

# Oilfield Services Seminar Series

## *Sorting M&A Targets Using Triage Due Diligence*

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# What is Happening in the Oil and Gas Markets

January 2016

**SRR**

**STOUT | RISIUS | ROSS**

Global Financial Advisory Services

IS ~~\$50~~...~~\$40~~...~~\$30~~ oil here to stay?

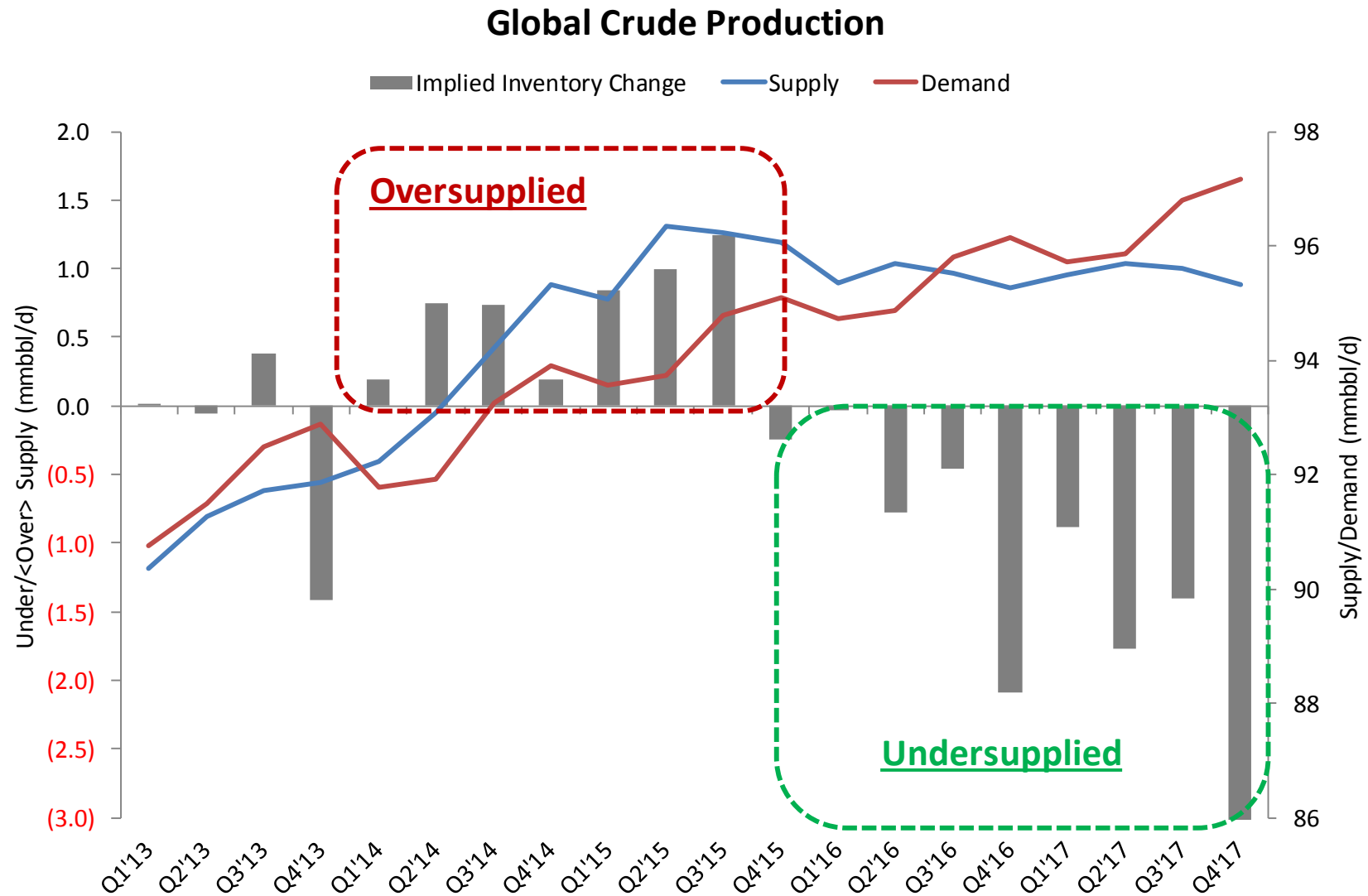


# What Traditionally Impacts the Price of Oil?

- Supply and Demand
- Global Political Stability
- The Strength of the Dollar



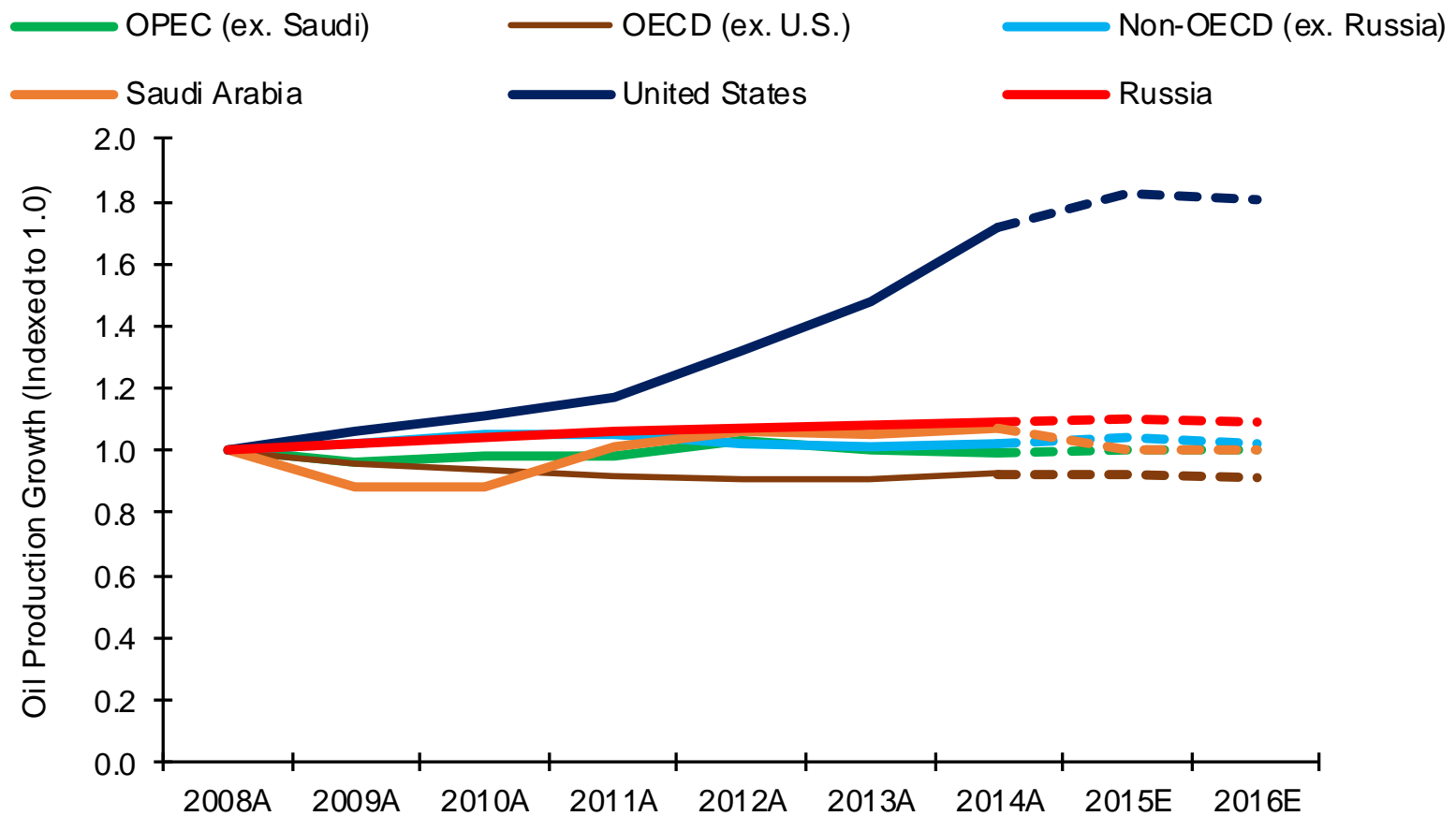
# Has the Supply Imbalance Reversed?



Source: EIA and Tudor Pickering

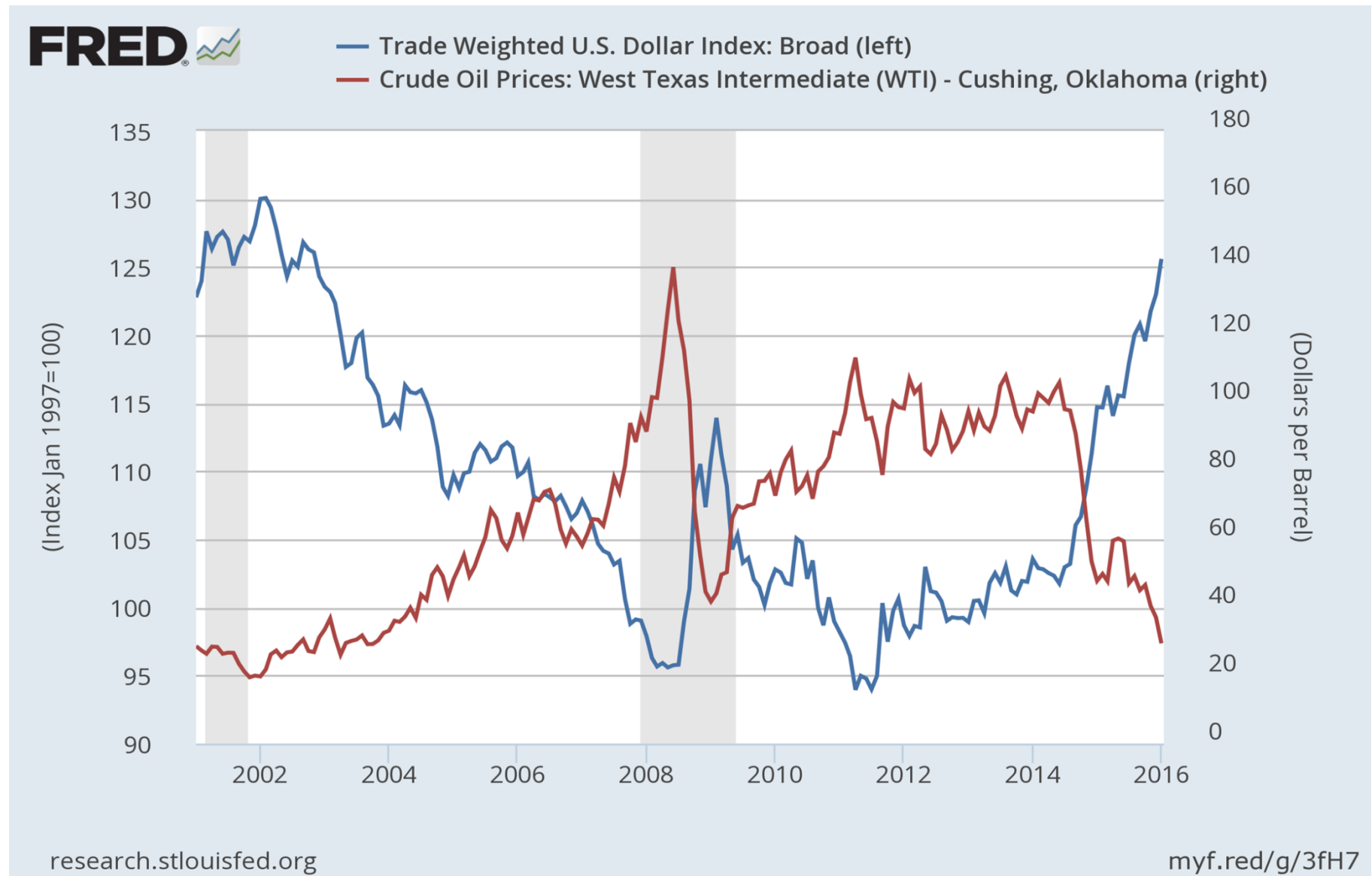
# Why Unrest in the Middle East is not Impacting Oil Prices This Time

## Oil Production Growth by Country/Region



Source: IEA, SRR.

# Relationship of the Dollar to Oil



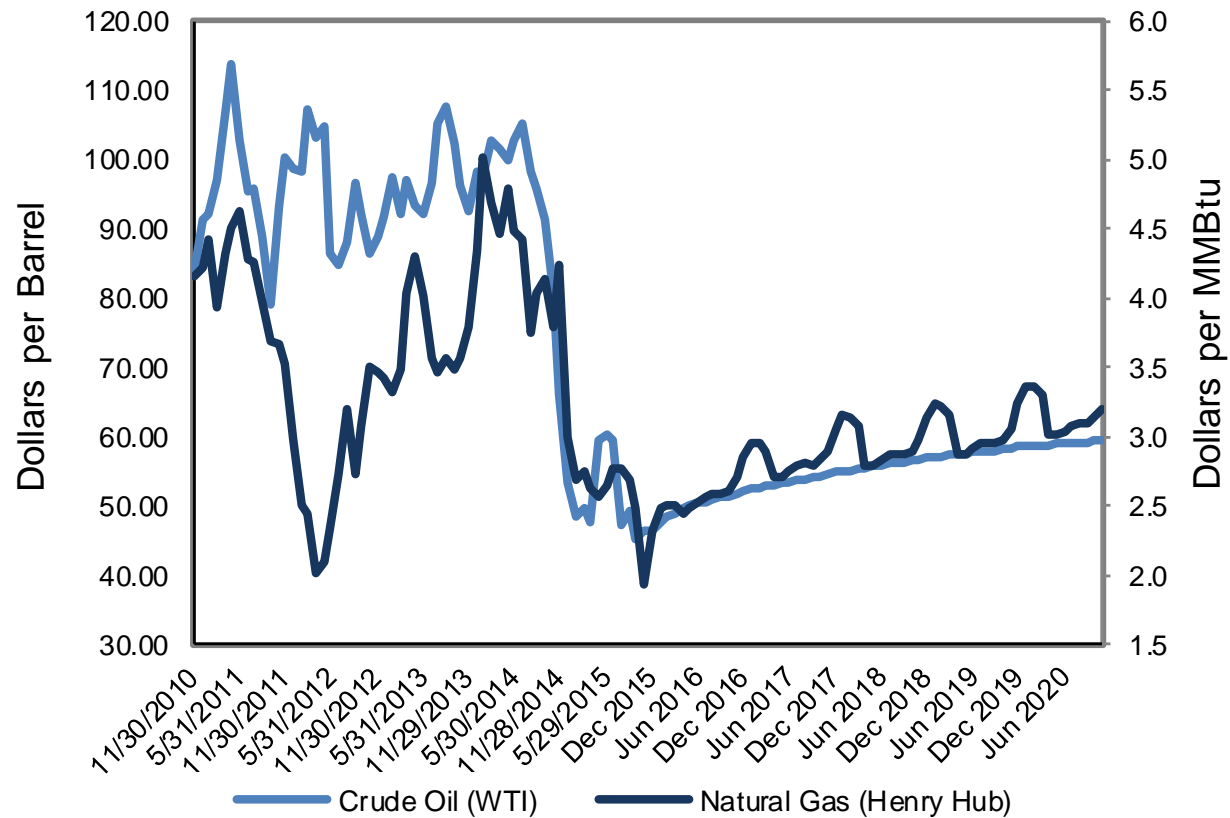
# The Strength of the Dollar Over the Last 10 Years





