EUROPEAN OIL AND GAS MARKET UPDATE

August 2016

ALVAREZ & MARSAL

OIL PRICE

Persistent is perhaps the most fitting term to describe OPEC (Organization of the Petroleum Exporting Countries) and its wannabe partner, Russia. Despite abject failure in April, relatively low oil prices, trending in the $43 - $50 per barrel (bbl) range since the previous Doha meeting, have once again spurred talk of coordinated action. Perhaps in hope rather than expectation of such a break-through, prices reached a one-month high of $47/bbl in mid-August.

Few would argue that supply-side action is required. Recent price recovery has been supply-led, but largely due to short-term issues such as strikes in Kuwait, followed by Nigeria, and then wild-fires in Canada. Recovery is now occurring in the output of each of these countries.

Non-OPEC players are taking action with reduced drilling activity causing U.S. production to fall by an average of 70 kilobarrels (kbbl) per day each month since mid-2015. The Gulf Oil & Gas report states that the top-ten major oil companies have reduced 2015 spend by 15 percent year-on-year, on top of a 6 percent decline in 2014.

However, two signals worry the market. First, crude stocks have continued to rise unabated, notably in the U.S. despite the production fall. Second, over the past month, Baker Hughes has reported an increase in the U.S. rig count.

It is hard to argue with Saudi energy minister Khalid bin Abdulaziz Al-Falih's observation that "the process of clearing crude and products inventories will take time," though his assertion that "market rebalancing is already taking place" appears optimistic or at least premature.

A&M VIEW

Market cannot afford higher prices

The additional 42 U.S. rigs (a 10 percent rise) added from July to August is a perturbing signal. On one side, it can be argued that the production impact is likely to have a lag of 9-12 months, mirroring the impact when drilling began to fall in 2014. However, the risk is that the increase is a result of signals from a market that continues to ignore fundamentals, the perilous situation on stocks being something that appears to be inadequately factored into price.

U.S. output has fallen by c.900 kbbl/d in the past year. However, according to the International Energy Agency (IEA), OPEC output is now at an 8-year high of 33.4 mbpd with Saudi output recently at a record of 10.67 mbpd; and Iran continues to ramp-up its output.

As a result, the net-global decrease in production was only 300 kbbl/d year-on-year to June 2016. Critically, the market continues to be over-supplied, perhaps by 400-800 kbbl/day by the end of 2016. As PVM Oil recently pointed out, even with conservative assumptions, the resultant rise in stocks of c.1000 kbbls from 2014 to 2016 can add 1 - 2 mbpd to supply if liquidated over 2 or 1 years, respectively.

Coordination to reduce OPEC / Russian production is a worthy cause but one likely based upon history and fundamentals. The perilous stock position demonstrates the need for lower prices. This again demonstrates A&M's position that price uncertainty will continue and that businesses need to prepare for a lower for longer price scenario.

SEISMIC MARKET

Seismic surveying is a key technique to increase the probability of exploration success, and is also key in monitoring change whilst in operation. Demand for seismic surveying shows a strong correlation with oil price and has accordingly fallen prodigiously. From a peak of c.$8.2 billion in 2013, Petroleum Geo-Services (PGS) predicted (in 2015) that 2016 global seismic spend would reduce to only $2.6 billion in 2016.

Whilst the trend in the last decade of operators preferring multi-client surveys is in line with reducing industry costs, such activity demands pre-funding commitment, something operators have been unwilling to give.

On the supply side, an over-hang is developing of new build survey vessels, with the 2015 new build volume being greater than the volume going out of service, a problem further exacerbated by new builds being more efficient.

Seismic operators have taken steps to reduce fleets and manpower, though distress is now evident e.g. Dolphin bankruptcy in December 2015, and the debt restructurings carried out at PGS and Polarcus.

