

Oilfield Services Seminar Series Part III | Running Out of Runway

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HEADWATERS | MB

Member FINRA

Haynes and Boone, LLP
Oilfield Services Seminar Series
Part III | Running Out of Runway

Agenda

Share our thoughts on:

- 1. How will oilfield service companies find capital?**
- 2. What is happening to working capital?**
- 3. What will OFS look like on the other side of the trough?**
- 4. How will OFS companies recapitalize?**
- 5. Industry charts**

Heard on the Street

Biggest oil boom in history... now the biggest oil bust?

OPEC will no longer shore up oil prices

DUCs are a stealth supply overhang

High oil prices justified expensive drilling & completions

E&Ps outspent cash flow and doubled down with debt to grow

Big banks add \$2 billion to loan loss reserves

Lower for longer

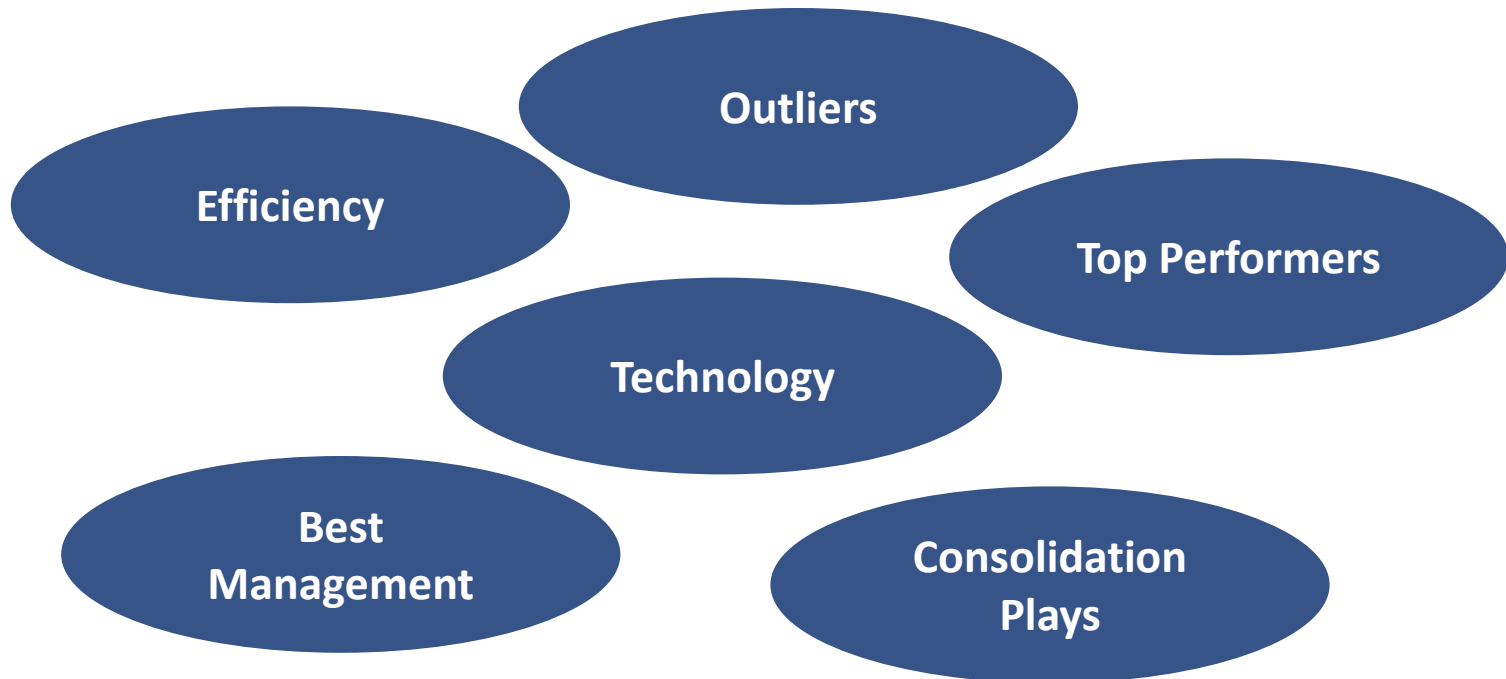
The shale revolution led US oil production to record highs

Oil busts shift risk from banks to equity players

How will oilfield service companies find capital?

Capital will find OFS companies.

Smart capital players are focused on finding:



How will oilfield service companies find capital?

Capital will find OFS companies.



Most money that finds a home will come from:

1. Strategics that have the wherewithal to make acquisitions, or
2. Financial investors that have experience and existing expertise in the sector

What is happening to working capital?

What working capital?

Forced slowdown of activity as operating companies must live within their means

Debt availability is shrinking rapidly.

Over \$5.6 billion has been cut from credit lines so far this year.

