



## **The Future of Project Profit Prediction**

**An SPE Forum**

**Denver, Colorado**

# Framing The Future

**Monday, June 3**

- Tom Gardner – Simmons & Co., International
- John Howie – Goldman Sachs
- Dick Westney – Westney Consulting Group.



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# Why Are We Here?

- Poor project performance is not acceptable when capital markets are looking for predictability & strong returns
- >50% of execs are dissatisfied with project performance (eg 40% of projects overrun) – more-so than ever
- “... cannot afford to miscalculate capital project risks – yet do not have a good grasp of how to manage (them)

Source: *Capital Project Execution in the Oil & Gas Industry* – Booz Allen Hamilton



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# Session #1: The Stakeholder's Perspective

- Stockholders – how profit predictability impacts *company* value
  - Tom Gardner, Simmons International
- Investors – how profit predictability impacts *project* value
  - John Howie, Goldman Sachs



# Impact of Profit Predictability on Company Valuation

- How many own energy sector stocks?
- How do you come to your purchase decision?
- Do you rely on analysts? Why?
- Have you ever made an investment decision based on a work-related observation? How did it turn out?



# The Analyst's Perspective

- Clients: Institutions & Individuals
- Goal: Pick the long term winners (and losers)
- What makes a good analyst: observant, analytical (cause & effect), unbiased
- The analyst's approach:
  - Top-down - macroeconomics
  - Bottoms-up – company details



# How We Look at a Company

- Company Data:
  - Reserves / Acreage (=> future opportunities)
  - Costs
  - Past Performance
- Impact of Company's Predictability
  - Compare quarterly guidance with actual results
  - BUT: Macro-economics can dominate (and usually do!)



# How Important is Predictability? Key to Survival!!

- Macro – environment may dominate but is essentially unpredictable
- Higher cost / inconsistent producers become non-competitive over time
- Those who do not deliver on expectations (or under-perform peers) will suffer!
  - Heavily discounted in equity market
  - Cost of capital is higher
  - Takeover candidate!



# Discussion Questions

- Does an outside perspective produce better predictions than those made by internal analysts?
- What lessons can internal analysts learn from external – and vice versa?
- How well do your project profitability predictions generally work out?



# The Investor's Perspective

## Impact of Project Profitability on Assessing Value

- Reserves
- Commodity Prices
- Opex
- Capital
- Credibility of the Execution Plan



# Assessing Risk

- Independent assessment of key variables
  - Volumes
  - Ability to hedge commodity pricing
  - Use existing production to hedge?
- Hold project to a defined performance standard
  - Capital
  - LOE
  - Timing
- People????



# Making the Decision

- Predicting profitability as a function of:
  - Value
  - Risk
  - Ability to mitigate risks
- Structure is critical – can mitigate some (but not all) risks



# Discussion

- Three opportunities to invest – (west Texas waterflood, no internal capital, co. can get outside capital or quit project)
  - Large public company
  - Small, private independent
  - Startup by experienced management team
- For each scenario, how would you assess:
  - Value
  - Risk / Reward
- Which deal would you prefer?



# The Knowing – Doing Gap

- Why do many organizations have a gap between “knowing” and “doing”?
- Jeffery Pfeffer<sup>1</sup> suggests:
  - Knowing what to do is not enough
  - Talk substitutes for action/memory substitutes for thinking
  - Fear prevents acting on knowledge
  - Measurement obstructs good judgment

***Why do we not translate learning into effective behavior?***

1. *The Knowing Doing Gap*, Harvard Business School Press



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# What is the Knowing – Doing Gap for Project Profit Prediction?

