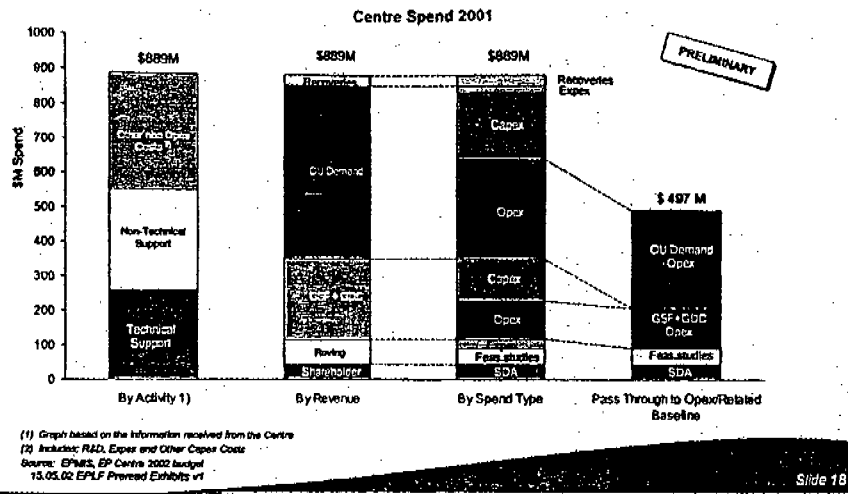
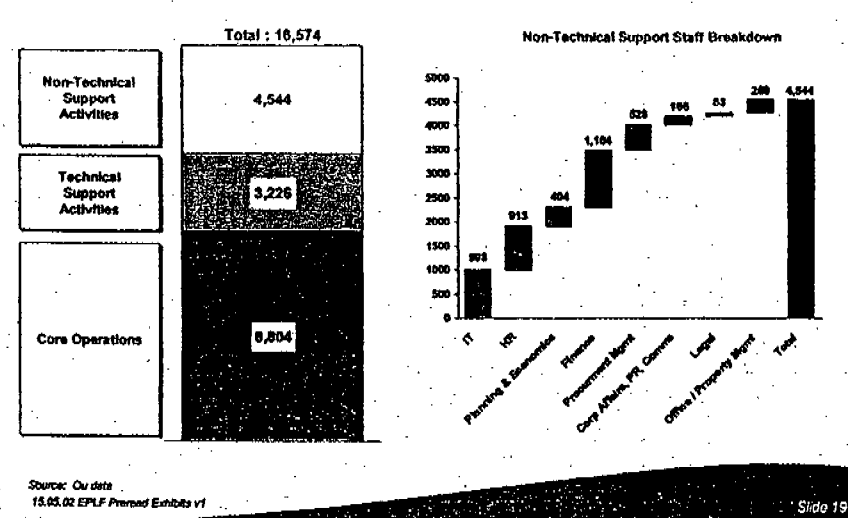


**Exhibit 15 : \$889M of spend was generated in the Centre and recharged out – of which \$500M appears in our opex/related baseline**



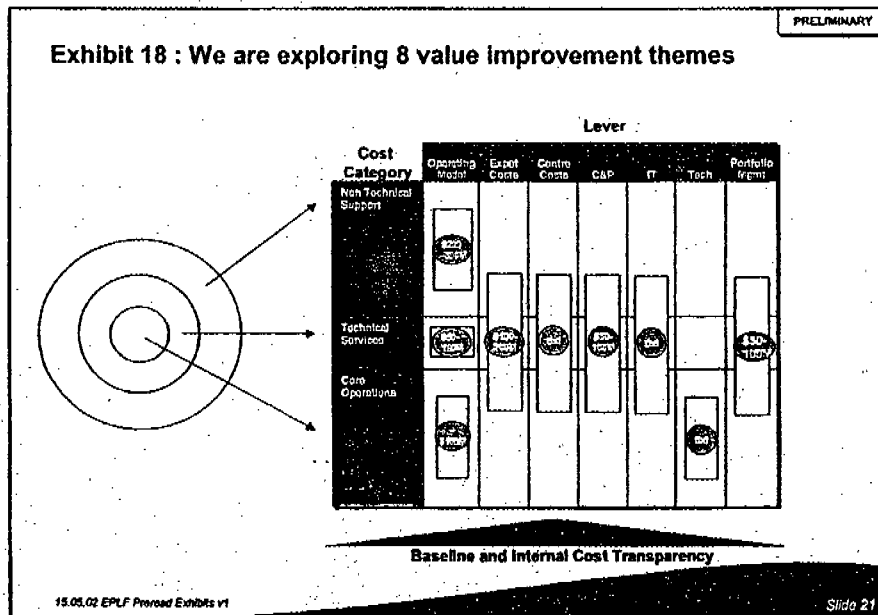
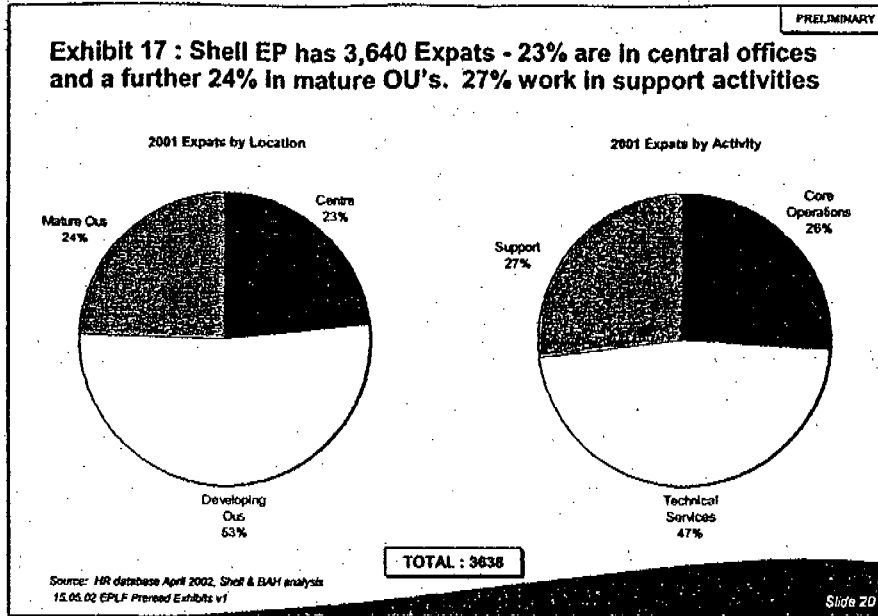
**Exhibit 16 : Of our 8 Sample OU's 27% of staff are employed in non-technical support activities**



