

A photograph of an oil refinery at sunset. The sky is filled with vibrant, fiery clouds in shades of red, orange, and yellow. The refinery's complex structure, including tall distillation columns, pipes, and scaffolding, is illuminated by warm lights, creating a stark contrast against the dramatic sky. The overall scene conveys a sense of industrial activity and complexity.

IR's oilmen:

Life after mayhem

Oil sector IROs talk to *Candice de Monts-Petit* about the challenges of working in a highly volatile and technically complex industry

At a glance

SECTOR RECAP

After a decade of high growth, oil firms' profits were hit by a massive drop in barrel price last fall. Fixed costs have squeezed margins and cash flows have dried up. The European upstream market was hit especially hard as investors had started to shun the sector a year previously in favor of US shale oil.

THE CHALLENGE

IROs face the arduous test of sustaining investor interest when outlook for the sector is grim and forecasting oil prices difficult. In a complex industry, mastering the know-how and technology requires IROs to have full access to in-house experts, which is not always a given.

MANAGING A LEANER FUTURE

As investors hunt for bargains, IROs will need to communicate how their firm's quality of management and value-adding technical expertise set them apart in riding the down cycle. They shouldn't neglect retail shareholders, who make up a stable and supportive investor base.

Oil sector IROs have seen it all. From double-digit growth figures and skyrocketing market caps at one end to plummeting oil prices and shrunken profits at the other, the period between late 2014 and Q2 2015 has been a far-from-enjoyable one for most professionals in the industry. But the show must go on, as the saying goes, and many IR heads have risen to the challenge, taking action to sustain investor interest and help their company's leaders plan for a leaner future.

'There's no doubt it's been a difficult year: you can't get away from the elephant in the room, which is the oil price and our share price,' says Chris Perry, head of IR at Tullow Oil, a mid-sized, London-based oil producer that, like many similar companies in the sector, had enjoyed sustained growth over the previous decade. When the former investment banker set up Tullow's IR department nine years ago, the stock was trading at £1.50 (\$2.35). After reaching a peak of £16 in 2012, it has now dropped back to just shy of £3 at time of writing.

There are many different reasons for that, Perry says. 'You need to look back to approximately a year ago: the oil price was in excess of \$100 per barrel, costs had gone through the roof and the markets were starting to think European exploration and production companies were overvalued and started looking elsewhere, namely to the unconventional shale oil in the US,' he explains. 'So we've seen a big flight of capital to the US and quite a significant decline in share prices in the European upstream

sector.' In addition, the lower oil price and increased overheads mean the commercial threshold for development has risen, making a number of firms' new exploration successes unprofitable.

'Analysts and investors are most focused on asking whether we can generate attractive returns if oil prices stay low for the next couple of years'

PREPARING FOR THE WORST

To address these issues, Tullow has reduced its exploration appraisal capital, suspended its dividend and implemented a major cost-cutting exercise that has led to a 'significant headcount reduction across the business'.

'We will save \$500 mn over the next three years,' Perry details. 'We don't make predictions, but we are being prudent and resetting our business so it works at a \$50 oil price. Given that resetting and the quality of our assets, however, we're in a very strong position to take advantage of the recovery in the oil price as and when it comes.'

Steve Douglas from Canadian energy major Suncor has also had his hands full thanks to the pricing turmoil. 'Historically, oil prices have been fairly volatile, but after four years of relatively stable

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Brent prices of around \$100-\$110 and a drop of around 50 percent-60 percent over a four-month period starting last fall, the question of oil prices is indeed at the center of every conversation,' he admits. 'Analysts and investors are most focused on asking whether we can generate attractive returns if oil prices stay low for the next couple of years.'

This past year, the Suncor IR team spent a lot of time communicating the concept of 'living within our means and being very disciplined in our capital allocation', a key message the firm had been developing over the previous couple of years. 'A lot of companies make that claim but it really came under the microscope as oil prices dropped and cash flows dried up,' Douglas says, noting that Suncor was one of the few firms in the sector still able to generate free cash flow in the first quarter of 2015.

'That's something investors are very intrigued by, interested in and ask a lot of questions about. We didn't predict the drop last fall but we always had it in mind that oil prices are very cyclical so we were thinking in terms of a sharp drop at some point. And what was really critical for us was being able to manage through that kind of drop without having to halt our capital spending or cut our dividend. It was groundwork that was laid out over three to five years

of very intentional discipline from the top of the house, which has really paid off.'

