Oiling the Aker machinery

We have a diversified portfolio, a strong balance sheet and considerable manoeuvrability, but for the Aker machine to gain full speed it has always been and will continue to be dependent on higher oil prices and activity levels.

"My formula for success is rise early, work late, and strike oil."

I have borrowed the above quote from Jean Paul Getty (1892-1976), the founder of Getty Oil and one of the world's first dollar billionaires. He is also known for penning articles for early editions of Playboy magazine. In these articles, Getty provided colourful advice on how to become wealthy, described his own investments and how he managed his wealth, and discussed his cooperation with trade unions.

I am honest enough to admit that it wasn't articles written by Getty – or anyone else for that matter – that prompted me to pick up my first Playboy magazine in the early 1970s, but I have come to realise that there are many lessons to be learned and much inspiration to be taken from Getty. At Aker and in the portfolio companies, we get up early, we work hard, and we've struck oil. The challenge in the short term is low oil prices and falling activity levels in the oil service sector.

If you don't believe in the future of the oil and gas industry, you should stop reading now. In that case, my advice is simple: sell your shares in Aker.

I have never sold a single share in Aker, and to do so now is unthinkable.

RETURN WITH AN X-FACTOR

2015 was in fact a good year for Aker's shareholders. The company's net asset value grew from NOK 17.7 billion to NOK 20.9 billion, corresponding to a rise in value per share from NOK 244 to NOK 282. In addition, a dividend of NOK 10 per share was paid, resulting in a total increase in shareholder value of 20 per cent in a year in which the Oslo Stock Exchange Benchmark Index (OSEBX) rose six per cent. We created NOK 3.6 billion in shareholder value in 2015, compared to NOK -5.4 billion in 2014.

Aker made a difference and created added value in 2015. This X-factor is easily calculated by dividing the percentage change in Aker's net asset value, including dividends, by the percentage change in the OSEBX. When the fraction exceeds 1, Aker has made a difference. The figure for 2015 was 3.33.

In 2015, shareholders reaped the benefits of a more diversified portfolio. The growth in value is quite simply due to the performance of Ocean Yield, Det norske and Havfisk. These three companies excel in their respective areas, and all have simple, easy to understand business models.

PORTFOLIO DIVERSIFICATION

Historically Aker has concentrated its investments in the oil service sector. The sharp downturn in the sector over the past couple of years has significantly altered Aker's portfolio composition. At the beginning of 2016, maritime assets accounted for 27 per cent of the portfolio, and both Ocean Yield and American Shipping have substantial future dividend capacity. Det norske represented 20 per cent, while the oil service companies Aker Solutions, Akastor and Kvaerner combined amounted to 18 per cent of Aker's total assets. Seafood and marine biotechnology (Havfisk and Aker BioMarine) have risen to 15 per cent. Cash/liquid fund investments, real estate and other financial investments each represented seven per cent.

This mix tells me two things: the portfolio is spread across sectors in which Aker has knowledge and experience, and the companies have considerable upside potential.

Aker's net asset value was NOK 20.9 billion at the end of 2015. The industrial portfolio alone was worth NOK 20.2 billion. The financial portfolio was valued at NOK 7.7 billion, and the company had NOK 7 billion in debt. Some 75 per cent of Aker's assets were listed.

Let me review the individual investments:

- *Aker Solutions:* Aker's direct and indirect ownership interest totalled 34.8 per cent, and was valued at NOK 2.9 billion. The company's underlying operations are satisfactory. Aker Solutions' NOK 40 billion backlog provides a solid foundation going into 2016 to face the uncertain and challenging conditions. Between 2014 and 2016, oil companies announced spending cuts averaging almost 40 per cent. Aker Solutions is adjusting to the lower activity levels, and we expect oil companies will want to see stable, higher oil prices before increasing their investments again

- *Akastor:* Aker's direct and indirect ownership interest totalled 36.7 per cent, and was valued at NOK 1.2 billion. Although the oil-service investment company is battling adverse market conditions, its portfolio of companies generally reports satisfactory operations and a total order backlog of NOK 16 billion. I'm pleased to see my son Kristian's enthusiasm, but no one could accuse him of having taken on an easy task. For Akastor, it is reassuring to have the support of a strong Aker.

- *Kvaerner:* Aker's ownership interest totalled 28.7 per cent, and was valued at NOK 0.6 billion. The company has implemented the right measures and is delivering satisfactory results amid a challenging market. Its backlog stood at NOK 14 billion, but the number of new field development projects is limited. Kvaerner has improved its competitiveness remarkably, cutting costs, strengthening its balance sheet and increasing cash holdings.

