EUROPEAN OIL AND GAS MARKET UPDATE

February 2016

OIL PRICE

Earlier this year, crude oil price continued to languish at sub-$40/bbl levels, at one point hitting levels not experienced for over a decade at below $30/bbl. Continued deterioration and the resulting dire position has raised the stakes for certain producers, leading to the first tangible signals of OPEC led action since their November 2014 meeting.

With the worst recession for 25 years and a spiralling trade deficit, it is of little wonder that Venezuela continues to lead calls for change. In early February, Venezuelan oil minister Eulogio Del Pino steered a number of meetings with OPEC members and Russia as well as calling for an emergency OPEC meeting. Russia also took up the baton with a pronouncement from their Energy Minister - Alexander Novak - that a coordinated Russia/OPEC cut of 5 percent of oil production (c.2 mmbbls/day) could be discussed. Proving that the market was desperate for good news, this saw oil prices shoot over $35/bbl (8%) in late January.

Saudi Arabia remains the bellwether of the market. Mid-February saw the first signals that they could be willing to change stance on using output to control price; Qatari energy minister Mohammad bin Saleh al-Sada announced that Saudi Arabia along with Russia, Qatar and Venezuela would freeze output at January 2016 levels "as long as other major oil producers followed suit". Iran’s initial support to the move caused a rally back towards the $35/bbl price level. However, short-term hope appeared to fade due to growing speculation that Iran was unlikely to support the requested cap of 300 kbbls/day above their current output.

A&M VIEW

“Triumph of hope over reality…”

Oil market fundamentals continue to be poor: The market remains out of balance by up to 2 mmbbls/day; Russia oil output continues to rise; U.S. commercial stock levels continue to set new record highs. Iran is due to return to the market in the coming months and is reported to have 47 million barrels of oil in storage.

For good words and positive sentiment to be translated into price recovery we propose four actions need to occur:

1. Manage Iran: Other producers accept deep cuts to enable Iran (1-2 mmbbls/day 'new' production) to re-join the market in the least disruptive way.
2. Cut Production, Not Hold-it: Success of the freeze at January production levels somehow leads to other collective action to pare output by at least 1-2 mmbbls/day to mitigate the current imbalance.
3. Keep Shale-Oil Off: Despite the fact that drilling could easily return if given sufficient price rise, the financial impairments in the U.S. reduces access to necessary funds and consolidation does not occur.
4. Discipline: OPEC and its partners show discipline in keeping within output limits; a capability that it failed to demonstrate for many years.

It is difficult to see how any of these conditions could be met in the near-term. We therefore advise participants to be robust to $20-40/bbl oil for the foreseeable.

North Sea Tax

Calls for changes to North Sea tax are unrelenting. Alex Kemp, professor of petroleum economics at Aberdeen University, recently published a paper for the Scottish Government outlining three areas for consideration:

- An investment allowance to provide a simple, stable and more competitive fiscal regime.
- Immediate reversal of the increase in the 'Supplementary Charge' implemented by the U.K. Government in 2011.
- Introduction of an exploration tax credit to help increase levels of exploration and sustain future production.

Oil and Gas U.K. (OGUK) go further, asking for the 'Supplementary Charge and Petroleum Revenue Tax' to be removed completely claiming "[they are] simply not appropriate".

Centrica chief, Iain Conn, echoed the call suspension of these taxes "They can always put it up again, indeed, they have quite a good record of doing that….corporation tax in the North Sea should just be corporation tax, petroleum revenue tax should probably disappear for a while."

A&M VIEW

"A time to review previous commitments"

"In future years, if the oil price falls below a set trigger price on a sustained basis, the government will reduce the supplementary charge back towards 20 percent on a staged and affordable basis while prices remain low". This was a statement by George Osborne in March 2011 after having raised the supplementary charge to 32 percent. The trigger price was set at $75/bbl. The supplementary charge was reduced in December 2014 to 30 percent.

North Sea producers face a significant tax burden. The sector pays an additional 10 percent corporation tax (total 30 percent), as well as a 20 percent supplementary charge; older fields are also levied 17 percent petroleum revenue tax. Older fields pay up to 67 percent of earnings. With over 70,000 jobs lost in the North Sea over the past year, it's therefore of little wonder that producers are expecting positive action from the Treasury.

It appears essential that the Treasury reviews all tax options and, critically, reviews previous commitments to reduce the burden in times of prolonged low oil price such as today.