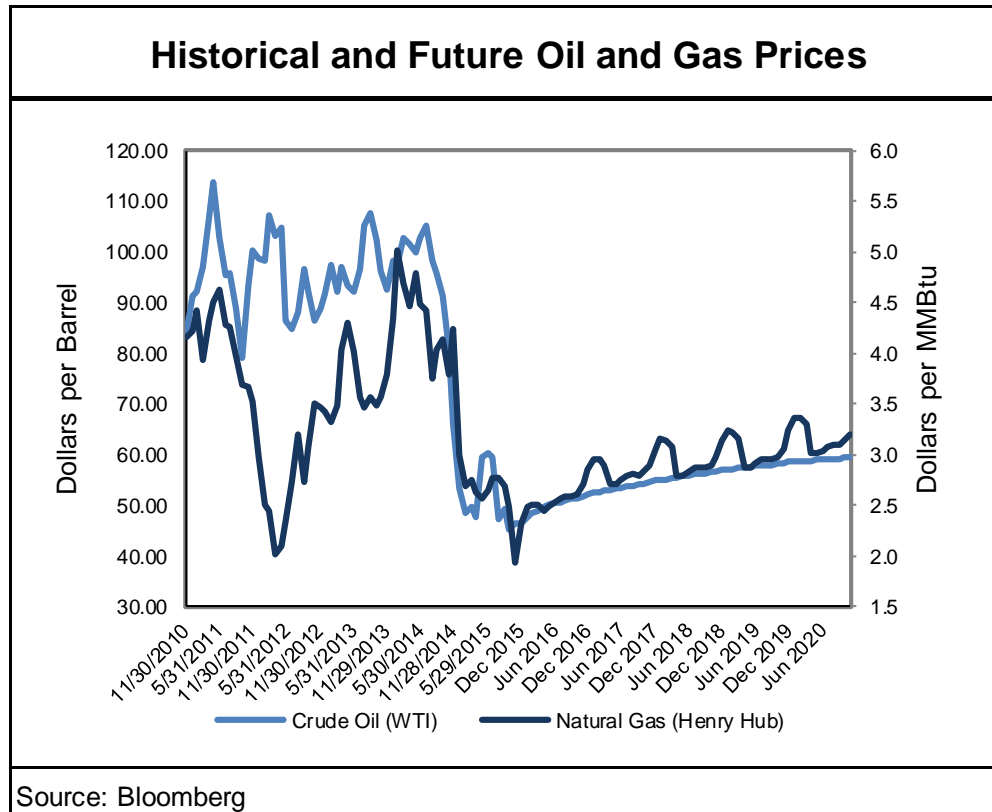
# Plateau?

## Historical and Future Oil and Gas Prices



Source: Bloomberg

# Plateau? I Wonder What is Just Outside the Picture Frame?



# Recovery Shape

V OR W OR L

# Predictions



**Raymond James** ... our model suggests the following: (1) oil prices should bottom in the first half (probably 1Q), and rise substantially in the back half, averaging \$50 WTI for the year but exiting the year closer to \$70

**Goldman** ... is standing by its prediction of \$20 a barrel bottom—the breakeven cash cost for highly levered high-cost US shale producers.

**Tudor Pickering** ... Tudor, Pickering, Holt & Co., talks with KHOU about his prediction of higher oil prices by the end of 2016. (Rise range is \$70 – 85)

# Predictions



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**EIA** ... These levels established the lower and upper limits of the 95% confidence interval for the market's expectations of monthly average WTI prices in April 2016 at \$25/b and \$56/b, respectively. The 95% confidence interval for market expectations widens over time, with lower and upper limits of \$22/b and \$82/b for prices in December 2016.



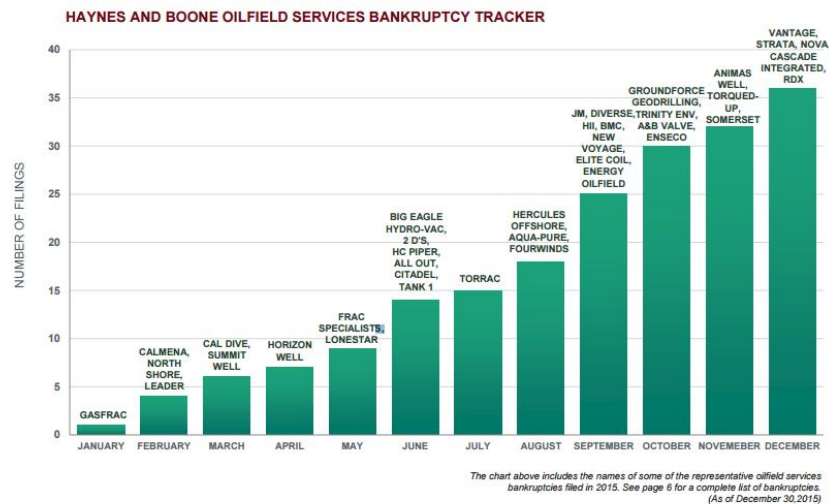
Is the time ripe?