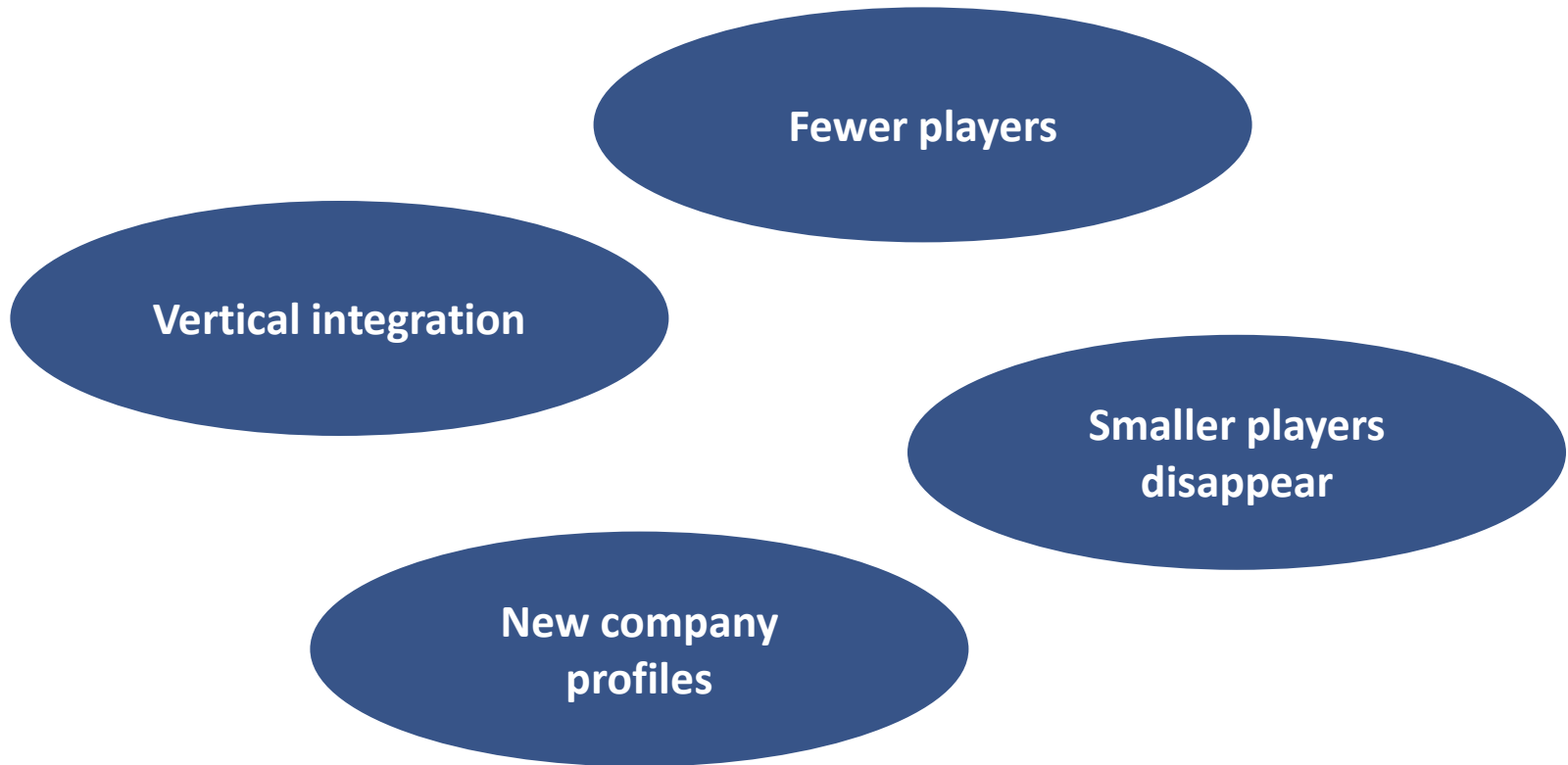
The search for cash includes

- Cutting CAPEX
- Cutting G&A
- Asset sales
- Focus on highest margin services and products
- Fight to keep key clients

Cash is king: Those with access to cash will have buying opportunities and take market share

What will OFS look like on the other side of the trough?

Consolidation will alter the competitive landscape



...energy may drive the next tech boom

How will OFS companies recapitalize?

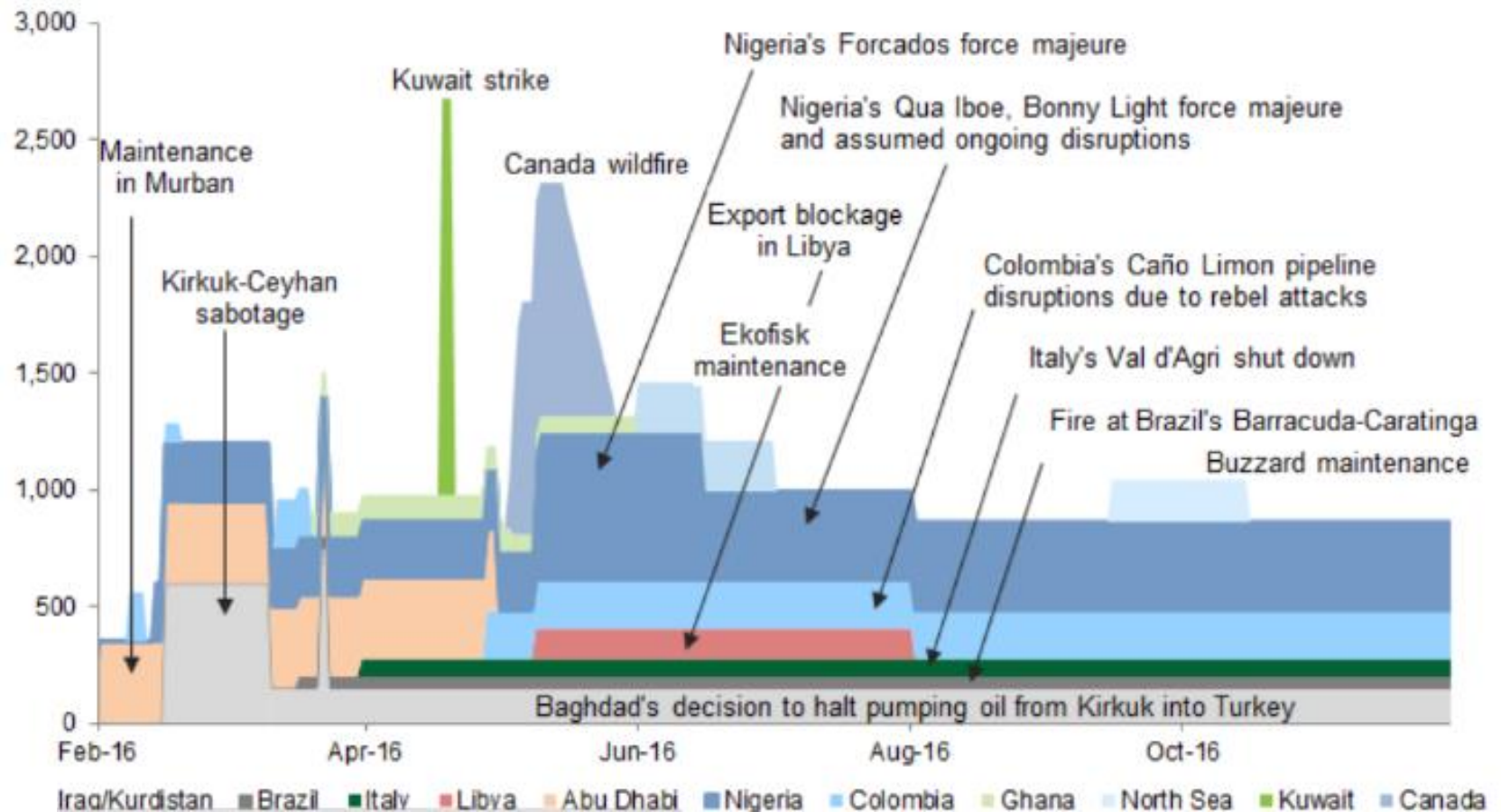
Pain will be absorbed by the typical collapse of the capital stack