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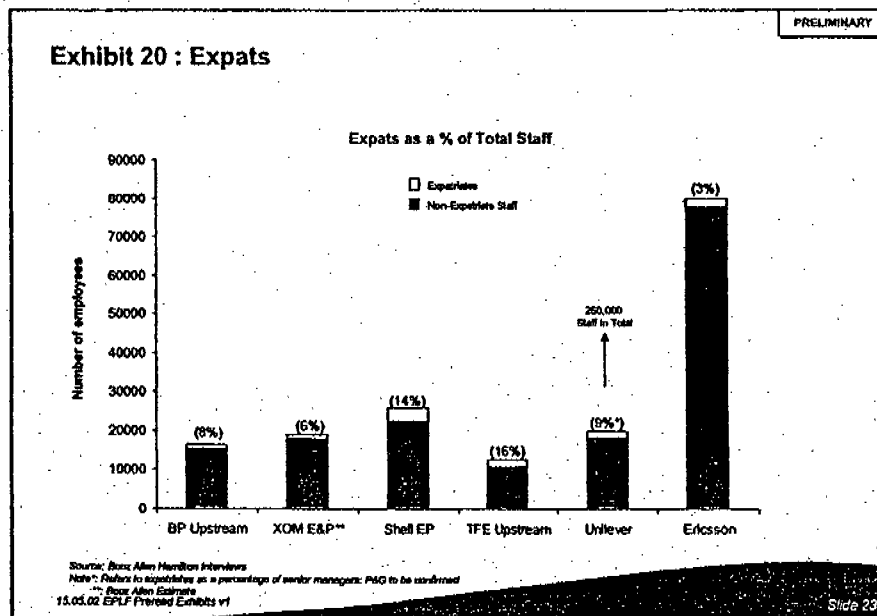
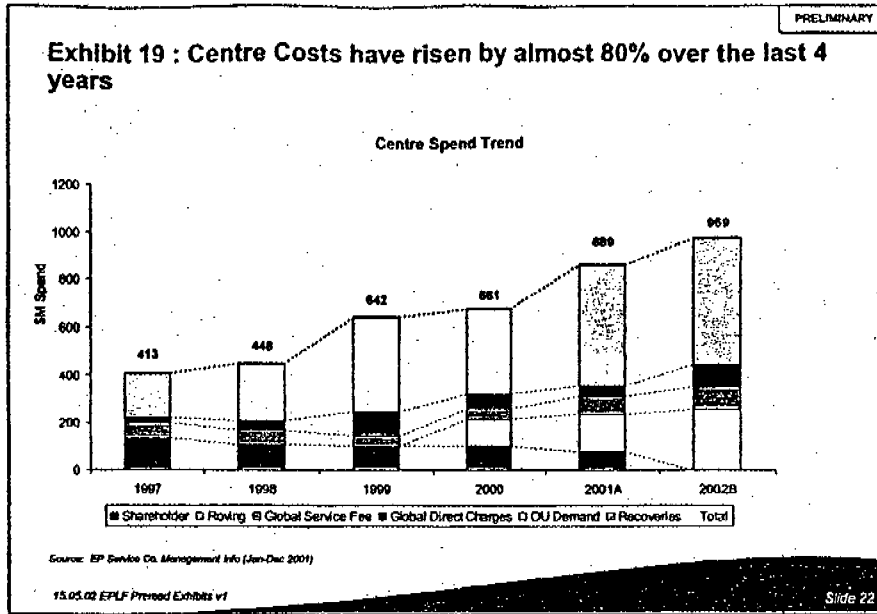
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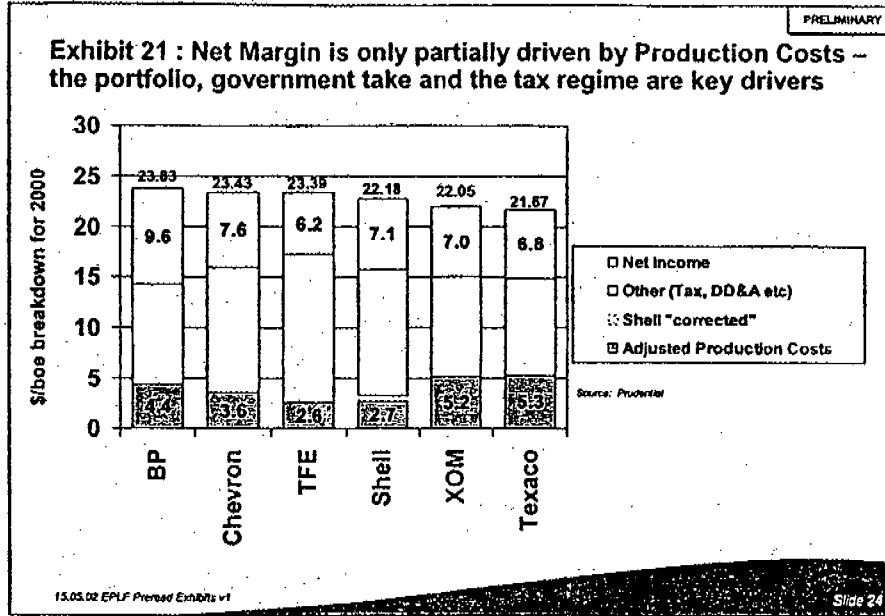
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Waller  
For info.  


