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**THE GOOD, THE BAD
& THE UGLY:**
A LOOK BEHIND
THE COMPENSATION
CONSULTANT CURTAIN



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Longnecker & Associates prides itself on being the foremost expert on strategic compensation in the energy industry. This expertise is rooted in our leadership's experience as board members, corporate employees and consultants at energy companies since the 1980s. Although energy is our expertise, within this diverse industry, L&A has emerged as a leader in the E&P space, now servicing over 50 E&P companies. In addition to our experience with small startup PE-backed companies, we work with some of the nation's most prominent publicly-traded companies.

KEY SERVICE OFFERINGS FOR E&P CLIENTS:

Executive Compensation Analysis

Annual and Long-term Incentive Plan Design

CD&A Drafting and Review

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CURRENT (MIS)PERCEPTION ON E&P EXECUTIVE PAY

- Despite the headlines, compensation tracks shareholder performance – but can still be better
- We believe some misperception is the result of poor disclosure practices
- Companies/Boards hear investor concerns and are making changes
- E&P pay ratios are lower than other commodity-intensive industries

B Bloomberg

Oil CEOs Sell Stock and Rip Investor Apathy, Raymond James Says

The top executives at America's independent oil and gas producers say ... of a Raymond James analysis of chief executive officers' pay across ...

1 week ago



★ Houston Chronicle

On day before Chevron announcement, Anadarko sweetened severance for top execs

The Anadarko Petroleum board approved compensation changes on the ... payouts and the payment of taxes on the golden parachute deals.

Apr 23, 2019



Energy Companies Perform Better When CEO Pay Isn't Tied to Production

Rewarding executives for delivering returns may be better for shareholders, a new report finds

‘Pay-for-luck’: Oil and gas execs out-earn their peers

B Bloomberg

Fracking's Biggest Gushers Are Struck in the Corner Office

Anadarko is a reminder that E&P management too often has little real ... Anadarko's compensation committee tweaked severance terms for its ...