...he who has the gold makes the rules

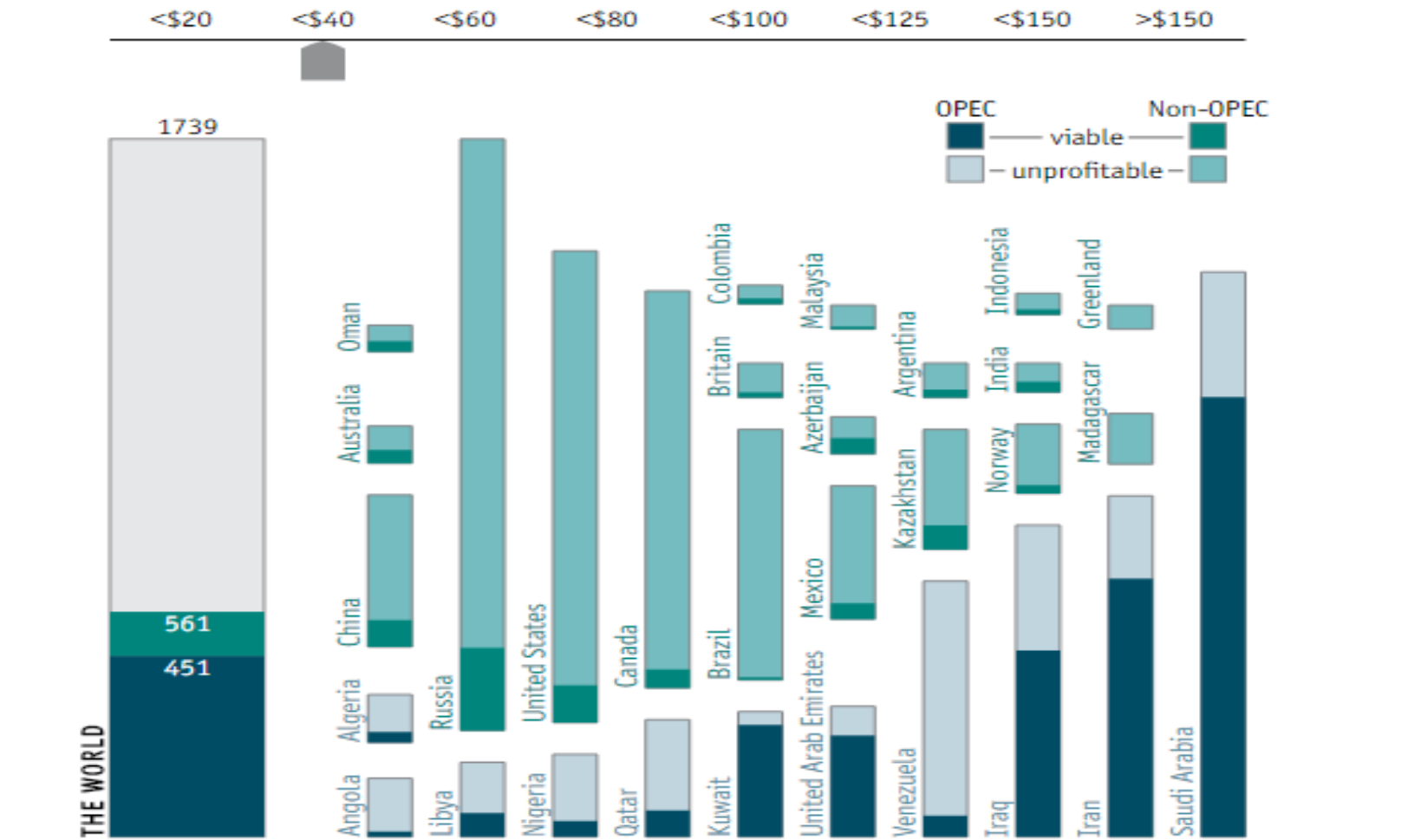
Large supply disruptions have pushed production lower in 2016

Key planned and unplanned outages since mid-February (kb/d)



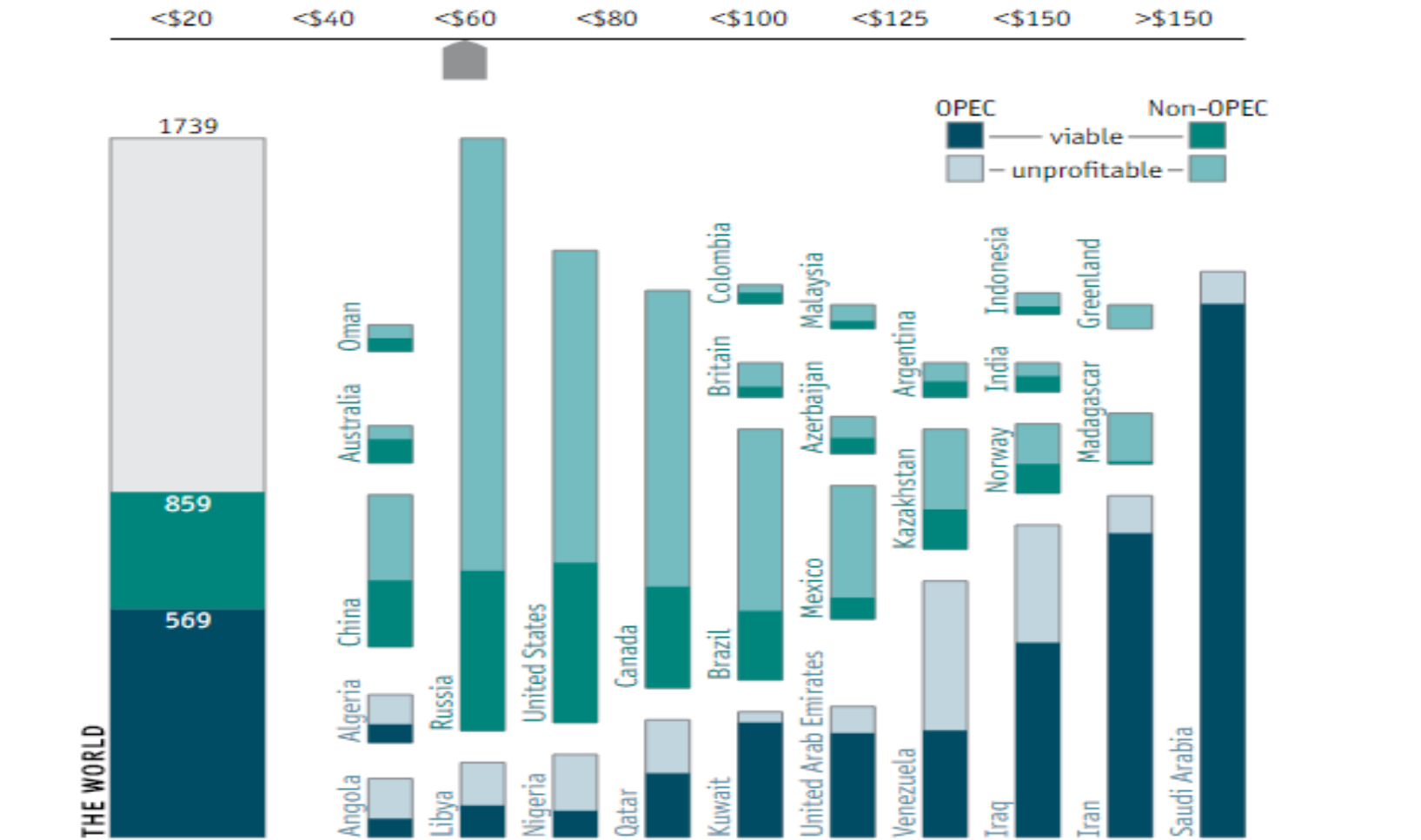
Source: Goldman Sachs.

Economically viable oil reserves by price (billions of barrels)



Source: Rystad Energy; Quandl.

Economically viable oil reserves by price (billions of barrels)