## FRD Cost Structures - Update 13/05/02

### **A CASE FOR ACTION IS EMERGING**

- The EP Operating Cost Structure is far from transparent and may be masking true performance levels
- The improvement in UOC from 98 - 01 has been driven to a large extent by factors other than underlying cost efficiencies (Exhibit 1)
- Viewed critically (after normalising for portfolio) our unit cost position appears average - our claim to be a cost leader can be challenged and there is a danger of believing we have "won the war" with associated complacency in the organisation (Exhibit 2)
- We are in danger of not meeting our external commitments to remain a cost leader and to reduce our underlying UOC reduction by 3% pa in 2002/2003
- Our 2001 Prudential ranking will be disappointing and will surprise/disappoint the market.
- Competitors have announced larger UOC declines and will take out significant fixed costs as part of their mergers
- Finally, and as demonstrated in the Enterprise case, to create room for more growth and further acquisitions we will need demonstrate a considerable structural cost take out capability

### **THE COST FRD IS A FIRST STEP TO MOVING FORWARD**

- The primary objectives of the first phase are to describe the current Cost Structure and to quantify the potential opex reduction opportunity - whilst maintaining integrity, protecting production and growth potential
- An element of this is to examine and quantify the benefit of existing procurement & IT initiatives
- We will also recommend standard cost reporting definitions and structures for internal & external use including a recommendation on the definition of underlying UOC

### **THE 2001 OPEX BASELINE THAT WE ARE ADDRESSING IS \$3.8 BILLION (EXHIBIT 3)**

- Of the \$ 3.8 bln some \$3.1 bln forms the numerator of the current UOC definition
- This is spread across 23 OU's with 80% of the opex in the top 8
- \$0.9 Bln of costs is generated in the Centre and recharged out to the OUs, of which ca. 1/3 ends up as opex. (CHECK)
- We are building a detailed cost and headcount breakdown for 8 key OUs and the Centre
- Building the baseline has been challenging and makes clear the need to adopt common definitions and reporting

### **EMERGING RECOMMENDATIONS**

#### **1. THE PROPOSED DEFINITION FOR "UNDERLYING UOC" IS BUILT ON OPERATING ACCOUNTS WITH REMOVAL OF SOME SPECIALS AND NON RECURRING COSTS**

- The trend on a GA basis is up slightly; on an OA basis is initially down but short of the promise (by \$ 50 mln); on an underlying (OA modified) basis it is improved and just enough to address the promise to 2003. (EXHIBIT 4)
- To continue on to 2006 removing 3% pa requires a cost take out of ca. \$ 420 mln on an underlying basis and \$ 600 mln on a straight OA basis.
- The above assumes production growth in line with plan - failure to grow at plan levels will further inflate the required opex cost take out (EXHIBIT 5)

#### **2. WHILE IT IS EARLY DAYS, IT APPEARS THAT OPPORTUNITIES EXIST TO SIGNIFICANTLY REDUCE THE COST BASE/IMPROVE OPERATIONAL EFFICIENCY TO MEET OR EVEN EXCEED EXTERNAL PROMISES - SOME EXAMPLES (EXHIBIT 6)**