Decommissioning

With the current low oil price, decommissioning of production facilities that have higher costs of production will become more of a focus. The U.K. North Sea is no exception and a recent study from Douglas Westwood suggests that 146 offshore platforms (25 percent of the total) will be decommissioned over the next ten years. Such expedited decommissioning programmes will create challenges for many oilfield service ("OFS") providers currently involved in North Sea production, but will also be a welcome and growing market for many. Decommissioning is complex and tightly controlled and represents an opportunity that many OFS providers will rightly target. Those that propose innovative and efficient solutions to the myriad of problems that harsh environment decommissioning represents will find eager listeners in the field operators who are seeking ever more efficiencies. The successful OFS providers will have proven technologies and track records to sell to other geographies, for example Norway whose own decommissioning programme will lag some years behind the U.K.

A&M VIEW

"Volume Protection, Rate Erosion"

In these challenging times, those OFS providers with the marketing, operational and financial flexibility to aggressively target new market opportunities will be at an advantage. However, it is also this current environment that has severely diminished financial flexibility (and as a result their operating and marketing) for many providers. These challenges have included the day rate cuts that many providers have suffered. Oil producers have sought reductions through their own supply chain which have then been passed down the chain. Cuts of 30 percent or more are common. A real challenge for OFS providers is that whilst their volumes might be protected by targeting different markets, their customers (typically the same oil producers) will still be seeking lower rates that tend to stick. History shows that even when oil prices recover, OFS rates do not readily spring back. High performing OFS providers are recognising this and adapting through driving ever more efficiencies and a ruthless focus on improving margins and reducing costs.

Positive Actions

Like many other global service providers, Weatherford has received considerable attention of late. There has been a focus on the reported headcount reductions (6,000 more workers during the first half of 2016 or ~15 percent of its workforce), but perhaps less commentary on the other measures being implemented. Such actions have been centred around focusing on their core offering, lowering their cost structure and allocating cash and generating cash as a company-wide discipline. This has resulted in the closure of 105 operating facilities in 2015 and reportedly another 25 scheduled for closure in Q1 2016. They report $2 billion of cost savings over 2014/15 (~$750 million seen as permanent) which has seen their Core Business Cost Support Ratio (support function cost as a percentage of direct function cost) fall from 59 percent in 2013 to below 40 percent in 2015.

A&M VIEW

"Weathering the storm"

These focused actions by Weatherford have significantly strengthened its positioning and created advantages beyond the immediate improved profitability. One of those advantages is the impact on cash. 2015 was expected to show positive adjusted net cash flow partly driven by ~$800 million of working capital reduction, and 2016 was forecast to improve further on that with a further ~$600 million of incremental cash flow compared to 2015.

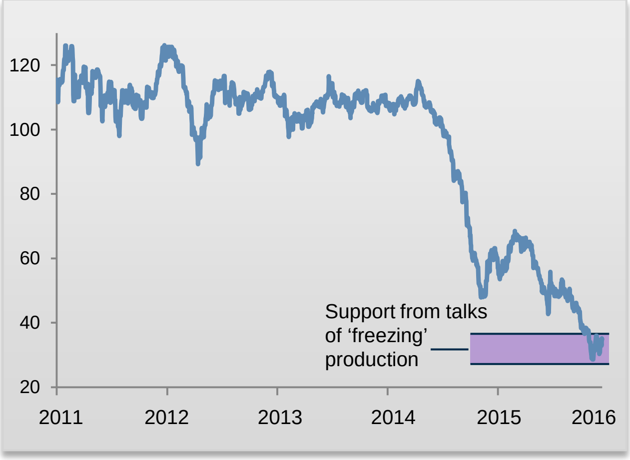
At A&M, we consider that a focus on cash is an increasingly key priority for all oil and gas operators. Whether such cash would be used to fund CapEx, dividends, acquisitions, support covenant compliance, help drive procurement improvements or simply pay the bills; a focus on improved cash generation should be on every Board's agenda.

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:

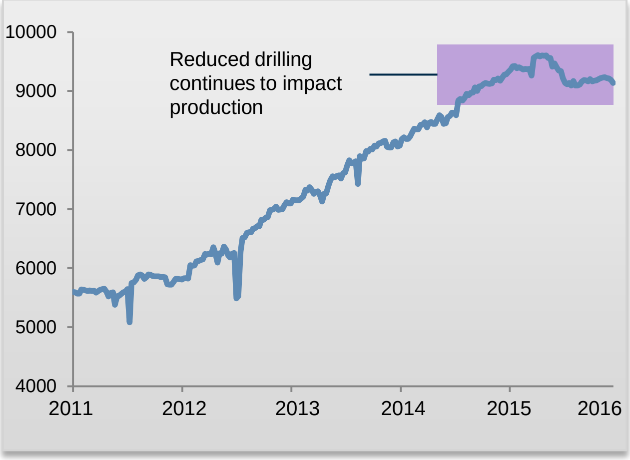
- Assisting companies pursue acquisitions, mergers or divestitures with financial and operational due diligence, valuation, tax structuring and acquisition/carve-out integration planning and execution.
- Working with management to optimise cost and CapEx, analyse asset performance and portfolio prioritisation, 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)