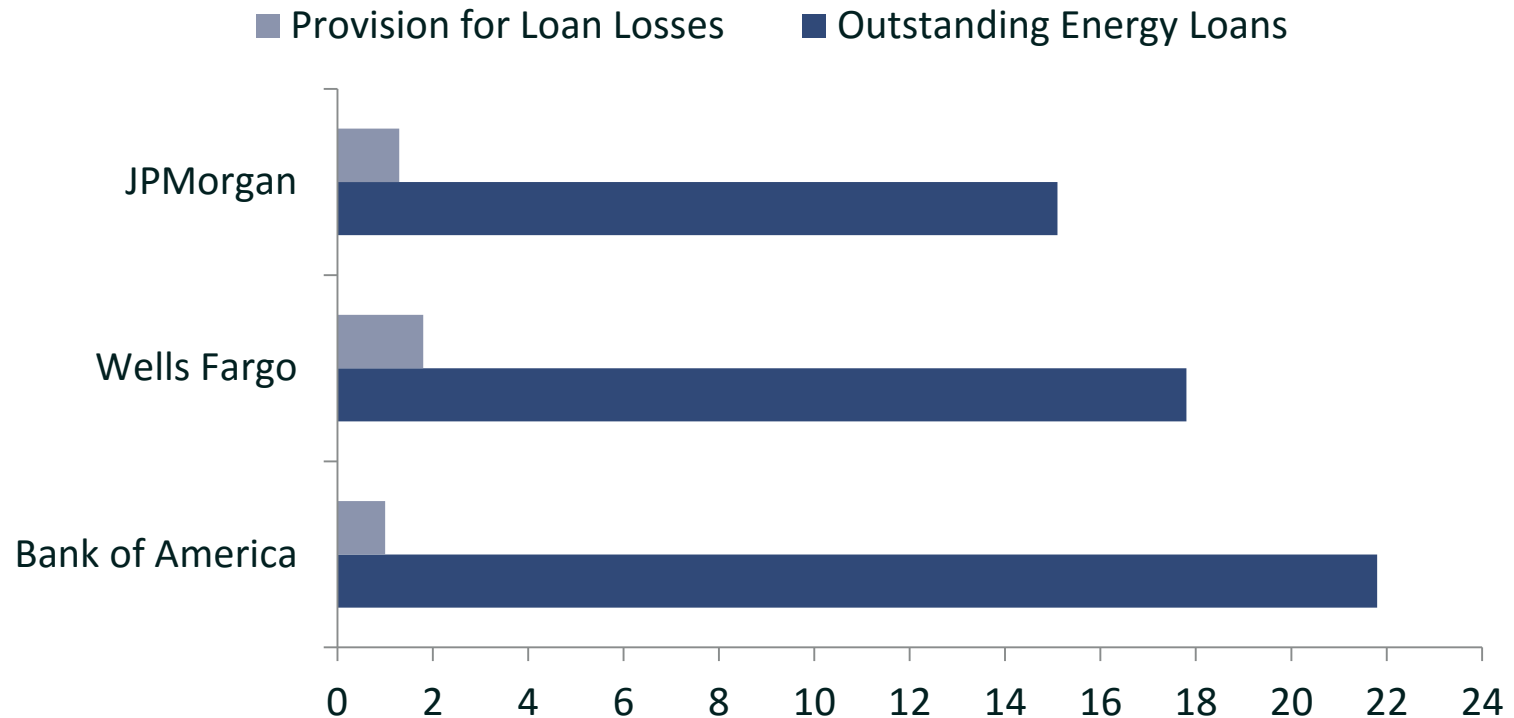


Source: Rystad Energy; Quandl.

Wall Street's oil risk

Banks are setting aside more money to cover potential energy loan losses

\$ billion

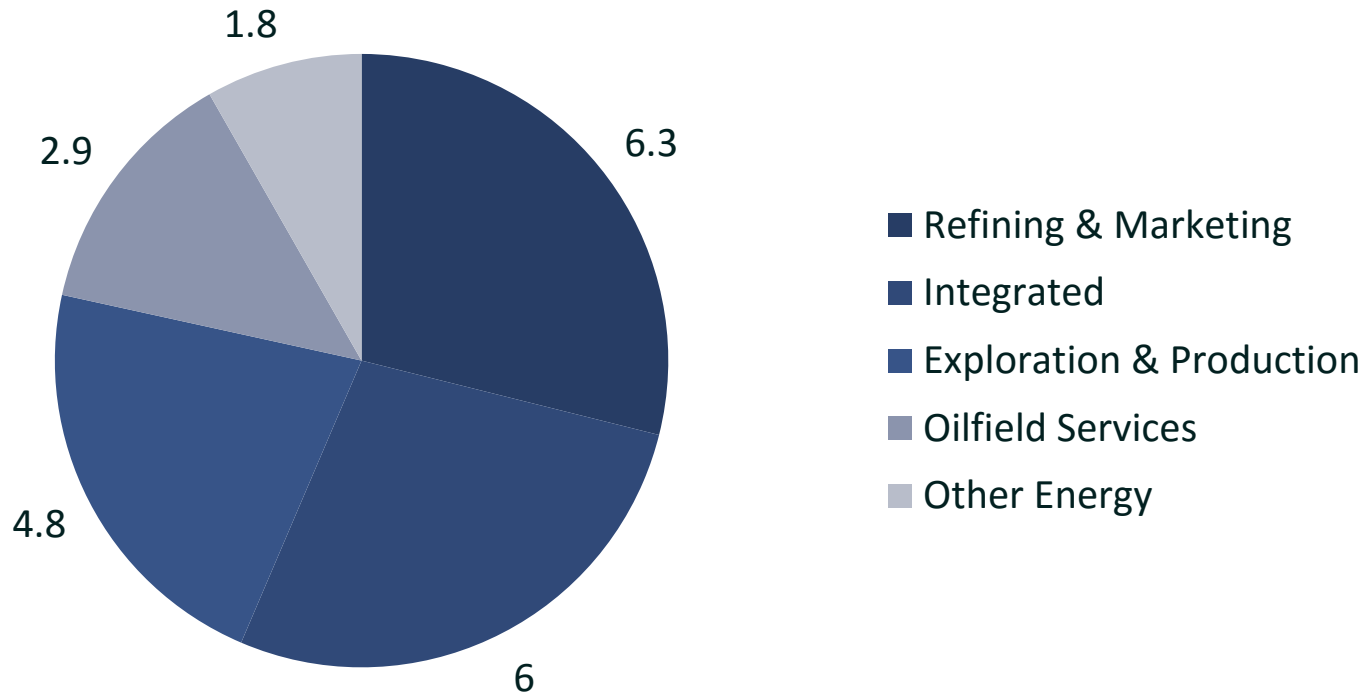


Source: First quarter results from JPMorgan, Bank of America and Wells Fargo; Bloomberg.

