

OIL & GAS

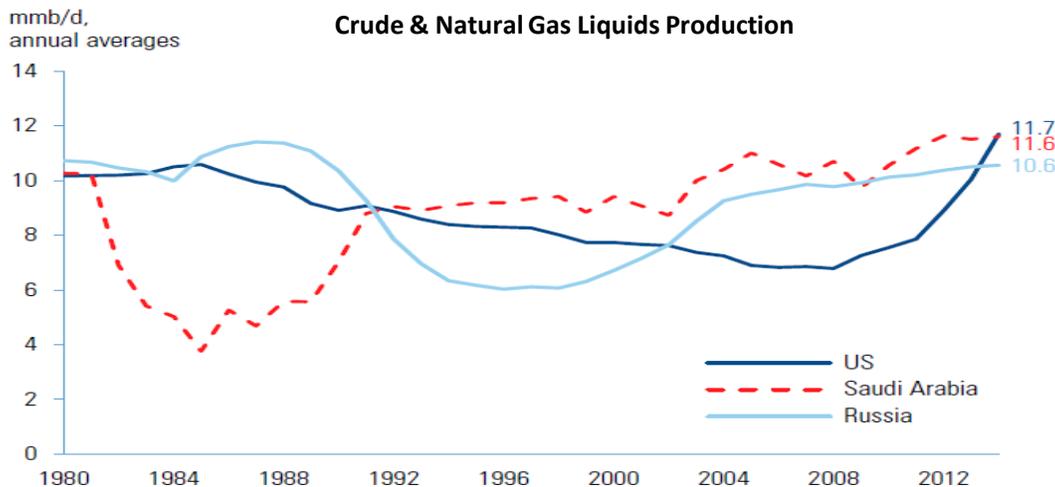
Newsletter

January Edition: A Shift in Supply

Kicking off 2015, we look back at 2014 and try to make sense of the dramatic slide in oil prices – a tough reminder the energy market is still a cyclical industry. The euphoria of WTI prices averaging over \$95 a barrel (Brent Crude \$107) the last four years had successfully suppressed those that may have been calling for a pullback. The market sentiment has been flipped on its head since July 2014. Rapid market changes from week to week have experts and analysts looking for any piece of data from which to extrapolate a thesis. In a matter of 6 months, we've seen the headlines go from "Oil & Gas Boom 2014: No End in Sight,"¹ to "Oil Bust of 1986 Reminds U.S. Drillers of Price War Risks."² In this month's newsletter, we look back at the shift in global production and what that means moving forward. We also discuss breakeven pricing and rig count projections in a low price environment.

► **New Kids on the Block** – *The Not So Unexpected Rise in U.S. O&G Production.* According to the International Energy Agency, the U.S. took the crown for the largest producer of crude oil and natural gas liquids in the world in Q1 of 2014, eclipsing 11 million barrels per day. Just two years prior, the IEA forecasted by the year 2020 the U.S. would surpass Russia and Saudi Arabia as the world's largest oil producer. Being the great overachievers that we are, the U.S. arrived six years ahead of schedule.³ However, now oil and gas producers have been forced to reevaluate their 2015 capital spending plans in light of a seemingly sudden supply glut, combined with weaker than expected global demand, which has driven crude oil prices down approximately 56% since June 2014³.

So why the sudden oversupply? The truth is that it hasn't been sudden. U.S. domestic production of crude oil and natural gas liquids has accounted for 80% of global production growth over the last seven years. The steady rise of another oil major in the ranks has thrown the supply/demand balance out of whack.



Source: Goldman Sachs

Prepared by:

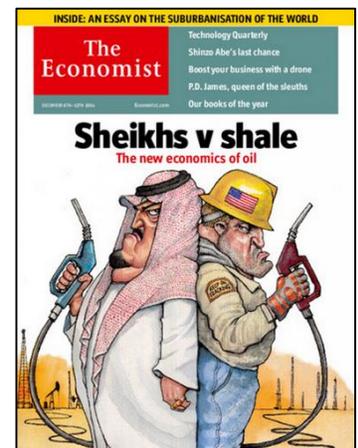
Duane Donner
ddonner@foundersib.com

Joe Brady
jbrady@foundersib.com

John Ortstadt
jortstadt@foundersib.com

Andrew Green
agreen@foundersib.com

Ben New
bnew@foundersib.com

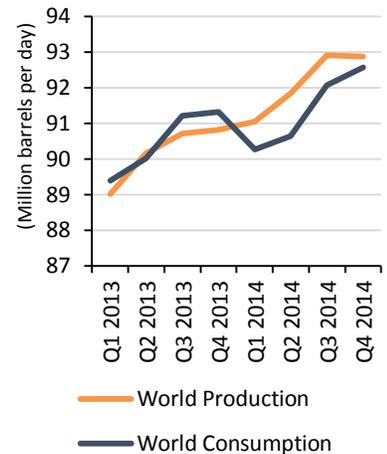


With OPEC opting not to cut production, most believe it will take meaningful signs of curtailing production before the price of crude oil begins to stabilize, and many expect the U.S. to be the marginal cost producer who will take the biggest hit.