- *Aker BioMarine:* Aker's ownership interest totalled 99.5 per cent, and its book value stood at NOK 1.4 billion. Profitability is developing in the right way, and the company controls its entire value chain, including a new factory in Houston. The Omega-3 brand ingredient Superba Krill Oil has established itself as a global market leader. Demand for Qrill Aqua from the aquaculture industry continues to grow. Aker BioMarine remains a wildcard in Aker's portfolio.

- *Philly Shipyard and American Shipping Company:* The value of these two financial investments in the U.S. Jones Act market totalled NOK 1.9 billion at the end of 2015. The shipyard has a robust order backlog and sound operations. Our investment in the shipping company generates a high direct annual return.

It is also worth mentioning some companies that are easy to forget, but which are delivering good results through commitment and hard work. Torstein Storækre and his team have created considerable values in Fornebuporten. At Norway Seafoods, Thomas Farstad and his team have shown admirable dedication to building a sustainable processing industry. Ocean Harvest has turned a difficult situation around, salvaging assets for Aker. The company will live on, following a management buyout by two former Aker executives Hallvard Muri and Finn-Arne Lorentsen. A number of smaller investments in Aker's portfolio also have the potential to generate value beyond the dry accounting figures. It may seem like a few meagre millions in the greater Aker context, but they illustrate the hard work that is being done on so many fronts and on so many levels for the benefit of Aker's shareholders.

EXCEPTIONAL COMPANIES

Aker's industrial portfolio includes three companies that made a major difference in 2015: Havfisk, Ocean Yield and Det norske.

- *Havfisk:* The harvesting company reported record results and achieved a share price increase of 90 per cent, including dividends. At year-end 2015, Aker's 73.2 per cent ownership interest was valued at NOK 1.75 billion. A solid resource base of whitefish (cod, saithe and haddock), sustainable harvesting, cost-effective operations and the modernisation of the trawler fleet are taking effect. Growing European demand for cod means better prices, while the depreciation of the Norwegian krone also made a notable contribution. When cod prices rise, just about every krone impacts the bottom line. It rapidly adds up when you're looking at annual catch volumes of 30 million kilos of cod. Aker sold 10 per cent of its ownership interest in Havfisk in the first quarter of 2016. The stock has become more liquid, the share price has risen further and the number of shareholders has increased three-fold to around 3,300 since 2014.

- *Ocean Yield:* The company's portfolio of modern vessels on long-term charters has grown and become more diversified. In 2015, the company's share price rose by 68 per cent, including dividends. Aker's 73 per cent ownership interest was valued at NOK 6.7 billion at year-end. Ocean Yield is a dollar company, and the U.S. dollar has appreciated approximately 40 per cent against the Norwegian krone over the past couple of years. This is good news for a krone investor like Aker. Ocean Yield has an EBITDA order reserve of NOK 24 billion (USD 2.7 billion). Thus far, the company has only paid out a small dividend compared to what is anticipated in the coming quarters and years. The portfolio has been diversified and is more balanced. Counterparty risk remains low, even after a slight increase last year.

- *Det norske:* This oil company's strategy is aggressive and it is unique. In 2015, Det norske was one of the independent E&P companies that gained the most on the world's stock exchanges. The share price rose 39 per cent, and Aker's 49.99 per cent ownership interest was valued at NOK 5.6 billion at year end. Det norske produced a total of 22 million barrels of oil in 2015. Through attractive acquisitions on the Norwegian continental shelf, the company increased its resource base by 130 million barrels of oil equivalents last year. This represents more than NOK 45 billion in future revenues for Det norske, at current oil prices. The company has reserves of half a billion barrels of oil equivalents, as well as a further 325 million barrels in potential resources, which may mature into reserves in the years ahead.

KEEPING IT SIMPLE WORKS BEST

These three companies have a common denominator: straightforward and easy-to-understand business models.

Havfisk is Norway's largest trawler company. It is a streamlined harvesting company that is focused on sustainable, cost-effective fishing of quota-determined volumes. The price of cod is therefore the most important indicator for future profits and shareholder value.

Ocean Yield is primarily engaged in long-term bareboat charters that generate predictable revenues. Its vessels are spread across various maritime segments, and minimising counterparty risk is an important objective. The average weighted contract term is 10 years, providing a robust foundation for attractive dividends going forward.

Det norske is an integrated E&P company operating on the Norwegian continental shelf, and is probably the most oil price-sensitive share traded on the Oslo Stock Exchange. While the company obviously has no influence on oil prices, I am impressed by its cost-cutting initiatives and the way it has seized opportunities to strengthen its position on the NCS. The Ivar Aasen development appears to be progressing better than I feared three years ago. In my letter to shareholders next year, which will be written after Aasen comes on stream, I will reflect on both the positive and negative experiences we've had along the way.

