



Compensation
Advisory Partners

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Impact of Oil Price on Executive Pay in Services & Drilling Sector

■ By Chris Earnest and David Jenkins

When OPEC meetings in Vienna ended last week without a deal to extend production cuts to counter the drop in demand brought about by the Coronavirus outbreak, Saudi Arabia and Russia initiated a production battle, flooding the market with more oil regardless of the price. As a result, the energy industry is in a tailspin with WTI crude prices at \$22.

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The impact of this price drop has had an immediate impact. Producers have already announced spending cuts which quickly trigger layoffs and furloughs among the oilfield services and drilling companies. Some companies have already announced these moves and it is inevitable at many others.

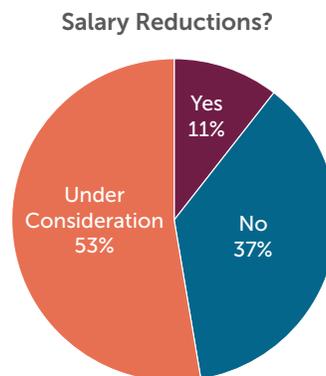
CAP has conducted a “pulse” survey within the oilfield services and drilling sectors to get a sense of the impact this is having on executive compensation. 19 companies participated in our survey this week and the findings are summarized below.

Key Takeaways

- While less than 10% have implemented base salary cuts, nearly half of the companies we spoke with are currently considering them and the reductions will be deeper than those made several years ago at the start of the downturn.
- Nearly one-third of companies have not yet established annual incentive goals for 2020.
- Another one-third indicated that discussions to adjust goals approved in the last few weeks have already begun.
- 16% indicated that bonus payouts for 2020 have already been capped or suspended altogether. The vast majority indicated bonus target reductions have not been considered.
- As the first quarter of 2020 comes to a close, 47% of companies already indicate they expect the Compensation Committee will exercise discretion on bonus payouts at the end of the year.
- 21% of companies have not yet made LTI grants with some citing market volatility.
- 79% of companies have already issued grants with 73% of those indicating that grant date award values were equal to or very close to prior year award values. 27% have modest reductions in grant date value mostly attributable to lower stock prices.
- Almost 60% of companies stated that cash-settled long-term awards were (or will be) used. The average allocation of cash awards is roughly 50% of the total value granted.

Base Salary

2020 was not going to be a year for prevalent salary increases in the sector, but within a matter of a weeks it now seems inevitable that executive salary cuts will be widespread. As talk of layoffs and furloughs turns into reality, the optics are not good (internally and externally) if executives are not also impacted. While only a handful of companies have already implemented salary cuts, the topic has come up and is under consideration at nearly half of the companies we spoke with.

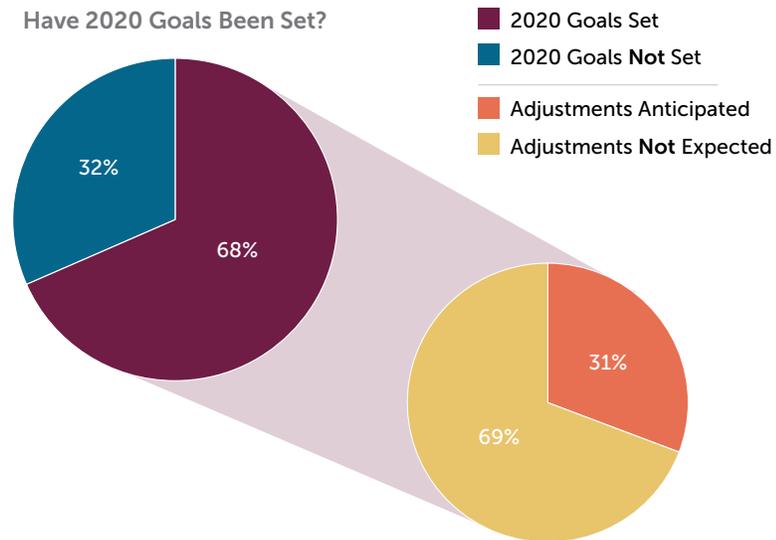


Our early read is that the cuts already implemented and under consideration are deeper than those we saw 4-5 years ago. At that time, reductions of 5-7.5% were common. Cuts of 15-20% have already occurred at a couple of companies with a few others indicating 10%-20% cuts are likely.

