Founders Investment Banking

August 2013 Oil & Gas Newsletter

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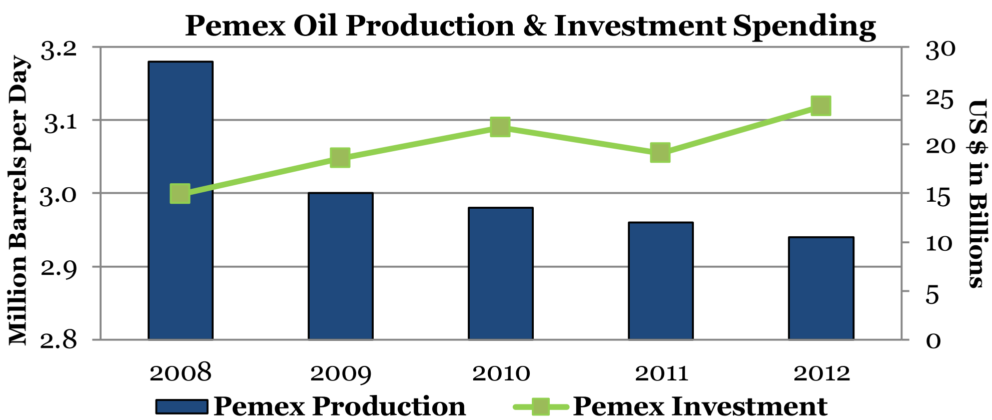
Mexican Energy Reform

For 75 years, the Mexican government has had a monopoly on the domestic oil and gas exploration and production space, limiting access to the country's oil and gas reserves to Petróleos Mexicanos, (or "Pemex"), the state-owned oil giant. However, new legislation introduced on August 13th by Mexico's current President, Enrique Pena Nieto, seeks to adjust Mexico's policies to attract interest from major oil companies.[1] The decision comes in the midst of the U.S. shale oil and gas boom, during which Mexico's oil production has consistently declined. Over the past five years, Mexico's total oil production has decreased by 8%, compared to a 30% surge in the U.S. over the same time period.[2]



In an effort to combat these production headwinds, Pemex has increased investment spending by about 60% over the past five years;[3] however, production has continued to decline, highlighting the need for outside expertise. The drop-off in oil production is not due to a lack of reserves. Citi Research estimates Mexico's oil reserves to be roughly 42 billion barrels (29 billion barrels in deep-water reserves and an additional 13 billion barrels in shale reserves).[4] For comparison, the EIA's most recent estimate of the Eagle Ford Shale's proven oil reserves is 25.2 billion barrels.

Furthermore, Mexico has traditionally concentrated on easy to reach reserves. With limited focus on unconventional drilling and Pemex's primary focus on shallow-water fields, they've lacked the expertise and technology to successfully exploit deep-water reserves. In addition, Pemex has only begun to scratch the surface in their unconventional drilling, completing just three shale gas wells to date.[1]

The ability to attract major oil companies to Mexico is vital to bringing in technology and expertise to exploit Mexico's larger and harder to reach reserves located in shale and deep-water plays. The geographic proximity of these plays to current U.S. oil and gas activity could have major implications for both U.S. exploration and production companies, as well as oilfield service companies. Major service players such as Schlumberger, Baker Hughes, and Halliburton stand to reap the benefits in the short-term, but substantial opportunities could exist for smaller players stemming from the close proximity of existing infrastructure located just over the border in Texas and in the Gulf of Mexico. Favorable geographic location may allow for U.S. oilfield service companies to capitalize on the opportunity and expand operations with lower entry costs.

Ultimately, with the U.S. moving up the ranks in the global energy race, Mexico's leadership understands the need for change. The degree of attractiveness to the majors' remains questionable based on details proposed in ownership rights with reserves. It is also possible that the bill meets opposition in the Mexican congress and the nation maintains what are among the world's most restrictive energy laws.[1] Alternatively, an incremental major energy play could be looming on the doorstep of the U.S.

