

Economic Analysis for Subsurface Applications in the Petroleum Industry _ Concepts and Examples Related to Subsurface Parameters

Table of Content

<i>Economic Analysis for Subsurface Applications in the Petroleum Industry _ Concepts and Examples Related to Subsurface Parameters.....</i>	2
1. Introduction.....	6
2. The Roles of Engineers, Evaluation-Team, and Management	7
3. Basic Economic Concepts.....	9
Cost of Money.....	9
Interest.....	9
Interest Rate	9
Investment	9
Economic Equivalence	9
Economic Life	10
Net Cash Flow	10
Payback Period.....	10
Discounted Payback Period as a Project Screening Method	10
Present Worth.....	10
Net-Present-Worth (NPW).....	10
Revenue	11
Annual-Equivalent-Worth-Analysis (AEW).....	11
Rate of Return.....	11
Minimum Attractive Rate of Return (MARN).....	11
Internal Rate of Return (IRR).....	11
Multiple Rates of Return	12
Appreciation of Equity Rate of Return (AOEROR).....	12
Costs.....	12
Operating Cost (OPEX)	13
Direct Costs	14
Indirect Costs	14
CAPEX Capital Costs or Capital Investment (CAPEX)	14
The Fixed Capital Cost	16
The Working Capital	16
Intangible Costs.....	16
Sunk Cost.....	16
Capital Recovery Cost (CR)	17
Profit	17
Models Used to Determine Profit.....	17
Cash Flow Model.....	17
Single Project	17

Mutually Exclusive Projects.....	17
Service Projects and Revenue Projects	17
Service Projects	18
Revenue Projects	18
Capital Budgeting.....	18
Feasibility Study	18
Value	18
Market Value.....	18
Full Cash Value	18
Salvage Value	19
Terminal Cash Surplus or Terminal Value (TCS)	19
Replacement Value	19
Capitalized Value.....	19
Book Value	19
Assessed Value	19
Insured Value	19
Reservoir Development and Reserves Production Plan.....	19
Acceleration Projects	19
Well Spacing.....	20
Maximum Capital Outlay (MCO).....	20
4. Risk Considerations in the Hydrocarbon Business.....	21
Sources of Uncertainty and Risk	22
Subsurface Risk	22
Surface Risk	22
Description of Some Risk in a Hydrocarbon Business Investment.....	23
Resources Risk.....	23
Conventional Resources	23
Unconventional Resources	23
Reserves Risk.....	24
Summary of Methodologies Used to Prepare Reserves Estimates.	26
Comments on the Methodologies.....	28
Investment Risk.....	29
Costs Risk	30
Hydrocarbon Prices Risk.....	30
Political Risk	31
Incomplete Input Data Risk.....	32
Risks Associated to International Business	32
Inflation Risk.....	32
Actual (Current) Dollars	32
Constant (Real) Dollars	32
Other Risks	34
Risk Reduction.....	34
Collect Information.....	34
Accounting for Risk	35
5. Basic Probability Concepts Related to an Economic Evaluation	36
Stochastic Risk Analysis Models.....	36
Continuous Probability Distribution	36
Cumulative Distribution Function ($F(x)$)	36
Random Variable.....	36
Discrete Random Variables (DRV).....	36
Probability Distribution	36
Continuous Random Variables (CRV).....	37

The Monte Carlo Method	40
6. Production Development Projects - The Most Frequent Case	43
Life Cycle of a Hydrocarbon Reservoir	44
Flow Process for Systematic Analysis – Basic Activities	45
7. Investment Decision Analysis	47
Bases for Project Comparison	47
The Economic Hurdles.....	48
8. Investment Analysis Hurdles/Yardsticks	49
Cash Flow Method	49
Net Cash Flow (NCF).....	49
NCF Model Construction	50
Time Shifting of Cash Flows - Compounding and Discounting.....	51
Discounted Cash Flow	51
Applications of Discounting	51
Discount Rate and Discounted Production	51
The Time-Value of Money Basic Formulas.....	52
Economic Criteria or Yardsticks Used – Spreadsheet format	54
Discount Payback Period.....	54
Net-Present-Worth or Value Factor (NPW-NPV)	54
Equivalent Uniform Annual Value or Annual Equivalent Cost Criterion	55
Benefit/Cost Ratio (B/C Ratio) or Profitability Index (PI)	56
Profit to investment Ratio (PIR)	57
Internal Rate of Return (IRR).....	57
Wealth Growth Rate (WGR).....	58
The Growth Rate of Return (GRR).....	59
Considerations on Economic Hurdles	60
Relationship Between Optional Methods.....	61
IRR and Payback Period.....	61
IRR and NPW	61
Evaluating Competing Investment Opportunities.....	61
Project Screening	63
Project Ranking	63
Considerations in Project investment Decisions.....	64
Framing Economic Evaluations	64
The Decision Cycle.....	65
Decision Trees	66
Example of Economics Influencing the Decision on an EOR (Enhanced Oil Recovery) or IOR (Improved Oil Recovery) Project.....	68
Spreadsheet for Economic Yardsticks – A Summary of Individual Methods and Tools.....	68
Summary of Economic Yardsticks	70
Annex 1 Decline Curve Analysis	71
DCA and Normalized Curves for Gas Shale	71
Normalized Curves	74
Summary of Decline Curve Analysis.....	75
Spreadsheet for Production Decline	76
Exponential Decline.....	76
Hyperbolic Decline.....	76
Annex 2 Oil and Gas Rights Concepts in the United States	79
Landowner	79
Assigned Rights	80

Assets	81
Operator of an Asset.....	81
Operating Interest.....	81
Non-operating Interest	81
Authorization for Expenditure (AFE).....	81
Bond	81
Partnerships	82
Joint Ventures	82
Operating Agreements Concepts in the United States	82
Operating Agreement	82
References	84
About the Authors	85
Martin Essenfeld	85
Rolando Alberto García-Lugo	85