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- The operating cost model can be seen as comprising core operational costs, overlaid with firstly technical support costs and thereafter non-technical support costs.
  - Non-technical support services (at least 20% of EP opex) consistently benchmark 30% to 40% higher than global best practice implying lack of economies of scale, non-optimised service levels, lack of global sharing and use of outsourcing - this would indicate a potential for \$ 150 - 250 mln cost take out.
  - Technical support costs (some 20% of EP opex) have fewer external benchmarks but internal benchmarking would suggest potential for \$ 50 - 75 mln take out.
  - Core operations costs (some 50 - 60% of EP opex) also have few external benchmarks. This is core T&OE ground where the transfer of best practices, imposition of minimum standards and increased staff competency will have a longer term impact on operational efficiency and resulting cost reduction.
  - There is limited use of regionalisation of operations support - extending the NESS concept to the whole of the North Sea / other regions could have significant benefits
  - Centre costs have risen by more than \$200m (CHECK!) over the last three years without evidence of related costs falling in the OUs (CHECK THIS AS WELL). Benchmarks suggest many centre billing rates are 30% higher than market rates, reflecting high overheads and low utilisation rates
  - Expat premium is \$350 million (over having equivalently competent regional staff) driven by a headcount double that of our competitors, and sub-optimal deployment. Coming down to competitor levels offers the potential to reduce costs by ca. \$150 - 200 mln.
- VAA
- Global procurement opportunities are under-utilised, in part due to a lack of central mandate
  - Global IT solutions are under-delivering, in part due to local resistance and track record of proven benefit and technical implementation

**IMPORTANT QUESTION - HOW FAR DO WE WANT TO GO?**

- There are a number of possible targets for a cost improvement drive;
  - o to meet the -3% pa challenge to 2003 on a GA basis (-\$XX mln) or on an OA basis (-\$50 mln)
  - o to extend the cost reduction target window to 2006 or later (i.e. evergreen the promise) on an underlying basis (-\$ 400 mln); more on an OA or GA basis
  - o to go for a larger cost improvement programme based on the opportunities presented and reposition Shell EP as THE leader and enable further acquisitive/organic growth

**TO GO EVEN PART WAY WILL REQUIRE A SIGNIFICANT CHANGE PROGRAM (EXHIBIT 7)**

- Implementation will shift the operating model from self sufficient autonomous OUs to an EP-wide model that optimises at an EP level rather than at an OU level by capturing economies of scale, applying global standardisation and addressing global priorities using the whole of the global EP resource base.

**THERE WILL BE MANY IMPLEMENTATION CHALLENGES**

- Decision rights will be changed throughout the organization
- The employee value proposition will be changed
- There will be significant headcount implications in low value adding activities

**IMPLEMENTATION WILL REQUIRE FOUR PHASES - MAJOR DECISIONS WILL BE REQUIRED BY THE EXCOM AND INTERNAL/EXTERNAL COMMUNICATIONS WILL NEED TO BE CAREFULLY MANAGED**

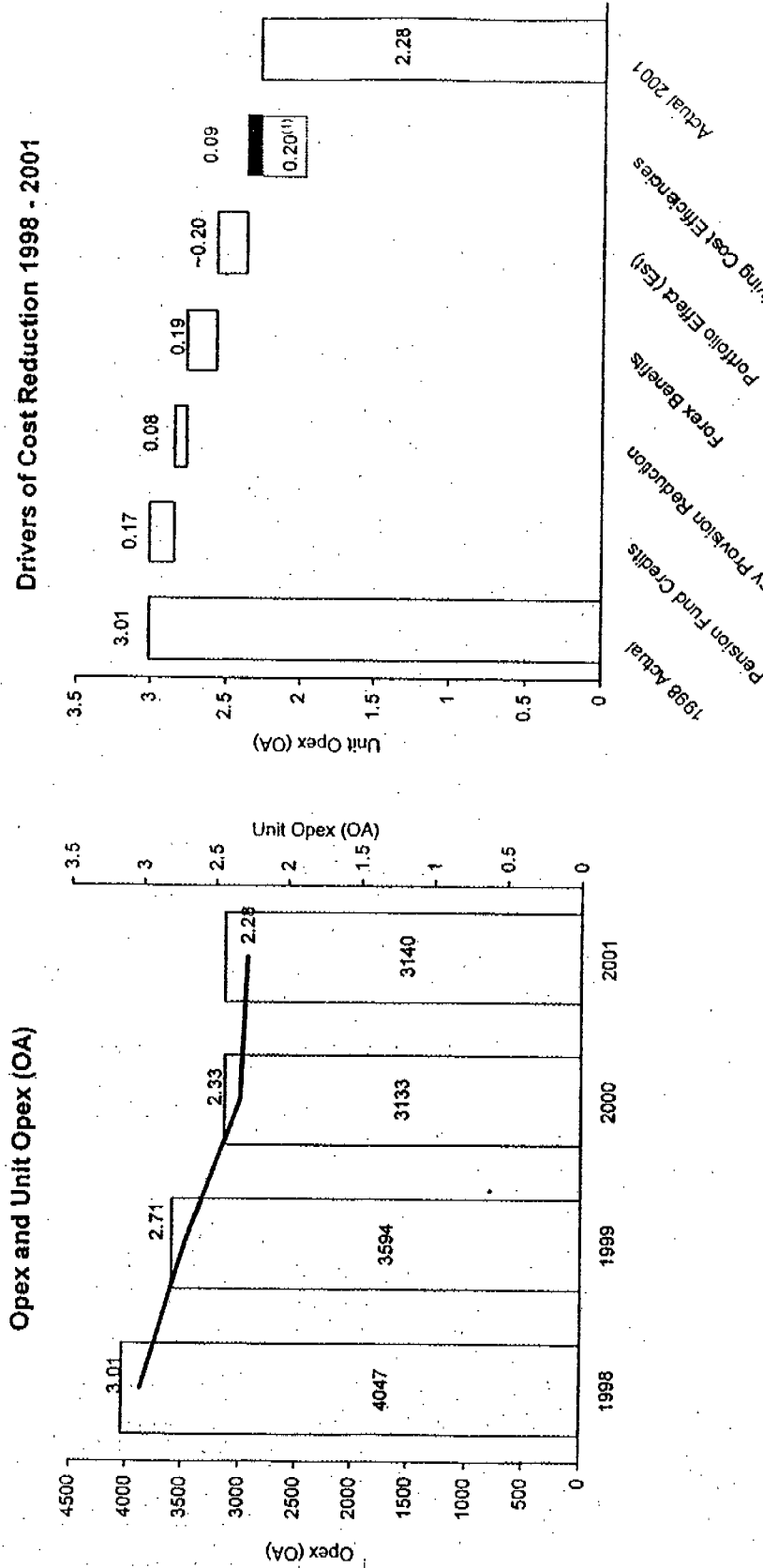
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PRELIMINARY