Select Oil & Gas Transactions

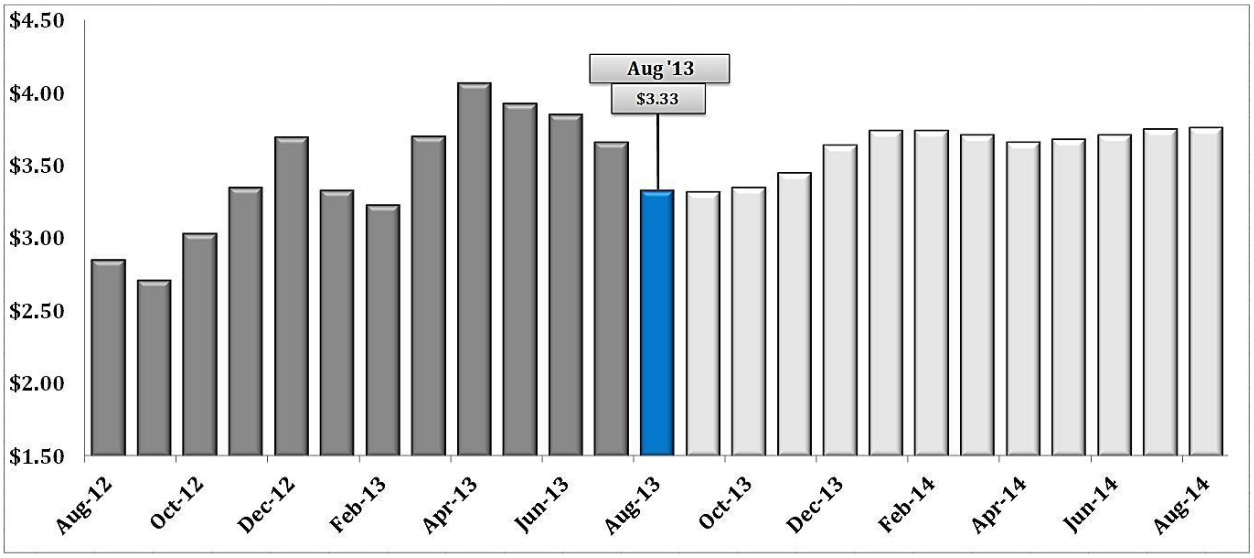
Date	Status	Target	Buyers/Investors	Type	Value ($mil.)
8/1/2013	Announced	Galvanic Applied Sciences Inc. (TSXV:GAV)	Jaguar Financial Corporation (TSX:JFC); Cinnamon Investments Limited	Merger/Acquisition	$30.40
8/1/2013	Closed	Summit Energy Services, LLC and Liquid Logistics	Waste Management, Inc. (NYSE:WM)	Merger/Acquisition	-
7/31/2013	Closed	J W Measurement Company	White Deer Energy	Merger/Acquisition	$200.00
7/30/2013	Closed	Farro Construction, Inc.	ODC Construction, LLC	Merger/Acquisition	-
7/29/2013	Closed	Halliburton Company (NYSE:HAL)	-	Public Offering	$1,097.43
7/29/2013	Closed	Halliburton Company (NYSE:HAL)	-	Public Offering	$898.15
7/29/2013	Closed	Halliburton Company (NYSE:HAL)	-	Public Offering	$599.54
7/29/2013	Closed	Halliburton Company (NYSE:HAL)	-	Public Offering	$399.72
7/29/2013	Announced	EOGA IOR Services, LLC	Flotek Industries Inc. (NYSE:FTK)	Merger/Acquisition	$6.50
7/26/2013	Announced	Hornbeck Offshore Services, Inc. (NYSE:HOS)	-	Public Offering	$450.00
7/26/2013	Announced	Enseco Energy Services Corp. (TSXV:ENS)	-	Buyback	-
7/25/2013	Announced	Halliburton Company (NYSE:HAL)	-	Buyback	$3,300.00
7/24/2013	Effective	Armada Water Assets, Inc.	-	Private Placement	$0.70
7/24/2013	Closed	Ziff Energy Group, Ltd.	HSB Solomon Associates, LLC	Merger/Acquisition	-
7/19/2013	Announced	Schlumberger Limited (NYSE:SLB)	-	Buyback	$10,000.00
7/19/2013	Closed	LoneStar West Inc (TSXV:LSI)	-	Private Placement	$9.85
7/18/2013	Closed	Canadian Energy Services & Technology Corp. (TSX:CEU)	-	Public Offering	$34.01
7/12/2013	Announced	U.S. Well Services, LLC	-	Public Offering	$12.00
7/8/2013	Closed	Planet Services, Inc.	Omega Well Monitoring Canada	Merger/Acquisition	-
7/5/2013	Announced	Universal Wing Technologies Inc. (TSXV:UAV)	-	Private Placement	$0.28
7/2/2013	Closed	High Roller Wells Big Lake SWD No. 1, Ltd	NGL Energy Partners LP (NYSE:NGL)	Merger/Acquisition	-

