

# OIL & GAS

## Newsletter

### May Edition: Offshore Outlook

The offshore O&G industry has been more resilient to the industry downturn than its onshore counterpart, thanks in part to inherent differences in market fundamentals. Recent reports have also indicated that the offshore O&G industry may be better positioned for a long term recovery in oil prices as well. However, offshore activity levels have suffered considerably in recent months and created a surplus of offshore drilling rigs, which means the industry will need a sharp uptick in drilling demand to absorb the additional offshore rigs that are slated to come online in 2015 and 2016. In this month's edition of the Founders Oil & Gas Newsletter, we turn our focus offshore to analyze the factors affecting both the short-term and long-term outlook for the offshore O&G industry with respect to both drilling activity and specialized equipment & service providers like subsea equipment companies.

#### ► Greater Resilience in a Downturn.

The offshore rig count has historically reacted slower to oil price fluctuations than onshore rig counts due to a variety of factors including the greater magnitude of sunk costs offshore, the duration of contractual agreements, and the longer lifespan of the wells. Many offshore wells have expected lifespans in excess of 30 years, which makes short-term changes in commodity prices far less impactful. Nonetheless, the 2014 downturn has caused a 42% year-to-date reduction in the offshore rig count, which compares to a 52% reduction in the onshore rig count over the same period.

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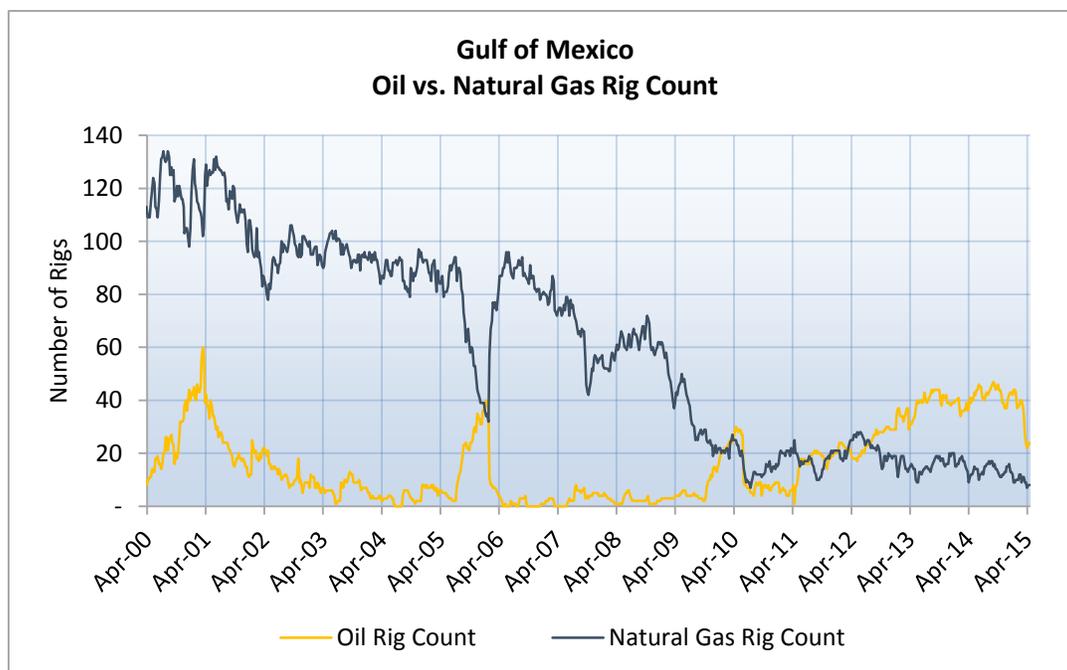
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### ► Short-term Outlook for Offshore Drillers

In the next 6 – 12 months we do not expect the market landscape for offshore drillers to change materially. But, without a recovery in drilling activity, the market will have difficulty absorbing the capacity of new rigs slated to come online in 2015 and 2016. In fact, the question of oversupply in the offshore rig market was already being raised prior to the downturn. Christian Beckett, CEO at Pacific Drilling recently stated in the company's Q1 earnings call that prior to the downturn he felt that "we [industry] had built and delivered into the market enough rigs to serve the majority of demand through the end of 2016."

Investment bank Tudor Pickering Holt estimates that approximately 32 new floating rigs will be delivered into the market in 2015 alone, with an additional 22 slated for a 2016 release. Of the new rigs expected to enter the market in the near-term, roughly half are lacking a contract and will simply add to the oversupply.