# Exhibit 1 : The improvement in UOC to date has largely been driven by factors other than underlying cost efficiencies



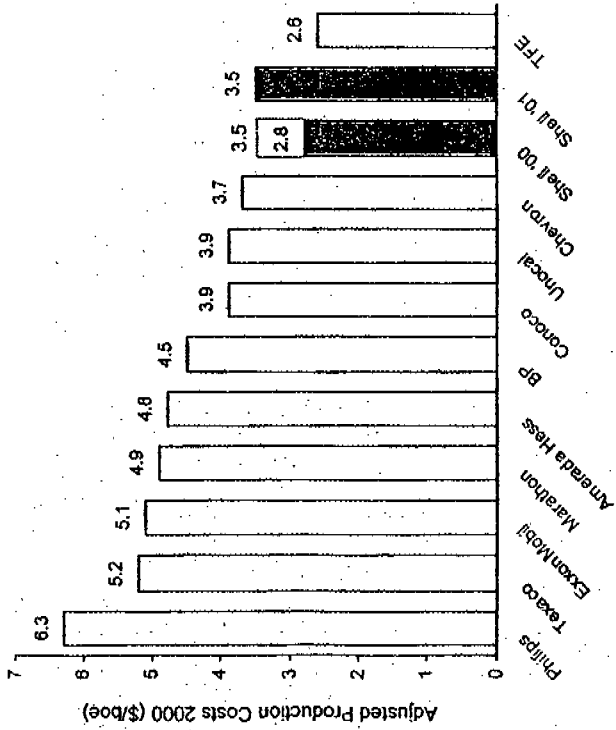
Note (1): Inflation effect based on 2% - some costs (eg. Wages) may have seen higher rates  
 Source : Shell Vol 1, SCL analysis  
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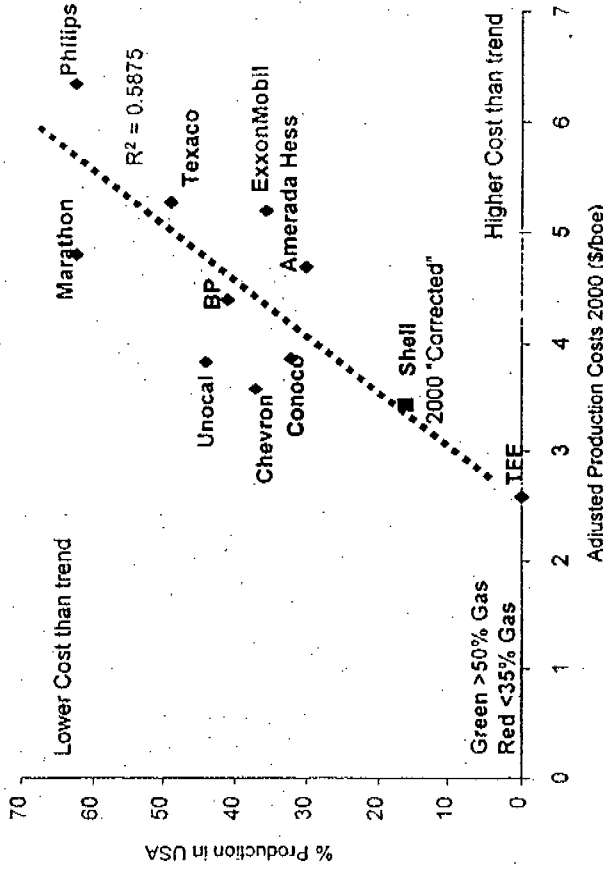
PRELIMINARY

# Exhibit 2: Viewed critically (adjusting for portfolio), our cost position is average

Adjusted Production Costs Worldwide



Adjusted Production Cost Correlation with US & Gas Content



Note: Average UOC in USA \$4.89 vs \$3.98 in ROW for all companies listed here  
 Note: Exxon Mobil partially adjusted for Canadian production  
 Source: Prudential, Shell and BAH Analysis