Transactions

Oil and gas M&A has yet to show any significant indication of a trend reversal, but the slowdown in activity through the first half of 2013 has given rise to other trends. Most notably, total transaction value for deals involving private equity investors, a value of $686 million in the 2nd quarter, represents a 90% decrease as compared to the same period in 2012. Meanwhile, no deals involving foreign investors were announced in the second quarter, despite their continued strategic interest in U.S. oil and gas assets.

Industry experts attribute these trends to a recent uptick in market valuations and price premiums demanded of foreign investors who wish to enter the space. “While PE remains very interested in the oil and gas sector, higher deal valuations, particularly for cash flowing assets, kept PE acquirers on the sidelines as domestic strategic acquirers found more opportunities to get deals announced at prices that didn’t fit financial investors’ models,” said Doug Meier, U.S. Energy Transactions & Deals Leader at PwC.

Natural Gas Futures

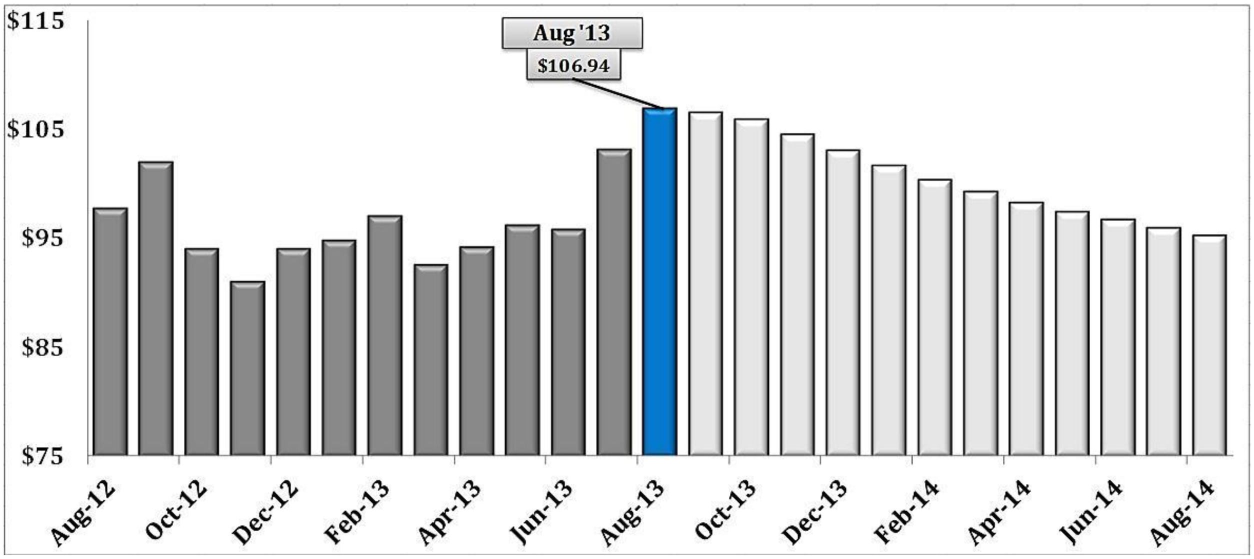


Natural Gas Future Pricing

Natural gas spot prices averaged $3.62 per MMBtu at the Henry Hub in July 2013, down 21 cents from the previous month's price. EIA expects the Henry Hub price will increase from an average of $2.75 per MMBtu in 2012 to $3.71 per MMBtu in 2013 and $3.95 per MMBtu in 2014. Despite declines in prices over the past few months, prices still remain substantially above their year-ago levels.

Natural gas production grew in the quarter at a monthly rate of 0.3 Bcf/d amid continued improvements in drilling efficiency and the recent uptick in the gas prices, likely incentivizing smaller 'mom & pop' producers to restart drilling. Merrill Lynch's Oil & Gas analyst Doug Legette says, "Our commodity team sees spot prices trading in a range of $3.50-$4.00/MMBtu in 3Q given the recent pick-up in output and producers' willingness to slowly add back rigs." Natural Gas futures are expected to rise slightly higher heading into the remainder of the year and into 2014.

