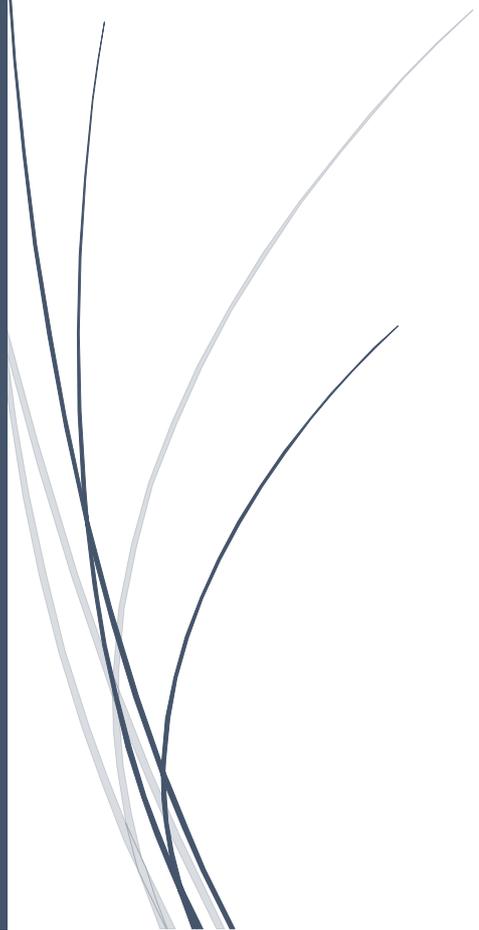


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Management Report

Cameron Process Systems
SG3018T



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1. EXECUTIVE SUMMARY

Regulation, internal inflexibility, poor supplier management and a lack of outward competitive analysis plays heavily on Cameron's ability to set itself apart from others in the market. Development of support infrastructures, that provide longer-term annuity (revenue) as well as internal adaptable process structures that are supported and managed by resources that are organised by capability, play a key part of the strategic direction for Cameron in the future. Expansion of successes such as Consumer Parts through clearly marketed and channelized distribution networks, provide linkage and opportunity for support services development, will set a differentiator for Cameron from its immediate competitors, and set new benchmarks for industry service and support philosophies.

2. INTRODUCTION

Cameron (NYSE:CAM) is a leading provider of flow control products, systems and services to worldwide oil, gas and process industries. As an oilfield service and supply company, Cameron and its competitors make up an essential part of these global markets, successfully providing the world with resources, makes the oil, gas and process industries some of the world's largest and most challenging global enterprises. At this point, it is important to realise that operators and service companies are interdependent; neither can exist without the other. It is this particular point, plus other connecting factors that will be explored and expanded during this report.

3. CAMERONS COMPETATIVE ENVIRONMENT

3.1. External forces

The use of the Porter's 5 forces model will help us understand what external factors affect or support Cameron's ability to trade in the competitive oil and gas market. The use of the model has been chosen due to its widely understood theory, although others exist, and have been referenced as sources of supporting information¹.

Cameron's wide portfolio of products and services may make it susceptible to both competition and erosion of margin due to both poor supplier management as well as ineffective buying strategies, all of which will be discussed and analysed in this report. For the purpose of this report, we will concentrate on the Process Systems division of Cameron, which covers activities around the following products and services.

- Gas Treatment Systems
- Oil Treatment Systems
- Produced Water Treatment Systems

¹ These include Gerard Debreu's *Theory of Value* (1959), and Arrow and Hahn's *General Competitive Analysis* (1971).

- Solids Treatment System

One of the biggest determinants for Cameron, as well as the industry as a whole, is the price of oil. Over the last year (2014 – 2015), the price of Brent Crude (the bench marker for oil) has dropped from a high of \$115 to a low in December 2014 of \$48.