Source: 2000 Prudential, 2001 Shell projections  
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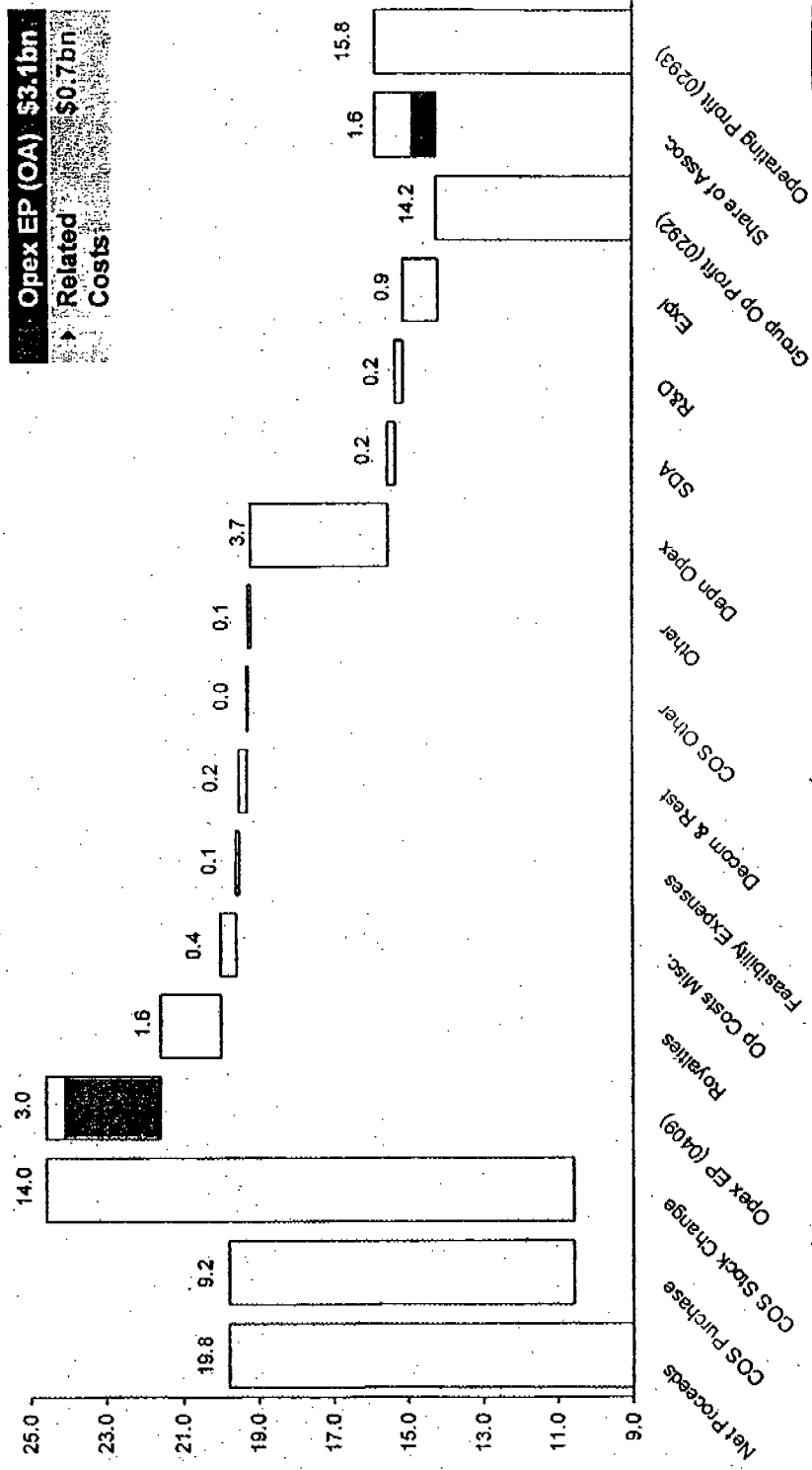
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PRELIMINARY

### Exhibit 3 : Our analysis is focussing on OA Opex plus some related P&L expenses – a total of \$3.8B

EP 2001 P&L Breakdown (GA Basis)



