EUROPEAN OIL AND GAS MARKET UPDATE

December 2015

ALVAREZ & MARSAL

OIL PRICE

Oil price deteriorated by over $8/bbl (20%) since mid-November, driven in particular by U.S. dollar strength and the inaction of OPEC; these factors outweighed the price strengthening forces of the Paris terrorist attacks, downing of a Russian jet and Saudi attempts to improve confidence.

Improved statistics and increasing rhetoric from the U.S. Fed have raised the expectation of an interest rate rise in December. October U.S. inflation increased 0.2% versus September, whilst U.S. firms added 211,000 nonfarm jobs in November. As the U.S. dollar strengthens, dollar denominated oil becomes more expensive to many consumers, causing 'head-winds' to demand and a weight upon oil price. In mid-November, oil price tested the psychological $40/bbl mark.

The downward trajectory of oil price was halted by the reaction to terrorist events in Paris and Turkey's shooting down of a Russian fighter; though the market judged these to have limited lasting effect - only contributing to a $2/bbl (5%) gain.

In late November, Saudi Arabia indicated, that it would be willing to work with others to "provide stability" to oil price; it was unclear what this would mean, or who the other parties would be. Price impact was short and minimal.

OPEC's failure to take action at its December meeting may be a new mile-stone in the downward spiral of oil price. Losing its late November gains oil price is currently below $40/bbl[1] at levels last seen in 2008.

[1] *This oil price quoted is as of 14.12.15*

A&M VIEW

"A point of inflexion…"

Oil price appears to have finally lost its grip on the $40-50/bbl range of the past 4 months. Rising oil storage, cuts to drilling, terrorism and war have failed to counter the fundamental over-supply situation. OPEC confounding market expectations as constructing some limitations to supply was perhaps the last hope against falling into the abyss of $20-40/bbl oil.

Those looking for price rises or at least stability, need to believe that the market over-predicted a rise in U.S. interest rates. It is hard to see other support factors that aren't already priced in. The market is at a point of inflexion.

With an over-supply of c.2 million bbl/day and Iran potentially adding 1 million bbl/day in 2016, savage cuts to supply or a major turnaround in demand are needed to avoid further price decline. There is little sign of either.

For those already invested, scenario planning for $20/bbl oil for a prolonged period is highly advised. Producers who have held back on hedging production, should consider whether this is prudent as opposed to a dangerous gamble.

For those looking to invest, consider E&P companies that have narrowly survived recent reserves redetermination or are short on hedges and those OFS companies that would be the quickest to gain from an eventual price recovery e.g. seismic, drilling and well intervention sectors.

December OPEC Meeting

The 4th December OPEC meeting ended with no agreement and a final statement that made no mention of a new production ceiling. The only strategy that could be agreed upon was to monitor the market. The meeting failed to bridge the vastly different aspirations of the eclectic group; whilst Venezuela called for a production reduction of 1.5 mmbbls/day, Iran insisted it would not consider any production cut with aims to raise production to pre-sanction levels starting with 1 mmbbls/day in 2016. The only hope left for the cartel was expressed by Abdallah Salem el-Badri, Head of OPEC, who stated that "we are looking for negotiations with non-OPEC and trying to reach a collective effort" the apparent call to Russia, in particular, has so far yielded nothing.

It was of little surprise that many commentators saw the meeting as the confirmation of the demise of OPEC as a credible force in oil price control, leaving a question as to what the cartel actually stands for, Bhushan Bahree of IHS Energy commented that "OPEC and non-OPEC are irrelevant classifications."

A&M VIEW

"OPEC has become little more than a sideshow…"

The laughter from reporters and analysts as Abdullah al-Badr gave a post-meeting assessment that OPEC was as strong as ever, perhaps best personifies the state of OPEC as a force in the market. Whilst key members, including Saudi Arabia need prices above $80/bbl to balance fiscal budgets, none appear willing to do anything other than rely upon Saudi Arabia to resume its historic swing producer role. With vastly different situations and acrimony between members, Saudi Arabia has shown no intention to subsidise the entire market.

Those waiting for collective action between OPEC and Russia are likely to be disappointed. Russian oil production is largely in the hands of public companies and Siberian wells aren't technically suited to be swing producers.

With OPEC by default letting the market dictate production, there appears to be no discernible difference between OPEC and non-OPEC members. So, other than a side-show, it seems OPEC no longer has a role in the market.

North Sea Rotations

Over the course of this year many producers in the North Sea have announced changes to the working rotation for their offshore workforce. Previously, offshore workers have been working a range of rotas such as two weeks on and three weeks off, or maybe two weeks on and two weeks off etc. However there has been a concerted move towards three weeks on and three weeks off. The benefits of such a move include overall increased workforce utilisation and reduced travel and workforce mobilisation costs. Operational efficiency is therefore improved and margins protected. It is of course worth noting that such reduced travel and mobilisation will cascade the challenges down the supply chain to the associated service providers. These rotation changes are another element of producers reacting to the ongoing challenges in the industry. However it has not been without resistance from unions and others who quote concerns around safety and welfare. The transition has not been straightforward particularly when combined with other cost reduction initiatives including benefit and pay reductions.