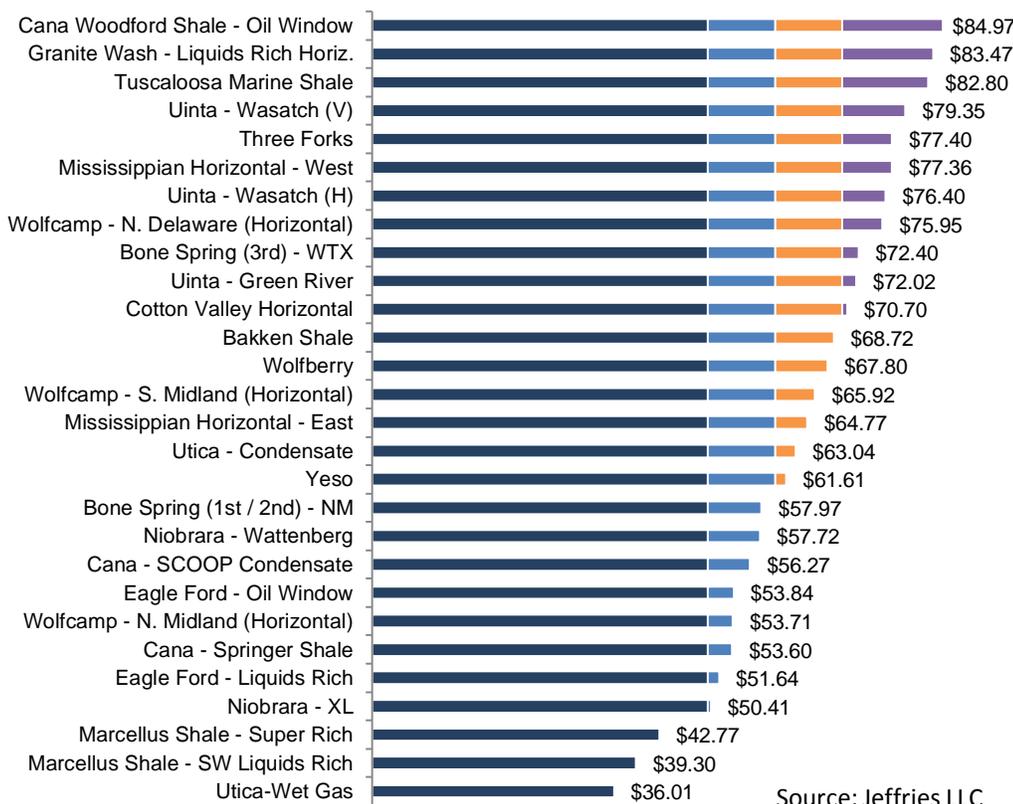
► **How Will U.S. Production Fare?**

A recent Goldman Sachs report, *2015 Outlook: U.S. Preeminence*, calls the U.S. shale the most expensive source of production, due primarily to the constant drilling necessary to offset the wells' rapid decline rates. In recent years drilling and completion costs have been studied at a granular level, but understanding the commodity price where those costs become uneconomical remains a moving target because the costs for producing oil is heavily basin and operator specific. William Marko, Managing Director at Jefferies, spoke at a Houston luncheon earlier this month and discussed the break-even pricing for WTI across the U.S. shale plays. In his presentation, Mr. Marko emphasized a threshold of \$50/bbl., below which new projects in the majority of shale basins become uneconomical.

World Liquid Fuels Production & Consumption Balance



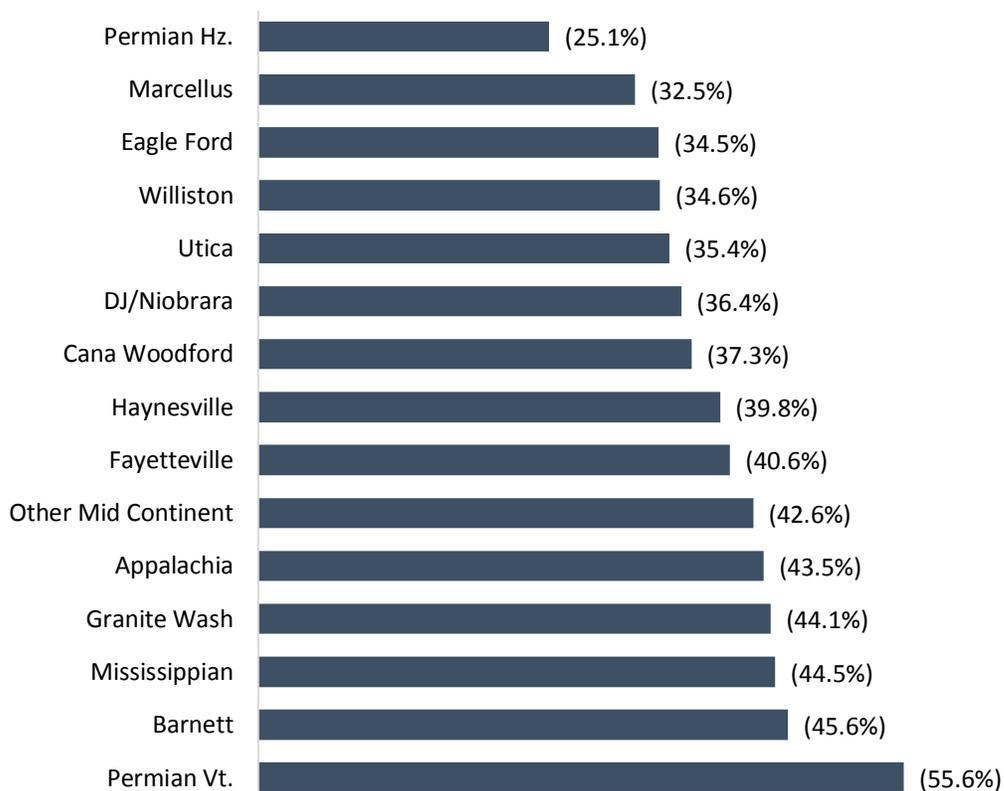
WTI Oil Breakeven Price¹



“ FOR OILFIELD SERVICE PROVIDERS, CUSTOMER DIVERSIFICATION, PROVIDING A BROAD RANGE OF SERVICES, AND FOCUSING ON THE HEALTHIEST CUSTOMERS IS PROVING TO BE OF THE UTMOST IMPORTANCE... ”

As operators pull back on their drilling programs, we fully expect to see basin-specific disparity in the severity of the rig count decline based on break-even costs depicted above. Adjustments to 2015 drilling programs will also be operator specific, due to a variety of factors including debt servicing requirements, hedged oil contracts, lease obligations, and drilling rig contracts. For oilfield service providers, customer diversification, providing a broad range of services, and focusing on the healthiest customers is proving to be of the utmost importance in a market where OFS companies are more impacted by over-exposure to certain basins and customers. The graph on the following page, based on the latest data from Spears & Associates, illustrates the estimated impact on 2015 average rig counts by basin if oil trades in the \$50-\$60 range.

Estimated 2015 Change in Average Rig Counts by Basin (\$50-\$60 oil)



Source: Spears & Associates

“MUCH WILL DEPEND ON WHICH COMPANIES CAN LIVE WITHIN THEIR MEANS. MANAGING COSTS AND CASH FLOWS, SHORTENING CASH CONVERSION CYCLES, AND CLOSELY MANAGING OPERATING BUDGETS WILL BE INTEGRAL IN THIS CYCLE.”

► **Closing Remarks**

A common phrase on the front lines over the last few weeks from oilfield service providers and professionals has been “there will be blood in the streets.” Service companies are responding to E&P demands to lower prices in an effort to maintain market share and retain their customer base. Companies will proceed with cost cutting measures, including headcount reductions and bonus cuts, already in process. Much will depend on which companies can live within their means. Managing costs and cash flows, shortening cash conversion cycles, and closely managing operating budgets will be integral in this cycle. But, as we discussed in last month’s newsletter, it’s still a wait and see game. On the front-end, the impact on the market will still depend on how many rigs actually get cut in each basin and how long it takes overall production/supply to be impacted. Founders Oil & Gas Director, Joe Brady, recently reflected to a group on a call, “it’s still supply and demand, we fully expect the correction to come on the supply side first. We’re not holding our breath for any substantial [oil] pricing changes or recovery until production flattens or curtails. It won’t happen overnight, and barring any major supply disruptions the US is the most likely candidate to make that happen. As for service providers, E&P’s are demanding cuts, and they will need to see some casualties before service pricing pressures get some relief.”