# 2015 Cumulative Energy Bankruptcy Filings

- 42 E&P Companies with over \$17 billion in Debt
- 39 OFS Service Companies with over \$5 billion in Debt

CUMULATIVE NORTH AMERICAN MIDDLE-MARKET OILFIELD SERVICES  
BANKRUPTCY FILINGS IN 2015

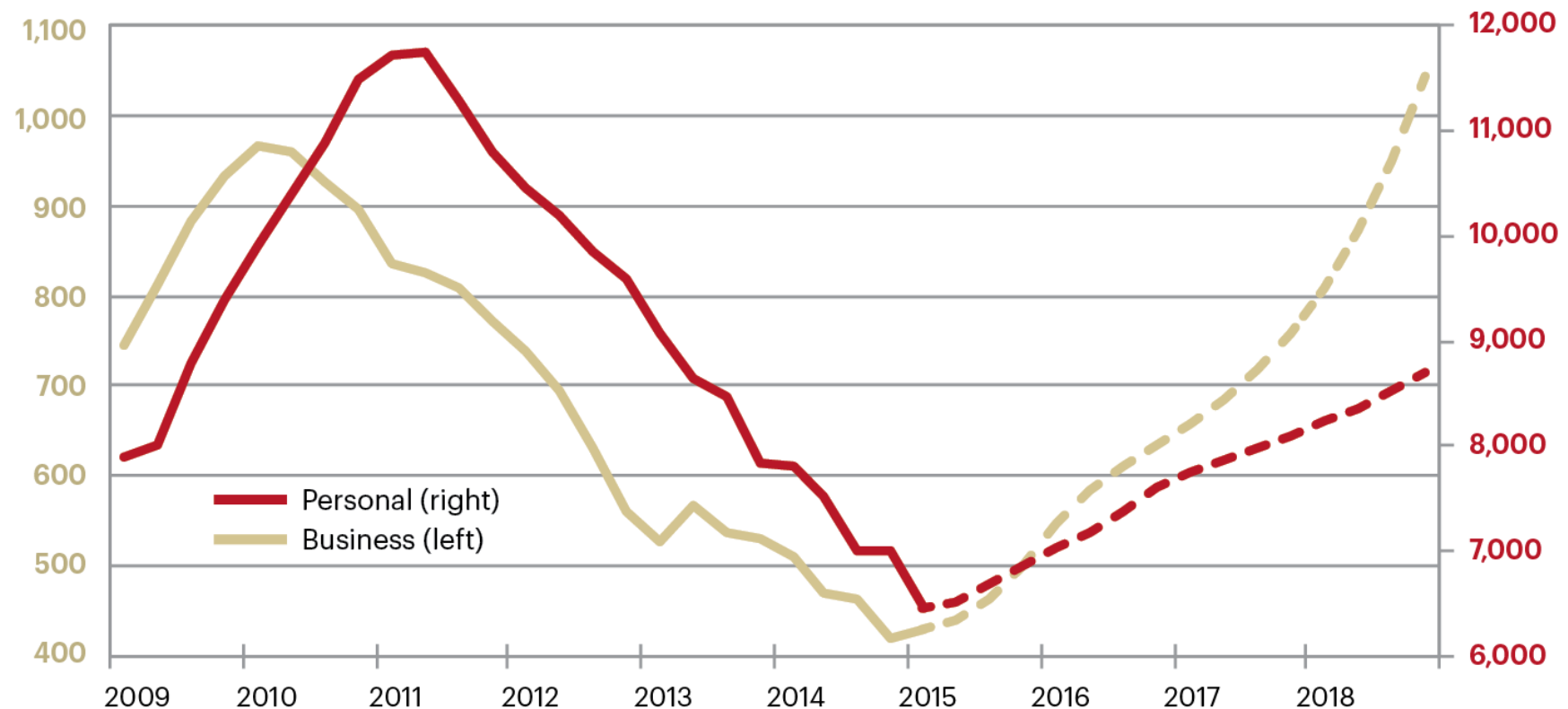


HAYNES AND BOONE OILFIELD SERVICES  
BANKRUPTCY TRACKER

Source: Haynes & Boone and Oil Pro

# Comerica's Prediction of Bankruptcies in Houston

## NUMBER OF PERSONAL, BUSINESS BANKRUPTCIES IN HOUSTON TO INCREASE



NOTE: DATA IS FROM THE FIRST QUARTER OF EACH YEAR AND REPRESENTS THE 12 MONTHS PRIOR.

SOURCE: COMERICA BANK'S REGIONAL ECONOMIC UPDATE REPORT ON THE HOUSTON AREA



# OPEC, the Russians and a Texan Together in the Soup Line...



# Free Market System at Work

- ✓ Drilling programs have been vetted and companies will only drill in the most cost effective locations
- ✓ Costs in the field have been reduced
- ✓ Consolidation plays are beginning to emerge
- ✓ Money that has been sitting on the sideline beginning to engage
- ✓ As the supply imbalance is reduced, the price of oil will begin to drift up until it reaches the cost of a marginal barrel, estimated to be in the range of \$65 to \$70 per barrel

So get ready, or you may miss the opportunity to get the bargains...