Opex EP (OA) \$3.1bn  
 Related Costs \$0.7bn

Source: GERRISS, EPMIS  
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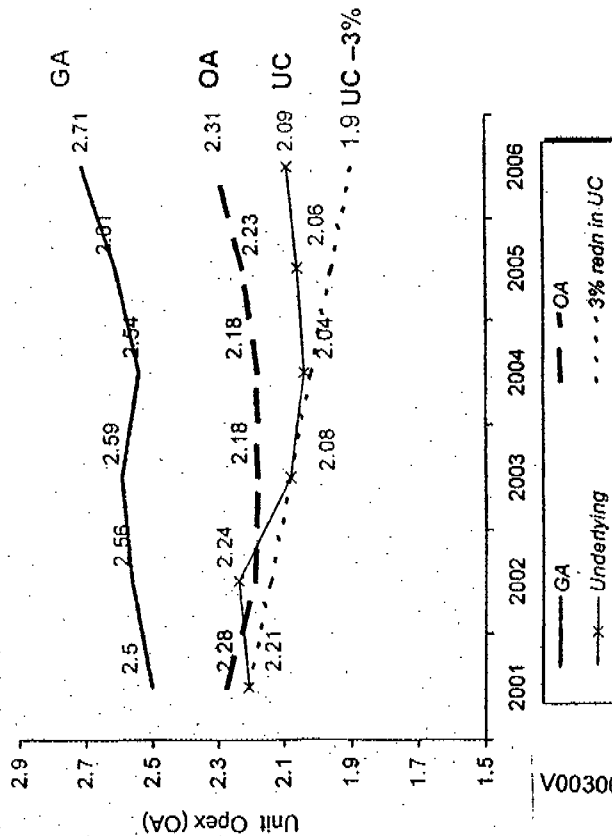
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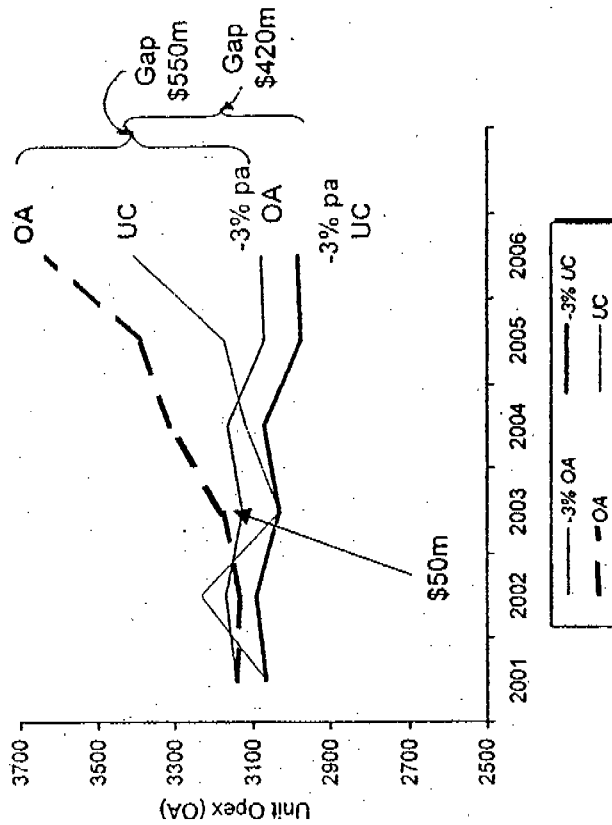
PRELIMINARY

**Exhibit 4 : Going forward, communicating the 'Underlying UOC' definition rather than AR, OA or GA definition appears favourable - although there is still a gap against the promise**

Unit Opex (OA) Forecasts (\$/boe)



Opex (OA) Forecasts (\$m)



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Note: All analysis at \$14  
 Source: CERES, EPMIS  
 RPUK\_219\_058\_123.ppt

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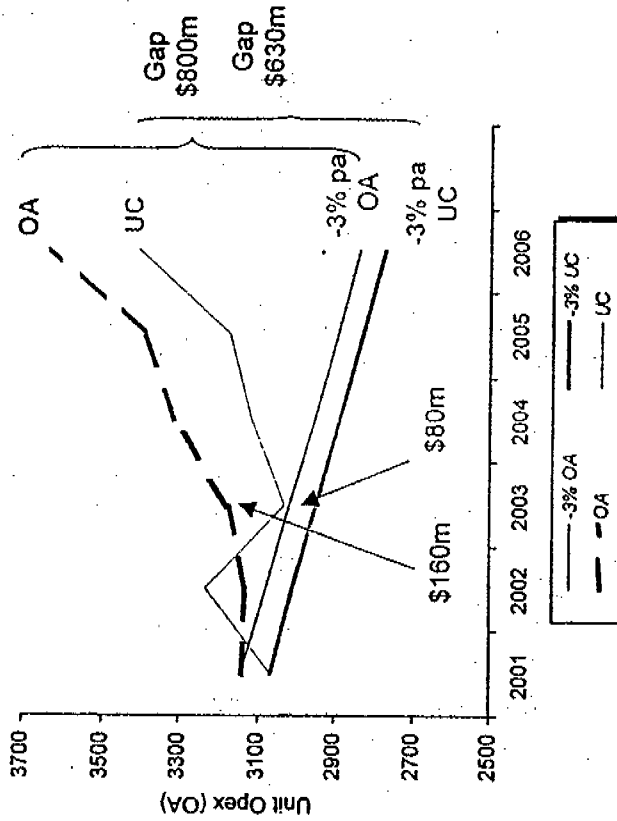
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PRELIMINARY

### Exhibit 5 : Failure to grow production at plan levels will put additional pressure on cost levels

BASED ON 1% PRODUCTION GROWTH

Opex (OA) Forecasts (\$m)