A&M VIEW

"A cascade of challenges…and opportunities"

Change programmes such as those being driven by the oil majors and other producers are complex and strewn with difficulties in implementation. Nevertheless, they are an essential reaction to the challenges that the continued depressed oil price is creating and will continue to create. We anticipate that these challenges will exacerbate in 2016 with pressures coming from shareholders, activist investors, lenders, governments and other stakeholders. Proactive steps are key to keeping one step ahead.

Such proactivity also applies to the affected service providers whose revenues and margins will come under threat. However, there will also be opportunities for some service providers, notably those that support the producers by deploying their own offshore workforce, for example drillers, machine operators etc. The picture is therefore complex and existing owners, potential investors, lenders and others need to ensure that they maintain a close and informed watch over current and potential future developments as they capitalise on opportunities and mitigate challenges.

Credit Quality

Moody's Investor Services recent report on the Oil & Gas landscape ("Growing Stress in Commodity Sectors is a Credit Hazard for 2016") offers stark words for 2016. Comments include "exceptionally adverse conditions", "staggering in breadth and severity" and "deteriorating credit quality." Mariarosa Verde, Moody's Vice Present and Senior Credit Officer, has commented that between them, the Oil & Gas and Mining & Minerals sectors, whilst representing 14% of Moody's non-financial corporate ratings, have contributed circa 36% of downgrades in 2015 and just less than 50% of the total defaults. Given that, as again Moody's noted, these two sectors have sold almost $2 trillion in bonds globally since 2010, the challenges for lenders and investors will be substantial, widespread and growing.

A&M VIEW

"Bad news seems inevitable….surprises need not be"

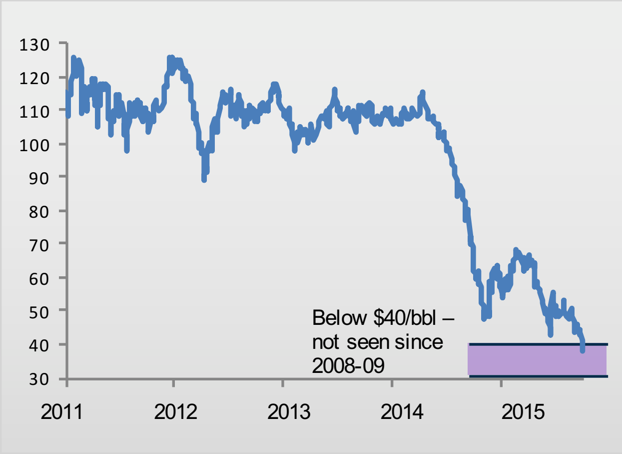
It seems clear that 2016 will bring significant challenges to lenders and borrowers. The level of challenge will vary dependent upon the borrowers own specific sector issues and positioning and its ability and willingness to take proactive mitigating steps. However, it will also depend on the level of buy-in, support and understanding the borrower receives from its lenders. In A&M's experience this is a vital area that can often be undermined by a lack of shared visibility and, on occasions, of good faith. The technical complexity inherent in Oil & Gas and the pride often felt by company management sometimes does not help in this regard. Given that 2016 will bring no respite to the market challenges, driving improved visibility and understanding would therefore be a welcome 2016 resolution for many lenders and borrowers.

In the current oil and gas environment, many companies need the support of experienced professionals who can work alongside management to deliver solutions to complex problems.

Founded in 1983, Alvarez & Marsal is known for its distinctive restructuring heritage, hands-on approach and relentless focus on execution and results. A&M works with clients across the energy investment life-cycle in the following ways:

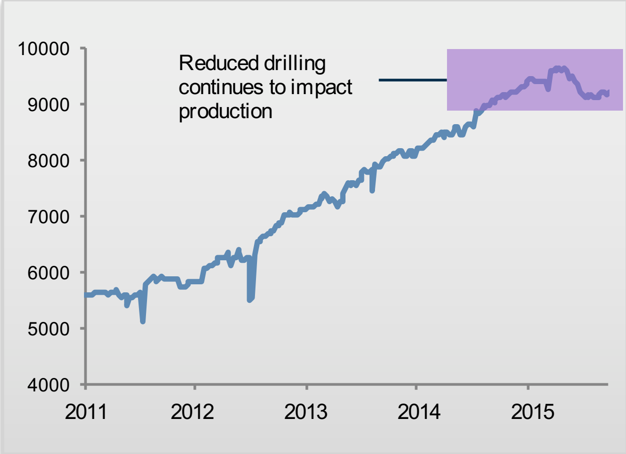
- Assisting companies pursue acquisitions, mergers or divestitures with financial and operational due diligence, valuation, tax structuring and acquisition/carve-out integration planning and execution.
- Working with management to optimise cost and CapEx, analyse asset performance and portfolio prioritisation, identify divestiture opportunities, and improve the company's planning and financial control processes and systems.
- Support management, legal and financial advisors of distressed companies to stabilise operations and cash flow, thereby extending their "liquidity runway".
- Providing interim management positions as appropriate.

