

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

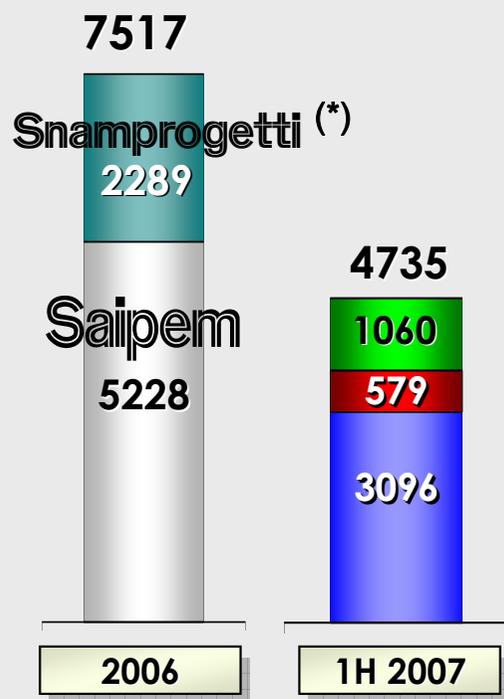
Do you know us?

A few introductory highlights on Saipem

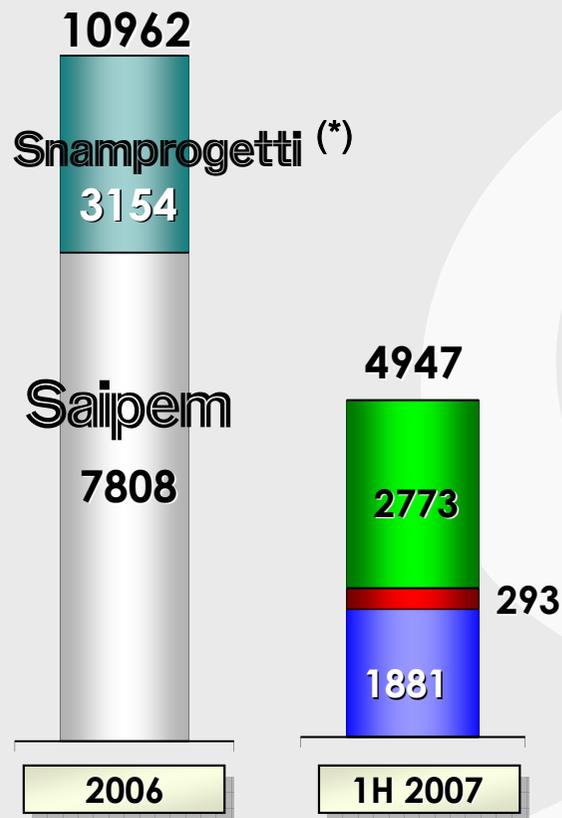
Financials

(M €)