Day rates for high-end floating rigs, which once reached nearly \$700k/day, have retreated to roughly \$400k/day, forcing the hand of offshore contractors who cannot put rigs to work and are faced with the decision to either retire older rigs or spend more to rehabilitate them for future use. The average day rate had already started to retreat prior to the downturn, adding credence to Beckett's statement above.

Even without the added capacity, offshore drilling contractors have been forced to take write-offs as they retire older, outdated rigs. Diamond Offshore, EnSCO, and Transocean are among the companies that have either announced or already taken significant write-offs associated with the decommissioning of offshore rigs, and more are expected to follow suit.

The continuing improvements in offshore drilling technology only fuel these write-offs as more technologically advanced rigs are forced to target lower hanging fruit. Jeremy Thigpen, CEO of Transocean, notes "We will continue to see higher specification units compete for these lower spec jobs and, in turn push the older, less-efficient assets to the beach and in many cases ultimately the scrapyards."

### ► Long-term Outlook for Offshore Drillers

Though the offshore drilling industry may continue to face headwinds associated with oversupply in the short-term, most industry professionals hold a far more optimistic long-term view. National Oilwell Varco estimates that 207 drillship deliveries will be made over the next ten years, compared to 163 in the last ten years, an increase indicative of the Company's long-term expectations for crude oil demand.

A recent global study conducted by Rystad Energy indicates that the average breakeven oil price for new offshore projects is just \$65 – 70/bbl, marginally higher than average onshore breakeven prices. This implies that the offshore market remains competitive and that the lower activity we are currently observing can be considered a short-term correction in a market with strong long-term fundamentals. Rystad expects a recovery in the offshore market by 2017/2018, and for offshore to become the most important source of new production by 2020 – 2025.

To fuel the growth offshore that many industry experts are calling for, companies will need to continue to improve on the technology of both the drilling rigs and supporting equipment. As companies increasingly turn to deepwater and ultra-deepwater plays, more sophisticated technology and increased spending is needed to yield comparable results. New global offshore discoveries by E&P companies peaked in 2010 with 34 billion boe of newly discovered resources, and reached the lowest point in 2014 falling below 10 billion boe of newly discovered resources. Further, the newly identified resources are at a higher exploration cost per barrel.

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- EP MAGAZINE



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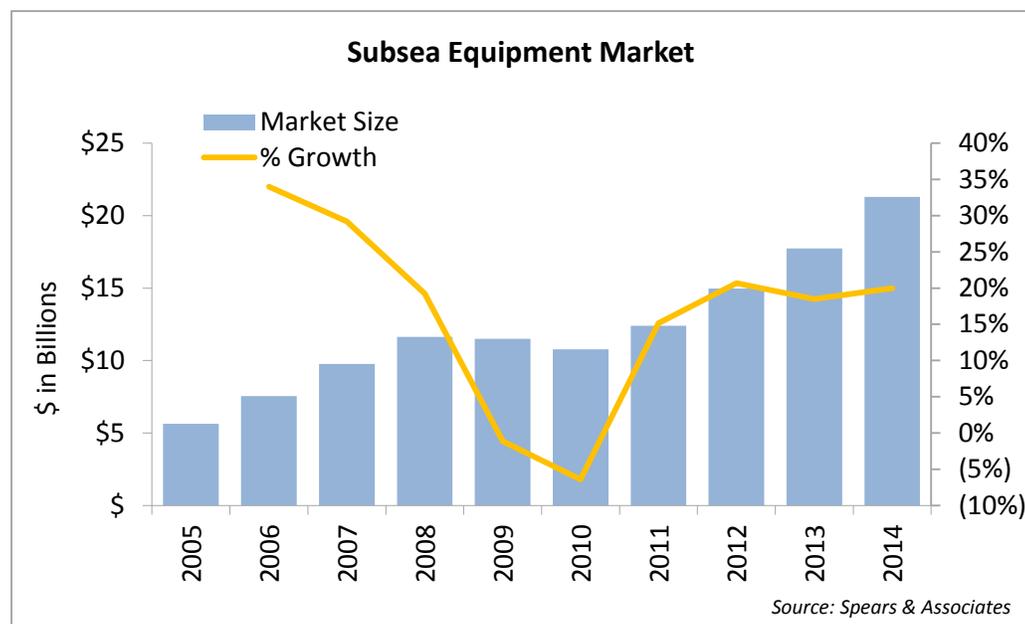
WE THINK THIS IS A SHORT-TERM ISSUE. DEEPWATER IS GOING TO BE A MAJOR GROWING ELEMENT IN THE FUTURE. LONG-TERM DEMAND CONTINUES.