Bank of America's energy exposure

This is the breakdown of BofA's \$21.8 billion of funded energy loans

\$ billion

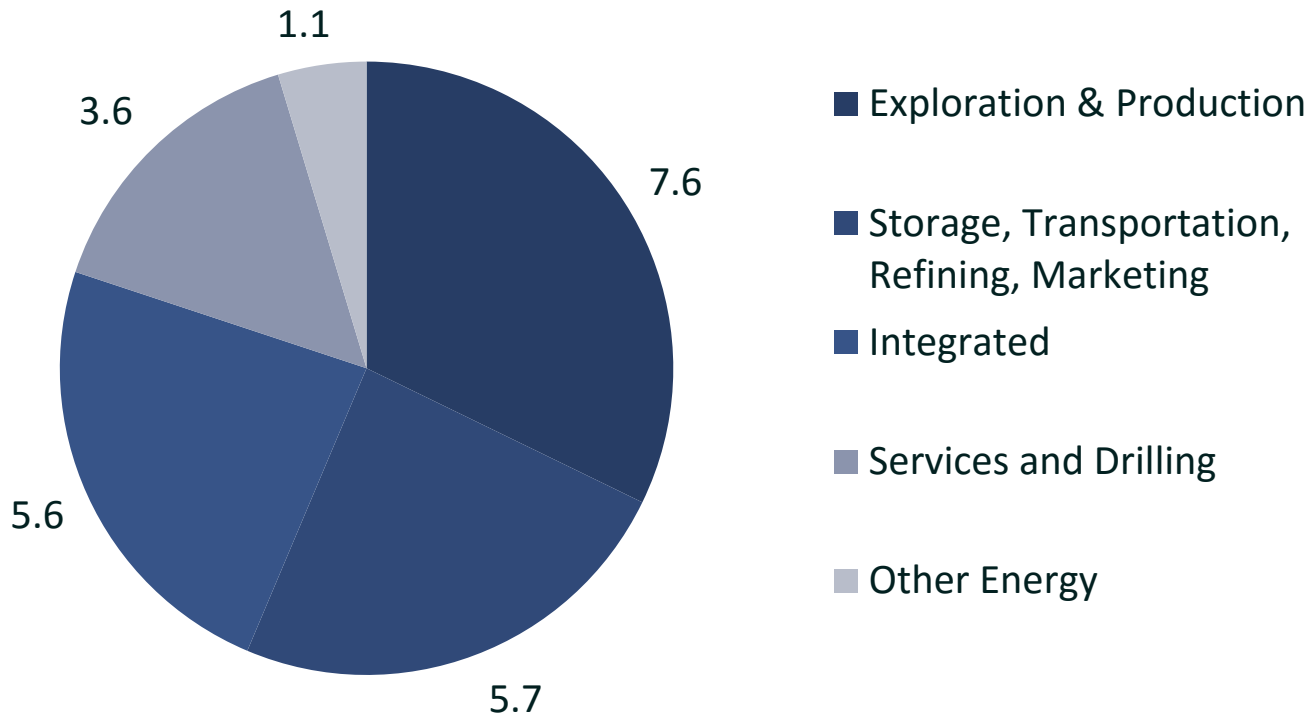


Source: Bank of America; Bloomberg.

Citigroup's energy exposure

This is the breakdown of Citigroup's \$23.6 billion of funded energy loans

\$ billion

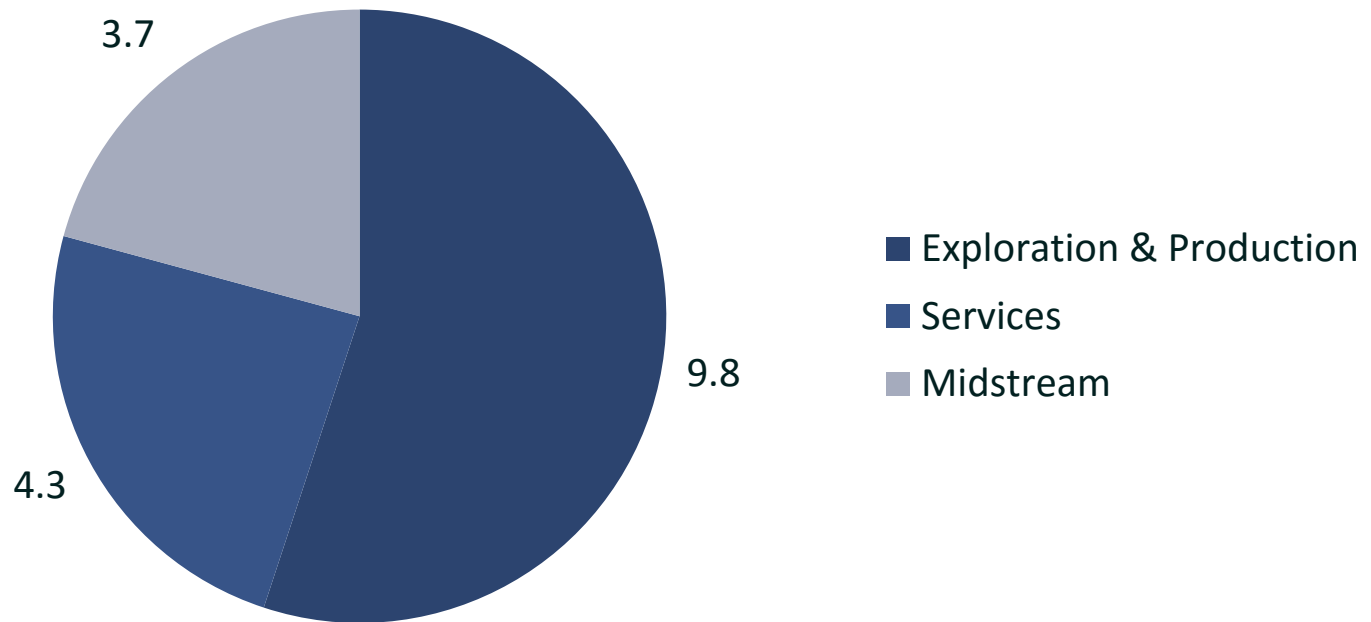


Source: Citigroup, 1Q16, combines GCB and ICG; Bloomberg.

Wells Fargo energy exposure

This is the breakdown of Wells Fargo's \$17.8 billion of funded energy loans

\$ billion

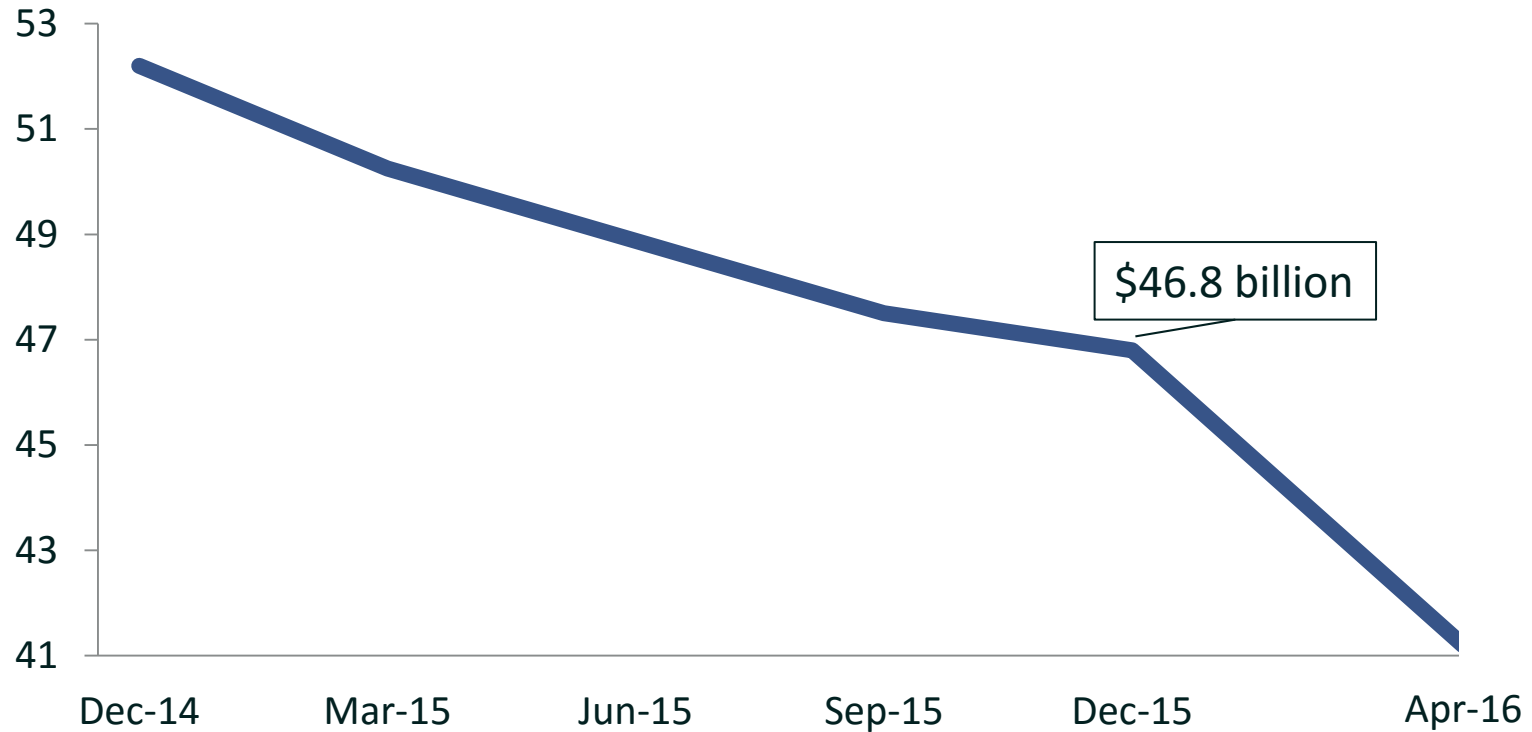


Source: Wells Fargo; Bloomberg.