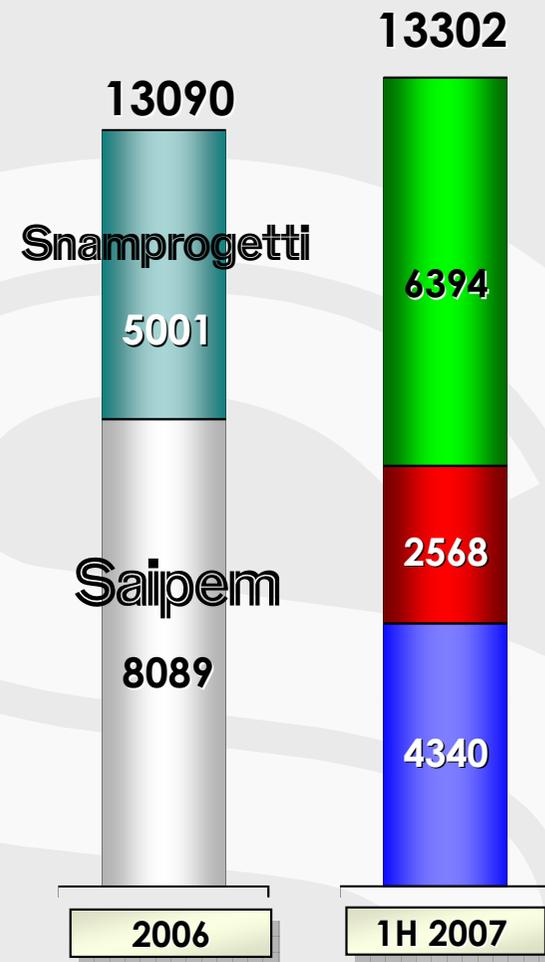
Revenues



New Contract Acquisitions



Backlog

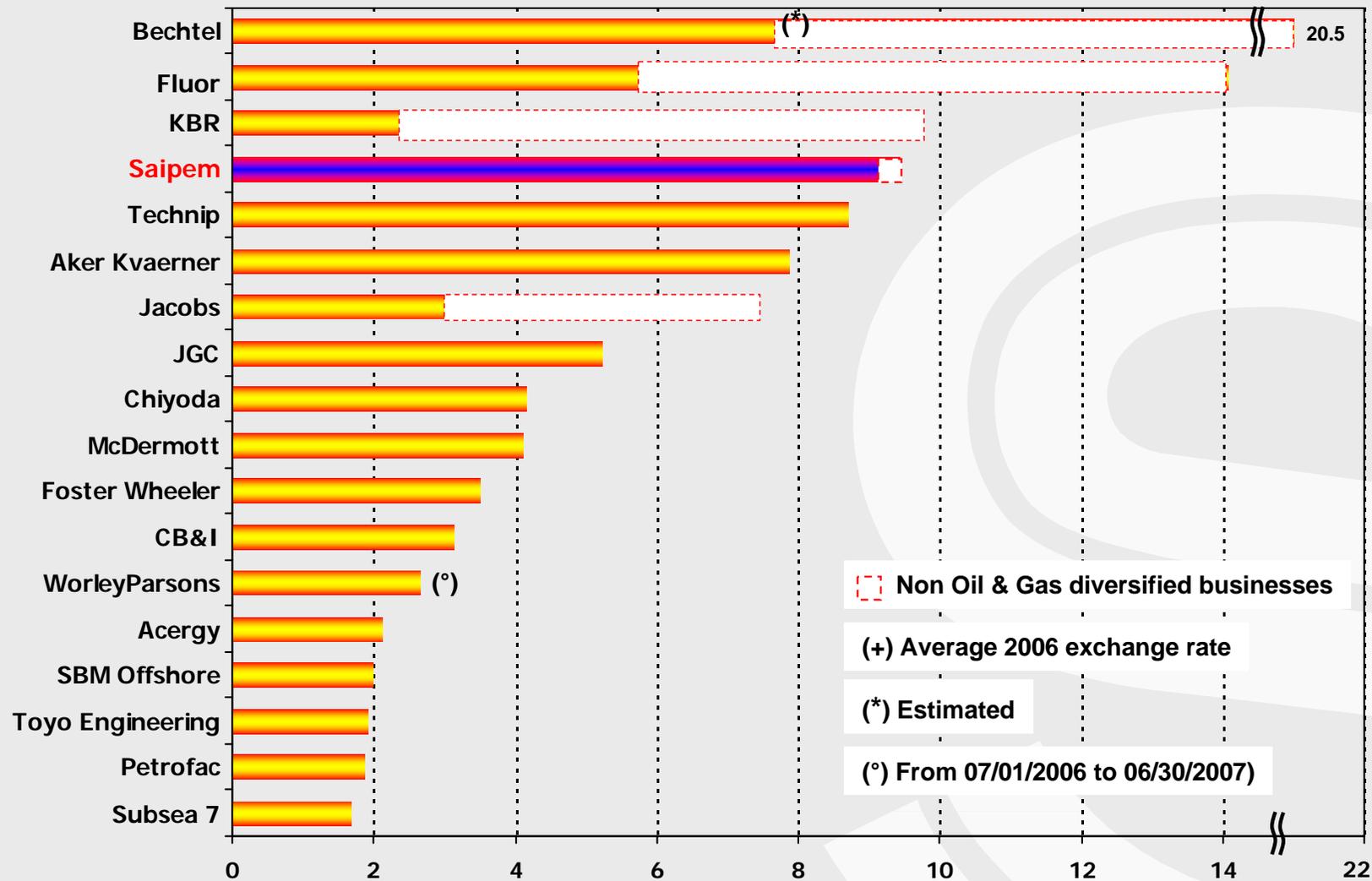


(*) Figures include Snamprogetti from Q2



Major Global E&C Oil & Gas Companies

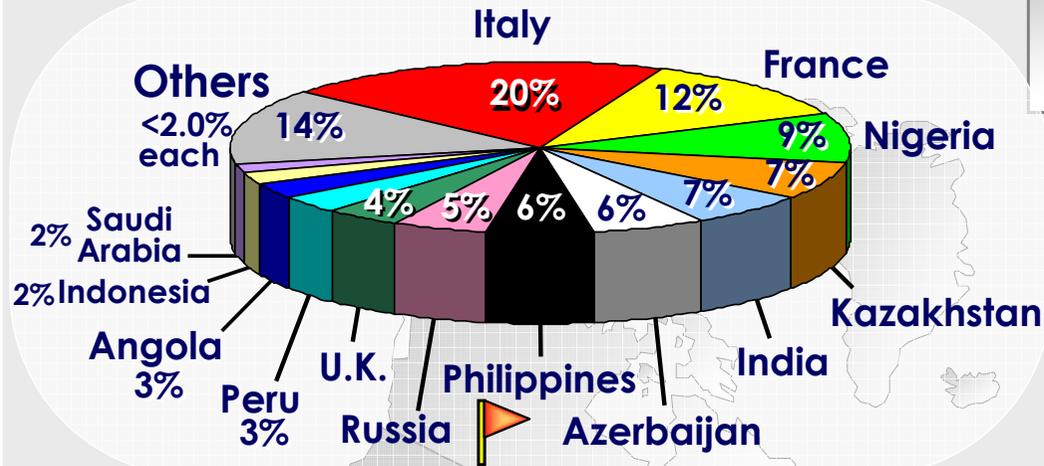
Revenues 2006 (Billion \$⁽⁺⁾)





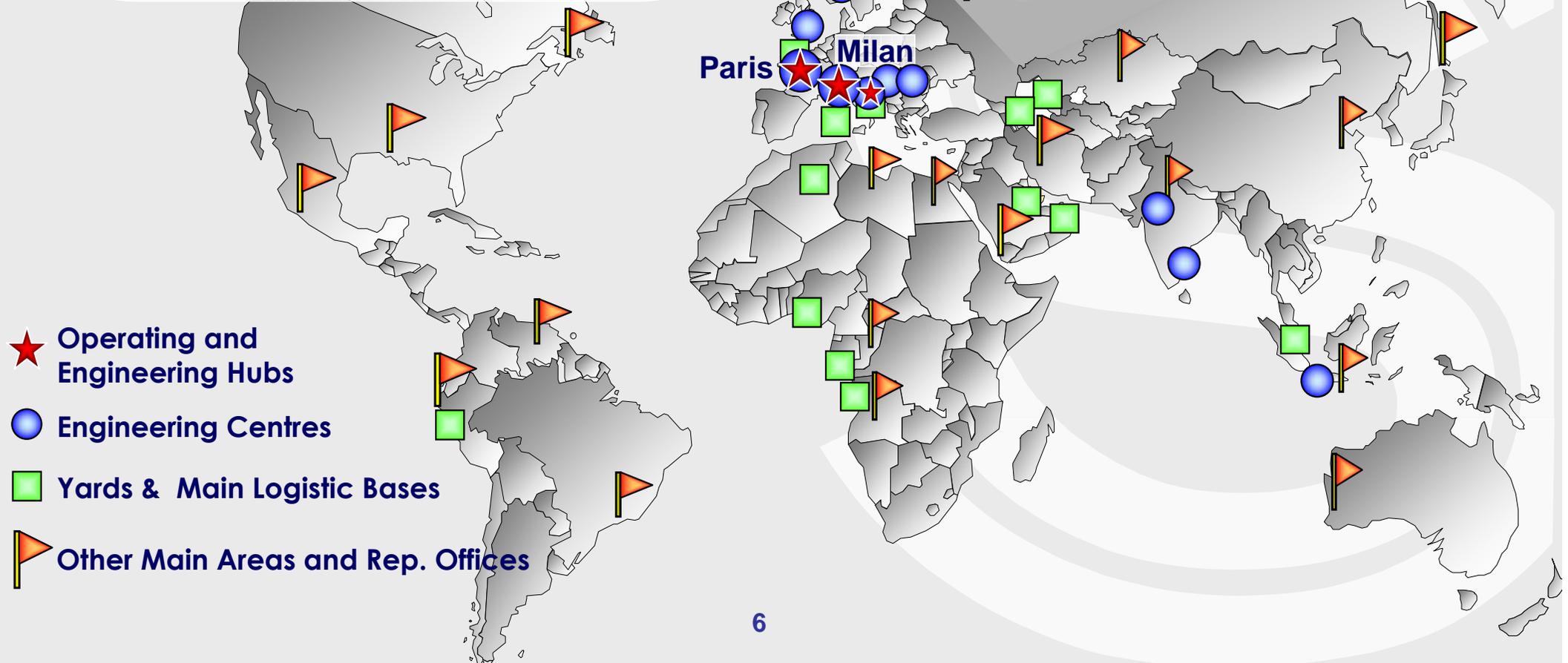
Global Presence with a Multilocal Emphasis

Human Resources by Nationality:



- 32,000 people
- 107 Nationalities

@ December 31, 2006

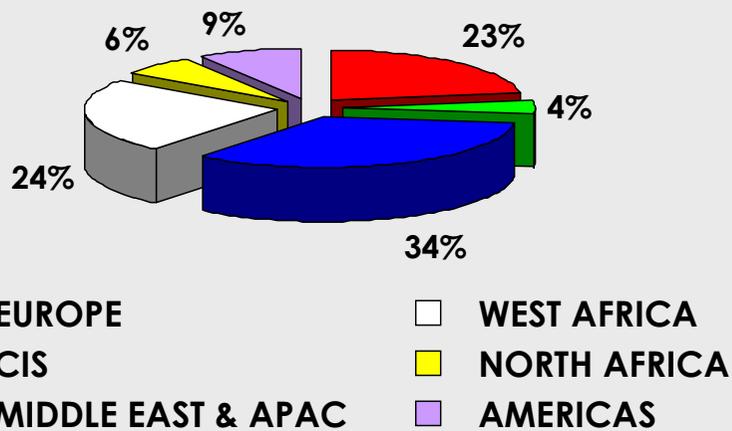




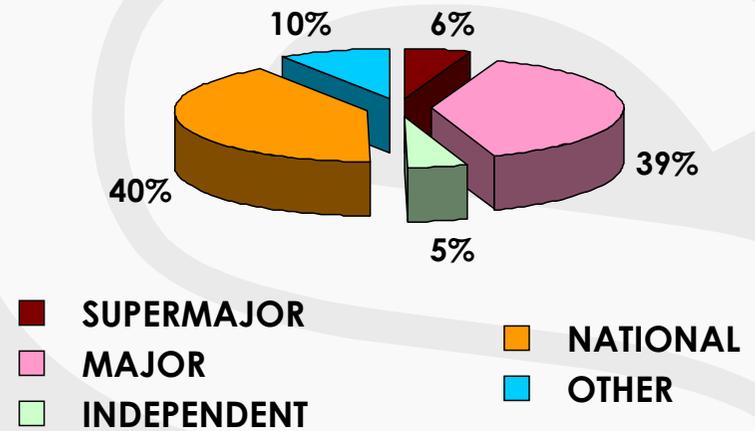
Backlog

on 12/31/2006

BY GEOGRAPHIC AREA



BY CLIENT



A Few Recent Achievements - Onshore



RasGas, Ras Laffan – Qatar
LNG Trains 3+5



Qatif, K.S.A.
842,000 bpsd oil production



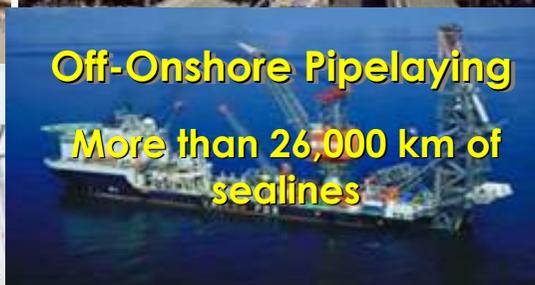
IGCC 550 MWe
Sarlux, Sarroch - Italy



CANAPORT LNG - Canada



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



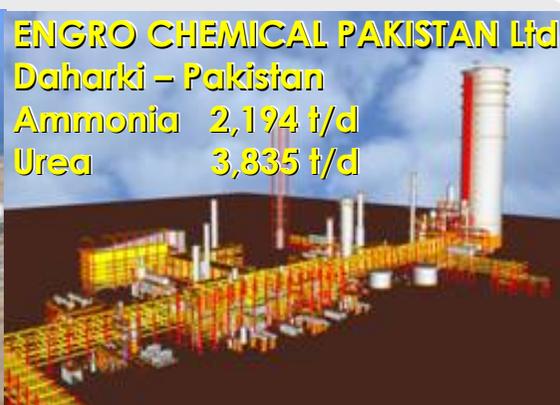
Off-Onshore Pipelaying
More than 26,000 km of
sealines



More than 75,000 km of
land pipelines



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



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



Pemex H-Oil Reactor
Tula - Mexico
Capacity: 50,000 bpsd

A Few Recent Achievements - Offshore



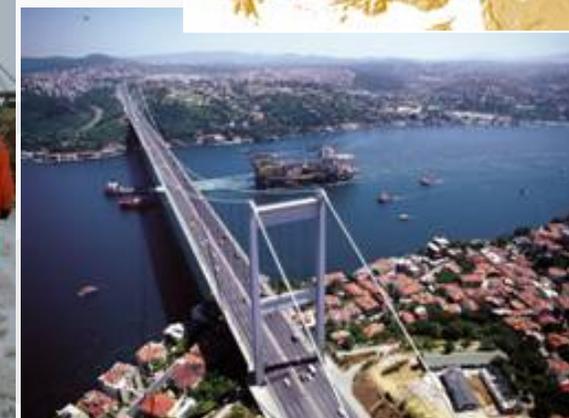
**KIZOMBA A
KIZOMBA B
(ANGOLA)**

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



**KAZAKHSTAN
Kashagan**

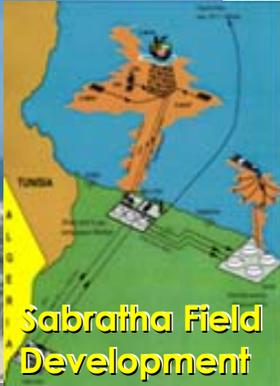


LIBYAN GAS PROJECT – ENI GAS BV/Green Stream BV
*SABRATHA PRODUCTION PLATF., BAHR-ESSALAM PIPELINES AND
 SUBSEA FACILITIES, MELLITAH GAS TREATMENT PLANT. GREENSTREAM EXPORT LINE LIBYA TO ITALY*

**MELLITAH
GAS TREATMENT PLANT**
Capacity: 700 MMscfd



**Sabratha Field
Development**



**GREEN
STREAM
PIPELINE**
516 Km
32" dia



**SABRATHA PLATFORM
Topside 12,100 tons**



**RUSSIAN FAR EAST
Sakhalin II**



'Reimbursable' vs. 'LSTK' Contracts for EPC Projects

'Reimbursable' and 'Lump Sum' Contracts

Who runs the project ?

Who is responsible for the outcome ?

Reimbursable

Owner

Short, can be subjective

Easy

Owner

Owner

Owner

High

- **Project Definition**
- **Contractor selection process**
- **Overlap between main steps**
- **Design**
 - **Leadership**
 - **Location**
 - **Project Risk**
- **Owner's involvement**

Lump Sum Turn Key

Contractor

Rigorous and formal, but long

Difficult

Contractor

Contractor

Contractor

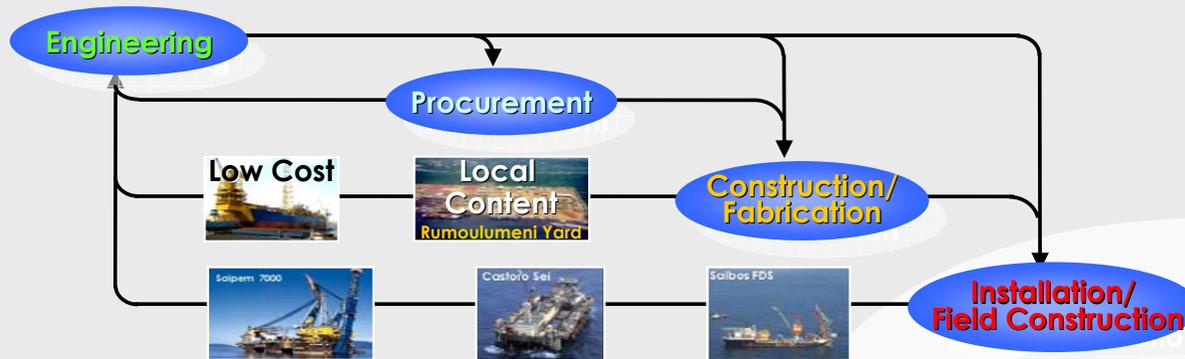
Low

- *Allows design development, flexibility, adaptation to evolving and unpredictable circumstances*
- *Little guarantee on final cost/schedule*