”

- JOE ROVIG, PRESIDENT OF NOV'S RIG SYSTEMS AND AFTERMARKET SEGMENTS

### ► Subsea Equipment – Historical Performance & Future Outlook

According to data from Spears & Associates, the Subsea equipment market has been one of the fastest growing markets in the oilfield, averaging 15% annual growth in the 10 year period from 2005 – 2014 despite the industry’s shutdown in 2010 due to the BP oil spill.



“ THE SUBSEA EQUIPMENT MARKET HAS BEEN ONE OF THE FASTEST GROWING MARKETS IN THE OILFIELD, AVERAGING 15% ANNUAL GROWTH IN THE 10 YEAR PERIOD FROM 2005 – 2014. ”

- SPEARS & ASSOCIATES

Certain advanced subsea equipment such as seafloor processing systems can be seen as expensive add-ons to facilitate the extra production necessary to make deepwater developments profitable. As capital budgets are reined in, higher cost projects are the first on the chopping block, so demand for subsea equipment may diminish further and some subsea projects may be shelved in the current environment.

However, the subsea equipment sector continues to contribute technological advances that allow companies to drill profitably in previously unreachable or uneconomical areas. With the long-term fundamentals for the offshore industry still in place, the subsea equipment market will benefit as companies increasingly turn to deepwater plays to unlock new resources.

### ► Closing Remarks.

With the shockwave of Q1 under the market’s belt, a lot of focus will be on how companies fair in Q2 for both onshore and offshore service companies. Onshore has felt the full squeeze of margin compression and activity slowdown. Conversely offshore service companies experienced a wave of new projects out for bid in late 2014 (materializing now in 2015). But the impacts of commodity price swings affect offshore differently than its onshore counterpart; the well economics, long-term planning cycles, and the nature of slow reaction to market changes have been compared to trying to make a U-turn with an oil tanker. Offshore markets require more time to slowdown and more time to pick back up. Sentiment of long-term fundamentals will play the biggest role in keeping the current price reduction from sidelining offshore assets. Joe Brady, Director of Founders O&G Team, stated, “thus far our offshore clients have faired well, all things considered. Continued technological advancements and the ability to move assets overseas have helped to insulate them more so than their onshore peers.”