Annual Incentive / Bonus Program

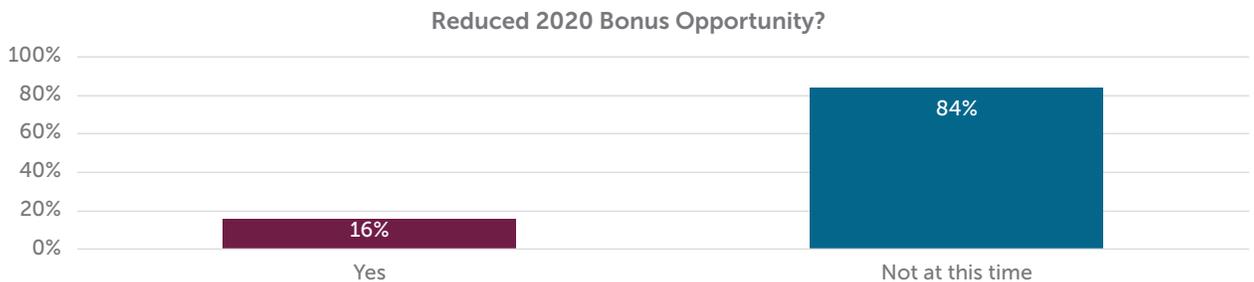
One of the toughest responsibilities of the Compensation Committee is to establish meaningful performance goals in the midst of great uncertainty. Based on our survey, approximately 32% of companies have not yet established performance goals for 2020.

Of those with approved goals, 31% indicated they already anticipate an adjustment to the performance levels approved just in the last few weeks.

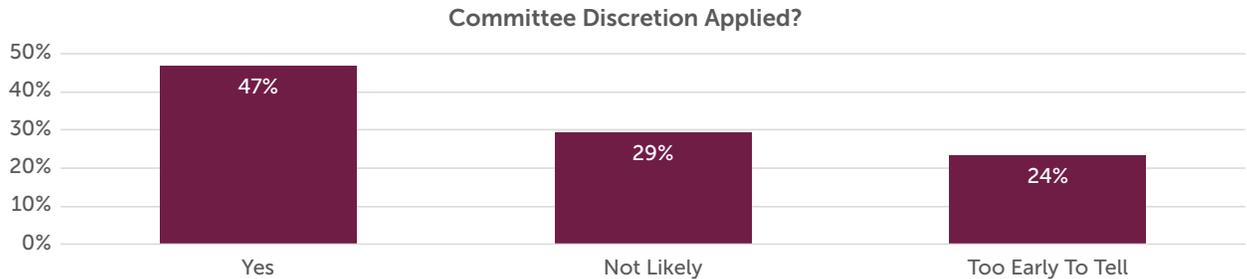


During the extended downturn, we have seen many companies widen the range of performance from threshold to maximum. With these wide performance ranges, the payout levels are typically lowered. For instance, when threshold performance is lowered to 60% or 70% of target the payout might start at 25% instead of the normal 50% of target. Likewise, maximum performance is often stretched further or the payout may be capped at a lower multiple (i.e. 150% vs. the standard 200% leverage).

A few companies indicated that within the last couple of weeks they have already suspended or capped 2020 bonus payouts. While only 16% of companies indicated such actions, it is not an insignificant development at this early stage.



One trend that we think will increase dramatically in 2020 will be the use of discretion by the Compensation Committee. In fact, with Coronavirus adding to the disruption caused by low oil prices, we believe discretion will be widely used across many industries this year. 47% of the companies in our survey already expect the Compensation Committee to exercise discretion over payouts at the end of the year. A little more than one-third (38%) of those expecting discretion indicated the application would only be negative (to lower payouts).



Competing views on the use of discretion are sure to emerge. ISS and Glass Lewis consider positive discretion to be problematic although that view may evolve this year given that global economy is under unprecedented stress. Some will argue that as stakeholders are hurt, executive bonuses should be reduced or even curtailed. On the other hand, executives will work tirelessly and often pick up additional responsibilities in times like these to stabilize and survive and some believe they should be rewarded for doing so.