A&M VIEW

Consolidate or specialise

Seismic surveying remains a vital service to the Oil & Gas industry with no credible alternatives. However, recovery on the demand side depends upon a step-up in exploration, an outcome requiring sustained higher oil prices. The bad news is that with a $40 - $60/bbl marginal cost of production and low re-establishment cost, the first frontier that would likely recover would be the on-land U.S., a region that is mature and already well covered by seismic data and unlikely to yield demand for seismic acquisition. Turnaround in demand depends upon new frontiers (e.g. Kurdistan, Middle East, Arctic), all of which need a much higher oil price.

Existing seismic operators and those looking to invest in the sector would be best served by seeking to improve the supply side of the market. Two generic strategies exist:

I. Consolidate: Acquire assets with attractive data-sets (new frontiers, etc.);

II. Specialise: Assuming there remains valuable niche areas, consider focusing on technologies (e.g. 3D versus 2D), geographies or scope (e.g. interpretation only versus acquisition).

BREXIT

Britain's vote to leave the EU has created a new lightning rod for those seeing a further down-turn in the oil market. Oil prices on 24 June (the day after the vote) crashed more than $3/bbl (6 percent), similar to the fall seen on the FTSE.

The investor flight to lower risk investments strengthened the dollar, a strong dollar raises the cost of oil in consuming nations, thereby eroding demand.

Commentators, including the IEA and Credit Suisse cut global demand growth forecasts for 2017, citing Brexit as a catalyst for a weaker outlook for the world economy. In the case of Credit Suisse, the demand reduction was seen as up to 300 kbpd - a relatively minor 0.3 percent of global demand.

Despite negative views on demand, many dismissed Brexit as a major factor in the global oil market and consensus oil price forecasts remain unchanged since the vote. Bigger factors are seen, such as offsetting revisions to U.S. oil demand (Jefferies); product over-supply and softer Chinese demand (Morgan Stanley); and U.S. crude stocks (FirstEnergy).

A&M VIEW

Both positive and negative effects

It is debatable whether Brexit has any material impact on oil supply and demand fundamentals. However, there are credible macro-economic effects that need to be considered by those operating within the U.K. Oil & Gas industry. We highlight three here:

- **Reduced Costs:** Sterling is likely to remain weak against the U.S dollar in the near-term giving the benefit of relatively lower costs compared to non-U.K. competition.
- **Scottish Independence:** Brexit has catalysed the potential for Scotland to break-away from the U.K. This may cause renewed uncertainty leading to delayed or cancelled investments.
- **Barriers to Trade:** It is unclear at this point, but the U.K. may face reduced or costlier access to international markets. Furthermore, the potential loss of free-movement of labour could impact bureaucracy and costs.

It is unclear how the above factors and general price effects will play out. In the mean-time, it is critical for U.K. exposed parties to build contingency plans.

OFFSHORE SUPPLY VESSEL (OSV) SECTOR

A long needed consolidation in the OSV sector has started with Aker Group entering the market by taking an equity position in Solstad Offshore, followed by a forced merger between Rem Offshore and Solstad Offshore. Aker acquired a stake in Rem's bond loan giving it negative control, and by voting against the proposed refinancing plan, Rem had no choice than accepting Aker's merger offer.

The other consolidators positioning themselves are Siem Industries, Fredriksen Group and Ferncliff which has established a new investment vehicle that acquired OSVs from banks at very low prices. The consolidation game has just started, and some OSV companies have not yet completed their refinancing plans. Maersk Supply has announced it will abandon 20 OSVs and other players will likely follow suit. The capacity overhang will still be large and further consolidation is likely required.

A&M VIEW

Leverage still too high

The restructurings completed in this sector include debt to equity swaps for bond investors, with old shareholders suffering from more than 90 percent dilution on their part. New equity has been provided in certain cases, with wealthy family owners stepping up further. However, along with this, debt maturity extensions have led to an increased debt mountain due in 2018.