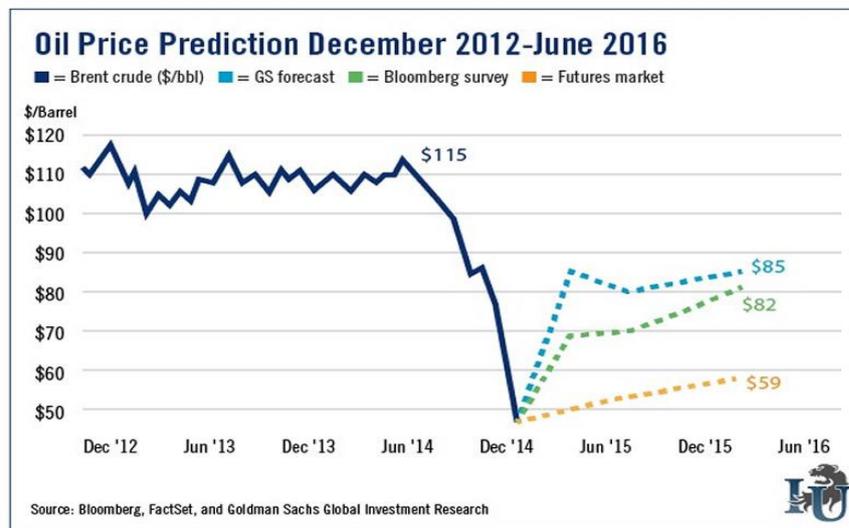


Figure 1: Crude Oil Price Forecast (2014-2015)

(Source: Bloomberg and Goldman Sachs Investment Research (2015))

This factor continues to drive changes in the external forces. For the purpose of this report, the author will concentrate on factors affecting UK production although these factors also have an impact on a global stage.

3.2. Competition & New Entrants

The oil and gas market certainly in the UK is made up of a number of key players, namely BP, TOTAL, ExxonMobil, Chevron, and Royal Dutch Shell. These companies have had the majority share of exploration operating licenses for the past 60 years in the North Sea sector. Academics² suggest that new entrants bring with them new capacity and willingness to gain market share. This willingness puts pressure on costs, prices and the rates of investment. The threat of entry depends on two factors: the height of the entry barrier and the reaction of the current players to new entrants.

The major barriers to entry in the oil & gas industry³ are:

- Large capital requirements
- Government regulation
- Ownership of resources
- Patents
- Product Differentiation

² Porter, M.E (2008) *The five competitive forces that shape strategy*. Harvard Business Review 86(1):78-93

³ Jones, R.O, Mead, W.J and Sorensen, P.E (1978) *Free entry into crude oil and gas production and competition in the US oil industry*. Natural Resources Journal 18(1):859-876

- Economies of scale

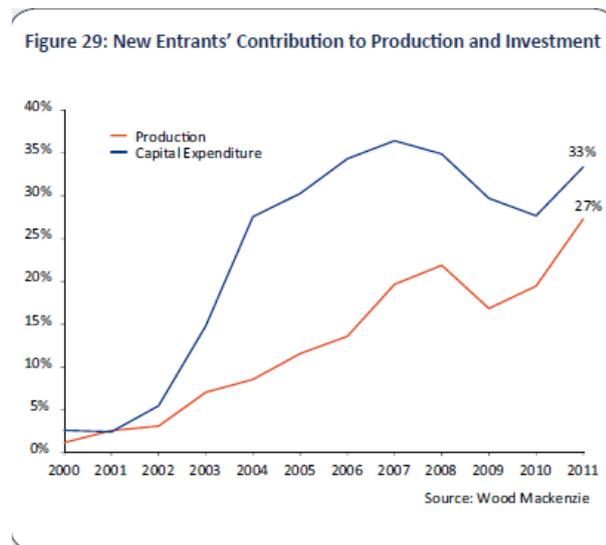


Figure 2: New Entrants Contribution & Production

(Source: Oil & Gas UK 2012 Economic Report)

Product patents and licenses for technology as well as investment in innovation can help to reduce as well as compliment the barriers to entry, these being mainly of cost and differentiation as described by Santos⁴. Many companies have invested in technology which provides increased production and longer term overall cost reduction. Cameron itself has invested in its CFU technology, which reduces platform footprint (space reduction) as well as increased production flow, giving operators a competitive advantage with overall greater output and reduced energy costs.

Government regulation plays a large part as a barrier to market entry and in some cases has forced companies to exit the market. Changing environmental regulation means that Cameron has to constantly assess and measure the performance of its equipment against ever-tighter standards. With constant investment in research and design (R&D) to meet these standards, Cameron's yearly investment in R&D in order to be compliant with environmental policies exceeds \$10MUSD. This cost is a bottom line reducer and is under constant review against cost saving measures as well as margin improvement demands.