# Challenges that present opportunities

- ✓ Continued pressure from lenders.
- ✓ E&P development budgets are expected to be reduced even further than the already reduced 2015.
- ✓ Oil field service companies have given all they can give, so further price concessions are not likely.

So now is now a good time to engage

# What makes my money better than someone else's?

- ✓ Speed! How fast can I help them find a solution.
- ✓ Rebound insurance... what can I give existing stakeholders that gives them a hope in the future
- ✓ Lender confidence that a new sheriff is in town
- ✓ Flexibility

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# Lemons to Lemonade: Buying Distressed Debt – Diligence and Other Considerations

Neal Kaminsky | Partner

*haynesboone*

# “Houston – we got a problem, so what’s the plan Stan?”

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- Distress in an economic downturn opens up the window of opportunity – uncovering the gem among the rocks does not have to be a mirage in the desert
- You have identified an opportunity. What’s the story? Industry problem or company centric problem, bank portfolio problem, or combination of any of those three
- Sign a confidentiality and non-disclosure agreement to get your hands on the loan papers.

# “Kicking the Tires”

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Zero in on the capital and debt structure – know where the hot points are located. Who are the lenders and have you worked with them before? Presume the bank debt has been moved to the bank’s special assets group

Questions to focus on and hot points to look at include:

- ☐ What are the defaults (payment, covenants, both)?
- ☐ Is there a forbearance agreement in place and if so, what are the terms?
- ☐ Has the debt been accelerated and has the lender begun foreclosure remedies?
- ☐ Do the loan documents contain any restrictions on bank assignment/sale of debt?
- ☐ Financial statements (audited, reviewed, compiled) and are there any charges to be aware of?
- ☐ Have prior or current taxes been paid to date? The tax man cometh....



# “Kicking the Tires”

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- ❑ If there is other debt involved, are there subordination agreements or intercreditor agreements in place?
- ❑ What are the terms and are there standstills or debt purchase options in intercreditors?
- ❑ Where are the assets located (personal property and real property)
- ❑ Major account debtors and ability to contact them
- ❑ For leased property or warehousemen arrangements, are there landlord waivers or collateral access agreements in place to confirm access to collateral, and if so what are the terms?
- ❑ Show me the money – where are the bank accounts (at lender or third party bank(s)? Are there DACA's (deposit account control agreements) in place and if so, what are the terms?
- ❑ Where is the possessory collateral (i.e., stock certificates, pledged investments, pledged notes, etc.) and are there property transfer powers or endorsements in place?

# “Kicking the Tires”

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- ❑ Any recent field audits, collateral exams or equipment appraisals?
- ❑ For real estate collateral, are there title policies, surveys, environmental reports, appraisals) – look for reliance letters for appraisals/environmental reports
- ❑ Order and review updated lien searches. Are all of the liens properly perfected?
- ❑ Any litigation or governmental investigations pending or looming?
- ❑ Status generally of operations, employee retention issues?
- ❑ Review the covenant package

# “Now what do we do? Go/No Go?”

- Let's presume it's a “Go” and proceed with the debt purchase documents
- Assignment of Note(s) and Liens
  - Customary reps/warrants typically provided (own the debt, authority to sell the debt, and amounts outstanding)
  - Get the original loan documents at the closing or as soon as possible thereafter
- Okay, you own the debt, now what do you do? Depends on the timing of implementing your solution and your purpose in buying the debt



# Go!

# “Other Considerations”

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- Understanding the capital structure
  - Who are the players and who is the management team? Any changes needed?
  - What does the equity look like and are there different species of equity (common, preferred, convertible, subordinated) and are there any warrants or other options hanging out there (look at shareholder and voting agreements, if any)
- Evaluate the management and are any financial advisors and/or interim financial or restructuring officers in place?
- Financial controls in place? Leaks in the pipes?
- Cash burn rate and liquidity needs to keep the business running
- Cap-X plans
- Major customers? Working the phones
- Licenses and permits up to date?
- Books and records up to date?