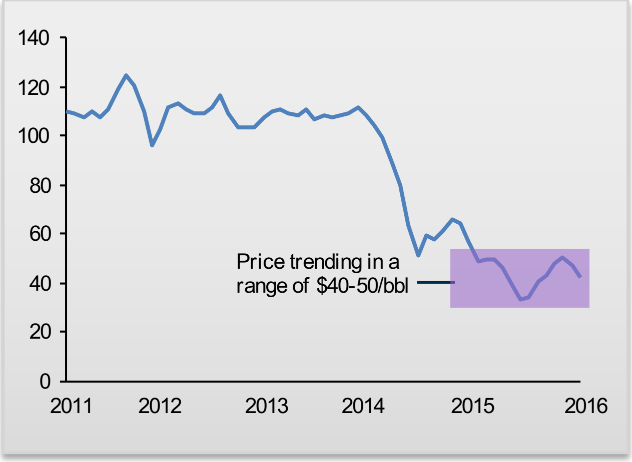
Even if oil prices rise sustainably above $50/bbl in the coming 12-24 months, there would still be a subsequent 18-36 month lead time until there is a rise in demand for OSV's. The OSV sector is therefore set for a continued period with very low rates, during which those entities that lowered their cost and debt burdens will be best positioned in the bidding process. There is a strong likelihood of increasing restructuring in the OSV market in the mean-time.

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:

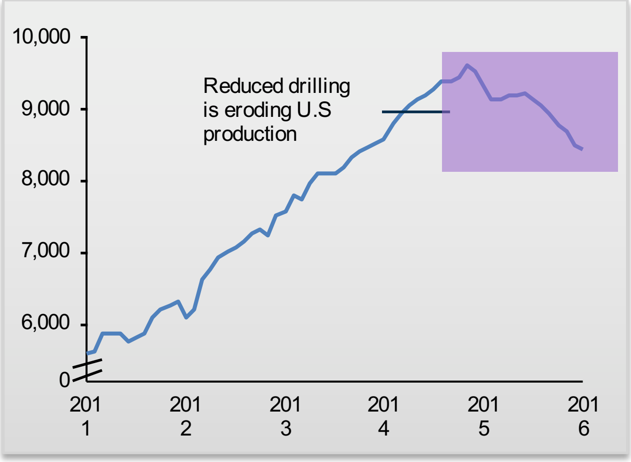
- Assisting companies pursue acquisitions, mergers or divestitures with financial and operational due diligence, valuation, tax structuring and acquisition/carve-out integration planning and execution.
- Working with management to optimise cost and CapEx, analyse asset performance and portfolio prioritisation,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