Oil WTI Futures

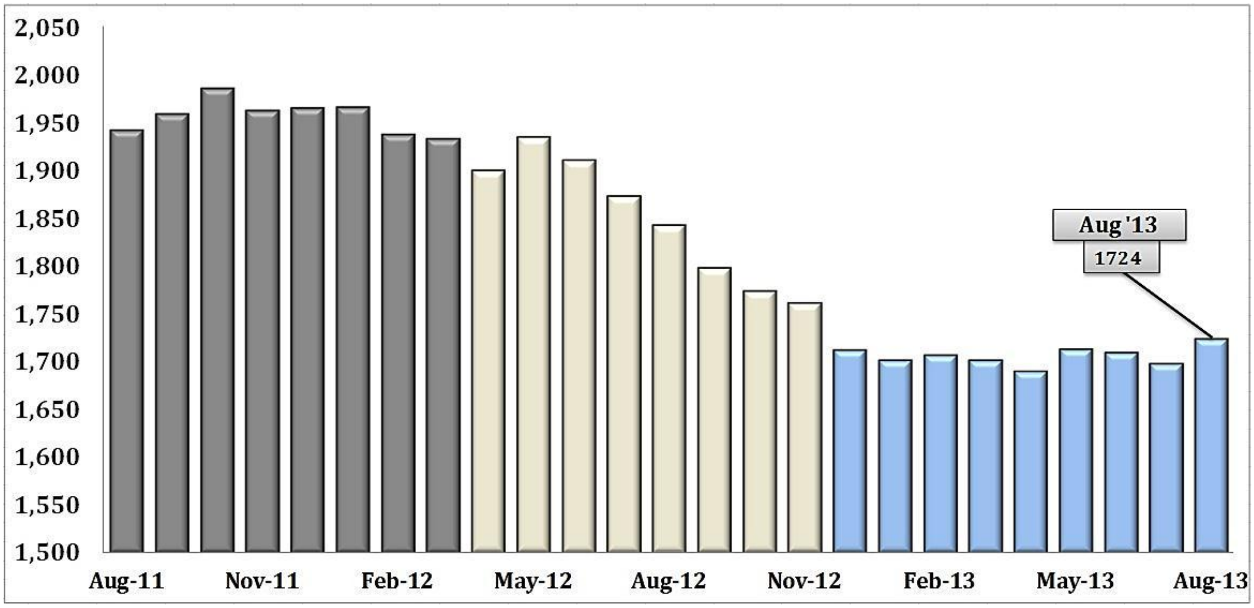


Oil Future Pricing

Crude oil prices increased during the first three weeks of July 2013 as world oil markets tightened in the face of seasonal increases in world consumption, unexpected supply disruptions, and heightened uncertainty over the security of supply with the renewed unrest in Egypt. The strong demand for light, sweet crude oil in the Midwest and new pipeline capacity to deliver production from the West Texas Permian Basin directly to the Gulf Coast contributed to the WTI crude oil price rise as well.

Heading into the remainder of 2013, crude oil prices could see slight downturns. "We will see a very rapid movement [correction], and we will be going short as we think WTI is overvalued at these levels... we could see moves of 5-10 percent in the short-term," said Andrew Su, CEO at Compass Global Markets. UBS oil and gas services analyst Angie Sedita also sees crude prices “turning” and heading into the "$90-$95" range by the end of 2013.

U.S. Total Onshore Rig Count

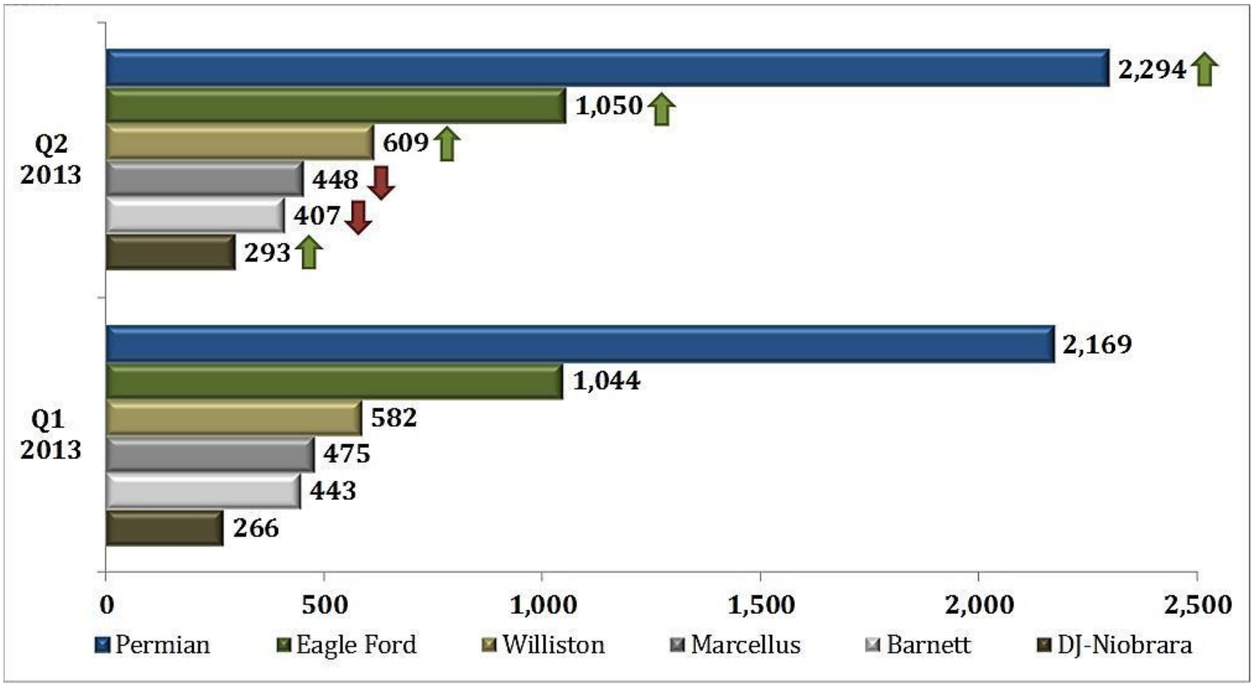


U.S. Total Onshore Rig Count

The U.S. onshore rig count has been hovering around the 1,700 mark for the majority of the year, with only slight increases and decreases seen each month. Entering the beginning of August, U.S. onshore rig counts saw their largest month-to-month gain since May of 2012. Increasing by 26 rigs, onshore rig counts increased from 1,698 in July to 1,724 in August.

Baker Hughes now expects the U.S. land rig count to rise to an average of ~1,720 rigs by Q4-13, which represents a ~30 rig increase vs. the Q2-13 average of 1,692 rigs. According to a Sterne Agee report, "Expected rises in rig counts could mean increased activity for oilfield services companies."