Credit crunch

Lenders have cut oil and gas credit lines by more than \$5.6 billion this year

\$ billion

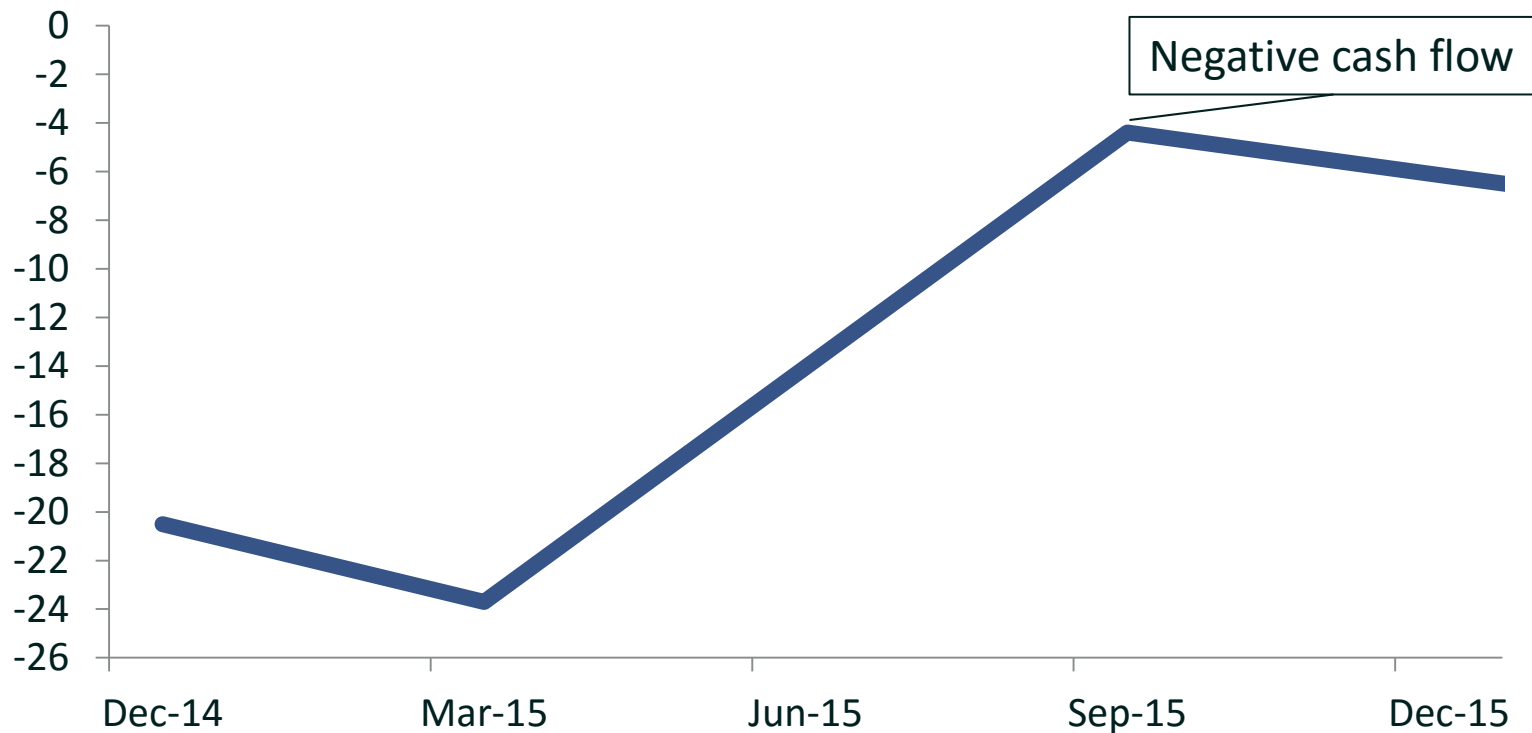


Source: Data compiled by Bloomberg on 36 oil and gas producers.

E&P operators' cash shortage

E&P operators still spend more than they take in despite slashing costs

\$ billion



Source: Data compiled by Bloomberg from SEC filings by 57 North American independent oil and gas producers.

Headwaters MB contact information

Headwaters MB has three distinct businesses

Mergers & Acquisitions

- Sell-side advisory
- Buy-side advisory
- Management buyouts
- Fairness opinions

Capital Raising

- Senior debt / Bank debt
- Mezzanine debt
- Equity
- Project finance / Infrastructure

Special Situations Advisory

- Refinancing / Restructuring
- Distressed / Bankruptcy
- Section 363 Sales
- Merchant Banking

Headwaters MB has closed over
\$8.4 billion in transaction value.

- One-quarter of our business is cross border
- Over 70% of M&A closings have been with strategic acquirers
- We maintain broad financial sponsor access – history with 1,900+ PE firms
- Valuation estimate exceeded 84% of the time

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OFS | ENERGY FUND



May 19, 2015

OFS Energy Fund Summary

- ◆ Investing out of our third fund (OFS Energy Fund III)
- ◆ \$175 million of committed capital
- ◆ Target energy service and equipment companies with Enterprise Values (EV) up to \$150 million for investments of equity (generally requiring control) of \$5-30 million per investment.
- ◆ Our capital is typically used to perform:
 - Buyouts
 - Recaps
 - Growth Capital
 - Rescues

Personal Background

Amegy

- 12 years with Southwest Bank / Amegy Bank, started in 1999.
- Co-founded the bank's energy service lending group.
- \$1.7 billion in commitments (eserv only) upon departure, March 2012.

Cadence

- Left Amegy in 2012 to start Cadence.
- Founded the Energy Lending effort.
- ~\$1.5 billion in energy loan commitments.

OFS Energy Fund

- Left banking for Private equity to join OFS Energy Fund, June 2014.

85% of my time in business was spent in the lending arena.

“May you live in interesting times.”

Since 1997, we’ve lived in interesting times:

- Asian Flu (‘97)
- Russian Default (‘98)
- \$10 oil (‘99)
- Y2K (‘00)
- The dot-com bubble burst (‘01)
- 9/11 (‘01)
- Enron/WorldCom (‘01)
- ‘02-03 gas cycle, conversion to oil rig count focus
- Merchant power bubble (‘02-03)
- Hurricanes Katrina & Rita (‘05)
- ‘05-07 capital sprint (Covenant Light & PIK Toggle)
- ‘08 Housing crisis
- ‘08 TARP
- Madoff/Stanford frauds ‘08-09
- ‘08-09 Hurricane Ike - Failure of Lehman, Merrill, Bear, Wachovia, WaMu, etc.
- ‘09 energy V-shaped recovery
- ‘10 European double-dip, Yankee Stadium torn down
- ‘12-14 shale boom
- ‘15-16 shale bust

What’s next?