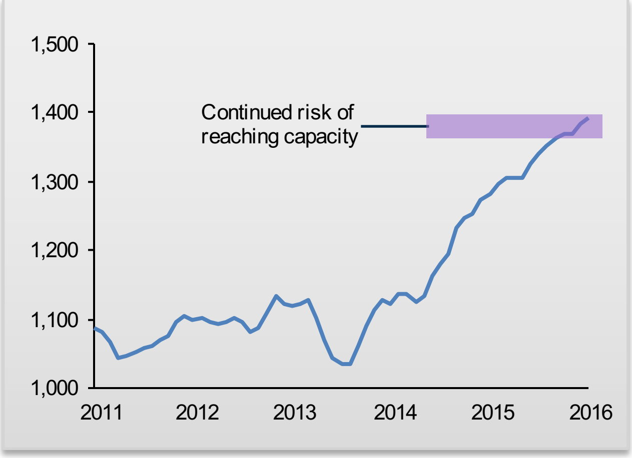
Source: EIA

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



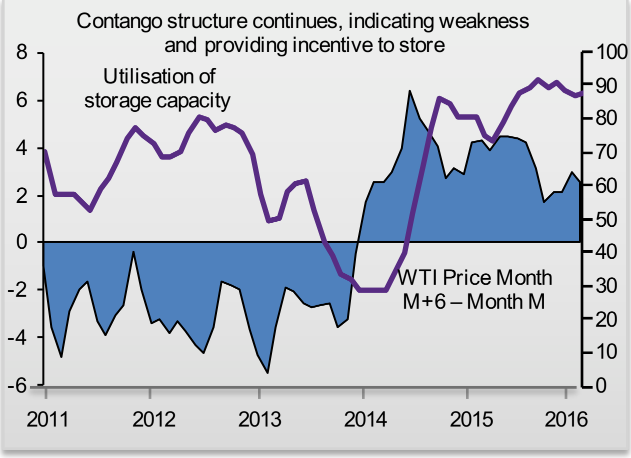
Source: EIA

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



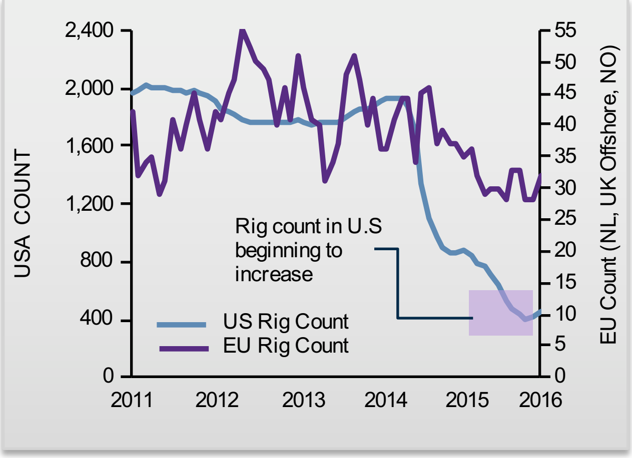
Source: EIA

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



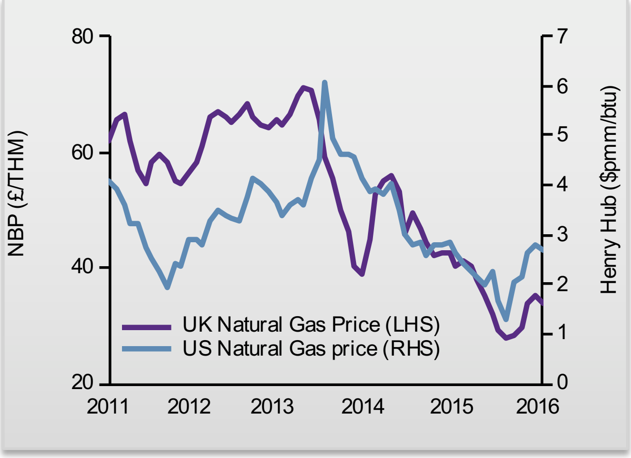
Source: Bloomberg, EIA

Rig Count



Source: Baker Hughes

Gas Price



Source: CapIQ

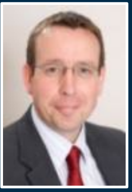
* Cushing OK is a key independent crude oil storage location. Current capacity around 71 mmbbls

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:

UK Key Contacts

Colie Spink
Managing Director
+44 207 715 5221
sspink@alvarezandmarsal.com



Paul Kinrade
Managing Director
+44 207 663 0446
Pkinrade@alvarezandmarsal.com

Senthil Alagar
Managing Director
+44 207 663 0441
salagar@alvarezandmarsal.com

David Jones
Senior Director
+44 207 663 0786
djones@alvarezandmarsal.com

Benelux Key Contact

Casper de Bruyn
Senior Director
+31 20 76 71 130
cdebruyn@alvarezandmarsal.com

France Key Contact

Tarek S. Hosni
Managing Director
+33 14 45 00 118
thosni@alvarezandmarsal.com

Nordic Key Contact

Ole Sivertsen
Senior Director
+47 454 11 043
ole.sivertsen@alvarezandmarsal.com

When action matters, find us at **http://www.alvarezandmarsal.com**

Follow us on:

ALVAREZ & MARSAL