 2015 through June 30, 2019 was EUR13.57. The fair value of these shares upon issue was EUR16.85, being the opening share price of August 9, 2019, the day of the additional vesting.

Under the Remuneration Policy 2015, the Management Board was entitled to an LTI, built up of EPS and relative TSR performance. For the LTI performance period 2017-2019, both the EPS performance indicator (weighting of 60%) and the relative TSR performance indicator (weighting of 40%) came in at the Maximum (2018: Maximum). The total vesting of the LTI grant 2017 will result in 200% (2018: 193%) for the CEO, and 150% (2018: 150%) for each of the other Management Board members.

RESTRICTED SHARE UNIT (RSU) PLANS

The number of shares granted under the RSU plan in 2019 was 601,200 (2018: 649,092), with the three year employment period starting on January 1, 2019 (2018: January 1, 2018).

The annual RSU award is based on individual performance. The RSU plans themselves have no performance condition, only a service condition, and will vest at the end of three years continuing service. The fair value is determined based on the share price at the grant dates, with an adjustment for the present value of the expected dividends during the vesting period.

	2019	2018
Regular, relocation and skills retention RSU (share price as at January 2, 2019)	€ 11.80	€ 14.72

RSU are valued at a share price at grant date, applying the Black & Scholes model. For regular, relocation and skills retention RSU, an average annual forfeiture percentage (including expectations on for example the number of employees leaving the Company before the vesting date of their respective RSU plan) of 2.5% is assumed.

MATCHING SHARES

Under the STI plans for the management and staff of the Company, 20% of the STI is or can be paid in shares. Subject to a vesting period of three years, an identical number of shares (matching shares) will be issued to participants. Assumed probability of vesting amounts to 95% for senior staff. The fair value is determined based on the share price at the grant dates, with an adjustment for the present value of the expected dividends during the vesting period.

The assumptions included in the calculation for the matching shares are:

2019 awards – Fair values

	2019	2018
STI matching shares	€ 15.67	€ 13.46

TOTAL SHARE-BASED PAYMENT COSTS

The amounts recognized in operating profit for all share-based payment transactions are summarized by taking into account both the provisional awards for the current year and the additional awards related to prior years. Total share-based compensation was almost stable versus 2018.

2019	Performance shares and RSU/Value Creation Stake	Matching shares	Total
Instruments granted	13,211	2,050	**15,262**
Performance conditions	1,795	0	**1,795**
Total expenses 2019	**15,007**	**2,050**	**17,057**

2018	Performance shares and RSU/Value Creation Stake	Matching shares	Total
Instruments granted	11,575	1,442	**13,017**
Performance conditions	4,281	0	**4,281**
Total expenses 2018	**15,856**	**1,442**	**17,298**

Rules of conduct with regard to inside information are in place to ensure compliance with the act on financial supervision. For example these rules forbid the exercise of options or other financial instruments during certain periods, more specifically when an employee is in possession of price sensitive information.

The movement in the outstanding number of shares which could potentially vest at a point in time under the Company share-based payment plans is illustrated in the following table.

in number of shares	2019	2018
Outstanding at 1 January	**2,406,331**	**2,593,759**
Granted	1,581,616	1,316,644
Vested	(1,935,761)	(1,309,005)
True-up at vesting	(11,755)	(100,477)
Cancelled	(48,955)	(94,589)
Total movements	**(414,855)**	**(187,428)**
Outstanding at 31 December	**1,991,476**	**2,406,331**

REMUNERATION OF THE SUPERVISORY BOARD

The remuneration of the Supervisory Board amounted to EUR778,000 (2018: EUR761,000) and can be specified as follows:

	2019			2018		
in thousands of EUR	Basic remuneration	Committees	Total	Basic remuneration	Committees	Total
Total	**684**	**94**	**778**	**669**	**92**	**761**

There are no share-based incentives granted to the members of the Supervisory Board. Nor are there any loans outstanding to the members of the Supervisory Board or guarantees given on behalf of members of the Supervisory Board.

NUMBER OF EMPLOYEES

Number of employees (by operating segment)

	2019		2018	
By operating segment:	Average	Year-end	Average	Year-end
Lease and Operate	1,596	1,656	1,524	1,535
Turnkey	1,620	1,783	1,443	1,456
Other	409	475	323	343
Total excluding employees working for JVs and associates	**3,624**	**3,914**	**3,289**	**3,334**
Employees working for JVs and associates	635	525	814	745
Total	**4,259**	**4,439**	**4,103**	**4,079**

Number of employees (by geographical area)

	2019		2018	
By geographical area:	Average	Year-end	Average	Year-end
the Netherlands	414	453	342	374
Worldwide	3,211	3,461	2,948	2,960
Total excluding employees working for JVs and associates	**3,624**	**3,914**	**3,289**	**3,334**
Employees working for JVs and associates	635	525	814	745
Total	**4,259**	**4,439**	**4,103**	**4,079**

The figures exclude fleet personnel hired through crewing agencies as well as other agency and freelance staff for whom expenses are included within other employee benefits. The increase year-on-year reflects the increased activity on Turnkey projects.

4.3.7 RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses amounted to US$24 million (2018: US$23 million) and mainly relate to the internal project 'Digital FPSO', Renewables and FPSO Product Line development costs and investments in laboratory facilities.

The amortization of development costs recognized in the statement of financial position is allocated to cost of sales when the developed technology is used through one or several projects. Otherwise, it is allocated to research and development expenses.

4.3.8 NET IMPAIRMENT GAINS/(LOSSES) ON FINANCIAL AND CONTRACT ASSETS

Impairments of financial assets and contract assets which relate to credit risk as per IFRS 9 requirements are recognized in a dedicated line of the income statement: 'Net impairment losses on financial and contract assets'. Impairments resulting from commercial disputes and other business decisions are not included in this dedicated line of the income statement.

During the year, the following gains/(losses) related to credit risks were recognized:

	2019	2018
Impairment losses		
- Movement in loss allowance for trade receivables	3	(3)
- Movement in loss allowance for construction work-in-progress	0	-
- Movement in loss allowance for finance lease receivables	0	-
- Movement in loss allowance for other assets	(1)	15
Net impairment gains/(losses) on financial and contract assets	**3**	**13**

During the year 2019, the Company recognized US$ 3 million net impairment gain on financial and contract assets. In 2018, the Company recognized a partial impairment reversal of funding loan provided to an Angolan joint venture. This impairment reversal of US$15 million was recognized based on an updated cash flow forecast which included additional cash available at the level of the joint venture.

The limited amount of loss allowance recognized by the Company over 2019 reflects the creditworthiness of the Company's client portfolio.