Acquiring or designing products that provide improved performance is a key competitive advantage. In order to do this Cameron has invested heavily in technology centres around the world, as well as acquiring key strategic companies, in order that its product portfolio has a differentiated profile from that of its competitors. Key company purchases over recent years include, **AXSIA**, **BFCCTM**, **CONSEPTM**, has meant that Cameron has both wider market penetration, as well as patented design rights, making market entry through similar technology by others difficult.

⁴ Santos, E.M (1999). Competitive Strategies and Strategic Positioning of Oil Companies in the International Oil Business: Theory and Practice in Perspective. Presented at the 1999 SPE Annual Technical Conference and Exhibition held in Houston, Texas, 3-6 October 1999 USA.

3.3. Substitution Factors

Oil & Gas has a price, which is considered inelastic, that is to say it has no close substitutes meaning that customers' choice is limited, this in part holds the price of oil & gas steady with any variance mainly being driven either through tax changes or through supply and demand. Recently (2014) the price of oil dropped dramatically due to oversupply, with the market being flooded with cheaper "low cost of production" shale oil & gas. Substitution in the case of Cameron comes through expiry of patents allowing competitors to offer products of similar design, shape or size.

Veolia, a competitor of Cameron in the Water Treatment sector have and continue to offer direct substitution components. This method of substitution does not replace systems completely but rather by stealth, replacing piece parts over time. This longer-term substitution is in part more difficult to both detect as well as prevent. Cameron's strategy against this is to offer longer term Guarantees as well as maintenance agreements that lock customers in for longer periods preventing early substitution by other as parts or systems need maintaining or replacing.

3.4. Suppliers

Cameron has invested heavily in buying smaller companies in order that its supply channel is controllable in terms of both delivery and cost (balanced integration). Dependency on suppliers has also been reduced by Cameron on key critical parts for systems by deciding to design and manufacture in house. Although an initial capital investment for production costs, this has been returned by quicker production times as well as stabilised procurement costs.

Cameron's challenges in the supplier sector is to maintain price stability on components it does not manufacture, it has done this by 1, Using its considerable size to secure component supply with advance payment and procurement models, including net 25 days payment to suppliers, over the standard industry of net 45 days. In addition to this, they have setup exclusive contracts with suppliers that have favourable terms such as limited liabilities to the supplier, which provides security and in return reduces the threat of supplier price change.

3.5. Purchasers (buyers)

The Oil & Gas market is dominated by a number of key players BP, TOTAL, ExxonMobil, Chevron, and Royal Dutch Shell. These companies exert great pressure on Cameron to reduce cost, improve quality or provide better services all of which reduces profitability these factors are consistent with academic writing and study⁵. The volatility of the recent oil & gas market (2014) has seen companies like BP ask suppliers like Cameron to reduce its cost by as much as 20% in some sectors, typically labour. In a market where the average return on margin is 25% a reduction in 20% overall on a typical project of £10M would drop the margin expectation by 8%, making a difficult choice for Cameron as to whether the project would be viable against its current financial modelling.

To counter this Cameron has developed "*blended margin*" projects whereby the initial cost of the project, which typically comes from a client's (the buyer) CAPEX budget, is reduced

⁵ Porter, M.E (2008) The five competitive forces that shape strategy. Harvard Business Review 86(1):78-93

in line with buyer demands. The margin is recovered through enhanced services and maintenance programmes, which run longer term and typically come from OPEX budgets, which tend to, have fewer constraints in terms of cost reduction. This blending has meant that Cameron has needed to change its expectations on margin return, looking further outwards and developing a financial model that tracks revenue over 3 -5 years rather than on a typical project delivery cycle of 52 weeks.

