Gaffney, Cline & Associates

Opportunities to Transform Portfolios in 2015
Latest Trends in M&A Markets

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Disclaimer

This set of presentations has been prepared exclusively for discussion purposes during this event. The materials presented should not be understood as GCA forecasts or predictions of oil and gas prices or future industry conditions and they should not be understood as a specific recommendation in respect of any particular decision or course of action.

Today's Agenda

- Impact of Oil Price Changes on Acquisitions and Divestitures (A&D)
- Asset Divestitures
  - Major Players
  - Asset Types
- Corporate Acquisitions
- How E&P Portfolios May Change in 2015-2017
- Operated versus Non-Operated Opportunities

Is power in A&D moving from sellers to buyers?

2009-2014 : A Personal Look Back Over the Last 5 Years

- **Flurry of acquisitions in North American unconventionals with concurrent departure of many U.S. and Canadian independents from international arena**
  - Many unconventional acquisitions led to large write-downs as U.S. gas and then oil prices declined (**Warning**: U.S. SEC 2014 Standard Measure of Oil and Gas (SMOG) tests @ >$90 oil)
- **Large number of late-life assets offered but many did not find buyers**
  - Abandonment issues and high operating costs
  - Shortage of can-do operators and need for new ideas
- **Q4 2014-Q1 2015 deals hit hard by price uncertainty; sellers' book values often higher than bidders' price decks due to oil futures market**
  - Even good quality assets, very well presented, did not sell (but they will)
  - Nigeria an exception as majors continued exit from coastal assets where independents' purchases now > $10 B of assets and still rising
- **Recent convergence in oil price perceptions triggering renewed 2015 A&D activity**
  - Asset quality on offer is increasing: projects have top quartile reservoirs and volumes
  - Buyer universe diversifying: sovereign wealth funds, private equity, selected utilities, contractors, and infrastructure funds
  - No cash shortage; $ trillions potentially available for investment

Sharp decline in 2015 oil revenue as Brent fell to $50-60 / bbl

- A 50% decline in oil price on 90 MM BOPD
  = **$1,643 B drop in gross annual cash flow**
  Oil-indexed gas revenues decline too
- Previously planned 2015-2017 capex investments exceeded revenues
  - Dividends (and executives!) at risk
  - Debt & ROACE become more prominent
- **Industry response is to cut capex** by ~20% or $100 B / year in 2015
  - Similar $100 B expected in 2016
  - Industry payrolls decline by 100,000+
- **Asset divestitures** by all sizes of players at a rate of **$100 B / year**
  - Majors alone promise $100 B in asset sales in 2015-2017
- **Industry consolidation diversifies**
  - Talisman, BG, Pacific Rubiales, Rosetta Resources, Dragon……

Asset divestitures by majors and equity stakes up for sale

- Majors selling ~$100 B of upstream, midstream, and downstream assets or equity stakes in next 3 years
- Some mature assets or non-operated stakes
- Equity in capital-intense mega-projects, e.g. LNG, with customer synergy
- Legacy ownership of pipelines, terminals, and midstream processing no longer viewed as core

12 February: **Total** accelerating plans to sell assets between 2014 and 2017..intends to offload $5 B worth this year.

11th March: **Chevron** plans $15 B in asset sales through 2017 … to maintain a strong dividend

13 March: **ENI** plans to sell $8.5 billion of assets over the next four years

8 April: **BG** prospectus – Shell expects asset sales from combined entity to total $30 billion for period 2016 to 2018

Infrastructure for sale: BP portfolio to be “smaller, simpler, and more focused”