## ► M&amp;A Activity

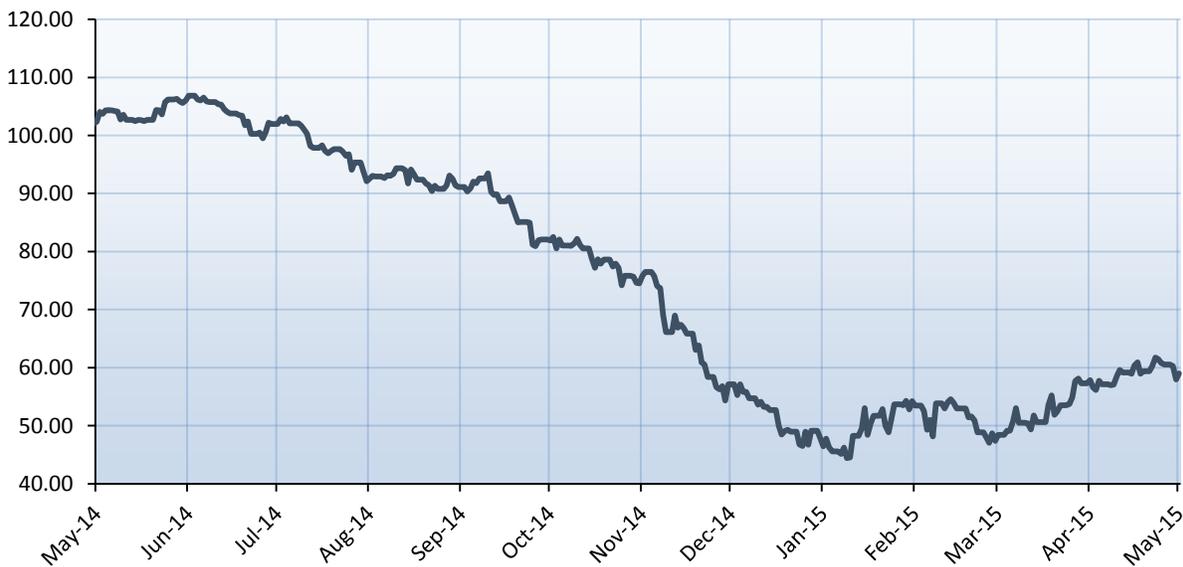
Announced Date	Target/Issuer	Buyers/Investors	Transaction Value (\$USDmm)
05/18/2015	Connor Oil Tools, LLC	GEODynamics, Inc.	-
05/08/2015	Valley Wells Gathering, Treating, Compression, and Transportation Assets	Southcross Energy Partners, L.P. (NYSE:SXE)	77.64
05/06/2015	Brown Integrity LLC	Cypress Energy Partners, L.P. (NYSE: CELP)	11.20
05/06/2015	American Quantum Energy Corporation	Lang International Holdings Limited	1.24
05/04/2015	Steam Testing Solutions, LLC and AccuSteam LLC	Enerlabs Inc. (OTCPK: ENLB)	-
05/01/2015	Rhodes Manufacturing, Inc.	3 Rivers Capital, LLC	3.00
05/01/2015	Southwest Oilfield Products. Inc.	American Block, Inc.	-
04/27/2015	Lightning Industries, Inc.	MJ Bioscience Corp.	-
04/24/2015	ROC Service Company, LLC	Coral Reef Capital, LLC	-
04/20/2015	Exterran Energy Solutions, L.P., Customer Contracts Covering 217,000 Horsepower of Compressor Units	Exterran Partners, L.P. (NasdaqGS:EXLP)	102.3
04/13/2015	Bayside Petroleum Company, Inc.	iSeeAutomation, Inc.	-
04/10/2015	640energy, LLC	Intercept Energy Services Inc. (TSXV:IES)	0.258
04/09/2015	Quality Energy Solutions, LLC	Start Scientific, Inc. (OTCPK:STSC)	2.93
04/07/2015	Horizon Marine Inc.	Collection Localisation Satellites SA	-
04/07/2015	Certain Fracking Assets and Related Services	GASFRAC Energy Services, Inc. (TSX:GFS)	-
03/31/2015	Premier Utility Services, LLC	USIC Locating Services, Inc.	51
03/27/2015	Cobey Inc.	-	-
<b>03/23/2015</b>	<b>Eagle Automation Ltd.*</b>	<b>Panhandle Oilfield Services, Inc.</b>	-
03/17/2015	Pelagic Tank, LLC	Legacy Measurement Solutions, Inc.	-
03/13/2015	Inspection Oilfield Services	LB Foster Co. (NasdaqGS:FSTR)	230
<b>03/12/2015</b>	<b>Timco Services, Inc.*</b>	<b>Frank's International, Inc.</b>	<b>95</b>
02/18/2015	The Oil & Gas Asset Clearinghouse L.L.C.	CenterGate Capital, L.P.	-

\*Indicates Founders Investment Banking advised on the transaction

Source: CapitalIQ

► Commodity Prices

Crude Oil - WTI



	Price per Barrel			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Crude Oil	\$58.98	\$57.88	\$102.33	1.9%	(42.4%)

Natural Gas - Henry Hub



	Price per Mmbtu			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Natural Gas	\$2.96	\$2.64	\$4.55	12.1%	(35.0%)