► Select M&A Transactions

Announced Date	Target	Buyer/Investors	Total Transaction Value (\$USD)
Jan-12-2015	Kirkey Specialized Drilling and Consulting, Inc.	First Drilling Group	-
Jan-8-2015	Worx America, Inc.	Resort Savers, Inc. (OTCBBL: RSSV)	-
Jan-06-2015	Anadarko E&P Company LP	Renee C-I Holding L.P.	-
Jan-05-2015	Chemtec Energy Services, LLC	LB Foster Co. (NasdaqGS: FSTR)	-
Dec-16-2014	Cimarron Energy, Inc.	Turnbridge Capital, LLC	\$100.0
Dec-12-2014	Flogistix, LP	White Deer Energy	-
Dec-11-2014	Advance Fabrication & Measurement, LLC	KW International, LLC	-
Dec-08-2014	Precision Drilling Corporation, U.S. Coil Tubing Operations	-	\$38.4
Dec-02-2014	Bray Production Services, LLC	Park Energy Services, LLC	-
Dec-01-2014	Thunder & Lightning Welding Ltd	Hyduke Energy Services Inc. (TSX:HYD)	-

► Commodity Prices

Crude Oil - WTI



	Price per Barrel			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Crude Oil	\$46.47	\$57.13	\$93.87	(18.7%)	(50.5%)

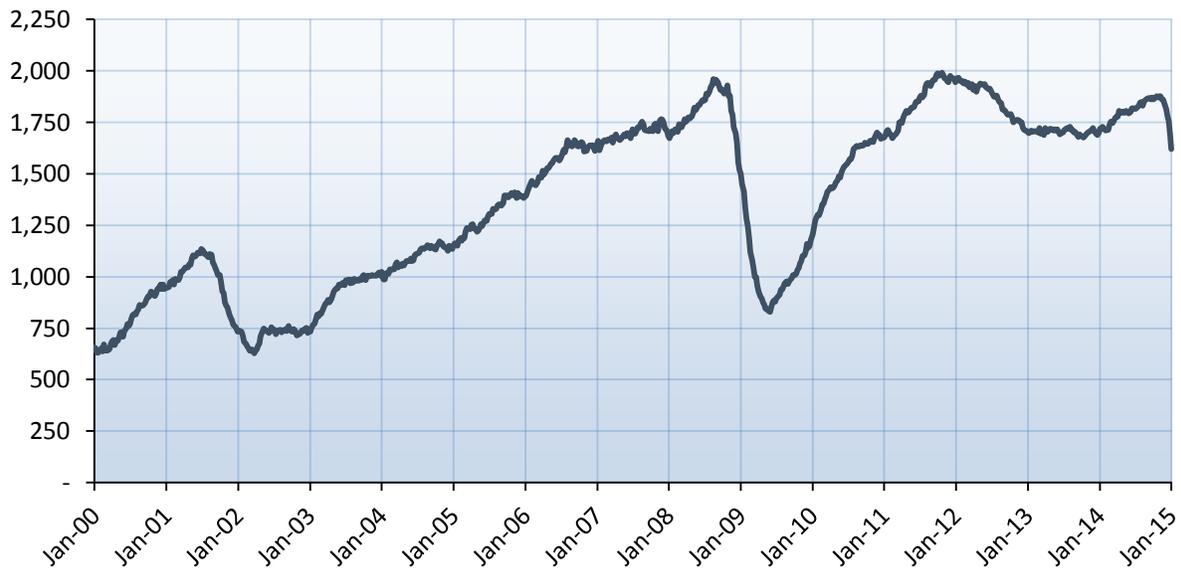
Natural Gas - Henry Hub



	Price per Mmbtu			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Natural Gas	\$2.82	\$3.46	\$4.26	(18.4%)	(33.8%)

