Optimizing Risk
by Adopting
New ‘Convertible’ Contracts

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Presentation Outline

- Saipem highlights
- Reimbursable vs. LSTK contracts for EPC projects
- Today’s market trends
- ‘Convertible’ Contracts
- Saipem focus on Risk Management
- Conclusions
Do you know us?

A few introductory highlights on Saipem
Financials
(M €)

Revenues

New Contract Acquisitions

Backlog

Saipem Group Business Units

Saipem

Snamprogetti (*)

(* Figures include Snamprogetti from Q2)

A company of Saipem
Major Global E&C Oil & Gas Companies
Revenues 2006 (Billion $\,^{(+)}\)
Global Presence with a Multilocal Emphasis

Human Resources by Nationality:

- **Italy**: 20%
- **France**: 12%
- **Nigeria**: 9%
- **Kazakhstan**: 7%
- **Angola**: 5%
- **U.K.**: 6%
- **Philippines**: 6%
- **Russia**: 7%
- **Azerbaijan**: 1%
- **Indonesia**: 2%
- **Saudi Arabia**: 2%
- **Peru**: 3%
- **others**: 3%

- **Total**: 32,000 people, 107 Nationalities

@ December 31, 2006

- Operating and Engineering Hubs
- Engineering Centres
- Yards & Main Logistic Bases
- Other Main Areas and Rep. Offices
New Group Balanced Exposure to Oil & Gas Industry

Backlog
on 12/31/2006

BY GEOGRAPHIC AREA

- EUROPE: 34%
- CIS: 24%
- MIDDLE EAST & APAC: 23%
- NORTH AFRICA: 9%
- WEST AFRICA: 6%
- AMERICAS: 4%

BY CLIENT

- SUPERMAJOR: 10%
- MAJOR: 6%
- INDEPENDENT: 40%
- NATIONAL: 5%
- OTHER: 39%
A Few Recent Achievements - Onshore

- RasGas, Ras Laffan – Qatar
  LNG Trains 3÷5

- Qarli, K.S.A.
  842,000 bpsd oil production

- Sarlux, Sarroch - Italy
  IGCC 550 MWe

- CANAPORT LNG - Canada

- Omifco, Oman
  Ammonia  2 x 1,750 t/d
  Urea     2 x 2,530 t/d

- CNRL Horizon Project, Fort McMurray, Alberta - Canada
  Capacity: 110,000 b/d

- ENGRO CHEMICAL PAKISTAN Ltd., Daharki – Pakistan
  Ammonia  2,194 t/d
  Urea     3,835 t/d

- PEMEX HP, Tula - Mexico
  Oil Reactor
  Capacity: 50,000 bpsd

- More than 75,000 km of land pipelines

- Off-Onshore Pipelaying
  More than 26,000 km of sealines
A Few Recent Achievements - Offshore

WORLD RECORDS:
• Largest rigid Oil Offloading Line (20” dia) between CALM buoy and FPSO
• First system of SLOR
• Largest pipe-in-pipe system in J-lay mode

LIBYAN GAS PROJECT – ENI GAS BV/Green Stream BV
SABRATHA PRODUCTION PLATF., BAHR-ESSALAM PIPELINES AND
SUBSEA FACILITIES, MELLITAH GAS TREATMENT PLANT. GREENSTREAM EXPORT LINE LIBYA TO ITALY

RUSSIAN FAR EAST
Sakhalin II

MELLITAH GAS TREATMENT PLANT
Capacity: 700 MMscfd

GREEN STREAM PIPELINE

SABRATHA PLATFORM
Topside 12,100 tons

Sabratha Field Development
‘Reimbursable’ vs. ‘LSTK’ Contracts for EPC Projects
### ‘Reimbursable’ and ‘Lump Sum’ Contracts

**Who runs the project?**

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<th>Reimbursable</th>
<th>Lump Sum Turn Key</th>
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**Who is responsible for the outcome?**

