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Maegan Evans

Rob Van Genderen, Tim May and I attended the NAPE Summit this month. NAPE (North American Prospect Expo) is the world's largest E&P expo bringing prospects, producing properties, capital formation, services and technologies together in one location creating an exceptional environment "Where Deals Happen". The Houston expo has now expanded its reach to include prospects from all over the world bringing deal makers together and optimizing opportunities within the oil and gas industry.

Our goal was to create new alliances, bring awareness to our industry expertise and meet companies who may need deal help with debt advisory services, restructuring and M&A in the current challenging oil and gas environment. There were over 12,000 attendees and 2,000 exhibitors. As we made our way around the enormous exhibition hall it was clear that the free market system is alive and well in the oil and gas industry. Everyone we spoke with was either interested in buying or selling producing assets, reserves, infrastructure or finding out how to take advantage of historically low pricing. And when we inquired as to why they felt the bottom has fallen out of the market, two factors were blamed for the oil price decline: the Chinese slowdown and great American technology. This is evident in the fracking industry that has resulted in the oil and natural gas glut that we are still burning through.

It was truly an awe inspiring experience mingling with some of the industry's most noteworthy companies and their representatives who all had one goal in mind: figure out where the bottom is on pricing for oil!

In follow up to the summit, two industry experts - including Rob Van Genderen - have provided very interesting insights on this topic below.

Warm regards,

Maegan

The Elephant in the Room

Rob Van Genderen

As oil peaked in 2008 around $140 per barrel I recall the Saudis saying in the press that oil over $100 was not good. Ostensibly they expressed concern about the potential for high oil prices to cause a slowdown in global economic growth and therefore decrease the demand for oil. In addition to those concerns, the high price of oil began to fuel the search for alternative and unconventional sources of energy, long-term threats to the lifeblood of OPEC countries and the political power of their rulers.

OPEC's concerns became reality. After a relatively brief oil price crash in 2009, the price rebounded quickly. The oil price averaged $80 in 2010, $95 in 2011, $94 in 2012 and $98 in 2013. In 2010 US crude production averaged approximately 5.5 million barrels per day. Supported by strong oil prices, investment poured into unconventional resource exploration, technology and development, particularly in the United States. As a result U.S. crude oil production increased to nearly 9.5 million barrels per day in 2015 compared to 5.5 million in 2010, a 72% increase in production in just 5 years, and unconventional production costs decreased from between 30 and 50%. In fact, the US oil production in 2015 was the highest since record US crude production which peaked nearly 45 years ago in the early 1970s. The U.S. became a top 3 global crude producer in the world after Russia and Saudi Arabia.

It is widely believed that Saudi Arabia, the world's leading producer recognizing the US oil & gas boom, implemented a strategy to increase production, over-supply the world market and lower the price of oil to make higher cost production such as US unconventional production uneconomical. Major producers of oil in the Middle East can produce a barrel of oil for under $10 while U.S. unconventional production is in excess of $50 so this strategy is causing some US producers to cut back on uneconomical production. Besides Saudi Arabia's increased production, the lifting of trade sanctions and an increase of production by Iran along with jitters over China's growth have also put pressure on the oil price.

The weak oil price environment is making an impact across the sector from exploration to upstream production to transportation to refining to services. Over the short to medium term, higher cost production, particularly unconventional, will be shut down and the oil price is expected by many analysts to gain more solid footing in the second half of 2016 as demand continues to edge up and supply is curtailed. Current price levels for oil are unsustainable over the long-term. The government budgets of the largest OPEC producers depend on oil prices being from $75 to $100 so one might would to see production cuts or other actions to push the oil price up. For many leaders in petrodollar economies, their ability to retain power depends on oil price levels that will sustain their economies and social services. The recently announced agreement to freeze production output between Russia and Saudi Arabia, who produce approximately 20% of global crude supply, is indicative of the measures that may have to be taken to push oil prices up. An equilibrium oil price will have to be found that can sufficiently support the OPEC economies yet not cause higher cost supply to come back on-stream.

Even with a firming up and partial recovery of the oil price, in 2016 we expect to see a lot of restructuring and M&A in the middle-market oil & gas sector as upstream and oil field service companies struggle with liquidity and strategic solutions. Wood Mackenzie, internal oil & gas consultants, recently estimated that there is up to $100 billion in private equity earmarked to invest in the oil & gas sector. The current market has created a unique buying opportunity in many investors' opinions. From our discussions with industry players and our observations at the National American Prospect Expo (NAPE) conference there are many opportunities and investors eager to invest in the sector.

Rob Van Genderen is a Director at Falls River Group

Continuing Distress in the Energy Markets

Doug Glass

Falling commodity prices defined 2015 in the US oil and gas sector. Over the course of calendar 2015, oil prices dropped approximately 60 percent. More than 40 oil and gas related companies filed for bankruptcy. Upstream companies, in an effort to protect balance sheets, cut capital expenditures in the fourth quarter alone by more than 50 percent. Capital markets are simply closed to all but a very fortunate few. Forecasters agree that the outlook for 2016 remains bleak, owing to the continued high volumes of oil being produced worldwide and the stagnate demand. Some reports indicate that $100 barrel oil may not be seen again in decades.

Many oil and gas companies were able to stay afloat last year by lowering costs and implementing greater operational efficiencies, but further savings may prove to be elusive. For many companies, commodity hedging programs will roll off in the coming months and the full impact of lower prices will cut already low revenue.   In addition to losing the protection of beneficial hedged volumes, companies may be faced with the choice of ether drilling lower return, or even marginally economic, wells or forfeit their leases due to inactivity.

Well positioned companies may try to seek capital through so-called "DrillCos" where the risk can be spread by allowing investors to pay the costs of drilling in return for an attractive rate of return. Highly leveraged companies will be forced to resort to asset sales, even of their best assets. Ultimately, companies with few quality assets and high debt will have no option but to continue to add to the already growing number of restructurings as lenders will force the hand of their borrowers.

In addition to the upstream producers who are trying desperately to hang on during the low price environment, oil field service companies will continue to feel the effects of low utilization rates and cost-cutting measures of their clients. Even midstream transportation companies, who are protected from commodity price fluctuations to some degree by the nature of their long-term contracts, may be affected as their upstream customers transport, process and sell less oil and gas. We will no doubt see consolidation across all sectors as the 'haves' swallow up the asset rich, but cash poor, 'have nots'.

Investors will inevitably come across a broad range of investment opportunities as commodity prices stay low. Some feel that this downturn will present significant potential for attractive investment returns, but the question is how to sort the good deals from the 'too-good-to-be-true' deals. The real key to successfully executing opportunities will be patience and proper diligence and risk assessment. This requires financial, legal and technical acumen in order to identify the deals worth pursuing.

About the author:

Doug Glass' principal areas of practice are energy transactions, mergers and acquisitions, project development and corporate finance, with an added expertise in international matters. Mr. Glass has represented public and private oil companies in all phases of their domestic and international business activities for more than 30 years. He has worked on joint ventures, infrastructure projects, financing's and acquisitions and dispositions for clients in a wide variety of structures. In addition to his extensive experience in the United States, he has worked on transactions in a number of foreign jurisdictions.

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