U.S. Total Onshore New Well Count



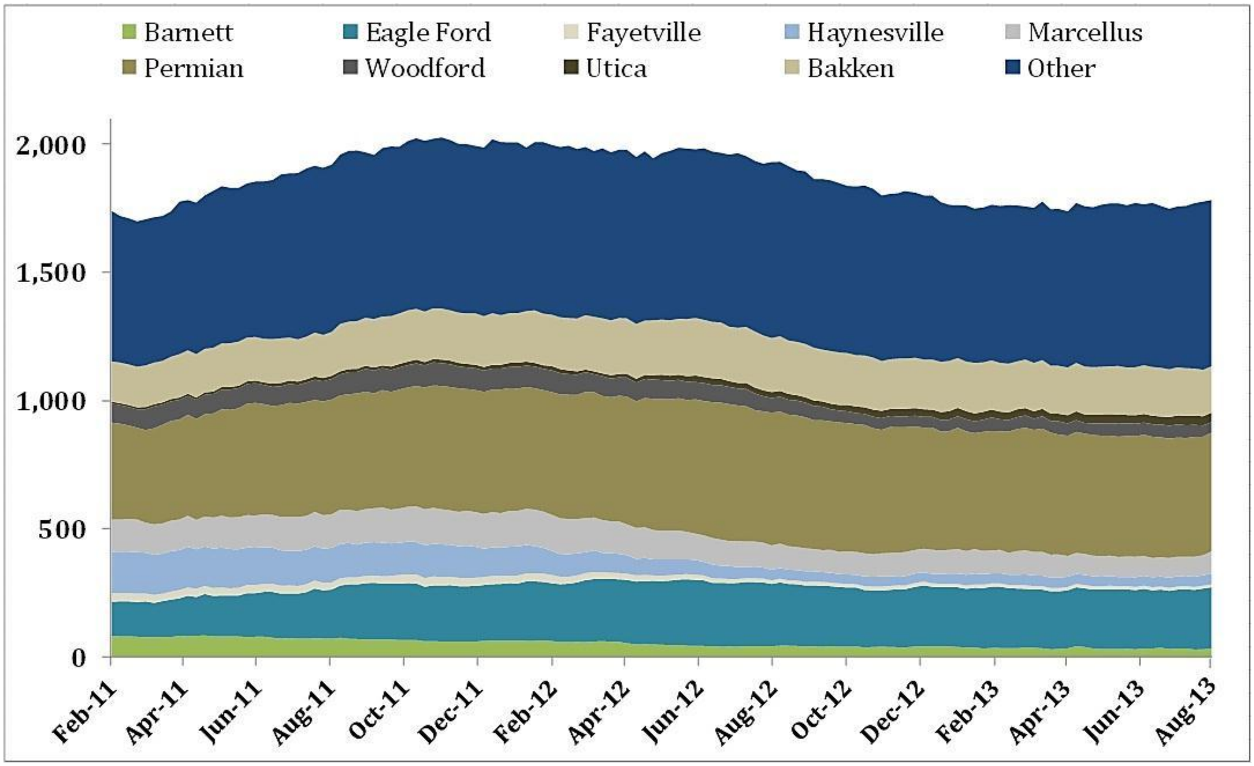
As wells become more complicated, bringing them online and keeping them producing has become a bigger part of the business than just drilling. Despite the U.S. rig count having decreased significantly over the past few years and remaining relatively flat this year, increases in drilling and production efficiencies have allowed production to continue to rise. According to Reuters, Halliburton is expecting 2nd quarter profit margins to rise 1.2% compared to the 1st quarter, even though the rig count has been moderately flat all year.

The underlying efficiency gain is contributed to “pad drilling,” a drilling method which allows operators to drill multiple wells within one pad, improving efficiency and rig mobility. Implementation of the technique reduces the time it takes to move from one well location to the next and allows multiple wells to be drilled in a shorter time than they would be with just one well per site. "We've seen probably upper-single-digits-type improvement in terms of efficiency even in the current year," said Halliburton COO Jeff Miller. Martin Craighead, CEO of Baker Hughes, said that in three U.S. basins, rigs were drilling about 20% more wells on average than last year.

New Wells as of 2nd Quarter 2013:

Barnett - 407, Eagle Ford - 1050, Fayetteville - 190, Haynesville - 112, Marcellus - 448, Permian - 2294, Woodford – 142, Utica - 160, Williston - 609, DJ-Niobrara - 293, Granite Wash - 153, Mississippian - 317 and Others - 2624.