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#### Reimbursable

- **Project Definition**
  - Owner, Contractor

- **Contractor selection process**
  - Owner, Contractor

- **Overlap between main steps**
  - Owner, Contractor

- **Design**
  - Owner, Contractor

- **Owner’s involvement**
  - Owner, Contractor

  - **Allows**
    - design development, flexibility, adaptation to evolving and unpredictable circumstances

  - **Little guarantee on final cost/schedule**

#### Lump Sum Turn Key

- **Contractor**

  - **Rigorous and formal, but long**

  - **Difficult**

  - **Low**

  - **Guarantees defined budget and completion time**

  - **Requires excellent project definition**
We believe that the EPC/EPIC approach can offer superior performance in large projects execution.

A company of Saipem
We believe that the EPC/EPIC approach can offer superior performance in large projects execution.

**Pros:**
- Most efficient process
- Parallel processes are possible (Indeed essential to capture program value)
- Continuous improvements (Project-to-project)
- Easier to maximize local content efficiently
- More sustainable than best-in-class alternatives

**Cons:**
- Complex/ High Risk (Especially without appropriate Industrial Model)
- Requires firm and precise execution of each step
EPC/EPIC Contract
Typical Phases and Cost/Influence Diagram

- Avoid/Manage Risks
- Exploit Opportunities

Influence

Pre-Award Phase

Contract Award

Cost to Contractor

Influence

Cost to Contractor

Time

Project Cost

Time

EPC/EPIC Contract Duration

More Friendly

Operating Environment

Less Friendly

Office (High Quality)

Multiple Offices

Factories/Suppliers

Yard

Project Site

Feed

E

P

C/Fab

I/C
In EPC/EPIC Contracts we need to avoid the “Avalanche Effects” of poor or changing FEED / Technical Package.
Today’s Market Trends
Huge investments and projects (> 1 B$, some 15 B$)

Remote and frontier areas
- Challenging locations – climate, access, remoteness
- Political uncertainties
- Simultaneous need for local content

Increasing technological complexity

Pressure for ‘Fast Track’ execution

Rapid price escalation and longer delivery times

Shortage of production and execution resources

Cost escalation

Unpredictability

Growing Risks

Reduced Number of E&C Bidders
Rapid and non-homogeneous cost rises contribute to unpredictability and higher risks

IHS/CERA Upstream Capital Costs Index

Pressure to Increase Manufacturing Capacity

Shop Lead Times

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’Convertible’ Contracts
In response to today’s markets needs, new “convertible” contracts offer a compromise contractual scheme

Reimbursable, Open Book

Lump Sum Turn Key

Maintain simultaneously the main advantages of the two extreme contractual forms

‘Convertible’ into Lump Sum Turn Key

Optimize risk balance between Owner and E&C Contractor

Project definition, Execution plan

CONTRACT CONVERSION

Project implementation

FEED EPC PROJECT EXECUTION

A company of Saipem
Execution Approaches

Open Book Reimbursable

Feasibility, Options → FEED → EPC (PMC + several subcontracts)

Bid/Award → Bid/Award → Bid/Award

LSTK

Feasibility, Options → FEED → EPC LSTK

Bid/Award → Bid/Award → Bid/Award

‘Convertible’ LSTK

Feasibility, Options → FEED + EPC LSTK

Bid/Award → Bid/Award

Contract Definition → Firm Price Definition
Traditional Open Book Cost Estimates
Occasional Conversions into Lump Sum Price

- Cost item 1 x TAb
- Cost item 2 x TAb
- ……………
- Cost item n x TAx

Escalation Factor

Miscellaneous Costs

Contingency, Risk Factor, Profit

Estimated or Lump Sum Price

Baseline Estimated Project Cost (±10%)
‘Converted’ Lump Sum - Contract and Final Price Development