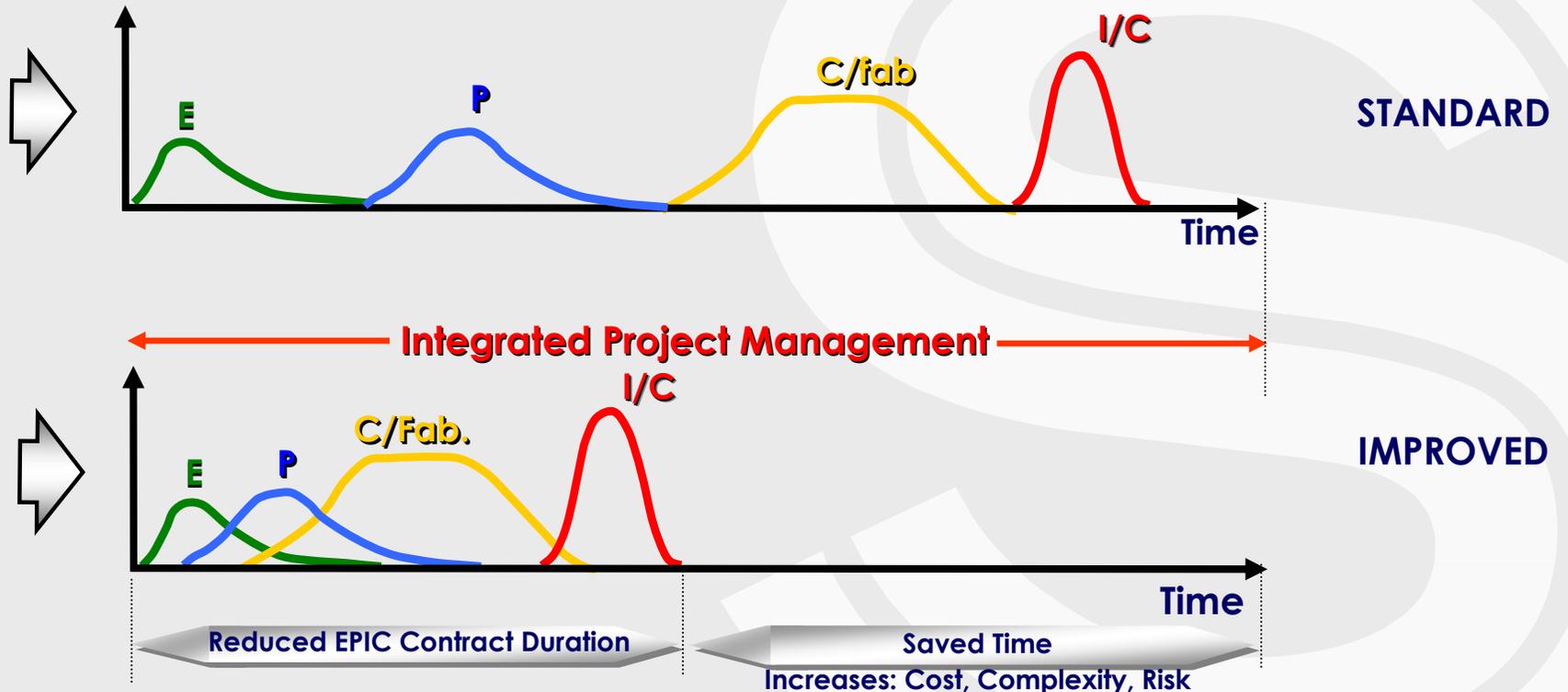
- *Guarantees defined budget and completion time*
- *Requires excellent project definition*

We believe that the **EPC/EPIC** approach can offer **superior performance** in large projects execution

Typical EPC/EPIC Process

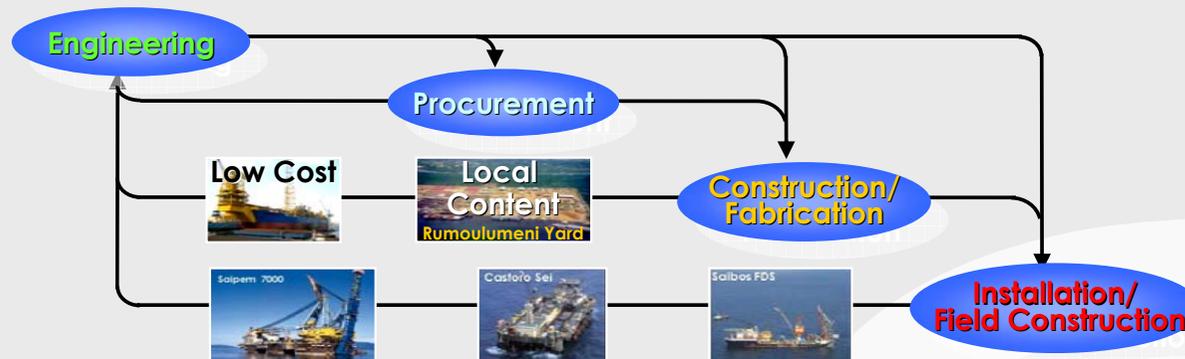


Project Cost



We believe that the **EPC/EPIC** approach can offer **superior performance** in large projects execution

Typical EPC/EPIC Process



Pros:

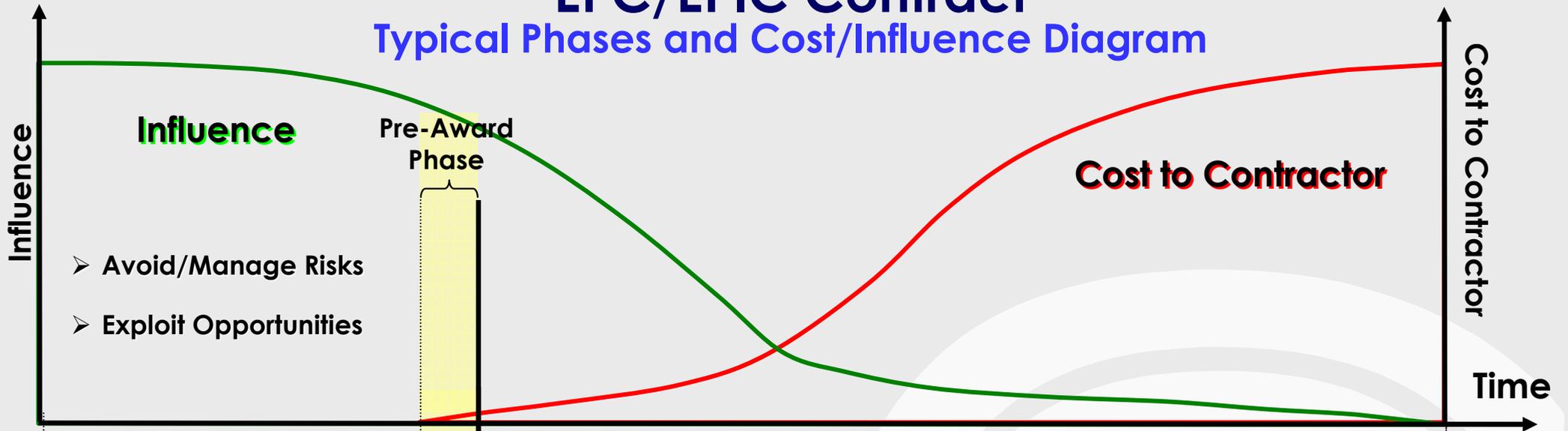
- Most efficient process
- Parallel processes are possible (Indeed essential to capture program value)
- Continuous improvements (Project-to-project)
- Easier to maximize local content efficiently
- More sustainable than best-in-class alternatives

Cons:

