Post #67: The Continued Evolution of Oil Industry Compensation will be Evident in Upcoming Disclosures

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The oil & gas industry continues to evolve to fit a new business model. Executive compensation has begun to evolve to align with these business changes, and to address past criticisms of the industry compensation model. This criticism has focused predominately on actual bonus payout levels (particularly within the E&P sector), the grant date value of long-term incentive awards, and the incentive metrics used to measure performance payouts. Each company situation is unique, but here is what we've observed about how the evolution has advanced.

Expected Trends

Limited salary increases; most restoring salary reductions

The majority of companies will restore previously reduced salaries by the 1st quarter of 2021. There are some exceptions, where restorations may be delayed or not fully restored, particularly among Oilfield Services companies. While a few companies may increase executive salaries this cycle, we expect most will limit increases to specific individuals that may be significantly below market or recently promoted.

LTI grant value reductions

In 2015-2016, approximately two-thirds of E&P companies temporarily reduced LTI grant values for one or more top officers as industry stock prices hit a low point in early 2016. Although we don't expect wholesale reductions across the industry this year, we do anticipate a general pullback in the overall competitive landscape due to reduced stock prices and market valuations, share usage concerns, and the broader industry environment. Expect to see about one-third of E&P companies reduce 2021 grant date values for the CEO and other named executive officers, with remaining companies likely held flat. Based on recent announcements, we've already seen some evidence of these reductions:

- Diamondback Energy: link
- Marathon Oil: link
- Murphy Oil: link

Oilfield Services and midstream companies tend to award more consistent LTI grant values year to year than E&P, but we anticipate a minority of these companies (20-30%) will also reduce LTI grant values in this cycle, reflecting the expected smaller revenue size for some of these organization as well as share usage concerns and the broader industry environment.

Lower bonus payouts

One of the most consistent criticisms of E&P compensation has been above target bonuses despite lagging shareholder returns. We expect E&P bonuses for 2020 performance will average below target in the industry, with the vast majority of companies expected to pay at or below target for the first time in recent history, particularly those with oil-focused operations. In many cases, the Committee's discretionary action will drive the lower payouts as the pandemic and related oil slide reset business plans for most oil-focused E&P companies.

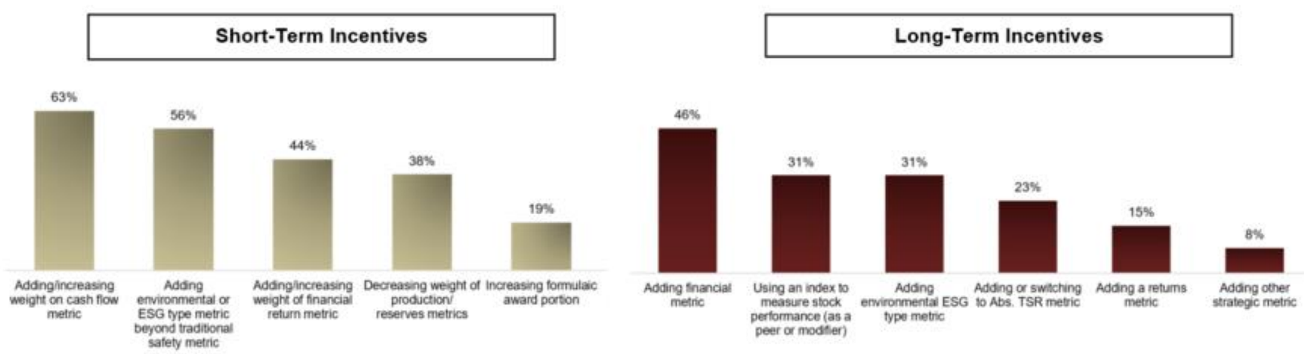
For the oilfield services industry, a significant focus on earnings in annual bonus plans will likely result in average bonuses well below target, with some paying zero bonus. Those companies with a balanced scorecard that includes cash flow, safety, and other efficiency metrics are more likely to pay closer to target, but we expect very few of these companies will payout at or above target.

Midstream companies are likely to see more mixed bonus outcomes, depending on where they fall within the value-chain. However, it's likely that their bonuses will also be down from last year.

Metric Changes

Some investors have also criticized the industry for its choice of incentive metrics. In particular, investors have expressed a preference for greater focus on cash generation, absolute returns, and ESG within the E&P sector (and to a lesser extent Oilfield services and midstream). We expect increased disclosure of these metrics in both 2020 incentive plans and in forward looking disclosures on 2021 incentive plans.

Based on one of our recent hot topic surveys, nearly 70% of E&P participants anticipate changes to their 2021 short-term incentive metrics and 55% reported changes to the long-term incentive performance metrics.



Longer Term Changes?

While we expect shareholders will react positively to many of these changes, it remains to be seen if companies have done enough to appease critics. Time will tell whether compensation levels have permanently been reset or just temporarily reduced. Will the reduced LTI grant values become the new market competitive rate? Have consistently above target bonus expectations been lowered among E&P recipients? How will incentive metrics, including ESG measures continue to evolve? How will the recent rebound in commodity and stock prices impact all of these decisions? We imagine that these questions will be considered, evaluated, and scrutinized over the next 12 months. More to come…

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