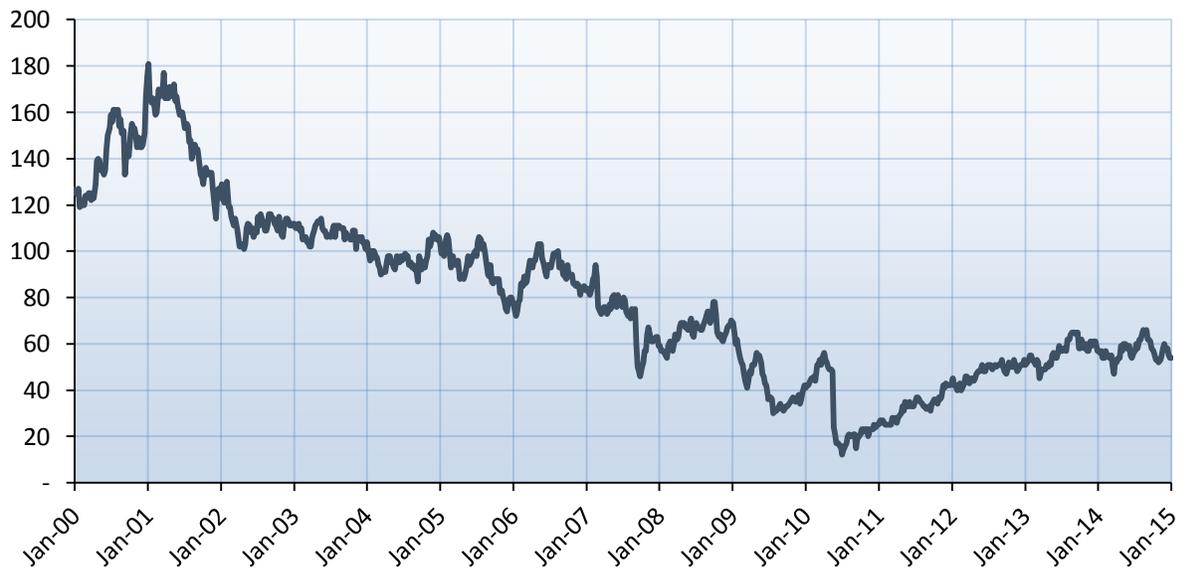
► Rig Counts

Onshore Rig Count



	Rig Count			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
U.S. Onshore	1,622	1,817	1,720	(10.7%)	(5.7%)