- Complex/ High Risk (Especially without appropriate Industrial Model)
- Requires firm and precise execution of each step

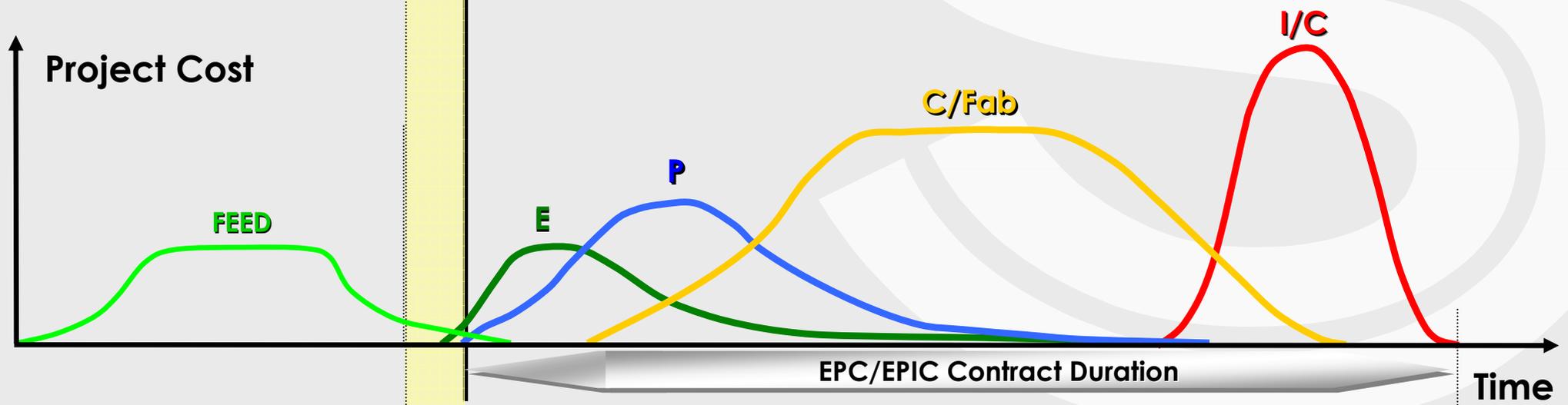
EPC/EPIC Contract

Typical Phases and Cost/Influence Diagram

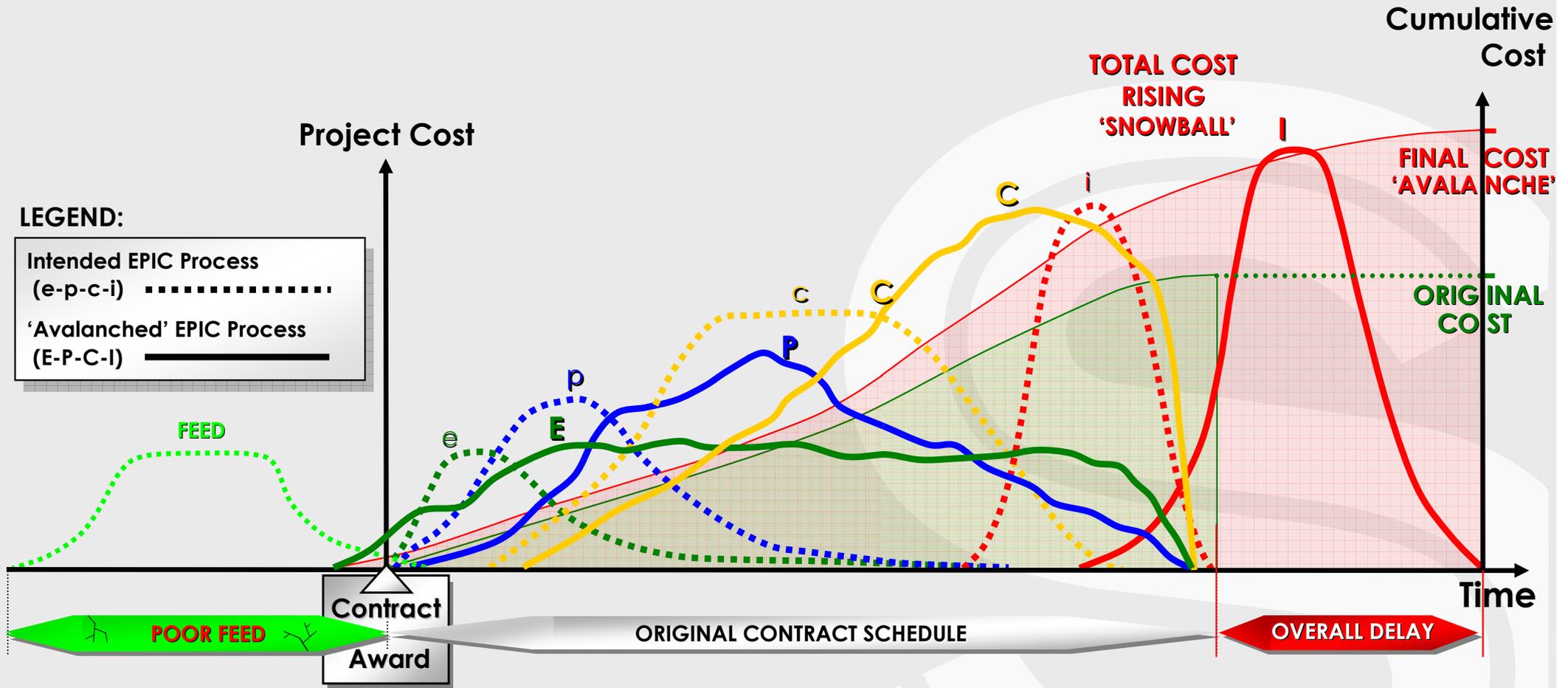


Contract Award

← *MORE FRIENDLY* ←
OPERATING ENVIRONMENT
→ *LESS FRIENDLY* →



In EPC/EPIC Contracts we need to avoid the “Avalanche Effects” of poor or changing FEED / Technical Package



Today's Market Trends

E&C Market Trends

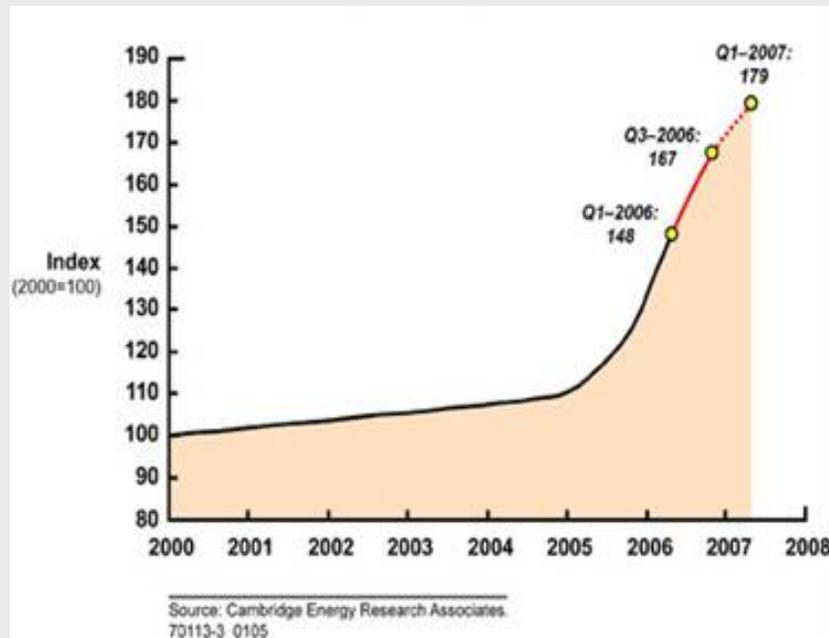


- ▶ Huge investments and projects (> 1 B\$, some 15 B\$)
- ▶ Remote and frontier areas
 - Challenging locations – climate, access, remoteness
 - Political uncertainties
 - Simultaneous need for local content
- ▶ Increasing technological complexity
- ▶ Pressure for ‘Fast Track’ execution
- ▶ Rapid price escalation and longer delivery times
- ▶ Shortage of production and execution resources