# Examining Trade Secrets: Protectable? Protected? Lost?

Yasser Madriz | Partner

*haynesboone*

# WHAT IS A TRADE SECRET?

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- Depends on when you ask:
  - Prior to (even if continuing after) September 1, 2013 → Common law definition
  - After September 1, 2013 → TUTSA definition



# WHAT IS A TRADE SECRET?

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## *Common law definition:*

“[A]ny formula, pattern, device, or compilation of information which is used in one’s business and **presents an opportunity** to obtain an advantage over competitors who **do not know or use it.**” *In re Bass*, 113 S.W.3<sup>rd</sup> 735, 739 (Tex. 2003).

# WHAT IS A TRADE SECRET?

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## *TUTSA Definition:*

“Information, including a formula, pattern, compilation, program, device, method, technique, process, financial data, or list of actual or potential customers or suppliers, that:

- a) derives independent **economic value**, actual or potential, from **not being generally known** to, and **not being readily ascertainable** by proper means by, other persons who can obtain economic value from its disclosure or use; and
- b) is the subject of efforts that are reasonable under the circumstances to maintain its **secrecy.**” TEX. CIV. PRAC. & REM. CODE § 134A.002(6).



# WHAT IS A TRADE SECRET?

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***Increasingly, a business's main asset is its intellectual property.***

# WHAT IS TRADE SECRET MISAPPROPRIATION CASE?

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- **Employer vs. Former Employee**
- **Business A vs. Business B**
- **Business A vs. Former Employee and Business B**



# PROTECTING TRADE SECRETS



"I KNOW PASTEUR DIDN'T WORK UNDER THESE CONDITIONS, BUT PASTEUR DIDN'T HAVE FIFTY COMPANIES TRYING TO STEAL HIS TRADE SECRETS."

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# EFFORTS TO MAINTAIN SECRECY

- NDAs with customers, vendors, other third parties
- NDAs with employees
- Company policies regarding protecting trade secrets and other confidential and proprietary information
- Limited access to trade secrets by company personnel
- Password protections, encryption, and other virtual security measures
- Security cameras and other physical security measures
- Employee training
- Visitor log books
- Confidentiality designations on documents
- Use email footer stamps
- Litigation when necessary



- Translating Strategy into Action
- Next Steps

Text appears on all slides

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**NON-DISCLOSURE AGREEMENT**

This Agreement is made on DDMMYYYY

**BETWEEN**

[The Disclosing Party]

**AND**

[The Receiving Party]

**Reference:** Information related, but not limited to, development projects and assignments to be performed by the Reagent for the Company.

The Company possesses competitively valuable Confidential Information (as hereinafter defined) regarding its current products, future products, research and development, and general business operations. Recipient may enter or has entered into a business relationship with the Company and is therefore bound to maintain the confidentiality of the Company's Confidential Information and Materials or to create new Confidential Information and Materials for the Company. In consideration of the premises and covenants contained in this Agreement and the disclosure of Confidential Information and Materials from the Company to the Recipient, the parties hereto agree as follows:

**1. Confidential Information and Materials**

1a. "Confidential Information" shall be written in different parts. Continue writing confidential information and relevant materials of this non-disclosure agreement template. "Confidential Information" shall be written in different parts. Continue writing confidential information and relevant materials of this non-disclosure agreement template. "Confidential Information" shall be written in different parts. Continue writing confidential information and relevant materials of this non-disclosure agreement template.

# DUE DILIGENCE CHECKLIST

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- **Step 1 - Protectable:** Identify the target company's trade secrets.
  - What does target company consider its trade secrets?
  - What does buyer consider to be the target's trade secrets?
  - Determine whether they are protectable under the law?
- **Step 2 - Protected:** Identify efforts of target company to protect trade secrets.
  - Existence of NDAs with employees, customers, vendors, other third parties
    - When required? Signed? Scope? Duration? Enforcement?
  - Efforts to maintain secrecy
  - Previous litigation over trade secrets
  - Check public facing documents/information.

# DUE DILIGENCE CHECKLIST

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- **Step 3 - Lost:** Determine whether target company has lost trade secret protection and whether it impacts deal.
- **Step 4:** Take all necessary steps to protect trade secrets post-closing
  - Proper assignment of NDAs, execution of new NDAs (or employment agreements), implementation of new policies or security measures.



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