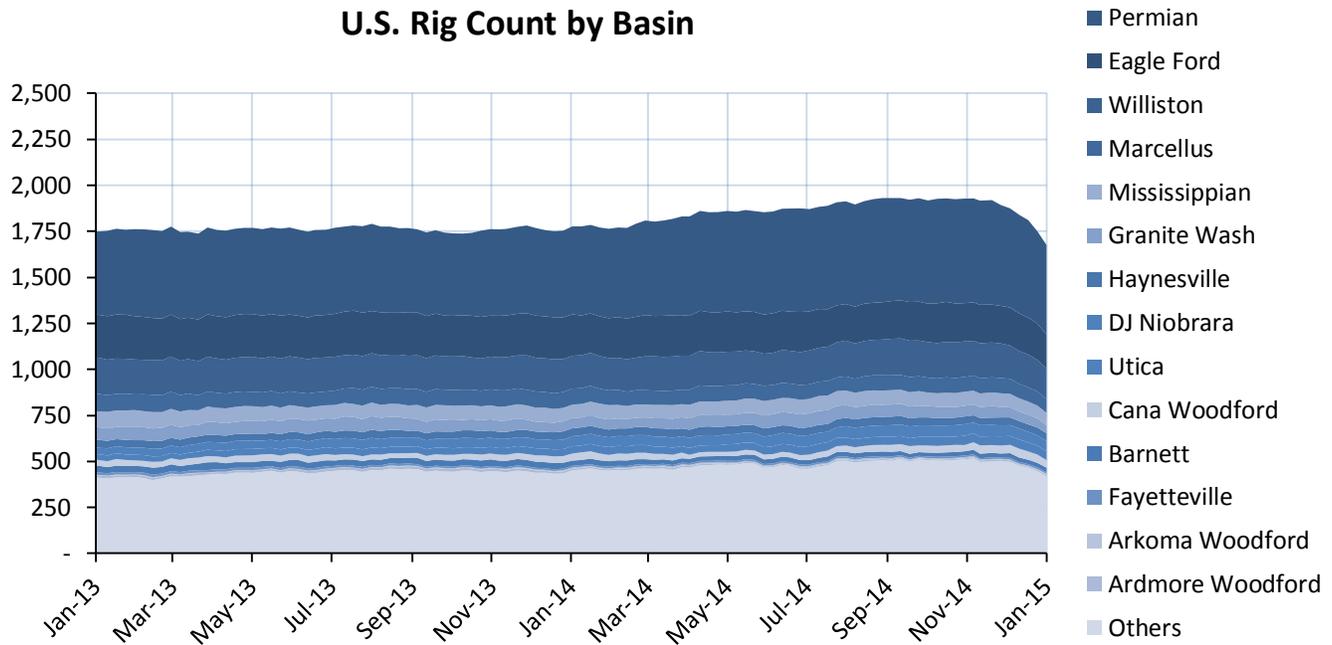
Offshore Rig Count



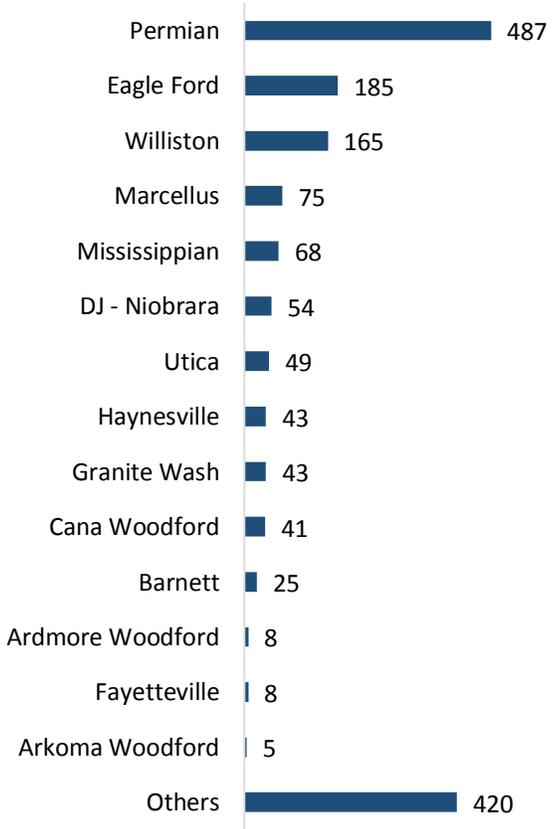
	Rig Count			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
U.S. Offshore	54	58	57	(6.9%)	(5.3%)

► Rig Counts (continued)

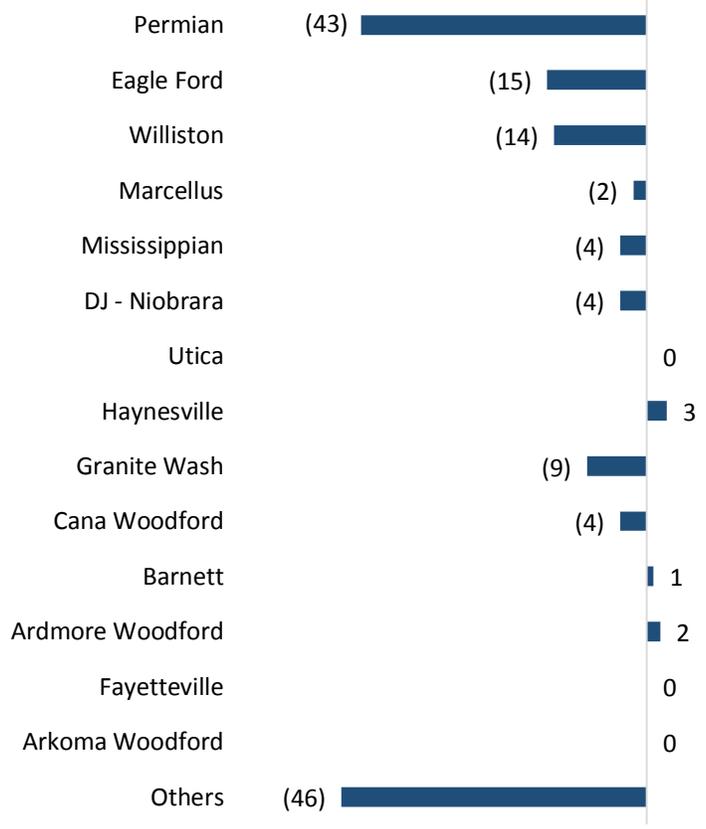
U.S. Rig Count by Basin



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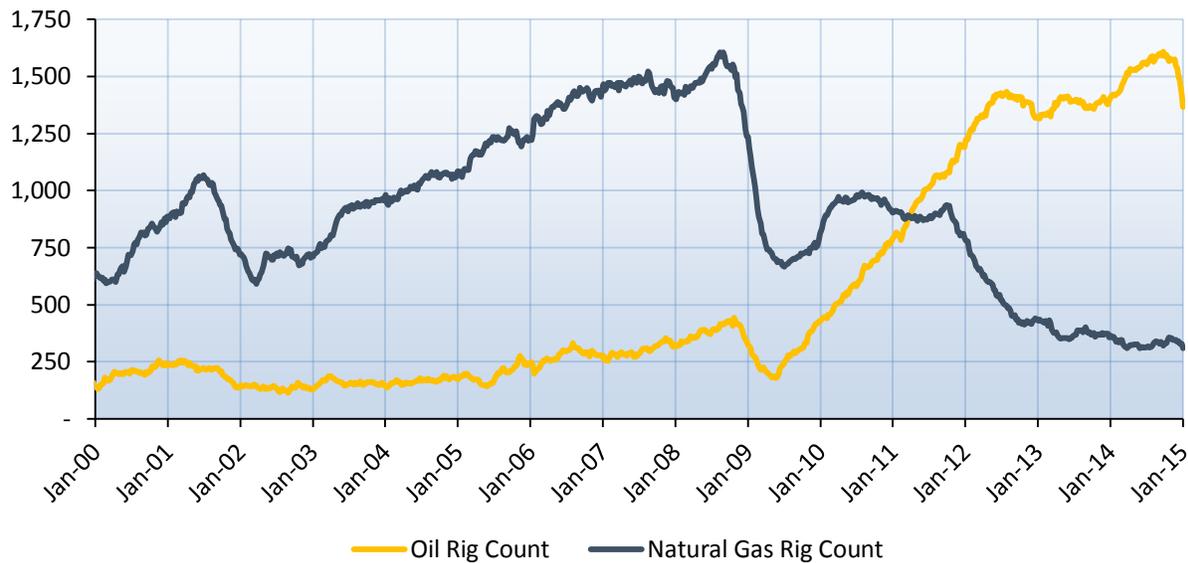