It will be important for all to document the impact of the oil price decline coupled with the impact of the Coronavirus. These events are so significant that it may be necessary for compensation committees to evaluate an executive team's performance on executing the adjusted strategic plan.

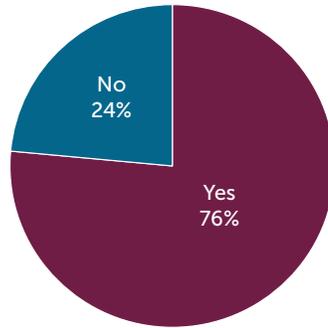
Whether discretion is applied or more qualitative type goals are used to assess performance, companies should be prepared to provide clear and enhanced disclosure of the decision-making process and the impact of the operating environment.

Long-Term Incentive Program

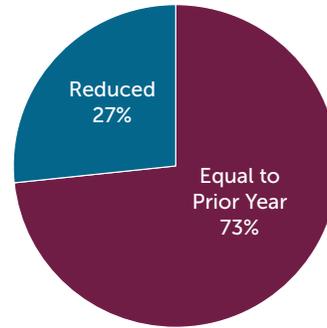
Stock prices within the sector were already low and many companies had already spent a great deal of time deliberating over grant sizes and values for 2019/2020 cycle awards. To make matters much worse, stock prices have fallen precipitously *in the last few days* – more than 50% in most cases. For those who have not yet made grants it will likely be impossible at this point to come close to awarding values from last year due to the severely reduced stock prices, burn rate implications, and share availability.

That said, most of the companies responding (74%) have already issued grants. 73% of those companies issued 2020 awards that have a grant date value equal to last year's award. 27% indicated that award values are less than prior year primarily due to share availability and lower stock prices as opposed to intentional reductions in award value.

Already made 2020 grants?

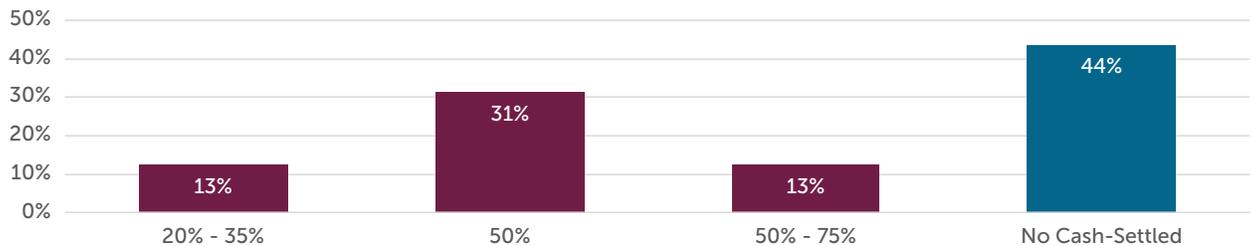


Grant Date Value



Nearly 60% of the sector issued (or intends to issue) cash-settled awards. The average company has allocated 50% of the total award value to cash-settled instruments. The most prevalent practice is to issue restricted stock awards with performance-based awards that pay out in cash. The use of cash alleviates some of the pressure on long-term plans by reducing share usage.

Cash-Settled LTI Mix (% of Total Award)



As we move forward, companies will be forced to consider various techniques. These could include dilution caps, using a 30- or 60-day average stock price to determine grants, restricted cash awards at and below the director level of the organization (and possibly higher), establishing stock price hurdles that act as performance conditions for vesting to occur or switching to a fixed share approach, among other practices.

Conclusion

While companies across the globe are in crisis mode, it will be important for compensation committees to strike a balance between stakeholder interests and the interests of their executives. A tremendous amount of wealth has been erased in a week. While retention is a key issue it should not be overplayed at this moment. The focus is to manage through the crisis. Achieve alignment by motivating the team to engage in the achievement of the strategic plan by incorporating milestone measures into the annual incentive plan and make financial performance goals achievable – at least at the threshold level. Use discretion where appropriate to balance outcomes at the end of the year. We are at the front end of an unprecedented year for the oil & gas industry while at the same time the entire world braces for recession due to Coronavirus. However, the recovery, when it comes, will bring opportunity.

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