If 2015 was the “year of losses” ...

... 2016 is likely “the lost year”.

How can you improve results from your business:

1. Increase Revenue – not possible in this environment.
 2. Improve Margins – requires cost/headcount reduction.
 3. Manage Working Capital – Clients are paying slower / carry A/P longer.
 4. Reduce taxes – not relevant with negative earnings.
-
- The only viable means to survival is to shrink the business / cut costs.
 - Cut from ~4400 to ~1760 employees (60% reduction).
 - Near bottom, losing employees to Wal-Mart at \$12-13/hr.
 - No expansionary capex committed during 2016.
 - Much of the service capacity built in 2014 won't be needed for years, if ever again.
 - E&Ps have gone from 6 to 4, to 3, to 2 vendors? Will they go to 1?
 - Does it matter? Effectively 0 via checkbook.

Capital Sources for a company

- Public equity
 - Closed – Most eserv co's are too small
- Public Debt
 - Closed – Too small, too volatile
- High-yield debt
 - Closed – Too small
- Uni-tranche lenders
 - Closed – Collateral issues
- Stretch lenders (BDC's & SBICs)
 - Closed – Too much variability in cash flows
- Second Liens
 - Closed – Not adequate collateral coverage
- Mezzanine
 - Sub-Optimal – expensive, fulcrum (counter) security
- Factoring
 - Sub-Optimal – Risk of robbing Peter's son to pay Paul
- PMSI
 - Open – collateral type is critical
- Vendor Financing
 - Open – Where a vendor needs the sale
- Bank Debt
 - Closed – paring back exposure
- Private Credit
 - Open – slow, time-consuming to close
- Private Equity
 - Open – expensive, selective, large opportunity set

Private equity works when other markets stop working.

Why is bank debt unavailable?

- In today's market banks are making <1.0% ROAs.

Bank	Symbol	TTM ROA	Payback (yrs)
Wells Fargo Co	WFC	1.34%	74.6
PNC Financial	PNC	1.18%	84.7
Regions Financial	RF	0.88%	113.6
Comerica Bank	CMA	0.74%	135.1
Zions Bank (Amegy)	ZION	0.53%	188.7
Average ROA		0.91%	109.6

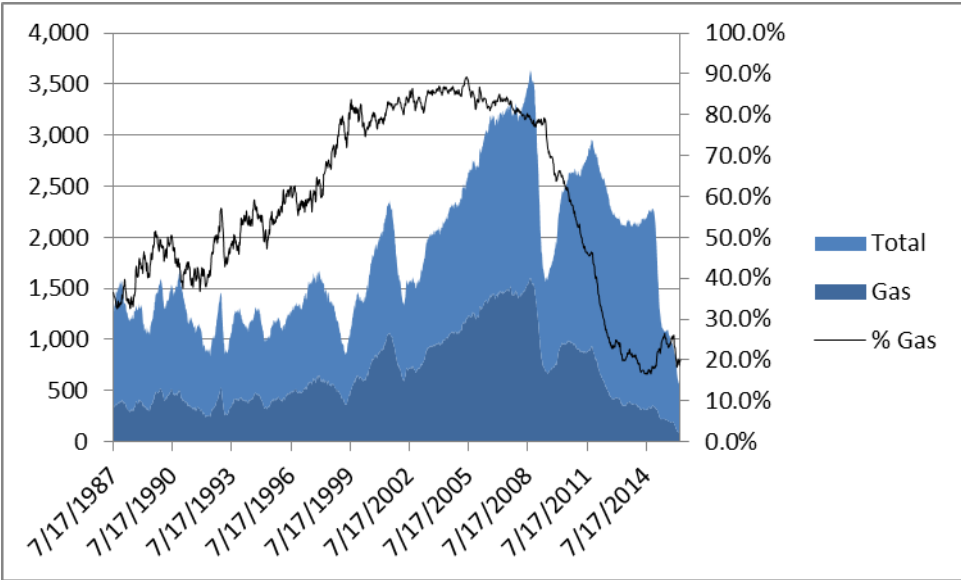
(Source: www.yahoo.com/finance)

- If a bank charges off \$1, need similar asset to work flawlessly for 100 years to earn back that \$1.
- Banks are not mean or overly cautious, they are not paid to take risk. The regulatory limitations will not permit a bank to increase returns adequately to take incremental risk.
- Given this return profile, banks are over-exposed to energy credit, particularly energy service.
- We are prepared for limited access to bank credit for 3-4 years (Eserv).
- Some of the major senior secured credit players may exit the business entirely (the origination teams have been sent to workout). >70% of their portfolios are already in workout.
- Bank loans – The best bank loan has three elements:
 1. Cash flow – typically requiring 6-12 months of proven performance.
 2. Collateral – will require demonstrated asset coverage.
 3. Guarantor Support – demonstrated liquidity and “willingness” to support the credit.

All will be required when bank lending returns to the space but it will take years for the banks to reduce their exposure adequately to re-enter the arena.

Gas Directed Rig Count Share

- Gas directed rig count has traditionally been a much larger share of the total rig count.
- It is hard to see much promise in the gas directed rig count in the near term.
- That being the case oil deserves the focus it has received.



What does the “end of the rope” feel like?

- Some business owners have been financing losses with cash collected from working capital contraction, that cannot continue.
- Working capital will be required to finance operations coming out of this cycle, whenever that occurs, and it will.
- If bank debt is not an option, first options?
 - Factoring – No covenants, only a validity guaranty and client confirmation of the A/R but selling your most liquid asset (A/R) for a discount (robbing Peter’s son to pay Paul) is precarious and potentially leads to a larger financing need in the future.
 - Asset Based Loans – wounded and hesitant (not unwilling) to return after this cycle. ABL lenders rely more heavily on assets to cover their loan, typically have a minimal fixed charge coverage ratio (1.05-1.10x). ABL lenders will need to see stabilization in asset prices. (No bidders in a recent auction in Calgary). Some may take a long break from the Eserv market.
 - Second Lien/Mezz Debt - Banks often preclude second lien/mezz for fear of creating a fulcrum security holder with counter interests. Acting like debt, when all others need equity?

What options remain?

- Private Credit – hybrid debt/equity security (debt with warrants). Non-regulated lenders. More challenging and expensive to arrange/negotiate. Limited alignment of interests so follow-on capital is always in question.
- Private Equity – typically seeking control, focused on multiples of return, offers more time and flexibility but it is the most expensive capital. More purely aligns interests and affords the company time to resolve its issues. Equity is expensive because it is invested when there are a lack of alternatives, specialized assets, or limited options for exit.

Private Equity's focus

- The who, not the what.
- Are we offering buggy whips?
- Do we have a business plan, or an employment plan?
- Is our plan fully funded?
- Does our plan incorporate liquidity needs?