U.S. Rig Count by Basin YTD Change



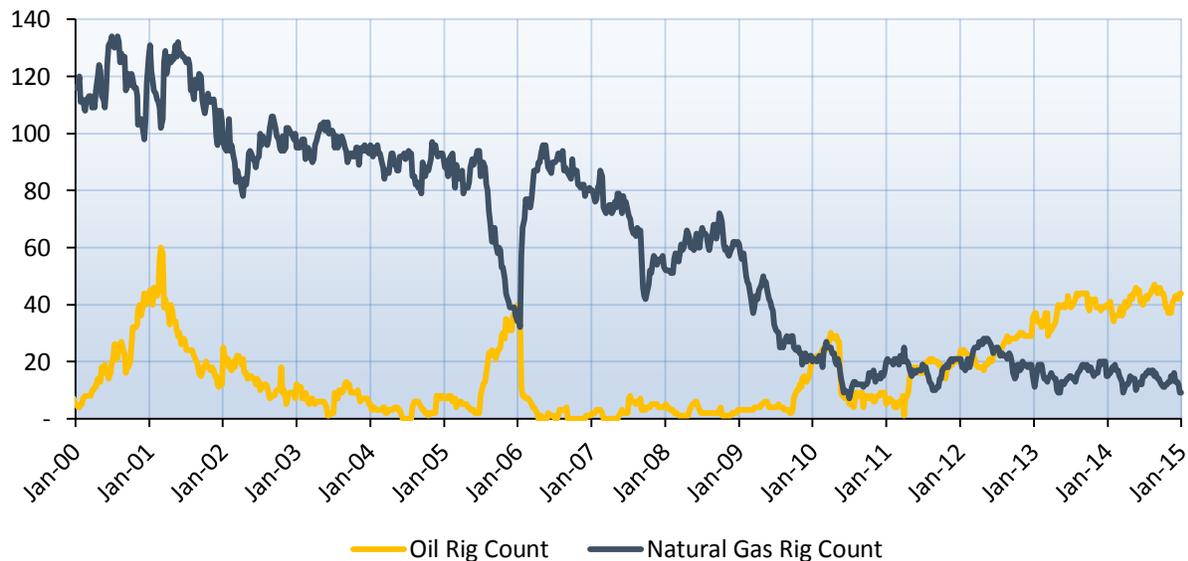
► Rig Counts (continued)

U.S. Oil vs. Natural Gas Rig Count



	Rig Count			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Oil	1,366	1,536	1,408	(11.1%)	(3.0%)
Natural Gas	310	338	365	(8.3%)	(15.1%)

