

10 Predictions for Middle Market Oilfield Services Companies in 2016

January 4, 2016

PRACTICES Energy Finance, Energy, Power and Natural Resources, Oil and Gas, Restructuring

If 2015 is considered to be the “Year to Amend and Extend,” then 2016 is setting up to be the “Year of Reckoning.” Last year began with high hopes for a reset to the oilfield activity levels of mid-2014, which did not materialize. Market conditions appeared to stabilize in the middle of 2015 at an activity level to support an oil price of \$60 per barrel, but that stability did not last long since 2015 concluded with oil below \$40 per barrel. The oilfield services sector is no exception to Darwinism – the weakest middle market companies did not survive in 2015 and it is likely that more will not survive in 2016.

Reduced commodity prices and over-leverage are cutting a huge swath in capex budgets for exploration and production customers. Overcapacity and over-leverage are cutting an even larger swath through middle market oilfield service companies. As oil remains an essential global commodity, history tells us that the price will rebound. The downturn’s carnage creates enormous opportunity for resolute, competent, well-capitalized middle-market oilfield service companies. So, what is predicted to happen in 2016?

1. Middle market oilfield services (“OFS”) companies will see a significant contraction in business.
2. Middle market OFS companies that enter bankruptcy under anything other than a pre-packaged bankruptcy will liquidate, not reorganize.
3. Many OFS companies will simply close their doors.
4. E&P customers will consolidate in M&A transactions to cut overhead.
5. E&P customers will sell assets to deleverage and only maintenance service work will be ordered on assets that will soon change hands.
6. As a result of M&A transactions and asset sales, many established relationships with E&P customers will be disrupted.
7. Oil is still the world’s transportation fuel. E&P customers will still buy efficient services (doing more for less).
8. The federal regulatory environment will continue to target the energy industry.
9. Equity will enter OFS to fund solid management teams to buy assets and businesses at fire sale prices.
10. The OFS industry may well bottom out in 2016, and start to recover in the second half of 2017 (unless current depressed oil prices do not result in E&P companies reducing supply).

Practical Considerations

The fat was trimmed in 2015, so what’s next?

1. **TIME FOR A CHECK UP.** The Department of Labor, Environmental Protection Agency, Occupational Safety and Health Administration and Department of Justice are active in the

oilfield service industry. Consider being proactive in ensuring regulatory compliance.

Compliance is like dental work – it is much better to get the semi-annual check-ups and fill the cavities. Do not ignore preventive steps until you need a root canal.

2. **THE 7 P's.** Liquidation can be a controlled crash or an explode and burn experience. Prior planning and preparation is the difference between the two. Consider crafting a well thought-out liquidation plan and have it prepared in your desk drawer.
3. **ORGANIZE A YARD SALE.** Holding any unpromising assets? It may be best to consider selling them – remember that one man's trash is another man's treasure.
4. **PREPARE BEFORE A DEFAULT.** Remember the 7 P's! It is much better for a company to restructure its debt outside of bankruptcy before there is a default. Many options are possible while an OFS company is still complying with debt covenants; however, those options dramatically decrease post-default.
5. **CALL FOR BACKUP.** Unless you have substantial dry powder, think about finding a private equity backer. Being a consolidator is much better than being someone else's synergy.
6. **BE ON THE LOOKOUT.** Consider preparing a list of your competitors' assets and businesses that could be game changers. Determine the maximum price that you would pay for those assets and then monitor for your chance to purchase them.
7. **TRIAGE YOUR ACQUISITION DUE DILIGENCE.** Deliberately organize your due diligence process. Organize using a triage approach to efficiently reach early go/no go decisions. In Tranche 1, start with areas of frequently encountered concerns that kill deals. In Tranche 2, move to areas of concern that are not fatal but that run up the cost of acquisition. Finally, in Tranche 3, conduct full blown due diligence on deals that you plan to close.
8. **EXAMINE YOUR COMPANY.** Run your reviewed and organized due diligence process on your company and fix defects so that you are ready to move fast and confidently when merging or raising equity.
9. **TRIM WITH TECH.** Consider looking at technologies outside of the energy sector that may be adapted to your business to take out significant costs in providing oilfield services.
10. **PLAN AHEAD.** Develop and implement a comprehensive plan of integration for acquired businesses so that the company is ready to come out of the gates quickly and position itself for success in the second half of 2017.

Quadrant of OFS Companies by Capital Structure

Conclusion

Although none of us can control commodity prices, we can control how we spend our time. It is important to hope for the best and be prepared for the worst.

For more information, please contact: