The Must-Have Cost Savings Tool for 2016

February 2016

Power Advocate
179 Lincoln Street
Boston, MA 02111
T 857.453.5700
F 857.453.5705
info@poweradvocate.com
www.poweradvocate.com

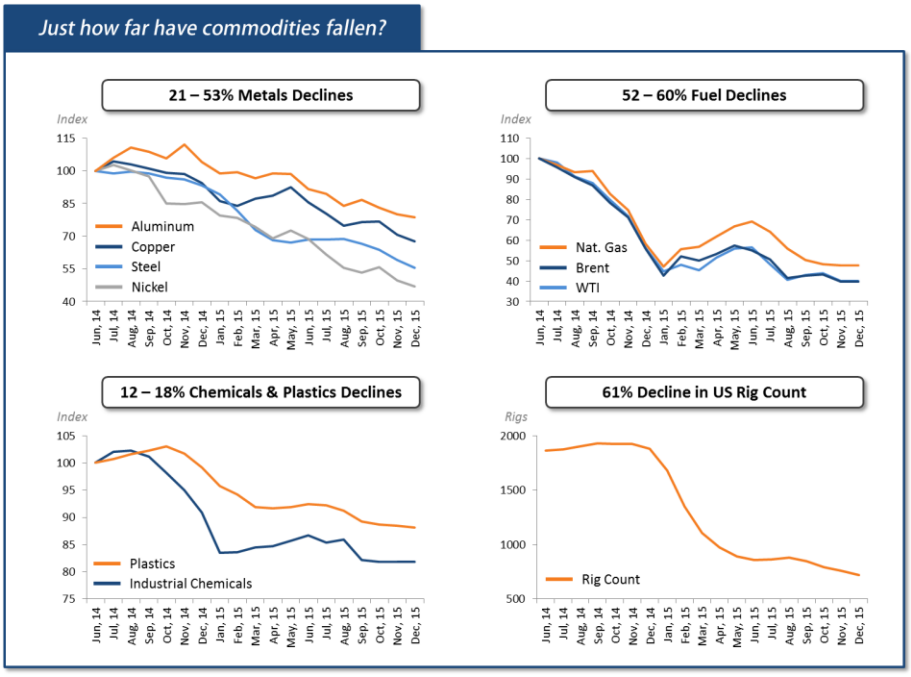
2015 was a tough year for oil and gas. Nine of the twelve S&P 500 companies posting top losses last quarter were E&P firms, and according to a recent Bloomberg article, one-sixth of smaller, independent O&G producers have debt payments greater than 20% of revenue.

The silver lining? It turns out the same market conditions crushing O&G firms' top lines just may help salvage their bottom lines. With commodity prices, demand for O&G-related products and services, and other cost-driving forces at record lows, those who systematically take advantage of market movements can drive large, sustainable cost reductions.

Through the use of cost modeling and should-cost analysis (explained in greater detail below), we've seen E&P, midstream, and downstream Oil and Gas companies consistently drive an incremental 5% -20% savings in supplier negotiations through the recent downturn.

The Opportunity and the Challenge

The diagram below illustrates how certain cost drivers have moved over the last 18 months. These price declines imply that the cost of the products and services that O&G firms procure should be declining substantially. However, suppliers often do not pass along these savings, and it can be difficult for operators to quantify the impact of these movements on their pricing.



Sources: EIA, Baker Hughes, AMM, PowerAdvocate Analysis

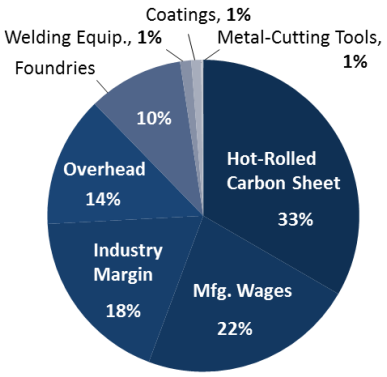
See which oil and gas materials and services should have seen the greatest price declines as a result of these falling commodity prices.