Rig Count by Basin



Rig Count by Basin

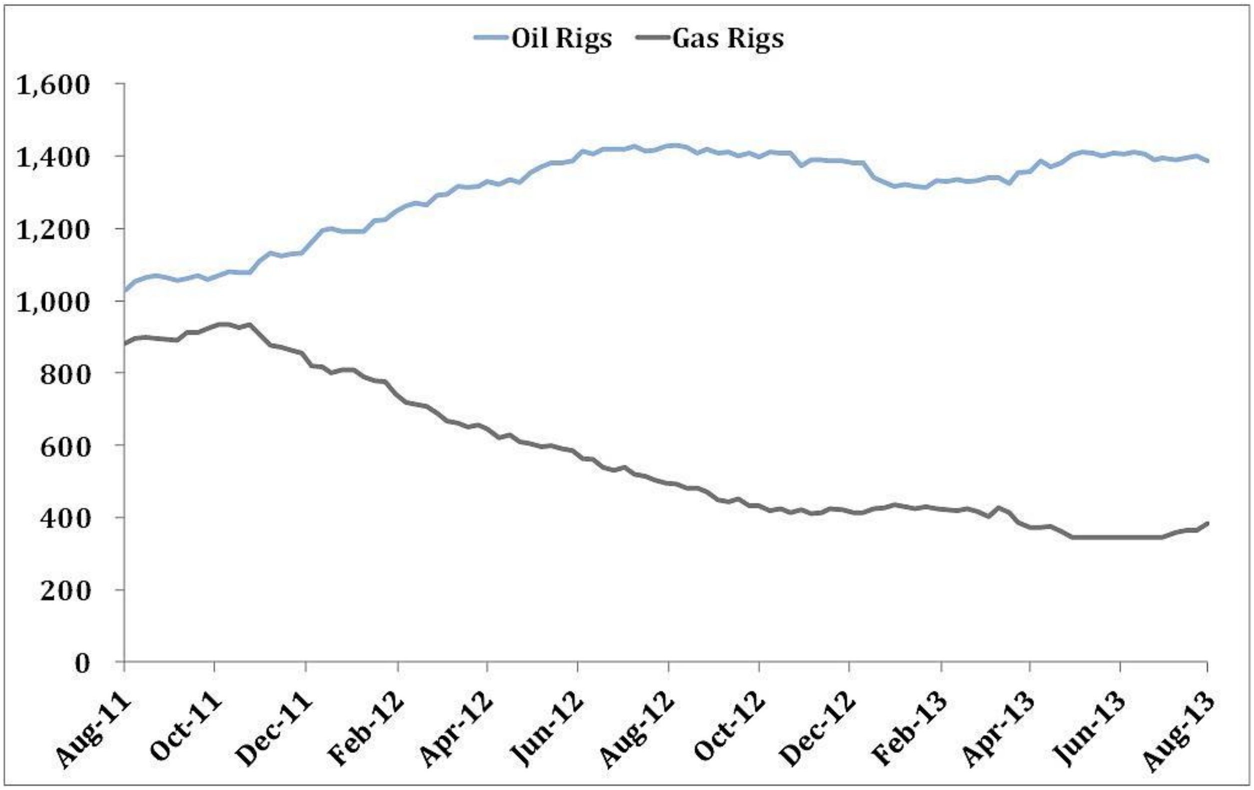
The Permian, Eagle Ford, and Bakken topped the rig counts as of this publication. Evolving drilling and completion technologies have driven improved performance in multiple plays around the U.S. Such shale plays include the Marcellus, where operators have focused on better lateral placement and vastly reduced drilling times, and the Bakken where early infill results and improving completions have driven a resurgence of investor interest for the Bakken players.

Economics continue to favor liquids-rich basins, such as the Marcellus, Eagle Ford, and the developing Niobrara Shale. Activity in the Niobrara has continued to ramp up in 2013 with increased optimism driven by delineation success. The Niobrara currently boasts one of the highest rates of return amongst U.S. onshore basins, though it has faced production bottlenecks caused by processing and takeaway capacity constraints. Operators also seem increasingly interested in the Permian and Wolfcamp plays out of West Texas and those could become some of the hottest U.S. shale plays in the coming months.

Rig counts as of August 2nd, 2013:

Barnett - 33, Eagle Ford - 239, Fayetteville - 11, Haynesville - 42, Marcellus - 87, Permian - 463, Woodford – 41, Utica - 37, Williston - 181, and Other - 648.