Gulf of Mexico Oil vs. Natural Gas Rig Count

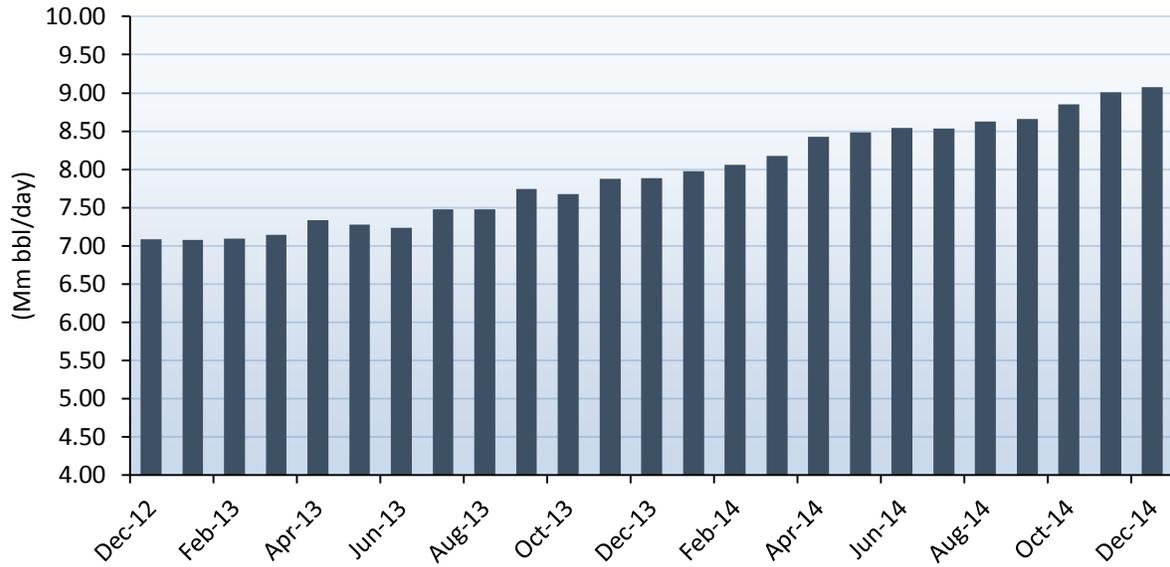


	Rig Count			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Oil	44	43	40	2.3%	10.0%
Natural Gas	9	13	15	(30.8%)	(40.0%)

Source: Baker Hughes

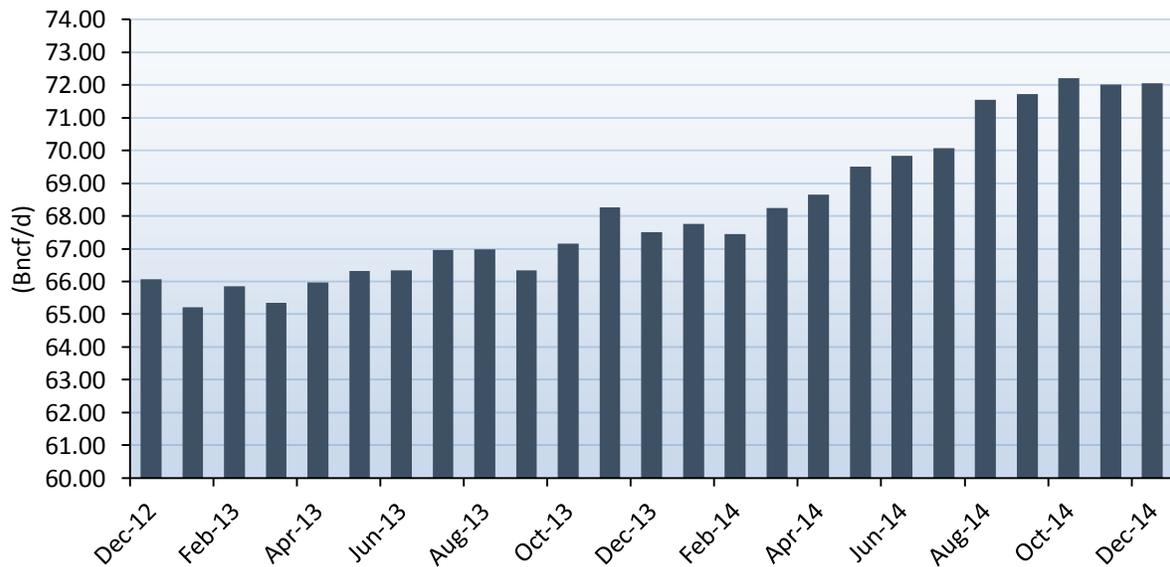
► Domestic Production

Crude Oil Production



	Million Barrels per Day			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Crude Oil	9.08	9.01	7.88	0.8%	15.2%

Natural Gas Production



	Billion Cubic Feet per Day			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Natural Gas	72.05	72.01	67.50	0.1%	6.7%



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O&G Services Lead Advisors:

Duane Donner
 Managing Director
 205-423-2548
 ddonner@foundersib.com

Joe Brady
 Director
 205-503-4023
 jbrady@foundersib.com

John Ortstadt
 Business Development
 205-503-4030
 jortstadt@foundersib.com

Andrew Green
 Associate
 agreen@foundersib.com

Ben New
 Analyst
 bnew@foundersib.com



Guests at the recent Founders' Forum enjoy a Cajun cuisine at the family lodge in Cameron Meadows, LA.

SAMPLE O&G TRANSACTIONS:

 Has been acquired by 	 Has been acquired by 	 Has completed a recapitalization by 	 Has acquired strategic assets from Corporate Advisor
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FOUNDERS INVESTMENT BANKING, LLC

2204 Lakeshore Drive
 Birmingham, AL 35223

www.foundersib.com – 866.594.4358

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