



Perspectives on the Global Response to Lower Oil Prices - the "New Normal"

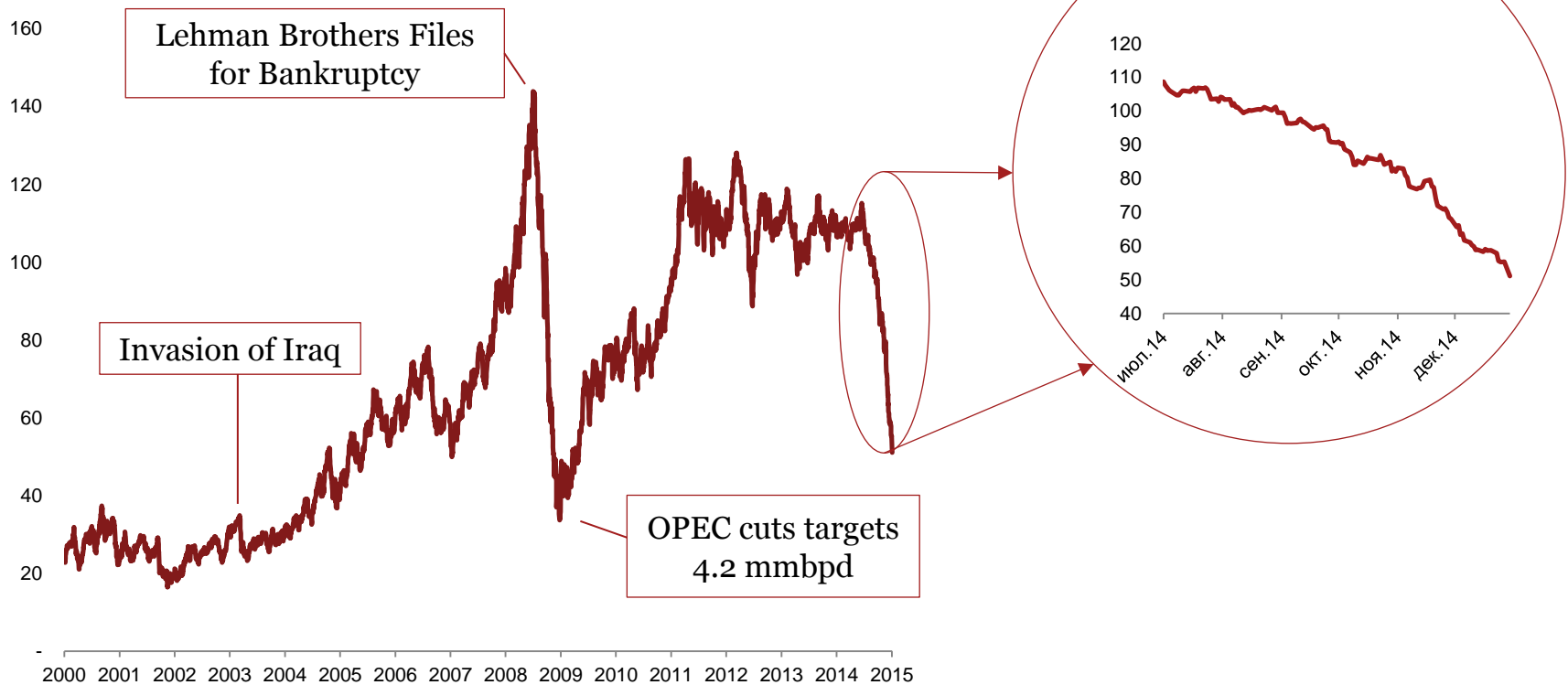
Richard Pollard
CEE / Russia Oil & Gas Leader

17 April 2015

I. What is happening in the marketplace?

There has been a huge fall in oil price which has not yet been met by a decrease in supply

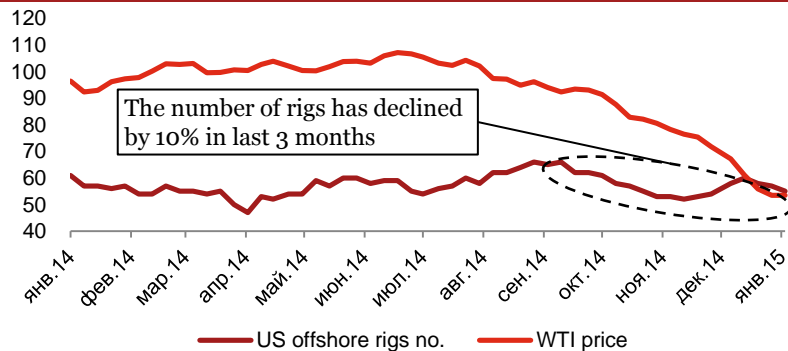
Historic oil price (Brent \$/bbl)