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Source: CERES, EPMIS  
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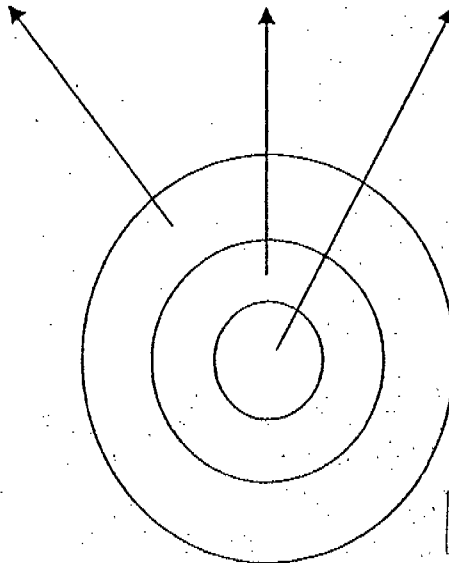
PRELIMINARY

**Exhibit 6 : Early analysis suggests a potential prize in excess of \$0.5B of ongoing annual saving**

Cost Category	Lever							
	Operating Model	Expat Costs	Centre Costs	C&P	IT	Tech	Portfolio Mgmt	Smarter Reporting
<b>\$3.8BN</b> Non Technical Support (XXX%)	\$\$\$							
Technical Services (XXX%)	\$\$\$	\$\$\$	\$\$\$	\$\$\$	\$\$\$		\$\$\$	\$\$\$
Core Operations (XXXXXX)	\$\$\$					\$\$\$		

Cost Category

Lever



Baseline and Internal Cost Transparency

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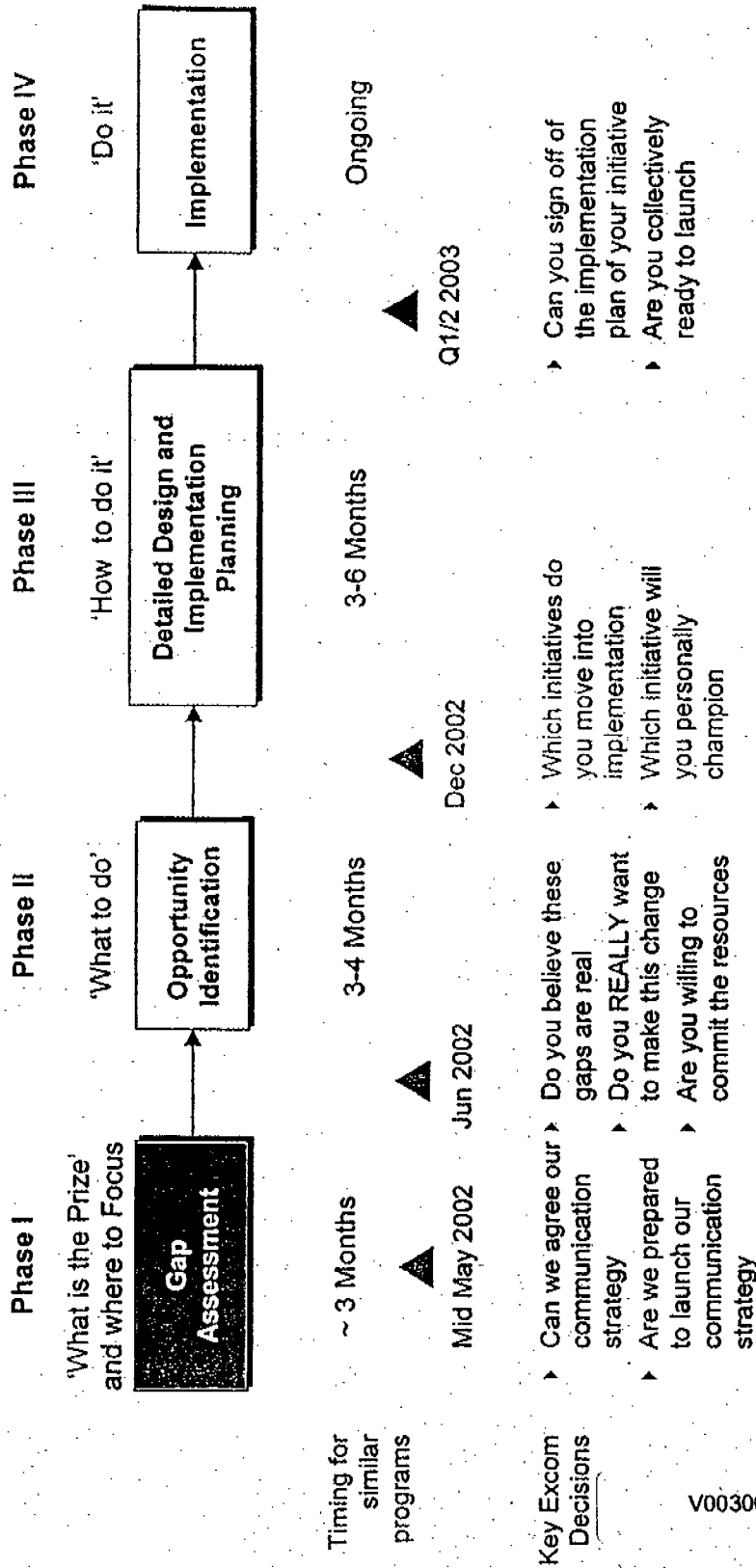
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# Exhibit 7 : Implementation will require four phases - major decisions will be required by the Excom



Underway

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