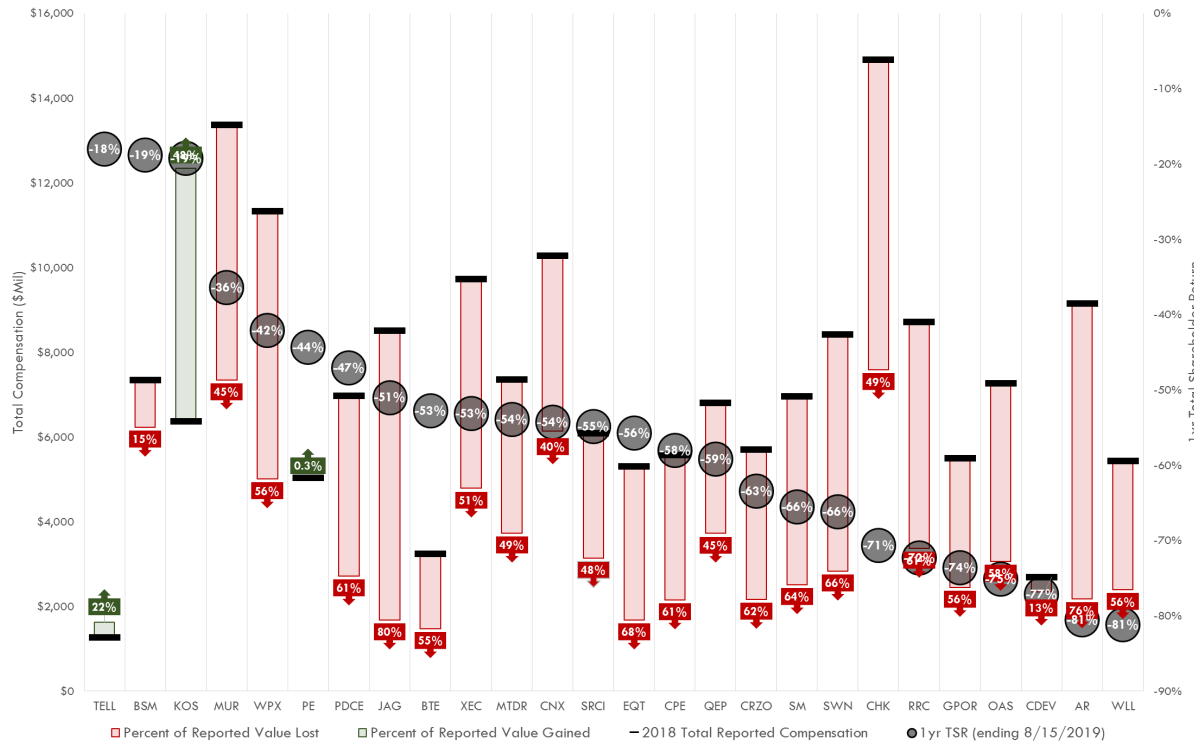
Apr 26, 2019



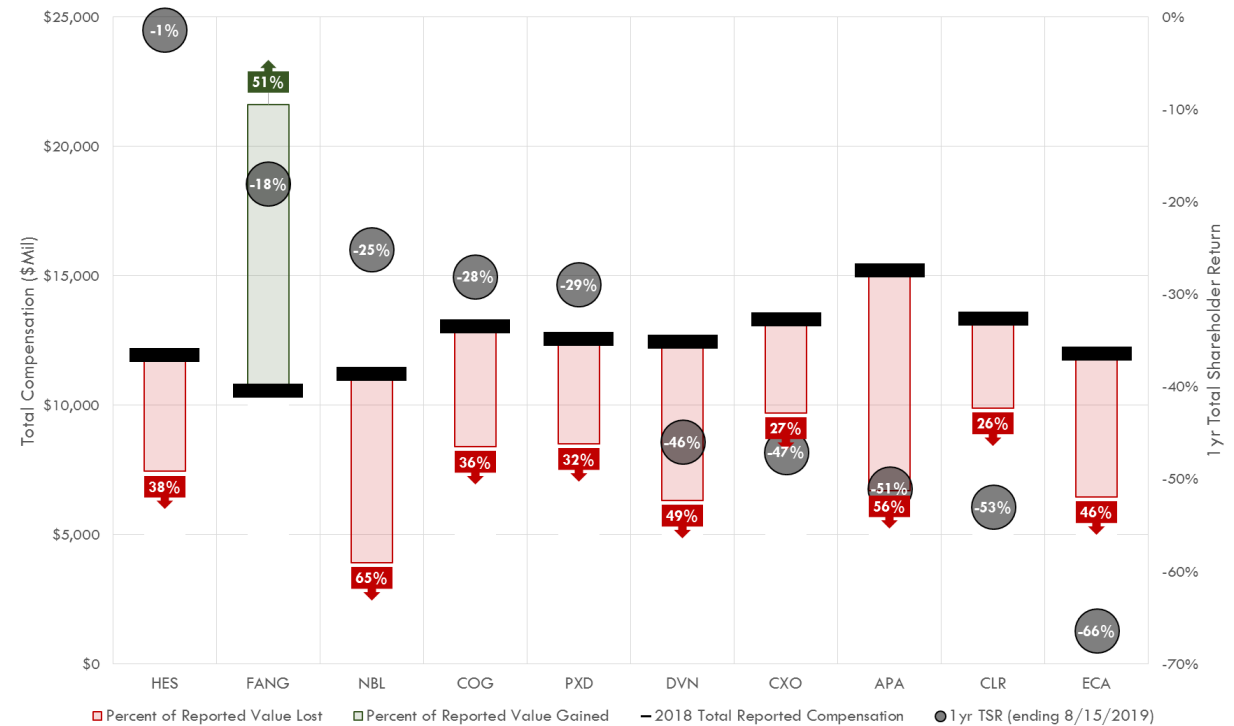
REALIZED PAY UPDATE

- We touched on realized compensation values for top shale company CEOs in May
- Charts below provide a relationship of current realized pay value based on current equity valuations and the relationship to FY18 reported compensation

TOTAL CEO COMPENSATION (FY2018) | Less than \$5B Market Cap (as of 8/15/2019)
Realized vs. Reported Value (as of 8/15/2019)



TOTAL CEO COMPENSATION (FY2018) | \$5B - \$25B Market Cap (as of 8/15/2019)
Realized vs. Reported Value (as of 8/15/2019)



KEY INDUSTRY TRENDS/THEMES THAT SHOULD IMPACT EXECUTIVE COMPENSATION DECISION-MAKING

- Investor (those that are left) demands – throwing “drill baby drill” out with the bath water – returns, cash flow, cost/capital efficiency and safety are key
 - Material increase in prevalence in 2018 for return/cash flow measures, decrease of total volume/growth and reserve adds measures
- Executive teams now exhibiting caution bias on capex
- Growth of institutional investor focus on ESG (to the tune of \$11.6 trillion managed assets)
- Growing concern of vulnerability to activist shareholders (EQT, PDCE, OXY, AXAS, etc.)
- Increase in shareholder engagement activity – especially in compensation