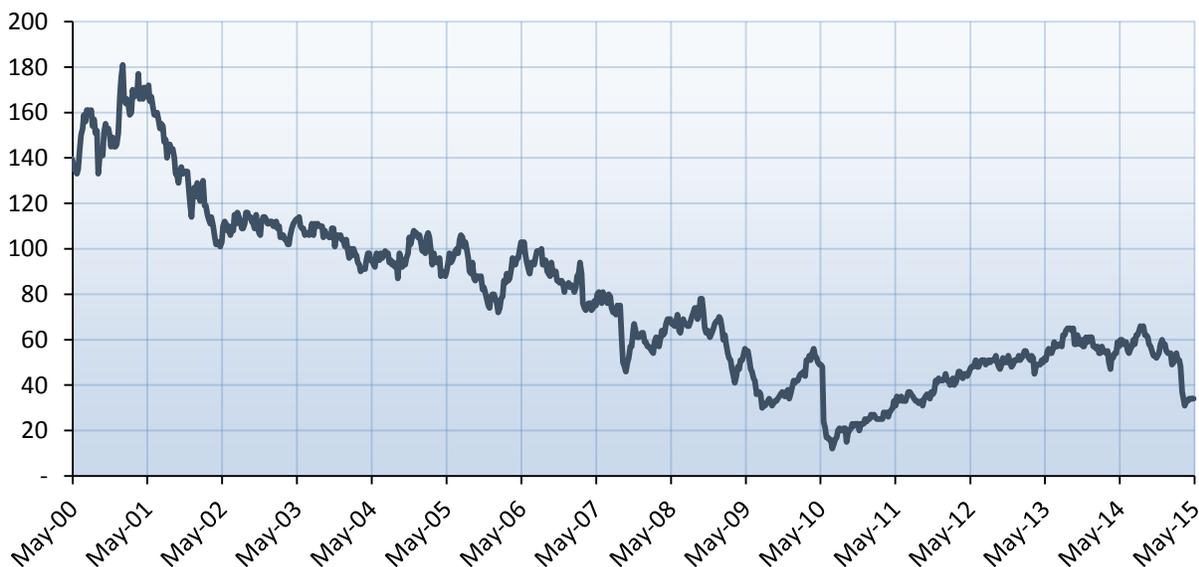
► Rig Counts

**Onshore Rig Count**



	Rig Count			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
<b>U.S. Onshore</b>	854	955	1,796	(10.6%)	(52.4%)