Brent Front Month Oil Price ($ / bbl)



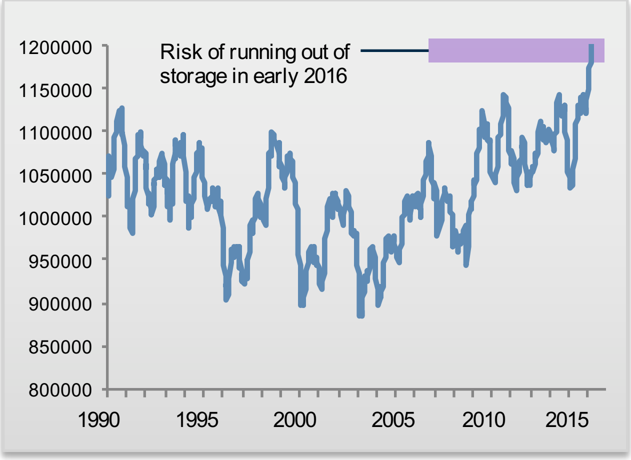
Source: EIA

U.S. Crude Oil Production (kbbl / month)



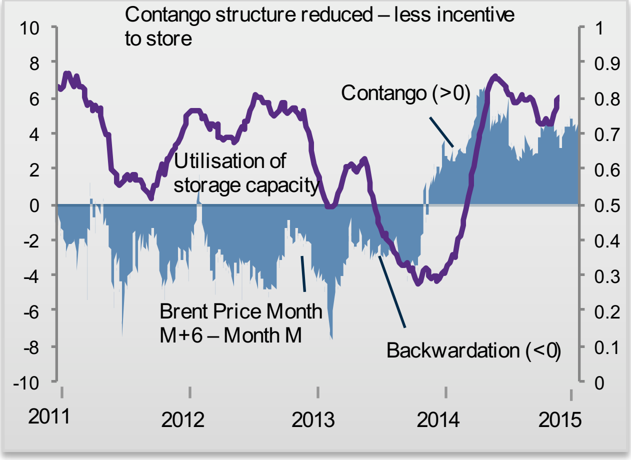
Source: EIA

U.S. Crude Oil Stocks (Exc SPR) (kbbl)



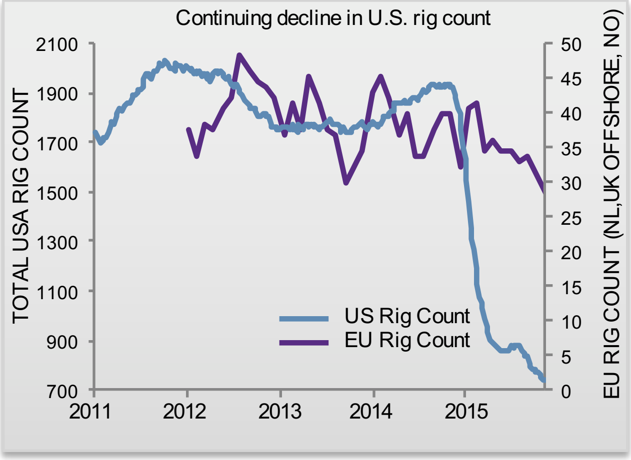
Source: EIA

Brent Month M+6 – M ($ / bbl) (LHS) and Cushing* Utilisation (%) (RHS)



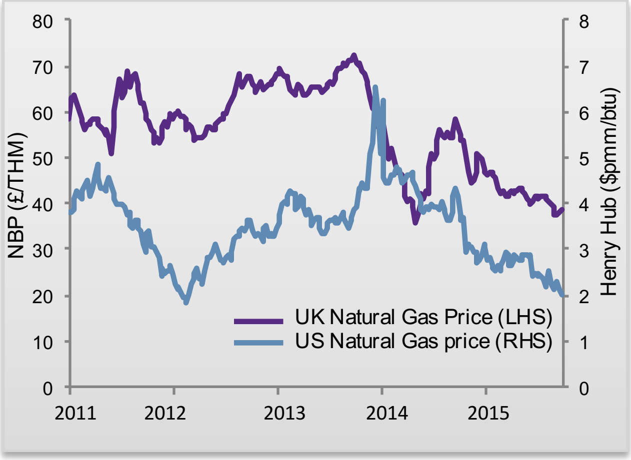
Source: Bloomberg, EIA

Rig Count



Source: Baker Hughes

Gas Price



Source: Quandi

* Cushing OK is a key independent crude oil storage location. Current capacity around 71 mmbbls

CONTACT US

To discuss how A&M might provide assistance with Transaction Services, Operational Performance Improvement, Restructuring or Interim Management please contact any of the following:

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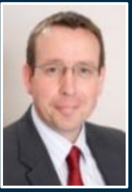

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