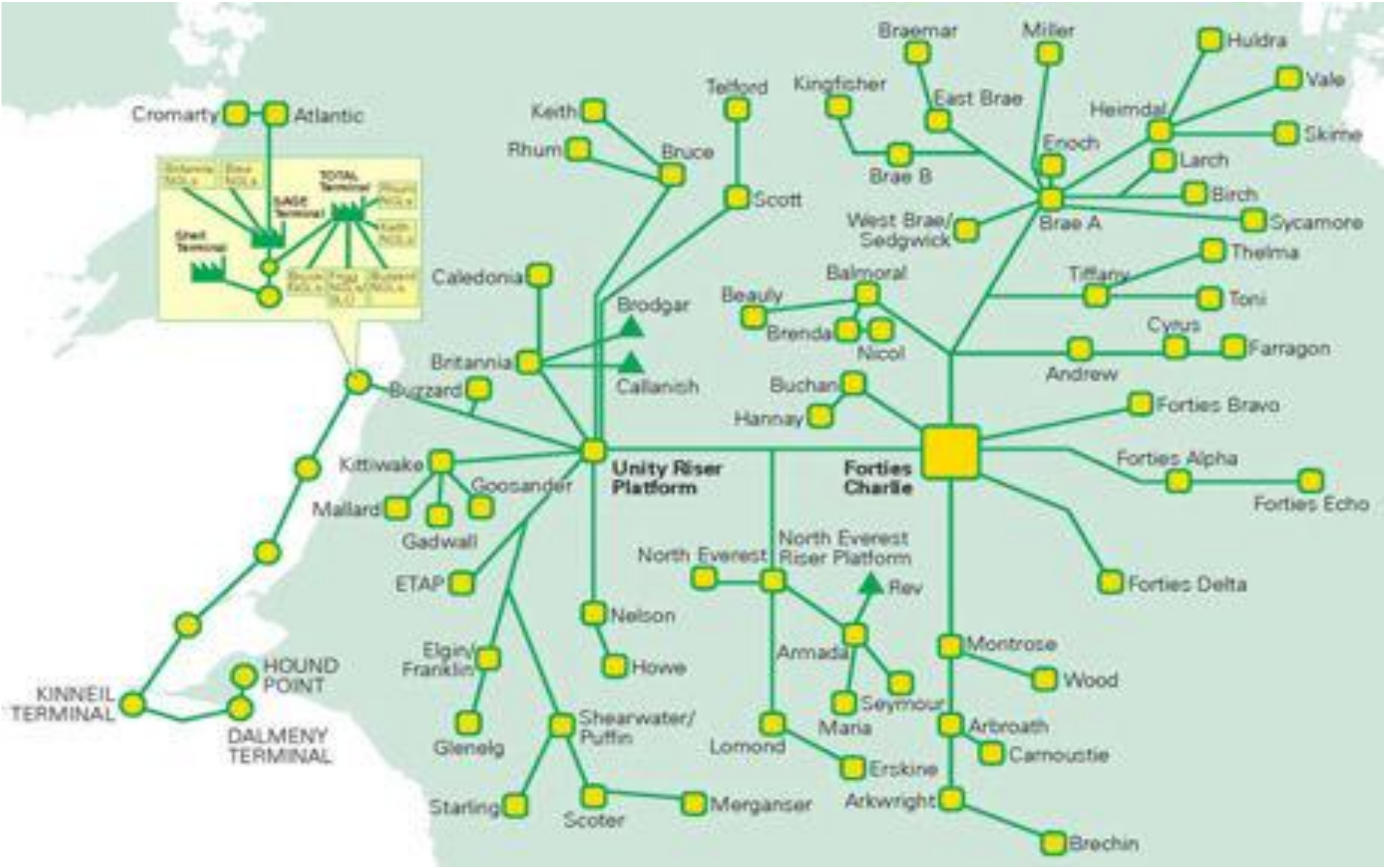
BP Company Statements, March 2014

- “In the Upstream, since April 2010 we have removed around 50% of our installations, 35% of our wells and 50% of our pipelines. This has significantly reduced complexity while only divesting around 10% of our reserves base.”

- “Active portfolio management means we will keep our portfolio constantly under review, looking for ways to refresh and optimise the portfolio. …. As you are already aware, we have announced that we plan to make a further $10 B of divestments by the end of 2015.”

BP equity in UK CATS pipeline sold in April 2015 to Antin Infrastructure Fund; expect more midstream sales to follow in coming years – Forties pipeline?

BP equity barrels throughput on BP-operated Forties pipeline has fallen dramatically in last few years



Original design capacity was 900,000+ BPOD; utilization has fallen from ~60% in 2009 to 38% today, and there is currently only 8% BP-operated production

Source: BP

Corporate Deals: target synergy or distressed companies?

- **Distressed E&P companies**
  - Financial analysis of share price declines, debt maturity, and Executive and Board level changes will highlight needs
  - Buyers' turnaround skills paramount
  - Better option: **selectively acquire robust assets** to ensure attractive returns

- **Marathon North Sea Division sale, June 2014 (@ Brent ~$110 / bbl)**
  - Mix of well-run, early maturity Norwegian assets, FPSO, subsea, late maturity UKCS high cost assets, and older fixed platforms
  - Target sale was a single transaction; bids focused on Norwegian unit (~$2.1 B net)
  - UKCS abandonment risks / costs not matched with long term growth plans via IOR, EOR, or revitalized hub management strategy; will assets be offered again?

- **Strategy / synergy-driven *proposed* corporate deals**
  - **Shell purchase of BG portfolio**: asset rich, cash-flow poor, with major scope for best of both (limiting gas-on-gas value destruction) plus $30 B of asset disposals
  - **Alfa / Harbour Energy purchase of Pacific Rubiales**: cash injection into capable Latin America-focused independent; positioned for Mexico "opening" opportunities
  - **Noble acquisition of Rosetta Resources**: optimised technology to drive improved margins in Eagle Ford and especially Permian tight oil in current lower price regime

Decline in Oil, Gas Prices stimulating Portfolio Change

	Majors, Near Majors	Utilities	Frontier Explorers	Unconventional
Drivers	Regain Margins	Renewables oust HC hedge	Farm-out, Equity, Debt options decline,	Costs > Prices
Actions	$5B/year sales to 2017	Spin off upstream	Slash exploration focus on appraisal	1000 rigs cut, delay frac completions
Opportunity	Non-core asset sales	Buy E&P co, optional IPO	Asset or Corporate sales	Acquire core areas