Source: Federal Reserve Economic Data

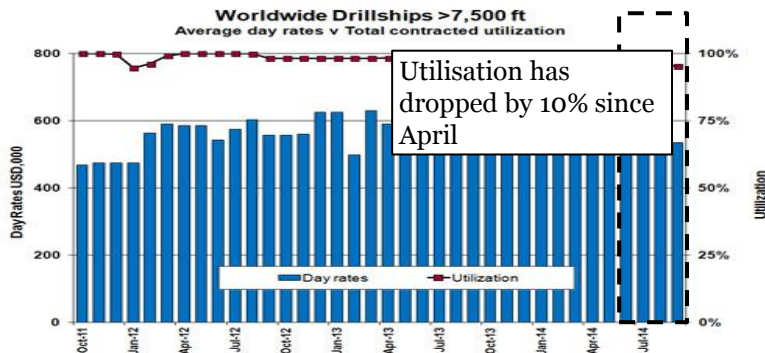
Activity is down as the first signs of restructuring are emerging

US offshore rigs show a declining trend in line with oil price



Source: Baker Hughes

Vessel utilisation is showing a similar decline



Source: Baker Hughes

Change in oil prices has hit companies across the value chain

Reuters.com

The First Shale Oil Casualty: WBH Energy Files For Bankruptcy

"WBH Energy... has filed for bankruptcy protection, becoming what may be the first U.S. oil company to do so since crude prices started tumbling six months ago"

Reuters.com

Oil fall could lead to capex collapse

"DoubleLine Capital's Jeffrey Gundlach said on Tuesday there is a possibility of a "true collapse" in U.S. capital expenditures and hiring if the price of oil stays at its current level"

Reuters.com

Schlumberger to axe 9,000 jobs

"Schlumberger plans to cut 9,000 jobs as a result of the fall in oil prices and cutbacks in spending by the energy groups that are its customers"

www.ft.com

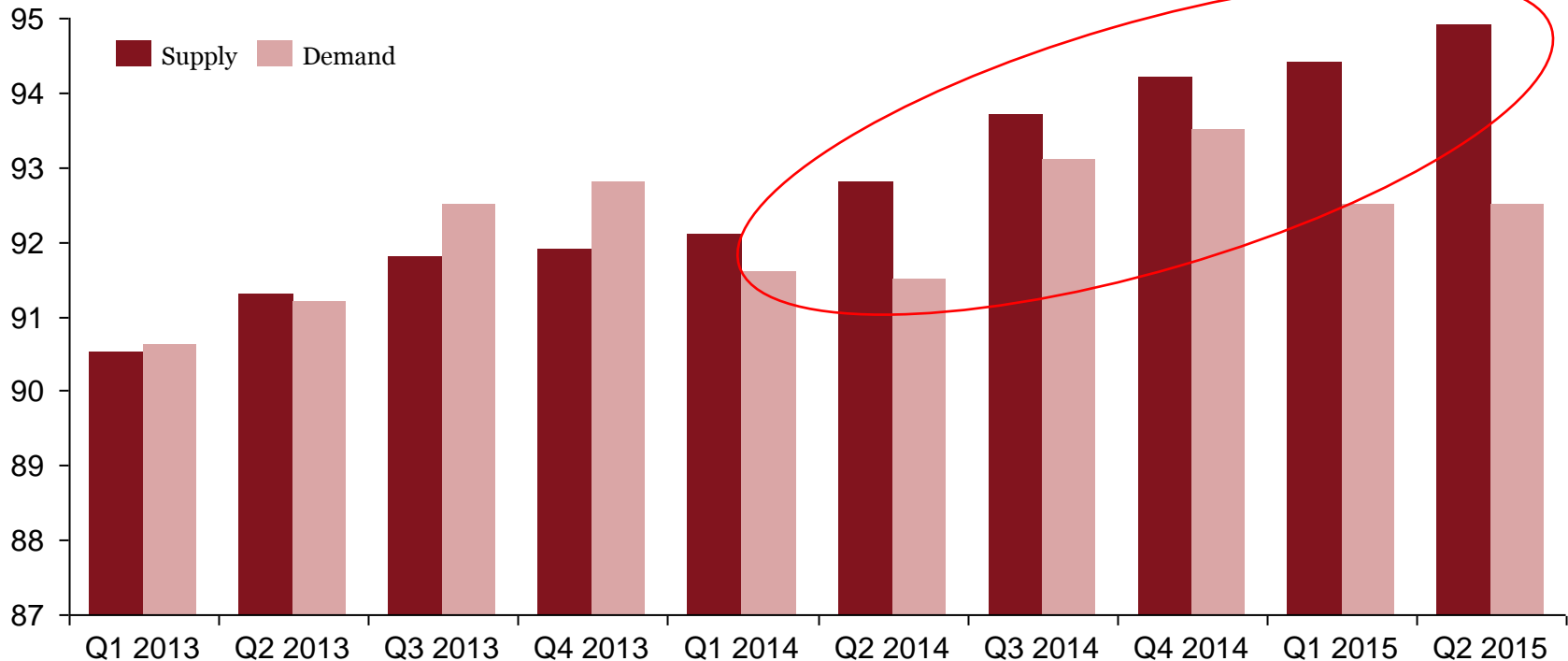
UK oil groups under scrutiny as crude price falls

"[Cairn Energy, Premier Oil, and Tullow Oil] are set to come under intense scrutiny from investors this week as they set out plans to cope with a collapse in prices that — if sustained — could halve the value of current and future production."