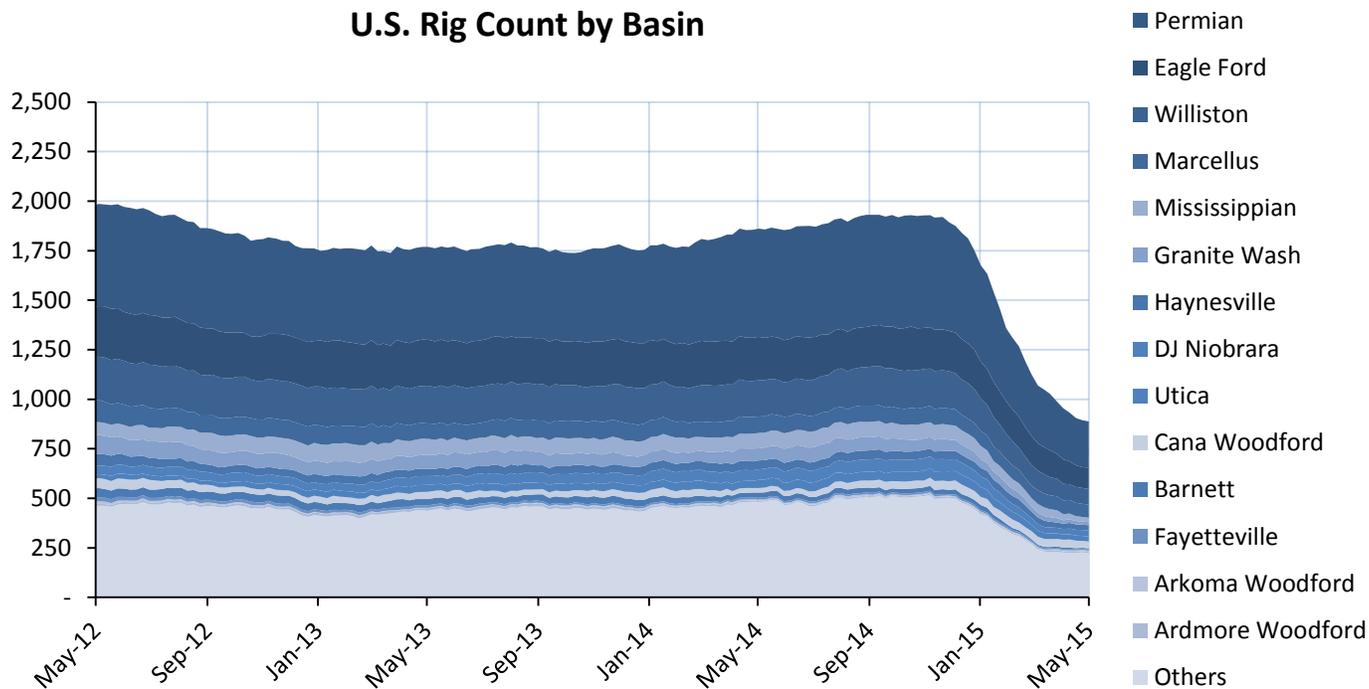
**Offshore Rig Count**



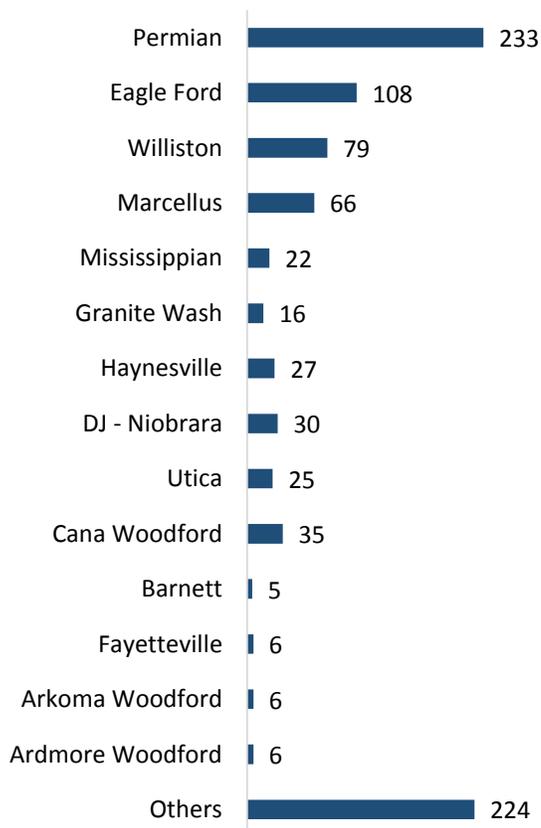
	Rig Count			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
<b>U.S. Offshore</b>	34	33	59	3.0%	(42.4%)

► Rig Counts (continued)

