



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 Pfeffer¹ 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?”²

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



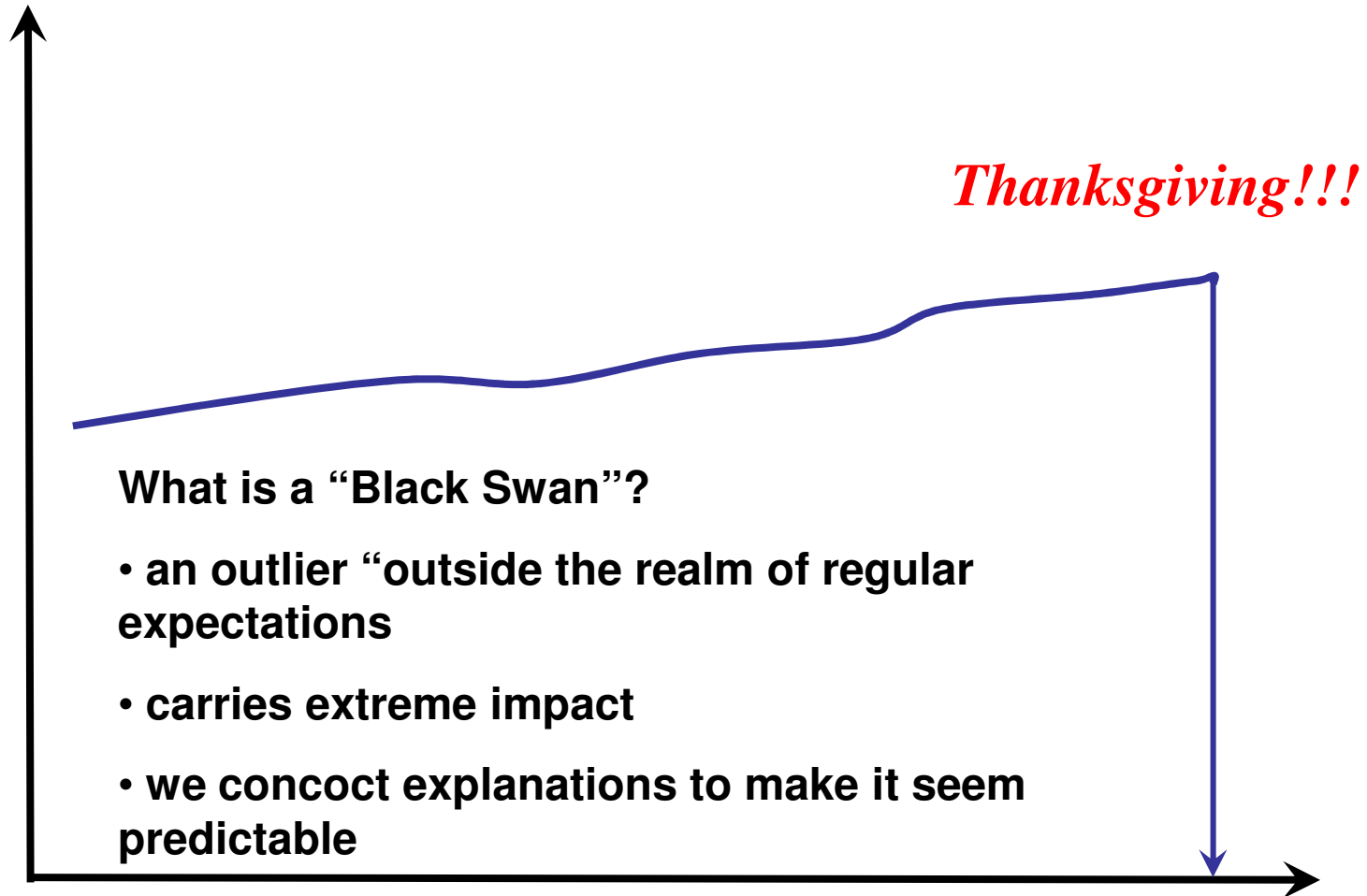
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HUNTING BLACK SWANS



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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