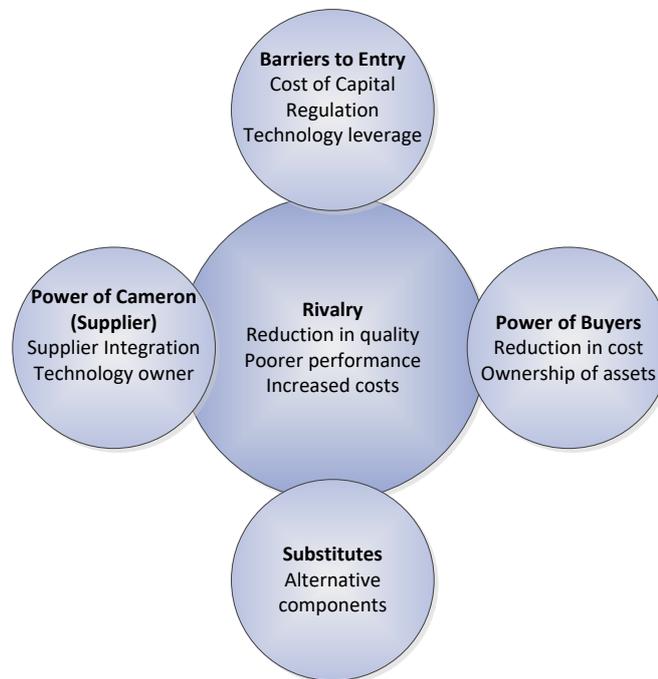


Figure 3: Cameron – Five Forces model

(Porter 2008)

4. CAMERONS ORGANISATIONAL STRATEGY

The drop in oil price has meant that all players in the market have had to look hard at their cost base and business strategies. In this regard, Cameron is no different, and from 2014 Cameron has embarked on a revised corporate strategy to maintain its core market share in order to show growth of 20% over the next 5 years (2014 – 2018). This strategy consists of a number of key areas:

4.1. Resources & Capability

Market segmentation analysis has highlighted that there is a shift in customer requirements which focuses on water treatment rather than oil treatment. This requires specific skills in certain technologies. In order to understand the spread and quantity of this type of resource available within Cameron, it has embarked on a 9-box review of its resource globally. Through this analysis, it will highlight Scarcity and well as Relevance of resources across the globe. This will drive four key strategic outcomes:

1. Potential profit earning capabilities – water treatment

-
2. Relevant market strength – regionally, globally
 3. Potential cost reduction strategies – surplus or redundant resource
 4. Ability to change against changing market trends – Dynamic capability

This internal analysis of Cameron’s capabilities is vital if it is to present to the market a “*can do*” organisation that through its resources and technical ability in a regional delivery model differentiates itself from its competitors. By contrast, a too aggressive approach is cautioned as reductions in resource to save cost will hinder Cameron’s ability to react to market changes as on boarding and work up for new resource is typically 4 – 6 months.

5. CAMERONS OPTIMAL CORPORATE STRATEGY

The Oil & Gas industry is changing from one, which was historically oil and gas production, to one, which is more reliant on integrated and connected service delivery companies. Cameron’s strategy from 2014 – 2018 is to reposition itself in the market from one which was as a systems provider to a Solutions Provider. This repositioning needs to focus on a number of key strategic deliveries:

Channelization of parts – through an already established supplier network clearly define and market Cameron’s parts distribution network, this network will enhance the differentiation from other companies as well as providing value added service capabilities by being able to delivery critical parts to clients with connected support service such as site engineering support and maintenance. **Capability based structure-** The rapid change in the world marked has highlighted that Cameron’s ability to change was limited. Capability based structures (resource, procurement, technology and supplier) are focused on key market sectors; provide responsiveness as well as tension. This *Adaptive Tension* allows changes to be made positively in line with client and market demands. However, larger structural corporate changes are and will not be enough to exploit innovation⁶, to achieve an advantage, “*patching*” in of new organisational structures that create flexibility and foster innovation need be considered.

6. CONCLUSION

Cameron needs to capitalise on its dominance in the market place to drive more effective and profitable supplier agreements. In doing so, it will have a stronger negotiation point with buyers, giving more opportunity to develop longer-term support frameworks. Rapid changes in the external market dynamics requires Cameron to change. Internal structures, decision-making and performance all need to be reassessed if it is to remain competitive. The is particularly important within a legal framework where protracted and inflexible contracts make either winning work or delivering work difficult, the consequence of which is lost market share and reduced ongoing service opportunities.

The corporate strategy employed needs to be reflective of this changing market, if not then Cameron will face real problems in being able to meet the needs of a client base which is looking for significant cost reduction and increased quality. If Cameron can engender flexibility, it will accelerate evolution and having flexibility will engender entrepreneurial initiative all of which

⁶ Brown, S.L, Eisenhardt, K.M, (1998) *Competing on the Edge: Strategy as Structured Chaos*. Harvard Business Press, USA.

will see Cameron fit to delivery shareholder value and position itself for the future oil and gas market.

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