- Does “Fear prevent acting on knowledge?”
- Does “measurement obstruct good judgment?”
- Is “delusion necessary for projects to proceed?”<sup>2</sup>

2. *Megaprojects & Risk*, Bent Flyvbjerg, Cambridge University Press



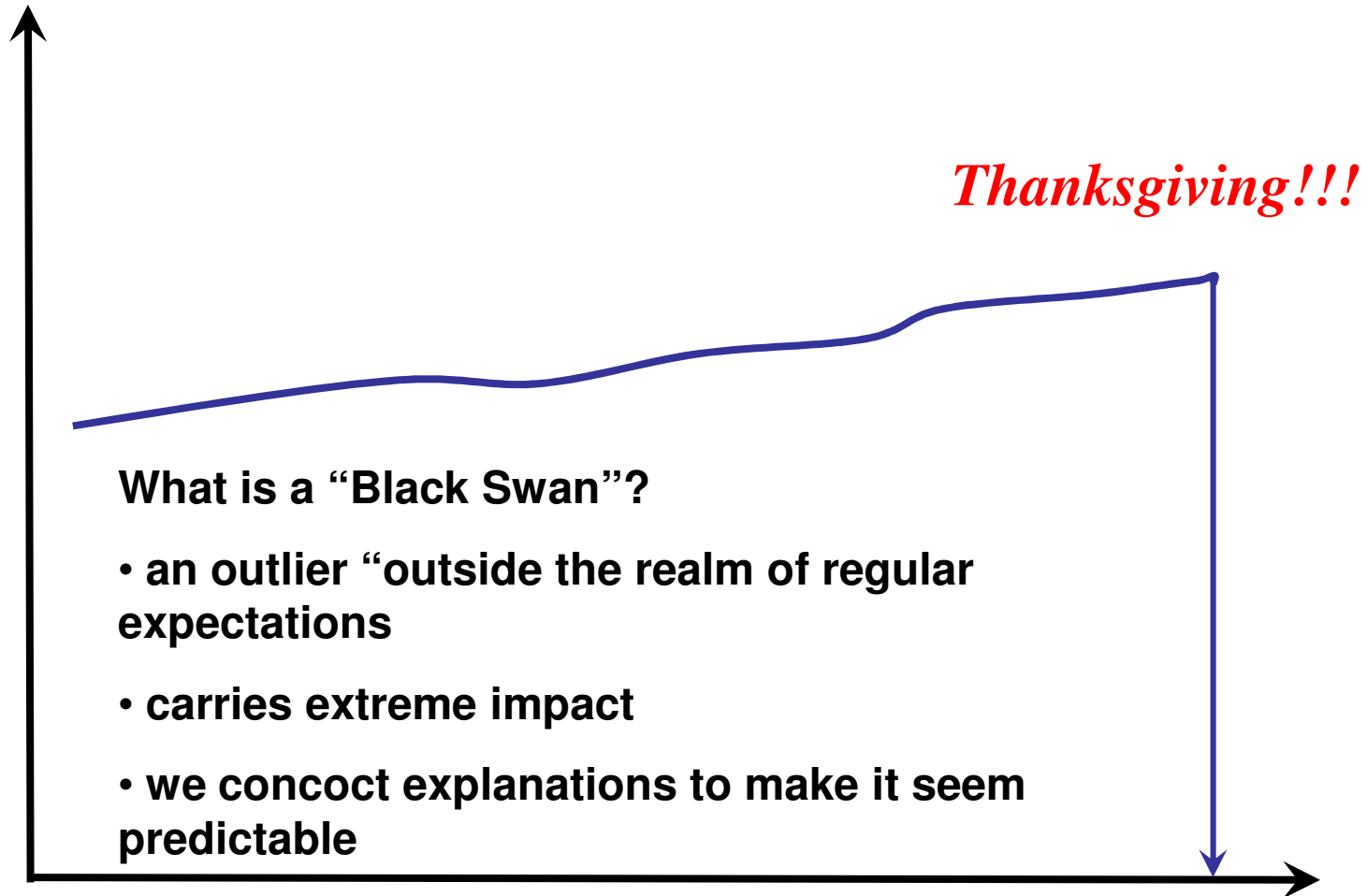
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# HUNTING BLACK SWANS



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# Avoiding the Turkey Trap



*Apologies to Bertram Russell*



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## ***Black Swans in the World of Capital Projects***

- ***What are examples of "Black Swans"?***
- ***How often are Black Swans the reasons for project failures?***
- ***We are we not better at predicting them?***



# Caging the Black Swans