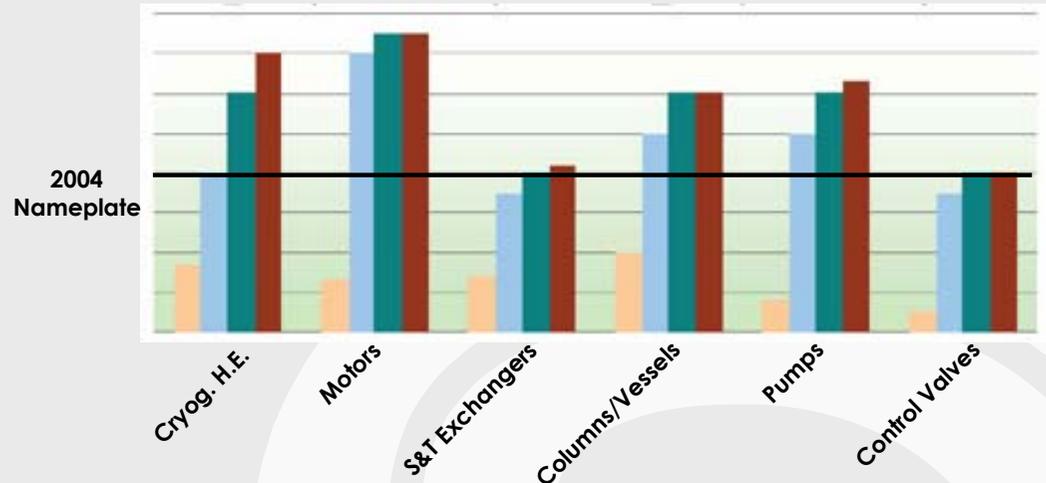


Rapid and non-homogeneous cost rises contribute to unpredictability and higher risks

