# THE OIL PRICE COLLAPSE

## ADDRESSING CHALLENGES AND FINDING OPPORTUNITIES

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**The collapse in oil prices, beginning slowly at first in July of 2014 and accelerating in earnest in late September 2014, has sent shock waves throughout the energy industry. With West Texas Intermediate crude losing more than half its value from a high in 2014 of around $110/bbl, the impacts have been profound on the energy industry, but particularly so for producers who are struggling to adapt and survive in this new market reality.**

**The primary factors that contributed to the fall in prices – excess supply brought on in large part by the boom in U.S. production and depressed demand due to low global economic growth – have also contributed to an increase in market volatility. With no clear direction, the market is experiencing price swings not seen since 2011 as traders and speculators buy or sell in reaction to any news or events they feel may portend a sustainable recovery or a further decline.**

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### CHALLENGES FOR PRODUCERS

For aforementioned producers, the impact of the price drop has been particularly problematic. The technologies that provided the windfall of production, horizontal drilling and massive hydraulic fracturing, have substantially increased capital costs for producers and lead many to finance their development activities with high levels of debt. Now in the face of declining revenues, these companies have been forced to not only reduce spending on new development, but also cut costs across the board in order to preserve cash and meet their debt obligations.

Unfortunately, many of the cuts that are occurring, or may be contemplated, can actually undermine the ability for these companies to cope with the current market uncertainty. While it is difficult to make sweeping generalizations that cost reduction in any particular group or organization within any single company are unwise, production companies contemplating cuts to their IT budgets should proceed with caution. Without the appropriate systems that provide a clear and up-to-date picture of the entirety of their operations, including marketing and/or trading, producers will have difficulty successfully navigating this market.

The ability to generate a predictable and reliable profit, despite near-term price fluctuations, will differentiate those that are able to weather the current storm versus those that may have difficulty. In this environment, sweeping cuts in IT spending are unlikely to improve these companies' chances of success. Implementation of any cost reductions should come only after a full IT and business process review, one that takes into account not only the installed systems and their costs, but looks at what capabilities and systems are necessary to ensure the business is operating most efficiently and profitably. No doubt some costs may be eliminated; however, those cost reductions cannot come at the expense of improved financial performance that could otherwise be realized through improved access to information, better analytics, accelerated cash flow or optimized marketing activities.

Any effort to reduce costs and/or improve performance should be guided by a roadmap – one that identifies the current state and clearly defines the desired state. Developing such a roadmap can identify opportunities to eliminate redundant systems or consolidate overlapping technologies.

The effort should also review the opportunities to upgrade or install new or alternative technologies that not only reduce costs, but can also better grow with the company once the oil price recovery inevitably begins.

But again, the effort should not focus just on systems and costs. IT systems should be the facilitators of improved business processes and the foundation of an analytics-centric capability; one that helps optimize operations (such as logistics and transportation) in order to reduce costs, enables the development of an effective hedging program to ensure future cash flows, or identifies optimal markets to maximize the value of production. While it may seem counter intuitive, investing in improved IT systems and analytic capabilities in a "down" market can actually improve bottom line performance far beyond simple cuts; and in the process, better position the company for success in an "up" market.

## OPPORTUNITIES FOR TRADERS

Despite the difficulties faced by producers, volatility is the life blood of any commodity trader, and with the current turmoil, oil traders are returning to the markets en masse and ramping up activities.

In the period between 2012 and late 2014, high prices and low volatilities had reduced traders' profits and limited opportunities. During that period, the return on any single trade was being measured in a few pennies on the dollar, and few companies saw reason to invest. Now, with daily price swings that have ranged up to 10 percent, and annualized volatilities over 50 percent, traders can again leverage these substantial price movements and, if backed by the right tools and market intelligence, realize a solid return on their deployed capital.

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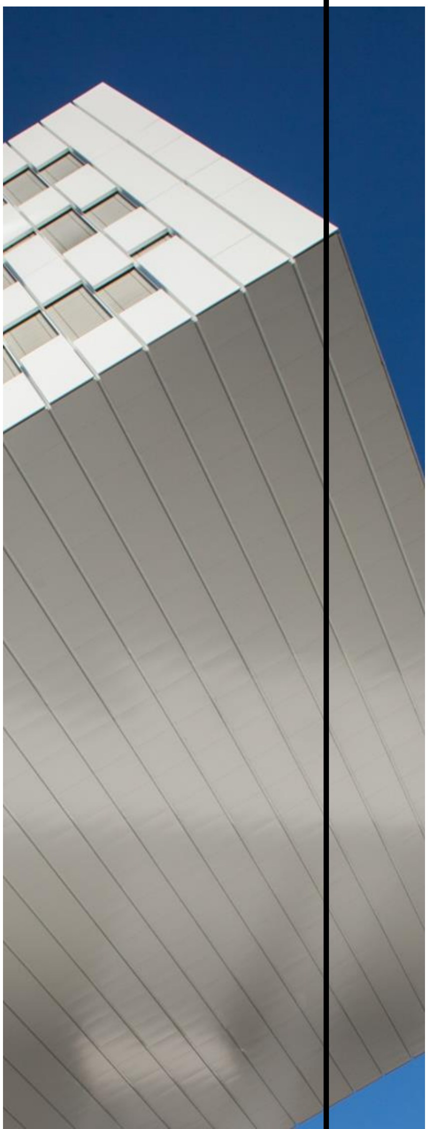
For these traders, the impetus to invest in systems is perhaps more clear than for others. With trading taking a backseat in recent years, some companies are finding that their systems may not be up to the task of managing their exposures in an environment where a single intraday price swing can make or break a month's worth of trading activity.

In a volatile market, real-time information becomes critical, not only in terms of monitoring price movements, but also in understanding and valuing the impacts of those movements on crucial exposures, such as credit risk and cash management. IT reviews for trading-centric companies should also focus on the elimination of spreadsheets, ensuring each trader's activities are captured, managed and valued as part of the company's portfolio. With increased regulatory scrutiny of trading organizations and the potential for errors, omissions or fraud associated with those spreadsheets, no company can afford to overlook the potential exposures spreadsheets bring, particularly in a volatile market.

Though their motives may be different, traders, like producers, need to ensure they are investing in the right technologies – those that allow them to cope with both current and future market conditions.

For both these groups, and for any business exposed to the fluctuations of the energy markets, developing a sustainable IT architecture and appropriate business processes that can identify opportunities, mitigate risks and optimize operations are the keys to long term success.



## MORE INFO

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Capco, an FIS™ company, is a global management consultancy with a focus in financial services including banking and payments, capital markets, and wealth and asset management, plus a dedicated energy division. Our professionals combine innovative thinking with our unrivalled first-hand industry knowledge to offer our clients consulting expertise, complex technology and package integration, and managed services to move their organizations forward. Through our collaborative and efficient approach, we help our clients successfully, innovate, increase revenue, manage risk and regulatory change, reduce costs and enhance control. We serve our clients from offices in leading business centers across North America, Europe, Asia Pacific and Africa.

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