



Post #65: Benchmarking in an Unusual Cycle

From Chris Havey, Partner, The Woodlands, TX

We expect that the typical fall benchmarking/market data process will look different for many oil & gas companies. The current commodity price and general economic environment will likely impact compensation levels across much of the industry, which will cause a few challenges when companies review survey data.

- Industry volatility will likely impact peer group selection – last year’s peers may be in very different circumstances this year
- Many oil & gas companies are more worried about functional talent leaving the industry altogether – finance/accounting, legal, HR, and IT professionals may have opportunities in other industries
- While some surveys may capture disclosed mid-year salary reductions, traditional surveys will not capture the impact of substantial stock price reductions on long-term incentive (LTI) awards; post-COVID grant values may not match pre-COVID grants

If it wasn’t otherwise clear, these challenges require rethinking the standard benchmarking/decision-making process.

Re-Assess Peer Groups

Bankruptcies, decreased valuations, and M&A activity will impact many peer groups. When evaluating size measures like enterprise value and market cap, it may be helpful to use a longer term average. Even then, many companies may struggle to find a statistically sufficient number of peers to use. Solutions might include:

- Broadening the selection criteria for benchmarking peers – this could include different geographies, different focus areas (e.g., oil vs. gas, offshore vs. onshore), etc. These different approaches may require establishing a separate group for measuring relative performance.
- Adding a secondary source – if fewer benchmarking peers are used, companies may consider supplementing that data with broader industry survey sources or general industry sources to validate the peer group data.

Supplement with General Industry Data

Many companies will likely include general industry data as a separate reference in this year’s reviews. A general industry perspective can help inform the Board about how competitive the programs are relative to other industries, especially amid concerns that talent may leave the energy industry. A broader perspective can also bring attention to any unique aspects of oil & gas compensation and may serve as a helpful secondary reference point on what competitive and appropriate compensation might look like.

Consider Other Information and Apply Judgment

Traditional executive compensation surveys in 2020 may be the least relevant they have ever been. The largest component of executive compensation is LTI, and LTI is the element most significantly impacted by the current environment. \$1M of LTI granted in February 2020 is very different from \$1M of LTI granted in April 2020, and will

not necessarily indicate that \$1M of LTI will be granted in this upcoming cycle. Context will be critical to interpreting this year's benchmark data.

Other information may become more important when evaluating LTI grants this year, including:

- Projected burn rates, share availability, and economic dilution as a percentage of market cap – reviewing these pieces of information relative to historical company practice and external standards provides an additional benchmark
- Trends surveys – trends surveys, or other more current information on expected or early actions in the cycle, provide information on how other companies are reacting to the same issues
- Board judgment – while judgment is always an important factor, judgment will be even more important than normal this year to arrive at reasonable compensation actions

We expect companies will take a wide range of actions in this upcoming cycle, particularly with regard to LTI. This unusual cycle will require an unusual approach to providing the board with information to make decisions. Companies will need to supplement traditional information sources with non-traditional sources, and more importantly with sound judgment.

Archived copies of previous Energy Insights can be found at www.meridiancp.com/insights/energy.

To have your name removed from our Energy Insights email list, please contact jlawler@meridiancp.com.