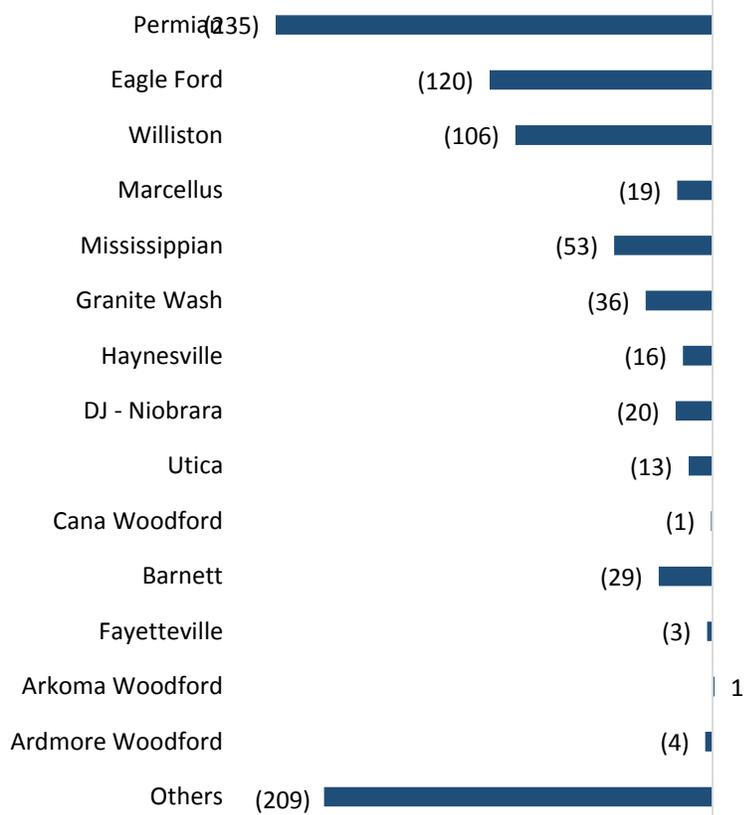
U.S. Rig Count by Basin



U.S. Rig Count by Basin

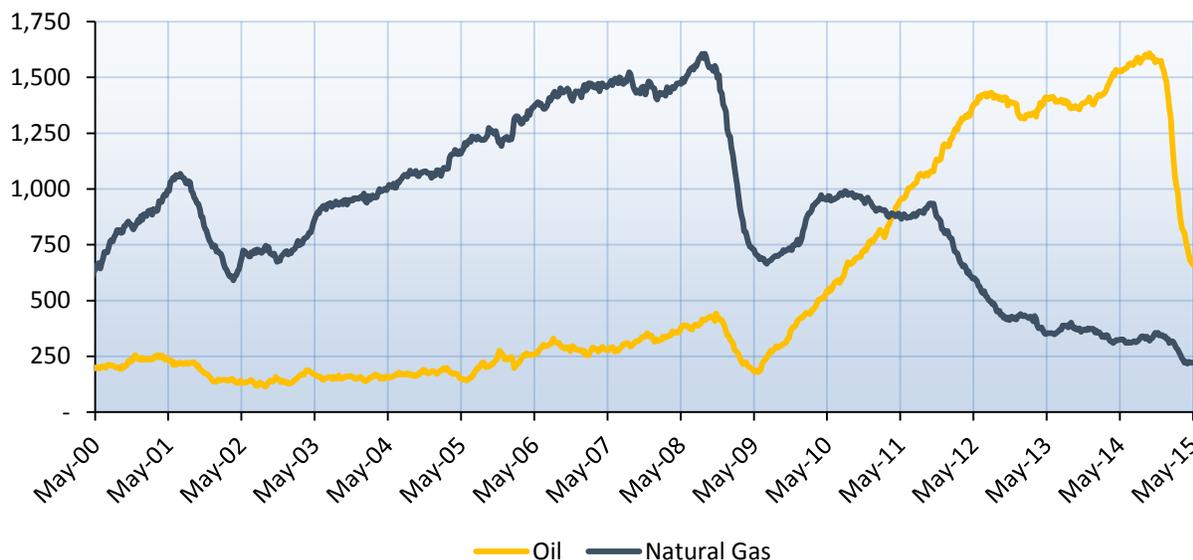


U.S. Rig Count by Basin YTD Change



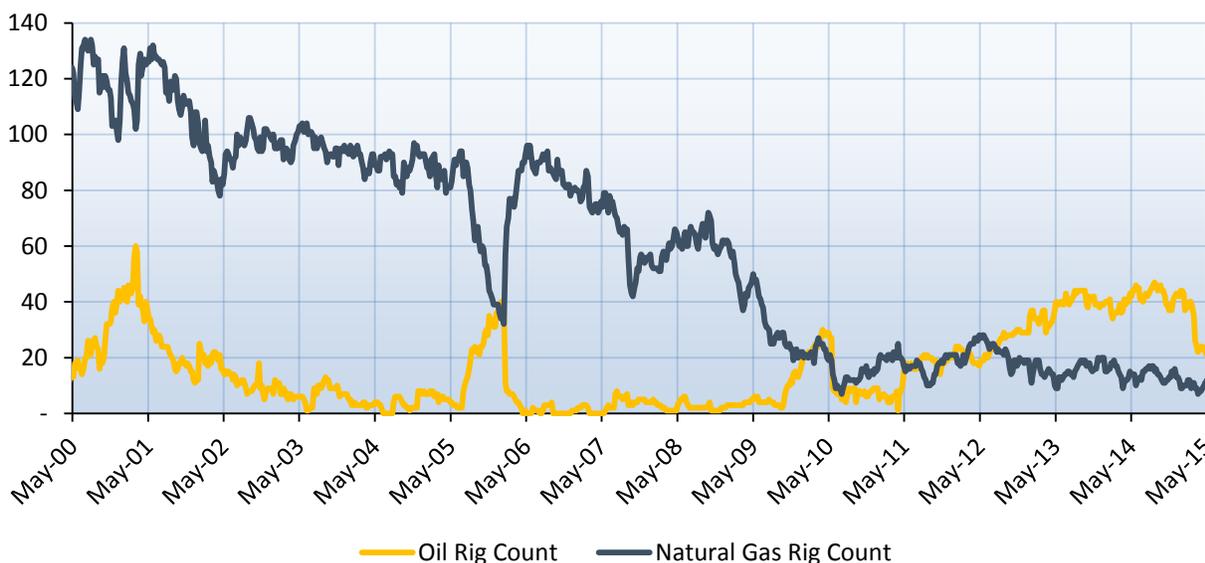
► Rig Counts (continued)

**U.S. Oil vs. Natural Gas Rig Count**



	Rig Count			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
<b>Oil</b>	660	760	1,528	(13.2%)	(56.8%)
<b>Natural Gas</b>	223	225	323	(0.9%)	(31.0%)

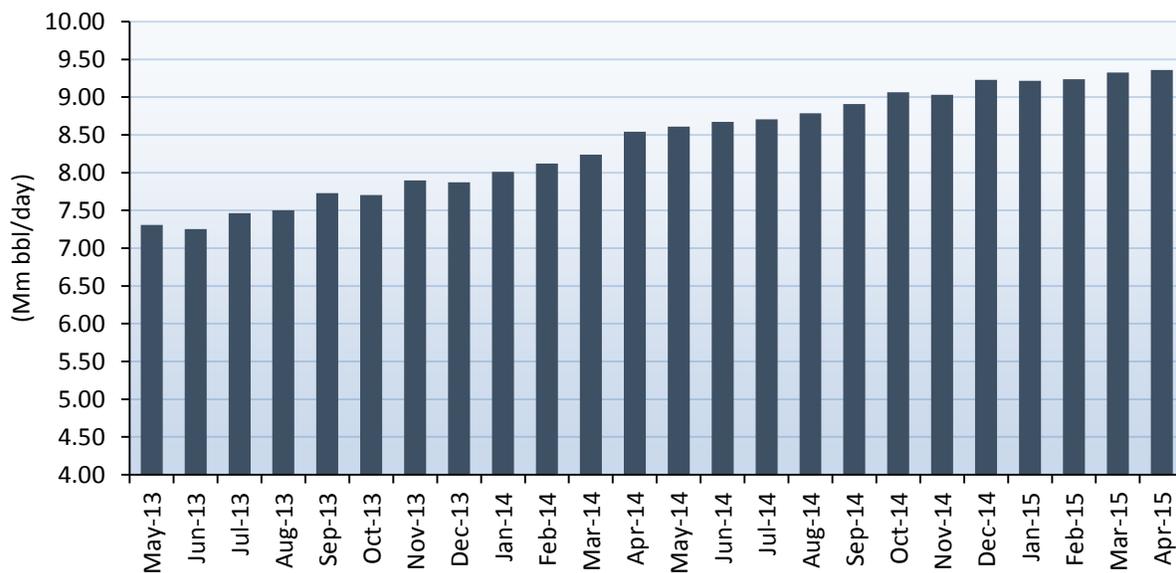
**Gulf of Mexico Oil vs. Natural Gas Rig Count**