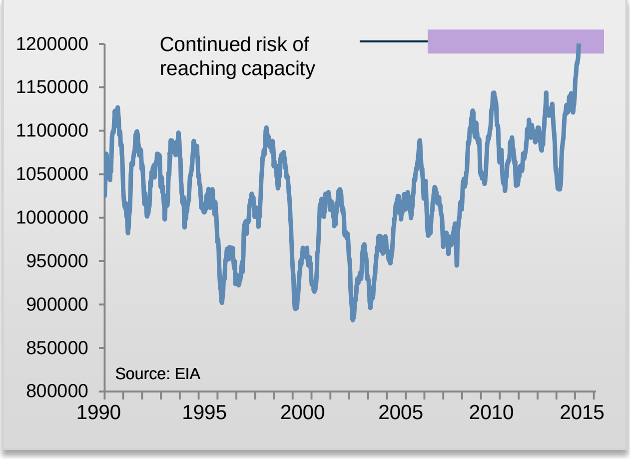
Source: EIA

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



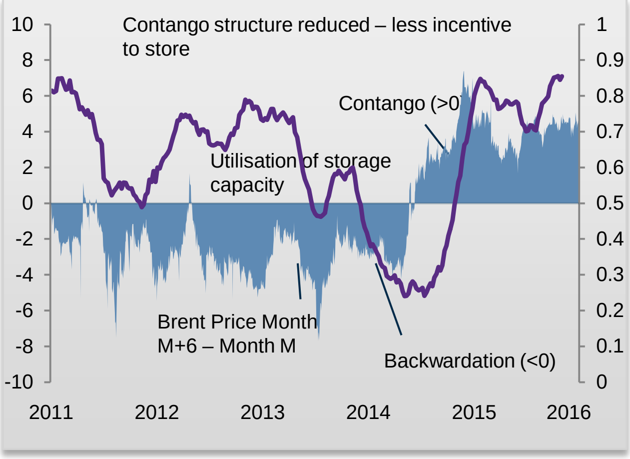
Source: EIA

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



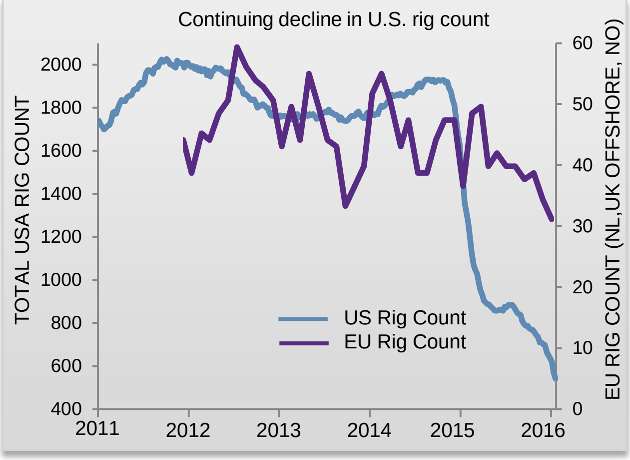
Source: EIA

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



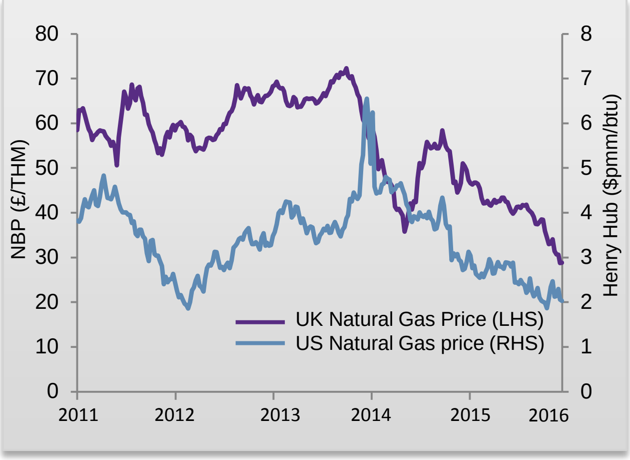
Source: Bloomberg, EIA

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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