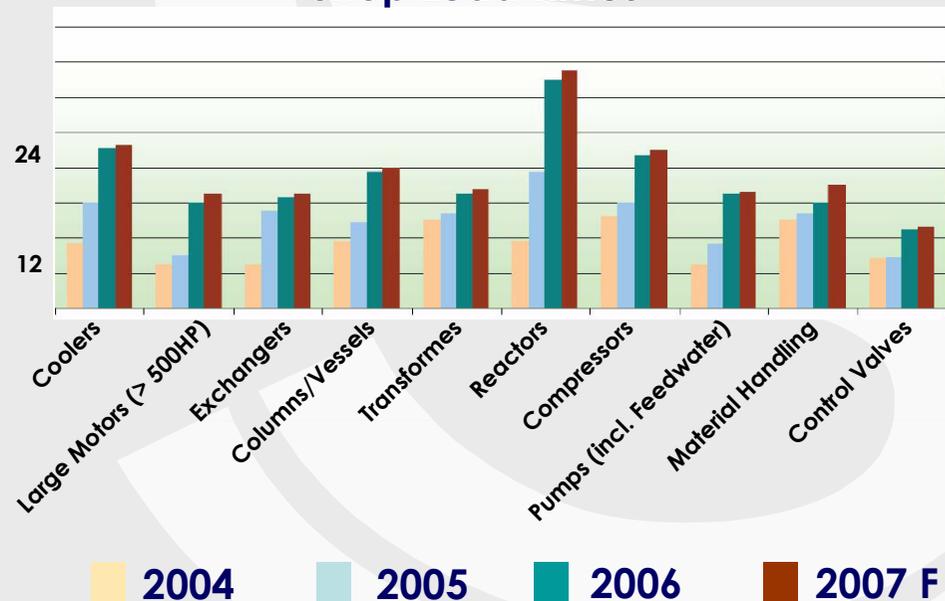
IHS/CERA Upstream Capital Costs Index



Pressure to Increase Manufacturing Capacity



Shop Lead Times



'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*

F E E D

E

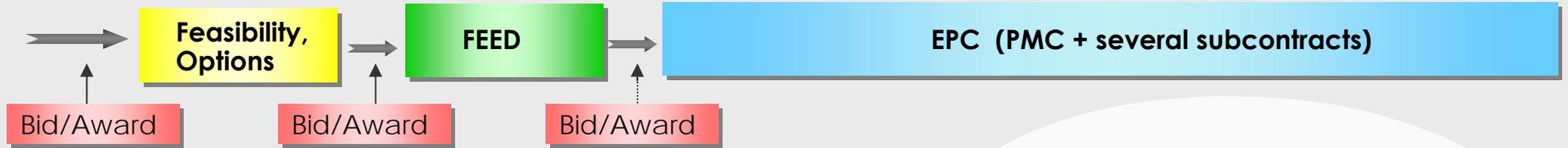
P

C

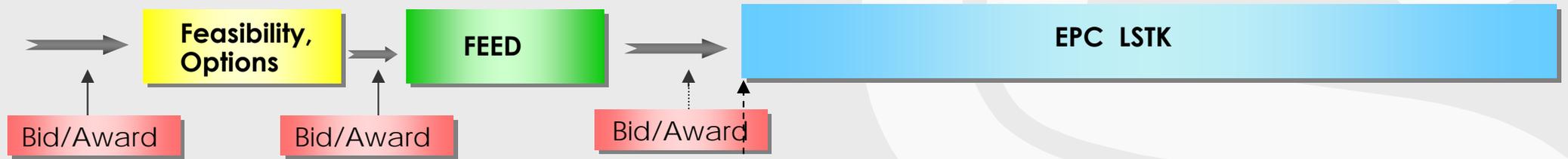
PROJECT EXECUTION

Execution Approaches

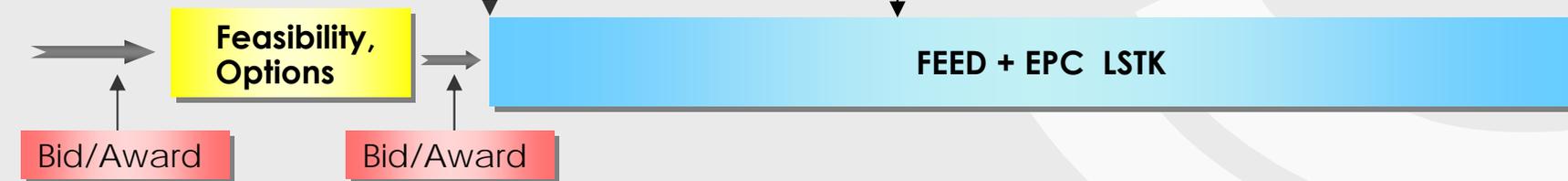
Open Book Reimbursable



LSTK

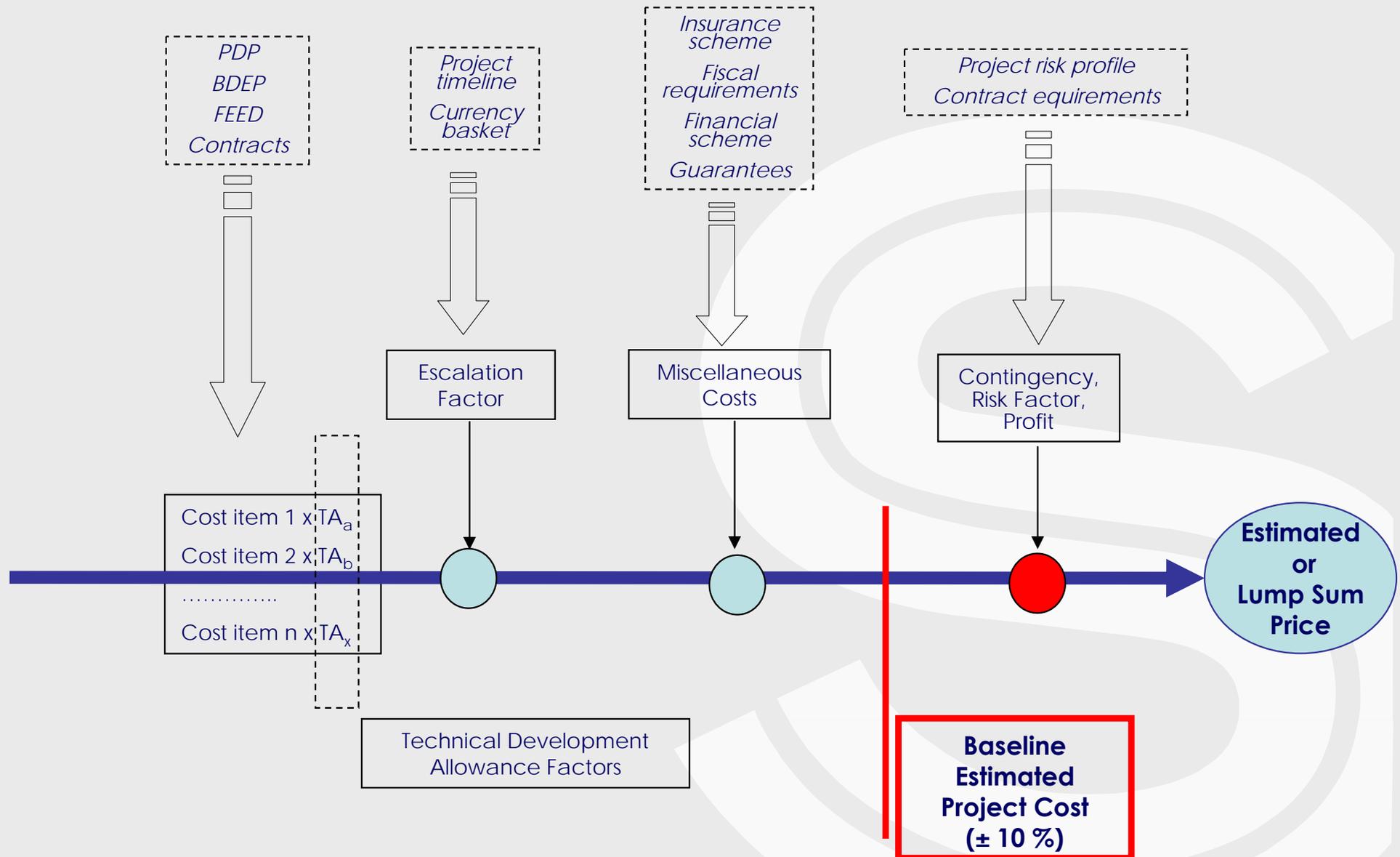


'Convertible' LSTK

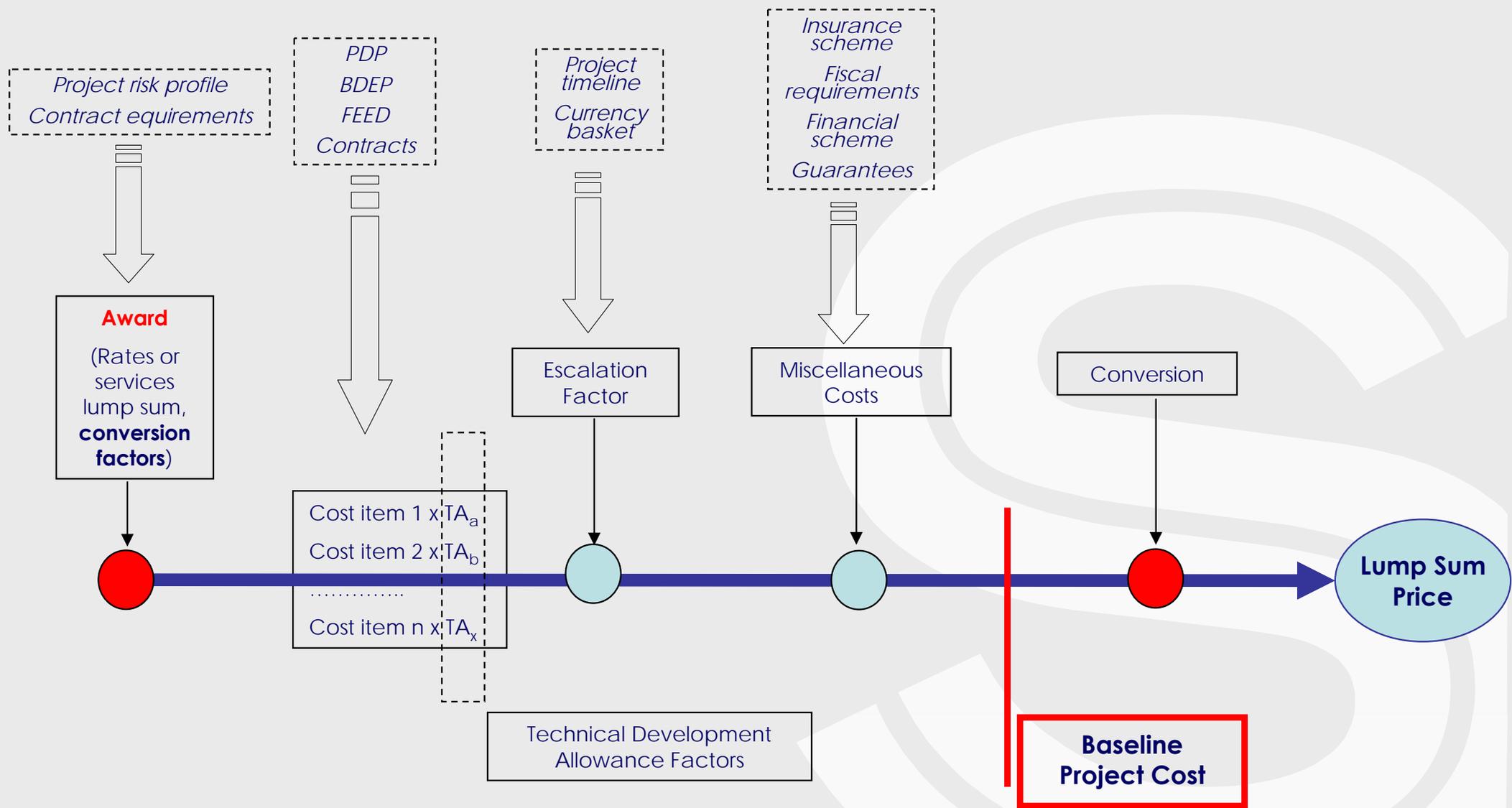


Traditional Open Book Cost Estimates

Occasional Conversions into Lump Sum Price



'Converted' Lump Sum - Contract and Final Price Development



'Convertible' Contracts

The initial contract at award time

- Very simple and straight forward
 - 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

