Venezuela Compensation Recommendations

<u>Background:</u> Venezuela is currently in the midst of a hyperinflation episode as their year-over-year inflation rate in 2015 reached nearly 180%. Sources including The World Bank expect real inflation rates to continue to rise throughout the remainder of 2016 unless extreme measures at the federal level are undertaken. Venezuelan residents have seen the buying power of their currency, the Bolivar (Bs.), reduced to nearly nothing and a black market for currency and goods arise. Though currency exchanges list the Bs. to USD FX Rate at around 6.2:1 locals are seeing the true exchange rate in the black market closer to 1,150:1.

Company's **<u>73</u>** employees within Venezuela, like other local Venezuelans, have felt the weight of this hyperinflation as well. At this time, the average company employee in Venezuela is earning ~20,000 Bs. per month. According to local intelligence within the country, a food basket of basic necessities used to feed a family of 3 for one month will cost close to ~150,000 Bs. or $130 USD. Additionally, this food basket though it is supposed to provide at least 2 meals a day for the family of 3 is realistically only enough sustenance to provide one small meal a day. At best, this presents grave HSE issues for employees at the office, yard, and on location at wellsites who are expected to perform intense manual labor on only a few hundred calories each day.

Regional and Country Operations Management along with the Finance and HR teams have been tasked with creation of recommendations to help curtail the extreme poverty of locals within Venezuela while at the same time ensuring operations within the country remain viable.

<u>Possible Recommendations:</u>

1. **Flat Monthly USD Payments to All Local Employees to Cover the Costs of Food Baskets**

The approximate cost in USD of a single food basket is $130 USD given a 150,000 Bs. cost of a basket and an 1150:1 exchange rate. (Black Market Exchange Rate). Rather than pay on Venezuela's semi-monthly pay schedule a single USD payment of $130 to each employee could be made at the end of month payroll run to allow for employees to purchase a food basket the following month.

Financial Impact: $130 USD (Approximate Cost of 1 Food Basket) + $50 USD Transaction Fee * 73 employees = $13,140 USD/month or $157,680 USD/year. **~8.3% decrease to OI$[1].**

1. OI$ = Operating Income Dollars in USD

Possible Problems:

Monthly fees to employees that company has verbally committed to paying on behalf of the employees will add up to a non-insignificant amount over time.

Compulsory inclusion in all future payments of paid in 4 consecutive months to employees leaves company unable to unwind this program in the future.

2. **One-Time Lump Sum USD Payment of $1500 to All Employees**

This was the most recently received request by the employee population in Venezuela. It allows the employee population to spend the money right now as necessary on goods and services but would be a large initial expense to business.

Financial Impact: $1500 USD + $50 USD Transaction Fee * 73 Employees = $113,150 USD **~5.8% decrease to OI$**[1]

Possible Problems:

Large up-front expenditure would deplete any USD reserves company has in Venezuela

Precedent set that company will always meet demands of employees when backed into a corner. Nothing to stop the employees from making similar monetary demands in the future.

Some employees may have nothing to show for the up-front lump sum payment a few months after delivery and the same HSE and/or Quality issues may present themselves due to lack of nutrition and basic goods.

3. **Increases to Base Salaries Made for all Employees to account for 180% Inflation in 2015. Quarterly Review and Subsequent Inflationary Increases Made Beginning Q3 2016.**

Though this could be the least cost effective measure especially long-term it also has potential to be the most beneficial to the employees if the currency stabilizes. Increases to base salary on a quarter-by-quarter basis would help minimize the impact of inflation and would remove the need of any USD to Bs. exchanges. There would also be no burden on company to move USD into Venezuela or eat away at the USD it currently has in-country.

Financial Impact: ~$420,000 USD **~22% decrease to OI$**[1]

Possible Problems:

Huge expense and hit to margins in Venezuela

Unlimited upside to the expense if there is no currency stabilization and we proceed with quarterly reviews and increase

Continued inflation still leads to no buying power based on current compensation even with increases

1. OI$ = Operating Income Dollars in USD

4. Quarterly USD Payments Made to Allow for Multiple Food Basket Purchases Per Month

A similar philosophy to proposal one but quarterly payments as opposed to monthly payment should allow company to circumvent the compulsory inclusion of this payment from future payments to Venezuelan employees according to Venezuela and LA HR Management team. Doubling or tripling the proposed allowance from scenario one will also allow for more than 1 meal a day, provides goodwill amongst the employee population, and provides a monetary buffer for additional essential goods and services.

Financial Impact: $780 USD Every 3 Months + $50 USD Transaction Fee * 73 employees = $67,890 USD/quarter or $271,560 USD/year. **~14.3% decrease to OI$[1].**

Possible Problems:

While not the most expensive option this decrease to Operating Income $ and % is not insignificant

Employees may become reliant upon this program and discontent may be present upon unwind of the program if this becomes a long term solution

$271k USD annually may be a problem in terms of getting dollars into the country if the dollars in country are insufficient to handle to commitment

5. Quarterly Bs. Payments Made to Allow for Multiple Food Basket Purchases Per Month

A similar philosophy to proposal one and 4 but in local currency. This mitigates the issues that may arise from transacting in dollars and also eliminates the need to cover the exchange fee.

Financial Impact: 897,000 Bs. Every 3 Months * 73 employees = $56,940 USD/quarter or $227,760 USD/year. **~12% decrease to OI$[1].**

Possible Problems:

Continued inflation may make any local currency payments insufficient to pay for goods

Employees may become reliant upon this program and discontent may be present upon unwind of the program if this becomes a long term solution

Large decrease to OI $ may become greater if changes are made to the program to account for inflation or black market rates. The local currency payment may in the end become more expensive than the USD option.

<u>Footnotes:</u>

1. $1,885,000 OI $ used for OI calculations based off of an average of January $186.5k and February $127.8k OI actuals.

1. OI$ = Operating Income Dollars in USD