- Award (Rates or services lump sum, conversion factors)
- Project risk profile
  - Contract requirements
  - PDP
  - BDEP
  - FEED
  - Contracts
- Escalation Factor
  - Cost item 1 \( \times T_A \)
  - Cost item 2 \( \times T_A \)
  - Cost item \( n \times T_A \)
- Project timeline
  - Currency basket
- Miscellaneous Costs
- Insurance scheme
  - Fiscal requirements
  - Financial scheme
  - Guarantees
- Conversion
- Technical Development Allowance Factors
- Baseline Project Cost

Baseline Project Cost

Lump Sum Price
‘Convertible’ Contracts

The initial contract at award time

- Very simple and straightforward
  - Pre-agreed Conversion Factors
  - Methodology for Project Baseline Cost Definition

- Later, Conversion Factors applied to Project Baseline cost, or to its components
  - Account for residual contingencies, residual risks and agreed profit

- Define FEED contractual terms, Reimbursable or LS
  - Optimization needs, Value Engineering vs. project constraints and execution needs

- Decide timing and modalities of contract conversion into LSTK
  - Project definition vs. residual contingencies
  - Typically after 50 ÷ 60 % Engineering completion, some Lead Items orders, main subcontracts definitions

High degree of mutual Owner/Contractor trust required
‘Convertible’ Contracts - Advantages

- Significant time saving vs. traditional LSTK: almost one year
  Big NPV improvement!
  - Proven experience on two parallel projects

- Fully transparent process
  - Owner maintains full access to all project data and prices

- Balanced risk sharing between Owner and E&C Contractor
  - Reduced risk for Contractor, lower need for contingencies/risk premium

- The process fosters a cooperative mutual relationship with
  Owner’s empowered project team
## Lump Sum vs. Convertible Contracts Overall Execution Schedules

### Example: Polymer Project (Middle East Location)

#### Competitive EPC LSTK Bidding
(License pre-selected by Owner, FEED needs to be carried out)

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**EPC LSTK Contract Award**

#### ‘Convertible’ EPC Contract
(License pre-selected by Owner)

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**Initial Contract Award**

**Converted EPC/LSTK Contract Award**

7 Months
Do these benefits outweigh the challenges?

It will depend on ....

- **Owner’s key success factors**
  - Achieve schedule?
  - Achieve cost certainty?
  - Optimize the project?
  - Fast track execution?
  - Achieve lowest cost?
  - Value Engineering?

Setting realistic and clearly communicated goals

- **Conversion methodology actually applied**
  - Well thought upfront contract

- **High level of competence on both sides**
Our Convertible Contracts Experience

- Almost 5 B$ of such projects either completed, ‘converted’ or today in design phases
- An additional 3 B$ awarded - not yet effective

... in parallel to many other projects executed on EPC LSTK basis
Saipem's Risk Management Context
Focus on Risk Management
One of Key Saipem Strategy Components

- Huge projects
- More complexity
- Frontiers
- Technological challenges

E&C Industry
“Risky Business”

- Risky contracts
- Value recognition by Clients?
- Management of suppliers and subcontractors
- Engineering management competence

Higher Risk implies potentially Higher Reward

How to achieve appropriate Risk Level?

 риск management – the organizational challenge

Decentralized Operations

Capillary Risk Assessment Process
Corporate Rules, Guidelines, Lessons Learned Risk Management services

✓ In-house control of critical EPC/EPIC phases

Own as much critical local content as possible
Outsource volume to cost effective subcontractors, but manage the overall EPC/EPIC process
Conclusions

➢ The ‘Convertible’ LSTK formula is catching on
  • Billions worth of contracts to Saipem/Snamprogetti, all proceeding well
  • Increasingly adopted by the market at large (Owner’s choice !), in parallel to LSTK and reimbursable contracts

➢ Critical factors of success:
  • Significant time savings, better investment NPV
  • Risk sharing between Owner and E&C
  • Avoidance of “excessive” risk-premiums and contingencies
  • Possible tailoring of specific schemes to individual Owner’s needs and circumstances

once again ....

The nature of this approach requires a high degree of mutual confidence between Owner and Contractor
Thank you!