	Rig Count			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
<b>Oil</b>	21	23	43	(8.7%)	(51.2%)
<b>Natural Gas</b>	12	8	15	50.0%	(20.0%)

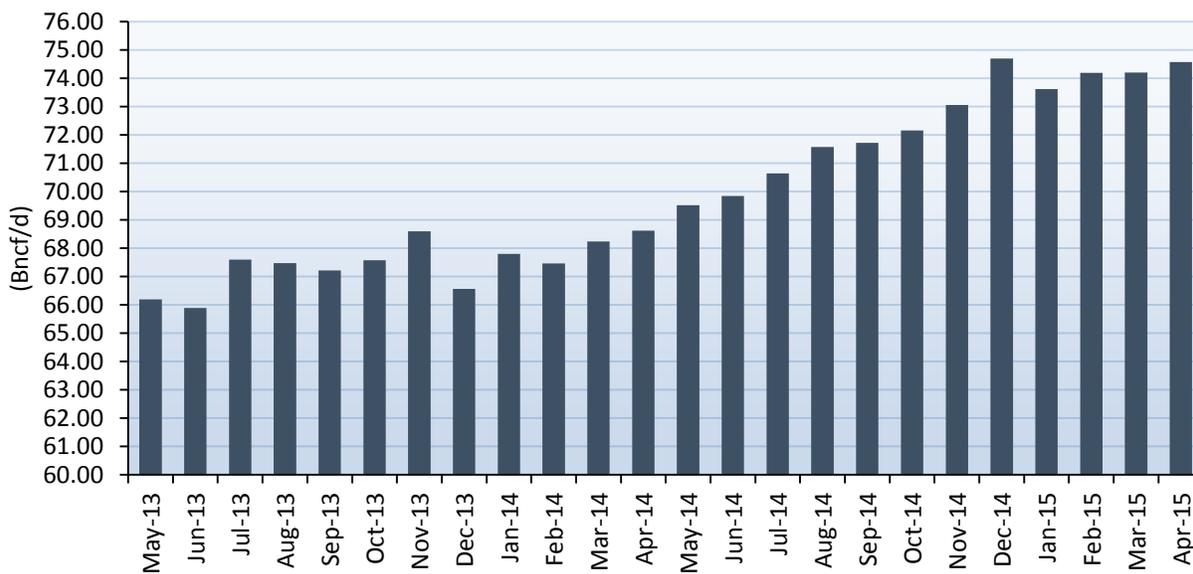
► Domestic Production

**Crude Oil Production**



	Million Barrels per Day			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Crude Oil	9.36	9.32	8.54	0.4%	9.6%

**Natural Gas Production**



	Billion Cubic Feet per Day			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Natural Gas	74.57	74.20	68.62	0.5%	8.7%



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

**SELECT O&G TRANSACTIONS:**

**TIMCO SERVICES**  
 Has been acquired by  
**FRANK'S INTERNATIONAL**  
 Sell-Side Advisor

**EAGLE AUTOMATION LIMITED**  
 "Keeping A Sharp Eye On Operations"  
 Has been acquired by  
**PANHANDLE**  
 A portfolio company of  
**ARGOSY PRIVATE EQUITY**  
 Sell-Side Advisor

**Tornado Production Services, LLC**  
 Has been acquired by  
**PRODIRECTIONAL**

**SPARTAN ENERGY SERVICES**  
 Has completed a recapitalization by  
**HARRIS EQUITY PARTNERS**

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