



Energy Insights



LOOKING FOR SHAREHOLDER VALUE DRIVERS

Analyzing Common Annual Bonus Metrics to Predict Shareholder Value

Posted by Chris Havey on May 30, 2014

Annual incentive metrics should be key drivers of long-term shareholder value. Most energy companies include this in their philosophy statements, and it sounds straightforward. But what are the drivers of long-term shareholder value? The answer to that question obviously varies by industry segment. Meridian analyzed some common E&P annual bonus metrics to determine which were most predictive of shareholder value over a five year time period. The metrics analyzed included the following:

- Production growth: overall production and oil production, both on an overall basis and per debt-adjusted share
- Reserves: reserves as a multiple of annual production, overall reserve growth, and reserve growth per debt-adjusted share
- EBITDA/EBITDAX growth: overall growth and per debt adjusted share
- Operating Cash Flow growth: overall growth and per debt adjusted share
- Per Barrel Metrics: revenue and operating cash flow per barrel of production

We tested these metrics against shareholder return over the last five years for a cross-section of E&P companies of all sizes. The highest correlated metrics generated correlations of between .6 and .9 with shareholder return over these time periods, which represents strong correlation for this type of analysis. The highest correlated metrics included:

- Production growth per debt-adjusted share: .6 to .9 correlation
- Reserve growth per debt-adjusted share: .5 to .8 correlation
- Operating Cash Flow growth per debt-adjusted share: .6 to .9 correlation

While production, reserves, and operating cash flow are all common metrics, few E&P companies measure them per debt-adjusted share. This suggests that growing production, reserves, and cash flow with the most efficient use of capital leads to greater shareholder value at an E&P company – which is not particularly surprising. Based on this analysis, one could reasonably conclude that these three metrics should play a key role in annual incentive plans for E&P companies. This analysis could be replicated for any segment within the energy industry. Do you know your drivers of shareholder value? Are they included in your annual incentive plan?



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