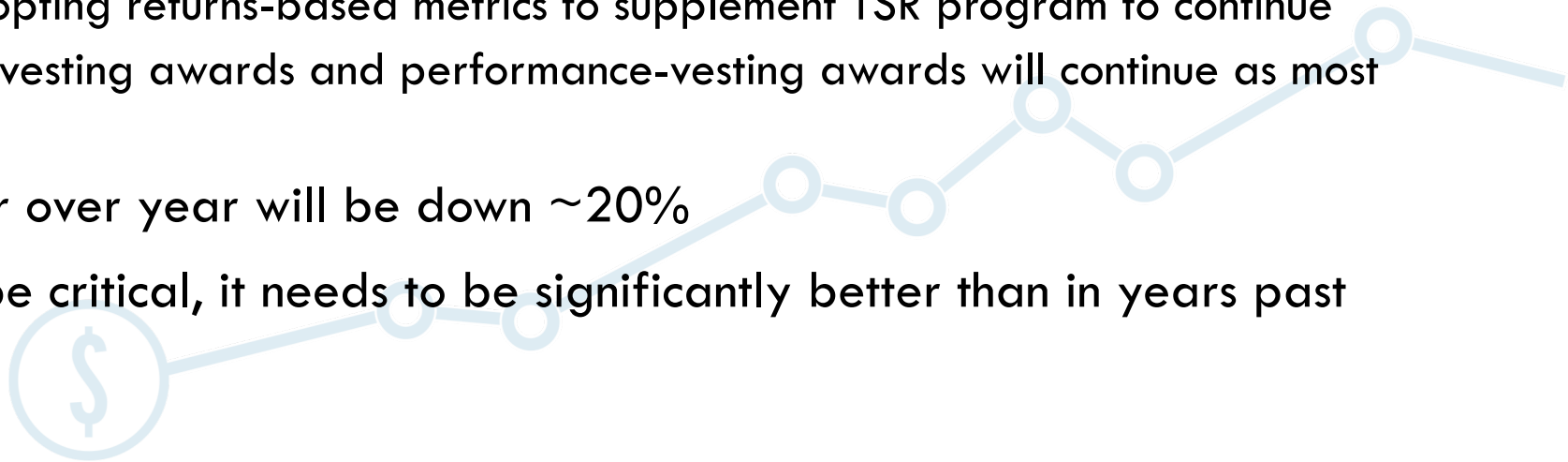
THE ROLE OF THE COMPENSATION CONSULTANT

- Not all consultants are created equal, some shouldn't even be consulting
- Rubber stamper for management team/board? Or independent voice?
The key is to pick the right one – knowledgeable in energy; integrity; and independent
- Process for determining pay recommendations
 - Peer practices (who should be a peer?)
 - Compensation survey results
 - Real time decision-making in competitive environment
 - Industry climate, investor sentiment, proxy advisory firm perspective
- Other factors considered when making recommendations on pay quantum, mechanics
- L&A believes in signed affidavits after every assignment attesting to the consultant's independence not being challenged in any way throughout



COMPENSATION TRENDS IN 2020

- Executive salaries to be stagnant, average increase 2% - 3%
- Annual cash bonuses will be increasingly focused on capital efficiency, returns and/or debt-adjusted per share metrics – but not majority
- Annual cash bonus programs will grow in complexity – tailored to company strategy
- Application of “positive discretion” from board members virtually non-existent
- Nascent changes in long-term incentive compensation design
 - Relative TSR to maintain majority prevalence, but increased adoption of absolute TSR mechanism
 - Early movers trend of adopting returns-based metrics to supplement TSR program to continue
 - 50/50 weighting of time-vesting awards and performance-vesting awards will continue as most common
- Grant date fair values year over year will be down ~20%
- Shareholder outreach will be critical, it needs to be significantly better than in years past



OTHER COMPENSATION-RELATED NOTABLE TRENDS



- G&A per employee stagnant in 2018, but G&A per boe is improving
-
- G&A costs per employee are expected to increase for FY2019 as a % of revenue
-
- SMIDs are, on average, spending more of revenue dollars on G&A than larger operators