Improved M&A processes in a market rich in Quality Assets

- Majors, Near Majors

Non-core asset sales

- **Vendor's Challenges**
  - Buyer-friendly asset selections
  - Comprehensive digital data access, technical and commercial
  - Options to provide key staff
  - Abandonment funding pre-set

- **Buyer's Challenges**
  - Forward price curve "match"
  - Clarity on long term deal value
  - **Focus M&A team on the 1 in 20 "fit" to your strategy**
  - Integrated due diligence team, with rapid decision making
  - Target value capture in Year 1

Decline in Oil, Gas Prices – NOCs/Para-NOCs, New Investors

	Chaos	Cash Short Asset Long	Expansion Seekers	Non-traditional Fund sources
Drivers	Political/Military instability	National budget needs, jobs	Domestic demand, state financing	$Billions looking for long term ROR
Key Players	Libya, Venezuela, Yemen, Syria, Iraq/Kurdistan, Ukraine,	Pemex, Pertamina, NPDC, Sonangol, EGPC/EGAS, YPF, OOC, Petrobras, TPDC, Ecuador	Rosneft, Gazprom, Sonatrach, Statoil, KNOC/Kogas Petronas, OVL/GAIL, Ecopetrol, Japan Inc.	Sovereign Wealth, Private Equity, Infrastructure Funds Power/Petchem buyers
Opportunity	**Service Contracts?**	**Partnerships for "crown jewels"**	**Co-finance, add capabilities**	**Counter Cycle Investment**

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Improved M&A processes in a market rich in Quality Assets

Non-traditional Fund sources

Counter Cycle Investment

- **Non-traditional buyer Challenges**
  - Balancing asset quality and risks to future cashflows
  - Focus and competence of Operator – is it still a core asset?
  - Ability to influence investments
  - Role, other than just $$'s
- **Execution of the Business Plan**
  - Sufficient funding to achieve growth goals
  - Reliable delivery of revenues; secure market for "products"
  - Skills transfer, secondments
  - Exit strategy options

In aftermath of oil price decline, oil ministry reactions have impacted course of A&D in several ways

- **Increasing state involvement in transaction approval**
  - **Pre-emption risk** in favour of NOC / NGC becoming more prominent
  - **Capital gains taxation,** even of overseas corporate transactions
  - **Limitations on dilution levels** for original production sharing contract operator

- **Exploration rounds less attractive in current price climate**
  - U.S. Gulf of Mexico a notable exception, in part due to limited $ commitments beyond bid price
  - Likely need improved term sheets to stimulate higher risk exploration

- **Expiration of major producing PSCs offers scope for new fundraising for state and/or growth options for state oil/gas companies**
  - Recent examples include **Indonesia, Colombia, Qatar**
  - Current contractor not precluded from re-applying, but terms may decline with perception of reduced risk, even with lower oil / gas prices

- **Mature asset production sharing contract relinquishments can be a challenge for state oil companies focused on large projects**
  - Service contracts an option, but who books the Reserves?

Diverse options for operated and non-operated investments

OPERATED ASSET INVESTMENTS

- **Corporate acquisition of asset strong, cash-short operators:** BG, Pacific Rubiales, Rosetta, many more to come……
- **Acquire entire division of competent operator:** Marathon Norway, Newfield SE Asia, RWE-DEA, Apache Argentina
- **Co-invest with strong operator:** Apache Egypt, Nigerian Independents/NPDC, Novatek, Occidental Middle East
- **Rationalize midstream assets (majors):** BP
- **Service partnership with NOC:** Malaysia, Colombia, Indonesia, Oman, Argentina

NON-OPERATED ASSETS – Go with Specialist Operator!

- **Major and near-major equity dilution (operator role unchanged)**
- **Minority shareholdings alongside low cost, dynamic industry leaders**
  - Latin America: CGC, Pluspetrol, Q.Galvao, Canacol
  - Africa: Perenco, Tullow, Noble, Apache, Anadarko
  - FSU, Europe: DNO, Lukoil, Irkutsk, Novatek
  - North America: EOG, Noble, SWN, Continental, Midstream Players
  - SE Asia/Australia: Woodside, Santos, Murphy, Talisman, Petrofac

So, is power in A&D moving from sellers to buyers?

- Only time will tell if there is a fundamental shift in the seller / buyer balance

- Almost certain that we need improved A&D processes, streamlined decision making and better documentation of all value drivers on both sides
  - Identify realistic revenues, costs, and schedule for all potential value streams
  - Develop realistic business plans to deliver them
  - Identify key “Spear Carriers” to deliver the plans

- Profile of buyers is changing
  - Different perspectives on returns and timelines
  - Changing requirements, especially on ability to sustain future net revenues

- Exciting times ahead for those ready to adapt to a changing marketplace