SHIFTING INVESTOR FOCUS

Over at French oil services firm Technip, the recent large-scale layoffs haven't dampened Kimberly Stewart's enthusiasm for her job. The firm's IRO of nearly eight years has been busy optimizing her team's budget and senior management's time, and answering investor requests – which have not reduced despite market conditions.

'There's high demand and we're very pleased in this cyclical market that investors are still interested in talking to us,' she says, noting that a large number of them are doing 'a lot of homework' and 'deep diving' into the annual report.

'Of course, we get a great number of questions about the price of oil and how that's affecting us,' she continues. 'Investors and analysts want to know what we're doing to reduce costs and how we're working with our clients to get those expenses down, so their projects can get sanctioned and move forward. Some companies in the oil and gas sector made cuts much earlier than we did, so we do get investors asking why we waited to do so.'

The firm runs a business model that is 'later in the cycle' than others and still enjoys a strong backlog of work, Stewart says. 'The challenge is trying to find the right balance, and there's also the human aspect: because of the great backlog, there are some employees we keep on, but when their project is done, there might be no more work for them,' she adds, highlighting the issue of keeping people motivated to finish their assignment.

She goes on to explain that Technip doesn't calculate an oil price forecast in-house. 'That skill set belongs to our clients as every project has a different pricing,' she explains. 'We look at how you can get the same results by doing it in a different way that will result in lower cost.'

Suncor also avoids spending too much time and too many resources on oil price forecasting. 'It's a bit of a fool's game,' says Douglas. 'Obviously, if you have five people in a room, there will probably be as many different views on where oil prices will go. They range from pulling back slightly and staying lower for longer – or even in perpetuity – to the bullish predictions of a return to a \$100-per-barrel price in the next 12-18 months.'



Perry, on the other hand, notes that discussions in meetings have only recently moved on to a longer view. 'In previous years we've been able to look forward a long way, with investors also looking to the future and giving us value for future exploration. But the last six months have been very focused on short-term issues,' he explains. 'Now that we've seen a more stable – albeit low – oil price, we're seeing investors becoming a little bit more interested in the upside of the business and starting to look at the slightly longer term again.'

'The highlight for the year is that there were a lot of doubters and cynics out there at the beginning of 2015. Now the focus of investors is switching from the Armageddon scenario of a low oil price to a company that is much stronger and can look forward to the future rather than worry too much about the issues of the present.'

KEEPING INVESTORS INTERESTED

So how can oil sector IROs keep investors interested during a downturn? One answer is offered by Simon Cole, founding partner of consultancy Reputation Divident: they should seize the opportunity to take greater control of their firm's reputation. 'The companies with very strong reputations tend to have suffered less from the fall in oil price than companies with weaker reputations, because reputation creates confidence.'

He advises IROs to aim for an image that is 'less one dimensional, a bit more wide-ranging. With the oil price crashing, we only hear about what's happening as a result of that, when there are opportunities to build around it and talk about other things [your company] does: innovations it's making, how it's ensuring it appeals to the next generation of oil engineers, and so on.'

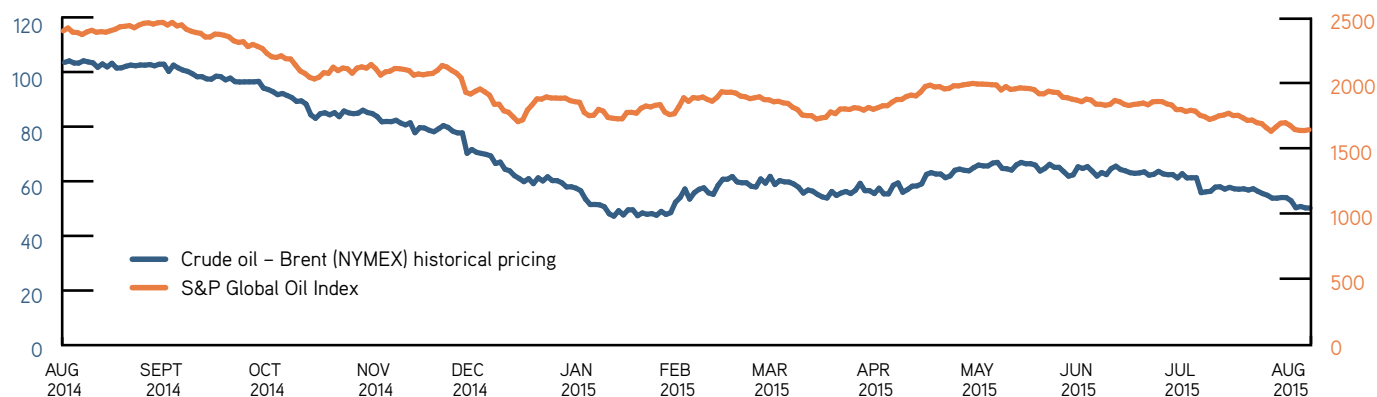
Because companies are under greater scrutiny, the timing is right to start 'wider stance' discussions, Cole says, pointing to those taking place around sectors such as fast-moving consumer goods or pharmaceuticals. 'In those industries, you find far more subjects of debate than just how firms are running their business,' he notes. 'We see much less of this in the oil and gas sector, so the challenge

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for IROs is to create a wider, deeper and richer reputation than they have at the moment.'

A strengthened corporate reputation is a particularly valuable asset when investors are hunting for a bargain. 'When you're in a cyclical downturn, investors see this as an opportunity,' says Stewart. 'They're busy trying to figure out where we are in the downside of the cycle, when might be a good point to enter and which firms in the sector they want to invest in. And they don't want to get a good understanding of just the business and the product, but also of the strategy and the management.'

'I'm having very good conversations with value investors,' confirms Perry. Historically, the upstream oil sector has attracted mainly growth investors that 'day to day are interested in well results and are very





excited by the exploration portfolio.' Now he reports getting inquiries from investors that are long term: 'They are looking at the broader business, the quality of management, how the business will evolve, our production growth and what options we have.'

The shift in Tullow's shareholder base has been gradual, Perry adds. The IR team has recently seen a lot more emerging market interest, as well as US interest, the proportion of which has been growing from below 10 percent to around 30 percent over the last five or six years.

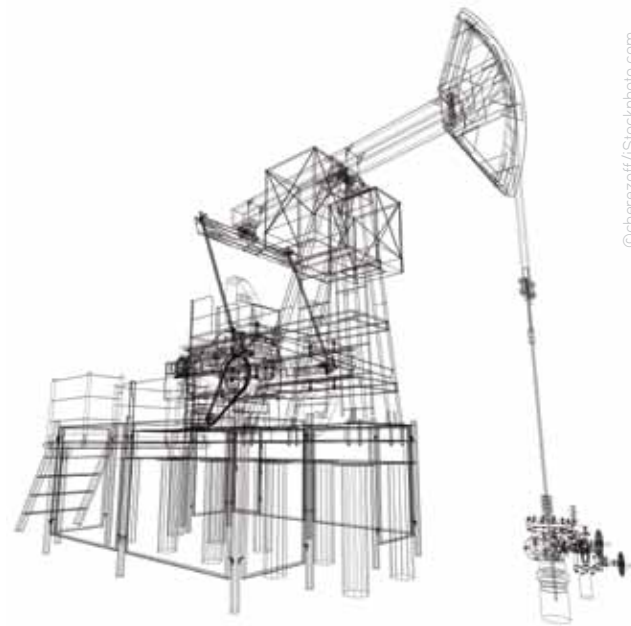
'Some of the longer-term shareholders, such as BlackRock and M&G – which for many years were our largest shareholders – are still within the top 10. But they don't dominate quite like they used to,' he says, adding that his targeting plan will continue to concentrate on the US, where outreach has been fruitful 'particularly with West Coast investors.'

Douglas says Suncor's team has put more focus this past year on visiting secondary markets, such as 'mid-continent places like Des Moines, Kansas City, Austin, Minneapolis, St Paul, Denver or Milwaukee, where there might typically be only one or two funds of real interest to us but they're important, material ones with real promise.' The company has also had good traction in European destinations like Dublin, Copenhagen and Oslo.

'It's very important to establish the bona fide operational credibility of the investor relations team in the minds of investors'

'If you look at the top 25 investors that hold more than one third of our float, you'll see there's been very little movement going back over two to three years,' Douglas points out. Another factor adding to the shareholder base's stability is the high proportion of retail investors on the register, making up around 20 percent of the total. A core holding for Canadians and also a consistent dividend payer, Suncor has managed to retain the confidence of its individual investors during these turbulent times.

'Even an unsophisticated investor recognizes that we have little or no impact on oil prices, even locally and much less globally,' Douglas notes. 'But in the past five years the dividend's compound annual growth is in excess of 25 percent – so retail shareholders tend to be quite supportive.'



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MASTERING THE JARGON

A challenge of another nature awaits the oil sector IRO, who must deal with an audience that can be more or less specialized. 'A generalist is not going to have a detailed technical background and understanding so you need to be able to explain things in layman's terms,' Perry points out. 'Moreover, the valuation is something very specific to the oil and gas sector – and particularly to the exploration and production segment in the way the market looks at it more on a net asset value base, rather than on P/E or EBITDA multiples. And of course, the volatility due to the fluctuation in oil price adds another challenge.'

Stewart couldn't agree more. 'What Technip does is more complex than working in outer space,' declares the former sell-side analyst. 'Unlike the airline or automotive industries, which I've covered in the past and where people actually come across the product in their day-to-day life, at Technip we set up installations 3,000 meters below the sea so, for our audience, understanding the size, scope and complexity of what we're working with is not always that easy.'

'You have to spend time with all these experts in your firm. You might only ever get one question from an investor or you might use the information for no more than five minutes in the whole year, but spending the time with experts and having access



to them to figure out the technology, the equipment and the know-how is really key.' She recalls a two-hour conversation with an engineer about the effects of nitrogen dioxide on steel: 'I'm lucky our CEO and senior management have always been very supportive of [this access].'

Her team also trains technical experts for investor-facing tasks. 'We'll prepare the experts for the type of information investors are seeking so we can make them understand what we do and how it creates value for shareholders.'

'It's very important to establish the bona fide operational credibility of the IR team in the minds of investors,' adds Douglas, who joined Suncor 25 years ago to work in chemical sales. 'I do days of marketing with the CEO and CFO and a few further

days with the leaders of the operational businesses, but half of the meetings are IR-only. I think that's a benefit of having someone in the role who's actually run operations and who's had a commercial role across the organization.'

The IRO of four years occasionally runs into his predecessor, who spent 17 years in the role. 'I told him it must have been grueling. *Not that much*, he laughed. *Fifteen of them were in a bull market!* And of course that makes a difference,' notes Douglas. 'The last few years since the financial crisis haven't really been a walk in the park, and the job is probably more gratifying when your share price is increasing 20 percent annually. Nevertheless, I've enjoyed it immensely: it's a nice culmination of a multi-decade career in the industry.'

Oiling the communication wheels

Simon Cole is the founding partner of Reputation Dividend, a consultancy that helps companies improve the aspects of corporate reputation that affect their shareholder value.

How are reputational challenges affecting the oil sector?

We cover a wide range of companies, and within that there is a large divergence in what we find as to how individual reputations are working. When we talk about performance of corporate reputation, we're talking about the impact it has on 'confidence' as it tracks back to the investment community to manifest in the company's share price.

The divergence of reputational impact we see in oil & gas companies is particularly interesting because the difference between the top and the bottom is one of the largest

spreads we've seen. You have the majors sitting at the top, still with reasonably well-performing reputations: Exxon, Chevron, Shell, and so on. Their reputations carry a lot of weight in the investment community, which perhaps isn't surprising given their scale and economic importance at the country or even international level. That said, we've seen all the majors' reputations decline over the last two or three years.

Then you have relatively smaller companies where reputations are somewhat more one-dimensional. Media discussion of those tend to be limited to financial performance, usually around quarterly results. So one of the biggest challenges for reputation managers in the sector probably faces those in the sub-major category and is the challenge of rising above the responsive, to flesh out and create real and enduring substance for their reputation assets.

How can IROs proactively promote and protect their firm's reputation?

IROs must be sensitive to where their company's reputations have already created value as well as where they can build it further. They need to recognize that what matters to the investment community changes. We've been through a deep recession over the last six or seven years and, going through the cycle, the factors that matter have changed considerably.

In 2011-2012, for example, it was about surviving, being seen to have everything in place when everything around was crumbling. As the cycle moves forward into recovery, it's [now a case of] being seen to have the qualities required for the upturn.

You say reputation can contribute up to an average of 23 percent of an oil and gas firm's share price. How do you determine that figure?

This year, across all the companies we've been tracking in the US and the UK, the highest reputation contribution we found was around 50 percent. At the other end of the spectrum, we see companies where the reputation is such that it's actually destroying up to 10 percent to 15 percent of their value. To determine this we use economic analysis, using data from a number of different sources.

After spending time talking with investment analysts, we collect financial metrics for close to 600 of the largest companies in the US and the UK, along with data from syndicated research surveys relating to corporate reputation. The researchers speak to people who lead companies and ask them to rate their peers and competitors using a variety of dimensions that constitute their corporate reputations. Then, using econometric analysis, we tease out how much reputation is contributing to the share price.