A Data-Driven, Sustainable Solution

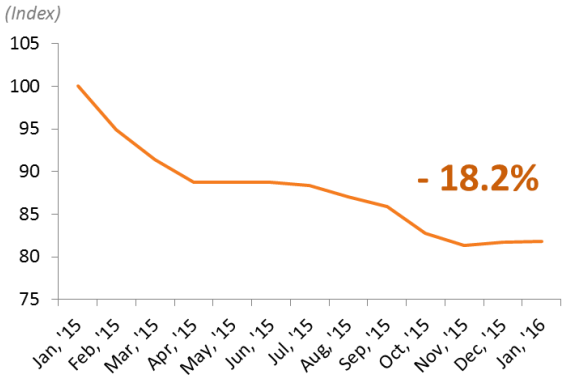
Those who have reigned in costs over the last year have taken a data-centric approach centering on cost models and should-cost analysis. This allows them to determine precisely how each of

their items' and services' pricing *should* have moved over time. For instance, using the tools below, you would know exactly what drives the cost of carbon steel pipe, and that you should pay 18.2% less for this item now than you did last January.

Carbon Steel Pipe: Cost Model



Carbon Steel Pipe: Should-Cost



Sources: PowerAdvocate Cost Intelligence®

Wondering how you can do this for your other materials and services? *See how easy this is to do for all your materials and services with the right cost modeling and should-cost tool…*

How Do Cost Models and Should-Cost Analysis Work?

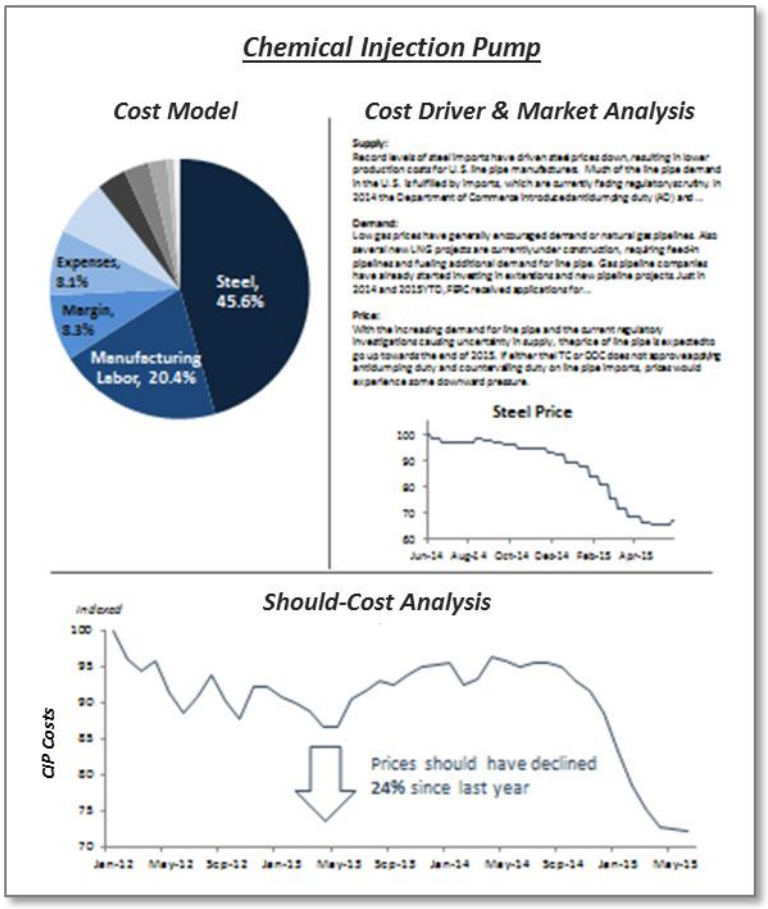
A **cost model** is a reflection of the weighted inputs – both tangible and intangible – that make up an item or service's price at any given point in time. For example, the cost model above reveals that, at this moment, 33% of the cost of carbon steel pipe is attributable to hot-rolled carbon sheet.