When a business model is simple and the objective clear, it is easier to track progress and to keep focus on value triggers, margins and risk factors. In more complex and complicated business models, it is easy to lose perspective and control, especially of cost drivers that consume margins. This is why Aker has concentrated on simplifying its portfolio companies.

At Aker, we are open and transparent about our assessments and views on the market. Aker invests in sectors and companies that we believe in, that we know and in which we can make a difference. Over the past year, Aker's investment team has worked hard on evaluating a number of projects, companies and transactions across different industries. The number of opportunities presented to us has been unusually high over the past year. We have crunched the numbers for companies across a range of industries, and assessed opportunities in all the sectors that we're familiar with. It is inspiring to see so many companies contacting us because they would like to have Aker as an owner.

We will continue to focus on industries in which we have experience and where we believe we excel. However, I cannot exclude the possibility that Aker may, in the right circumstances, consider investing in new segments. Aker is ready to engage in transactions and restructurings in which it can contribute knowledge and capital.

ENERGY INVESTMENTS

Investments in the energy space will remain Aker's top priority going forward. Although I am deliberately using the word "energy" to expand the realm of possibilities, oil, gas and related opportunities remain at the top of Aker's near-term agenda.

Aker thinks of itself as an industrial, long-term player. The portfolio is "long" in oil, and will remain so. We will continue doing what we have been doing, albeit hopefully even better. Our macro view of the oil market is unchanged.

In the spring of 2014, we assumed a long-term oil price of USD 90–100 per barrel and an exchange rate of 6 kroner to the dollar - in other words, NOK 540-600 per barrel. At the time of this writing, the oil price is about USD 45 and the exchange rate is at NOK 8.15, or NOK 365 per barrel. In NOK, this represents a decline of around 35 per cent.

Oil is, and will remain, the world's largest and most important raw material for many, many years to come. I dedicated considerable space to this analysis in last year's letter to shareholders, and I stand by my conclusion. In my view, current oil prices are unsustainable if you believe demand will continue to grow.

PART OF THE SOLUTION

Aker's and my view on the oil industry is based on great respect for all the people, organisations, stakeholders and companies working to develop renewable energy sources and solutions, and to promote the shift to green energy. However, we must also be realistic. Aker has been part of Norway's energy solution since the 1870s, first in the hydropower sector and, for the past 50 years, in the oil and gas industry.

Oil and gas will continue to be Norway's most important value driver and to finance the Norwegian welfare state for many decades to come. Norwegian knowledge and industry are spearheading the development of products, technologies and solutions for a sustainable, safe and profitable petroleum industry. Aker will also be part of the solution for reducing emissions of greenhouse gases and environmental toxins.

I am a climate optimist and have great confidence that technological developments and the right financial incentives can make the shift to green energy a reality. Oil and gas will still be an important component of the solution and energy mix. Over time, the use of coal will decline, while the importance of gas and CO_2-friendly energy sources will increase in the medium term.

OUR COURSE IS FIRM

Aker turns 175 years in 2016, and I have been the company's principal shareholder for the past 20 years. I intend to share my reflections on this period in our upcoming anniversary book that is being written by author Henrik H. Langeland. That is why this year's letter to shareholders is shorter than usual. But, as in previous letters, I have sought to express clearly my views on Aker's results and future. Our course remains firm.

2015 was a good year, with a NOK 3.6 billion increase in shareholder value. The start of 2016 has confirmed that the stock and oil markets are volatile and that Aker operates in cyclical industries. Øyvind Eriksen, my most important business partner and Aker's president and CEO, has delivered strong results, ensures a clear direction and effective implementation. To all employees of Aker and the Aker-owned companies, I would simply like to say: thank you for your efforts amid tough and demanding conditions.

Aker's history of delivering in the long term is a strong motivator. Since the company's listing almost 12 years ago, the oil service and maritime businesses have generated the most value. Shareholders have received an average annual return of 24 per cent in the form of share price increase and dividends, while the OSEBX has generated 10 per cent. Aker and Aker-owned companies are likely to engage in more transactions in the years ahead.

I feel that our new, modern offices at Fornebu have given us an extra boost. Many were sceptical to the move, but now I'm met with smiles and positive energy. The Aker Quarter has gathered the management teams and expertise of Aker and the Aker-owned companies. Interaction and collaboration are generating new ideas and fostering an innovative drive. This will contribute to generating shareholder values going forward.

On behalf of the family

PS: As always, I wish to thank my wife and fellow shareholder Anne Grete for her help with the writing, form, content and spelling of this year's letter to shareholders.

Fornebu, 22 April 2016