U.S. NG v. Oil Rig Count



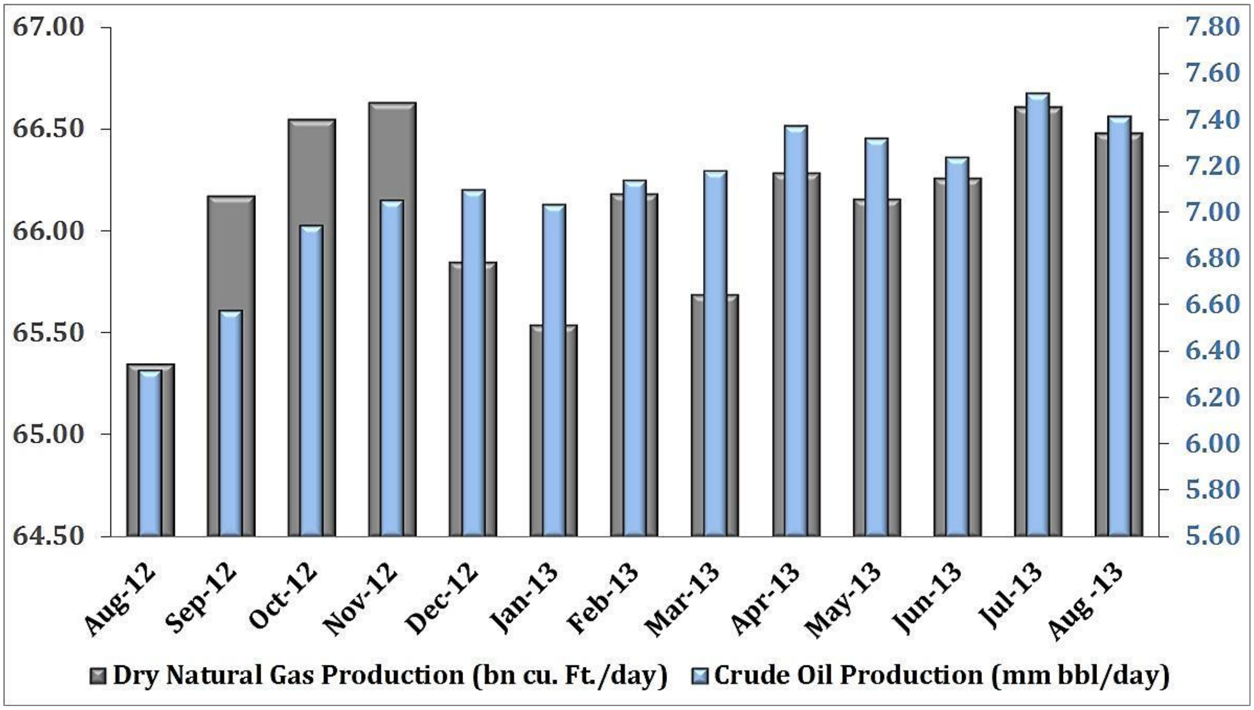
U.S. NG v. Oil Rig Count

At 388 rigs, the number of rigs drilling for natural gas in the United States is up to its highest level since May of this year. On the contrary, oil rigs are now down to their lowest level since April of this year at 1,388. Oil rig counts still outnumber gas rigs by 1,000 and current oil and gas price levels show no reason why this should change in the near future.

Despite the weekly jump, the number of gas-directed rigs is down by 52% from its 2012 peak of 811. The current increases may signal that the gas directed rig count has bottomed out and may in fact be rising. Dale Dusterhoff, the CEO of Trican Well Services, says, "The drop in rig count from February through April could have signaled that despite the strong rally, natural gas prices of over ~$4.00 per MMBtu still aren't high enough to incentivize producers to shift significantly more capital towards natural gas and that there's no compelling reason to increase natural gas rig counts."

The oil rig count - that rocketed to a 25-year high of 1,432 in August last year - fell by 13 to 1,388 and is currently below the previous year's total of 1,429. Nevertheless, it has recovered strongly from a low of 179 in Jun 2009, rising 7.8 times.

U.S. NG v. Oil Production



<u>U.S. NG v. Oil Production</u>

According to the EIA, U.S. oil production broke a 22-year record in July with 7.5 million bbl/d. Additionally, U.S. monthly oil production is expected to exceed U.S. crude oil imports as early as this October, due to increasing production and decreasing imports. The EIA estimates averages of 7.3 million bbl/d in 2013 and 8.2 million bbl/d in 2014. Meanwhile, Natural gas marketed production is projected to increase from 69.2 Bcf/d in 2012 to 69.9 Bcf/d in 2013 and to 70.5 Bcf/d in 2014.

The continued focus on drilling in tight oil plays in the onshore Williston, Western Gulf, and Permian Basins is expected to account for the bulk of forecast production growth over the next two years. “After U.S. crude oil production reached 7 million barrels a day at the end of last year for the first time in two decades, daily oil output is on its way to topping 8 million barrels by mid-2014,” said Adam Sieminski, the administrator of the EIA in Washington.

Dry Natural Gas production has also been steadily increasing over the past 6 months. According to ExxonMobil, North American unconventional gas production is expected to grow and satisfy 80% of gas demand by 2040. According to the EIA, onshore production is expected to increase, while federal Gulf of Mexico production from existing fields declines as the economics of onshore drilling remain more favorable.