Should-cost analysis uses cost models to track how an item's total price *should* move over time, based on the movement of its cost inputs. Put simply, a should-cost trend line is a cost model in motion. When informed by high-quality models, it's easy to see how useful a tool like this can be to oil and gas firms in today's volatile market. Here are some of way's we've seen it used most effectively:

1. **Quickly identify top market driven savings opportunities**. Knowing which of your highest-spend items should have seen the biggest year-over-year decline (e.g., well stimulation services) will help you prioritize your re-negotiation roadmap.

2. **Improve negotiation tactics**. When you *do* renegotiate, coming to the table with a market data based price anchor will not only help you achieve lower pricing, but maintain strategic supplier relationships that can be damaged through unsubstantiated demands.

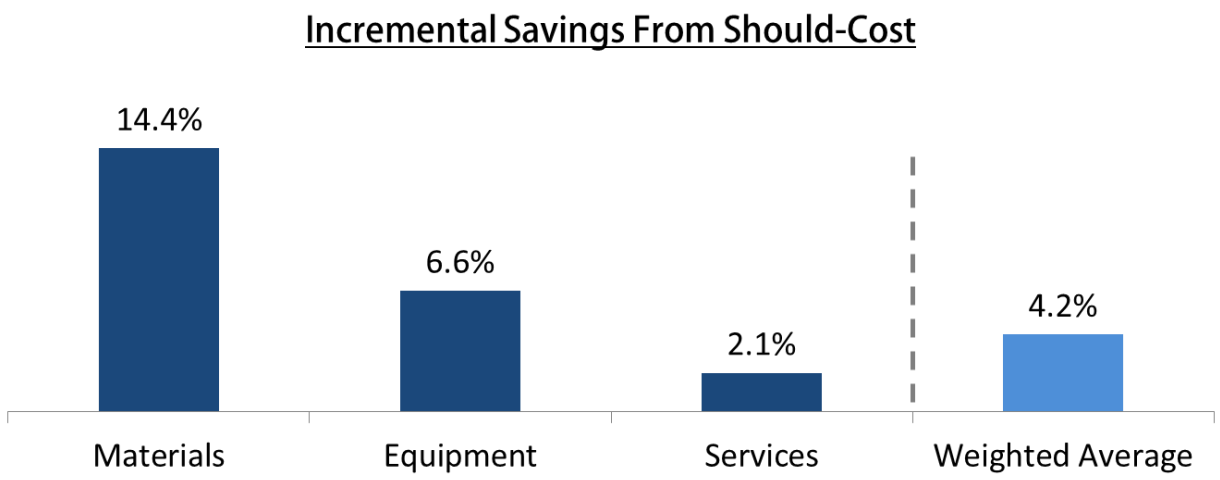
3. **Drive down supplier bids**. By including cost models and other market data in bid packages, you can anchor bidding around a lower starting point than would otherwise have been arrived at. For instance, if you were going to market for a chemical injection pump, you may include the following fact sheet in your package:



4. **Tie contract pricing to the right indices**. By negotiating pricing tied to indices optimized for your specific sourcing objectives (e.g., maximum savings vs. stability), you'll benefit in real-time and eliminate the need to renegotiate every six months.

What Incremental Savings Can You Expect From Should-Cost?

In our experience with the numerous Oil and Gas companies that leverage our cost modeling and should-cost solution, we routinely see firms drive an *incremental* 5-20% savings in supplier negotiations. On average, buyers that leveraged should-cost achieved an incremental 2-15% compared with their less-equipped peers.



Sources: PowerAdvocate Analysis

To put these numbers in perspective, let's say you're a small to medium sized E&P firm that spent $100 million on OCTG casing and tubing, and $190 million on rig services last year. By leveraging should-cost analysis, you could save over $10.5 million dollars *on top of* the savings you would have achieved without should-cost. Scale this across all of your items and services, and you're looking at an opportunity in the hundreds of millions.

About PowerAdvocate:

We work with nearly 100 energy companies to achieve enterprise-wide cost reduction. We empower our clients through data drawn from the world's largest Energy FactBase™, proprietary analytical tools and deep industry expertise.

- Request a demo of our cost modeling and should-cost solution
- See our complete list of oil and gas cost models and which items should be see the greatest declines