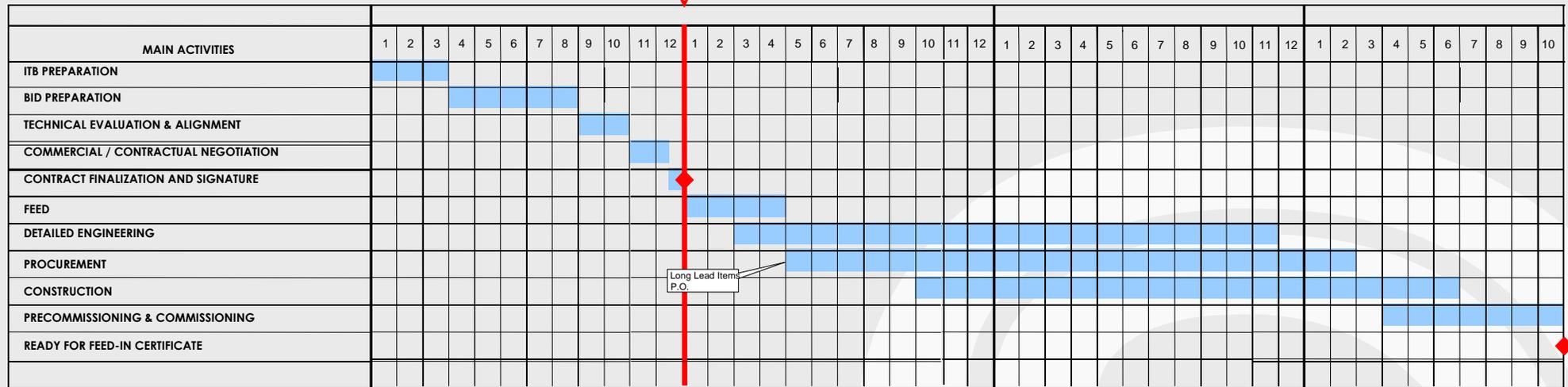
Lump Sum vs. Convertible Contracts Overall Execution Schedules

Example: Polymer Project (Middle East Location)

COMPETITIVE EPC LSTK BIDDING

(License pre-selected by Owner, FEED needs to be carried out)

EPC LSTK CONTRACT AWARD

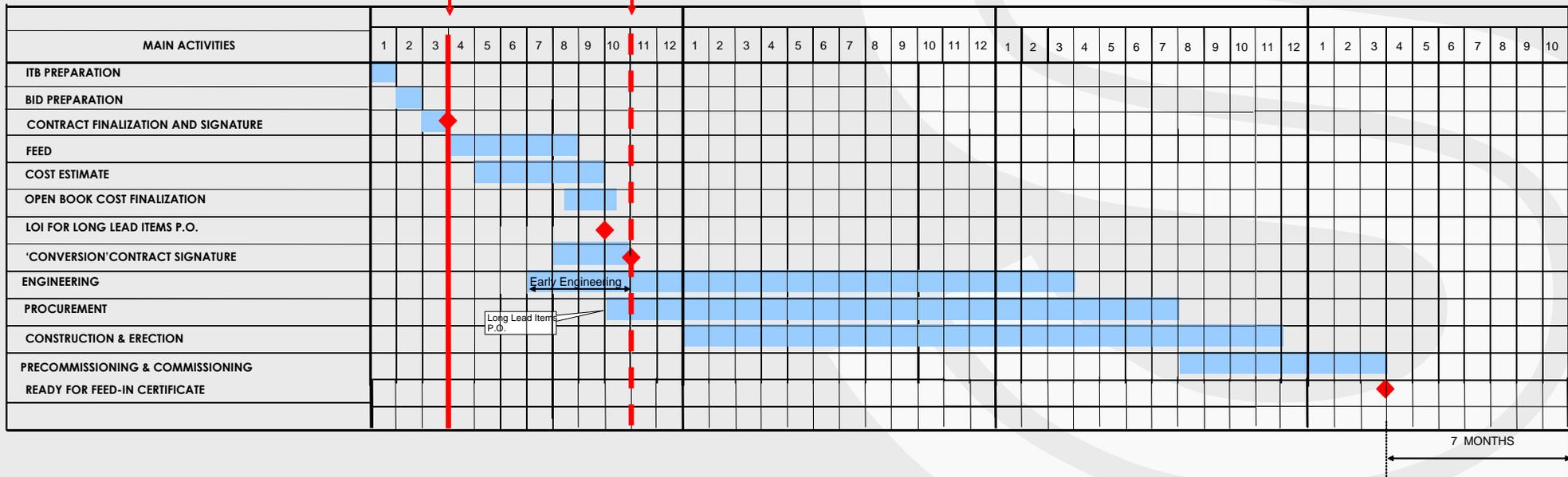


'CONVERTIBLE' EPC CONTRACT

(License pre-selected by Owner)

INITIAL CONTRACT AWARD

CONVERTED EPC/LSTK CONTRACT AWARD



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 ?

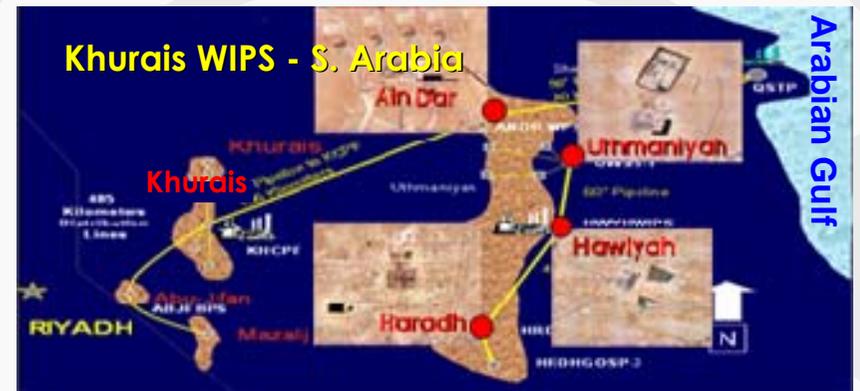
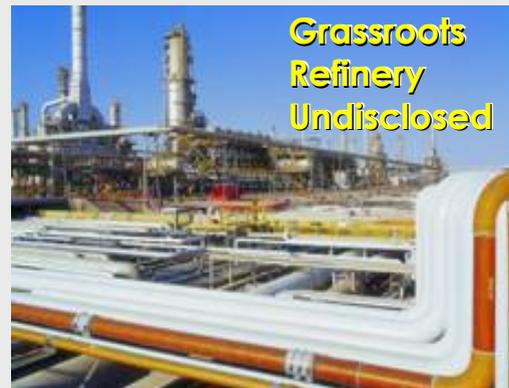
Setting realistic and clearly communicated goals

➤ 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

Saipems'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 ?

✓ Risk 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

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!