Close the doors. Be fearful when others are greedy. Be greedy when others are fearful." - Warren Buffett



WHEN THE BANK
COMES KNOCKING

REALITY CHECK

- The bank will not renew the loan or will significantly amend the terms
- Your local bank contact is not in control of the relationship
- Bank portfolio decisions are made far removed from the business relationship
- Bank may start managing your cash flow for you
- Dilution is very likely

IT IS EXPENSIVE TO BE CASH POOR

- Bank may require a 3rd party advisor
- Bank could start tapering down the allowed amount on the collateral
- Returned working capital used to pay the loan down may not be available
- Cash is used for non revenue producing activities, accelerating cash squeeze
- Operations team will get distracted, impacting financial results
- Non banks institutions will be the source of new cash through high yield loans or equity or a combination

BE PREPARED AND PRO ACTIVE

- Plan for the worst and work for the best
- The longer the process the better the value you receive
- Rushing the process results in reduced pricing
- Accurate cash flow forecasting is a must
- Have a realistic view of value
- Many small to mid size shops have extensive access to non bank hard money or hi-bred arrangements

Running Out of Runway

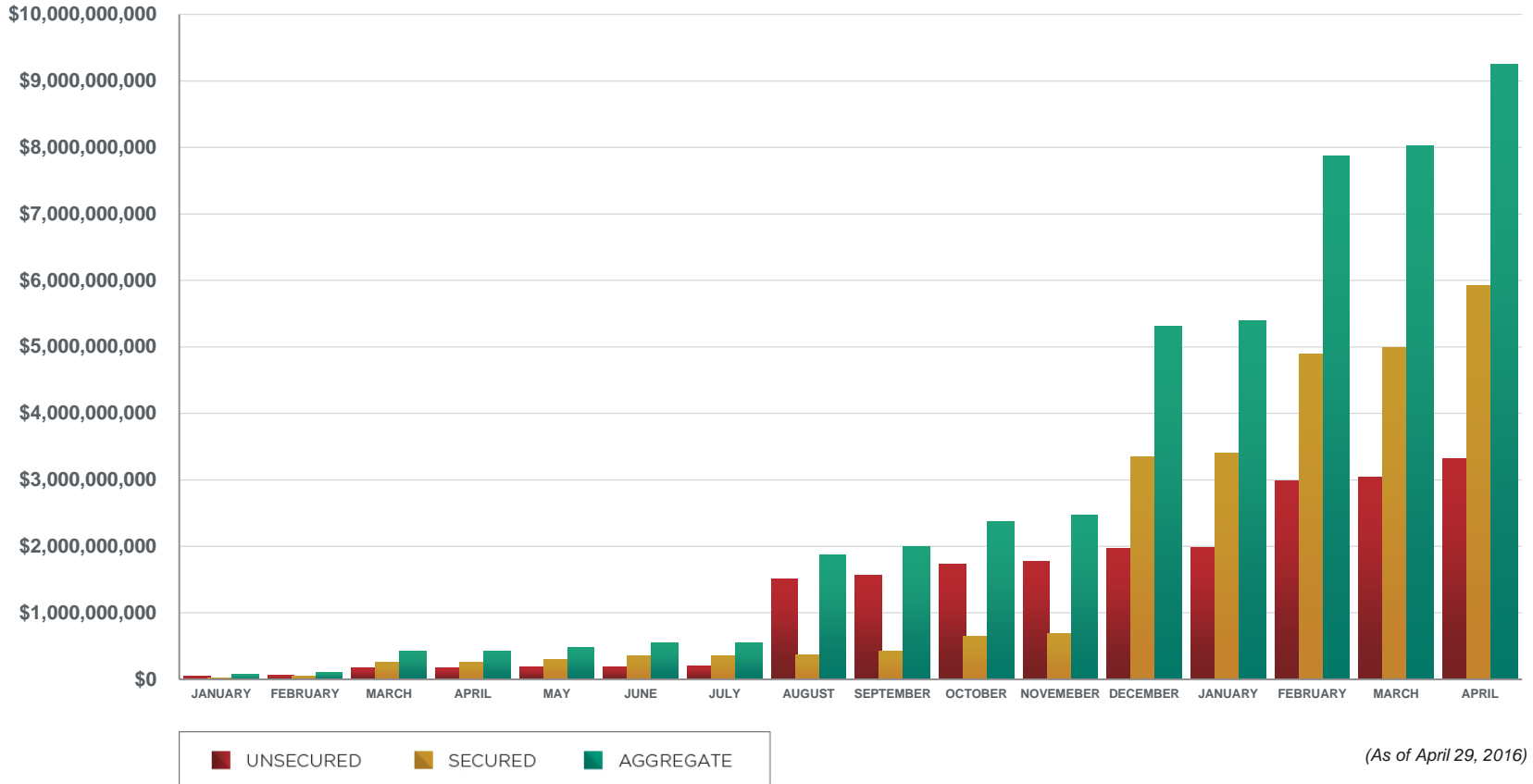
Bankruptcy Issues for Oilfield Service Companies

Kelli S. Norfleet
May 19, 2016

haynesboone

2015-2016 CUMULATIVE NORTH AMERICAN OILFIELD SERVICES UNSECURED DEBT, SECURED DEBT, AND AGGREGATE DEBT

HAYNES AND BOONE OILFIELD SERVICES BANKRUPTCY TRACKER



Why file bankruptcy?

- Liquidity problems resulting from decreased demand, increased pressure to slash rates for services
 - Covenant and/or payment defaults under secured credit facilities
- Stay creditors' pursuit of remedies to buy time
- Reject burdensome contracts
- Consolidate operations and sell non-core assets/business units
- Restructure pre-petition debt
 - Convert debt to equity

Exit Strategies

- Plan of Reorganization
- Section 363 Sale of Assets and Plan of Liquidation
- Conversion to Chapter 7

Differences in OFS Bankruptcies

- Enterprise value vs. asset value
- Demand for services significantly influenced by oil and gas price fluctuations
- Revenues can be controlled by project schedule delays
 - Financial performance can be difficult to predict → restructuring difficulty

Cal Dive International, Inc. (March 3, 2015 – Delaware)

- Pre-Petition Debt
 - First Lien Revolver - **\$99.8 million**
 - Second Lien Term Loan - **\$100 million**
 - Unsecured Convertible Notes - **\$86.25 million**
- DIP Facility
 - **\$120 million** – included roll-up of prepetition first lien debt and sale milestones
- Sale Process
 - Auctions resulted in sale of vessels and certain business units for total of approximately **\$47.5 million**
- Chapter 11 cases still pending

Hercules Offshore, Inc. (August 13, 2015 – Delaware)

- Pre-Petition Debt
 - Unsecured Notes totaling approximately **\$1.2 billion**
- Prepackaged Plan of Reorganization
 - General Unsecured Claims paid in full
 - Unsecured Notes converted to **96.9% of new equity**
 - Existing equity received 3.1% of new equity
- Plan confirmed September 24, 2015

Paragon Offshore plc (February 14, 2016 – Delaware)

- Pre-Petition Debt
 - First Lien Revolver - \$795.9 million
 - First Lien Term Loan - \$642 million
 - Senior Notes - \$983.5 million
- Pre-Petition Plan Support Agreement
 - First Lien Revolver – receive \$165 million cash, remainder converted to first lien term loan
 - First Lien Term Loan – reinstated
 - Senior Notes – receive 35% of new equity, \$345 million cash
 - General Unsecured Claims – paid in full
- Plan confirmation hearing set for June 21, 2016

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