Supply since Q1 2014 has outstripped demand with a surplus of 2.4m bbls/d forecast by Q2 2015

Global Oil Supply and Demand Q1 2013 – Q2 2015

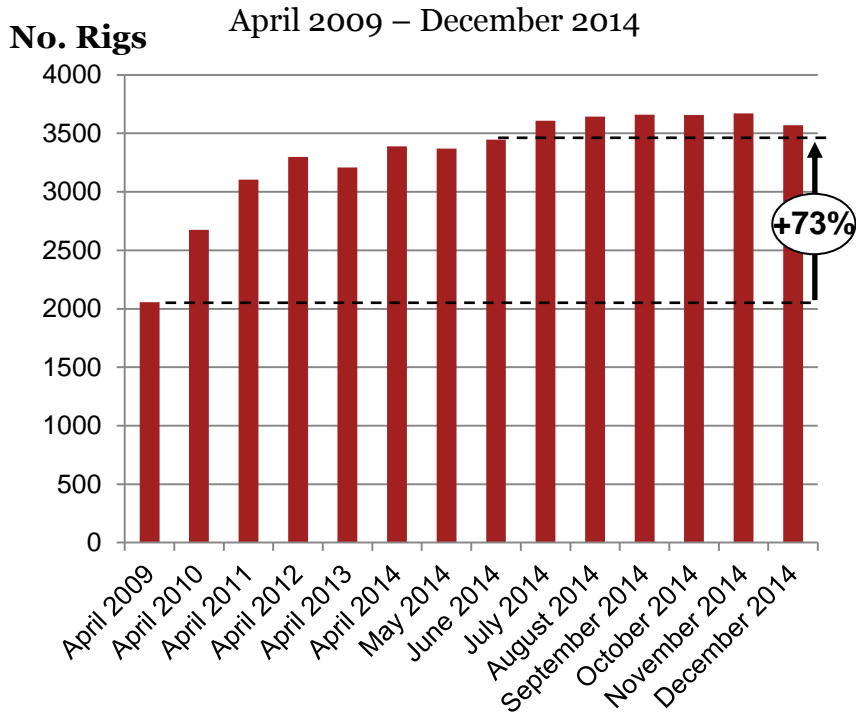
Million bbls



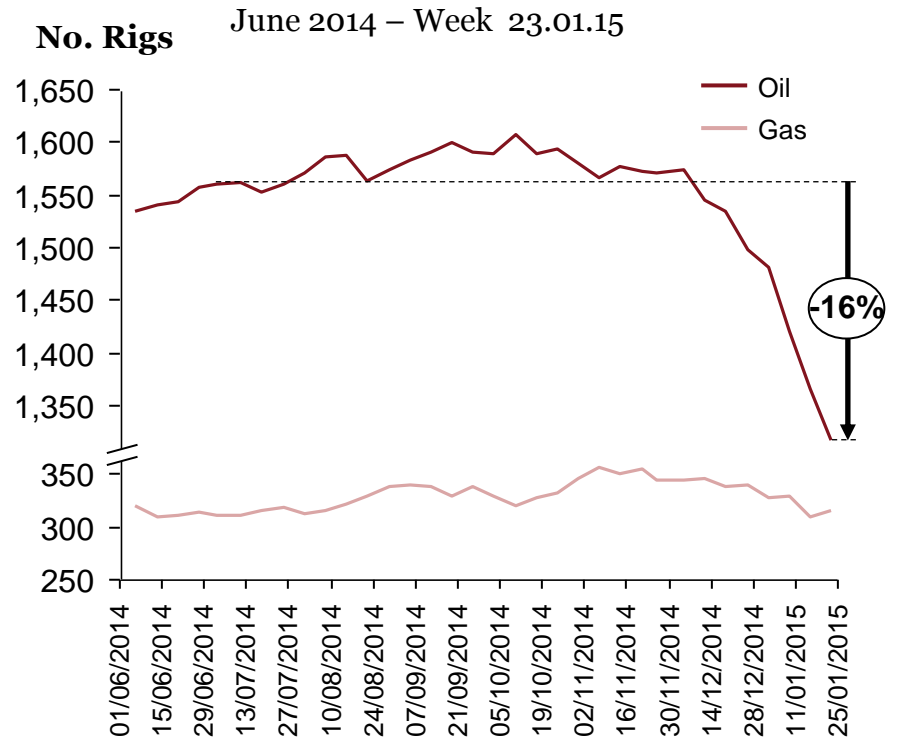
Note: Q4 2014 – Q2 2015 assumes OPEC crude will remain at 30.5m bbls/d
Source: IEA Oil Market Report December 2014

Since 2009 rig numbers had grown significantly, while since summer 2014 US rig numbers have eased off

Worldwide Rig Count (Onshore & Offshore)



US Rigs by Oil & Gas



Note: Baker Hughes Rig Count aggregates onshore and offshore rigs in Latin America, Europe, Africa, Middle East, Asia Pacific, Canada, U.S.

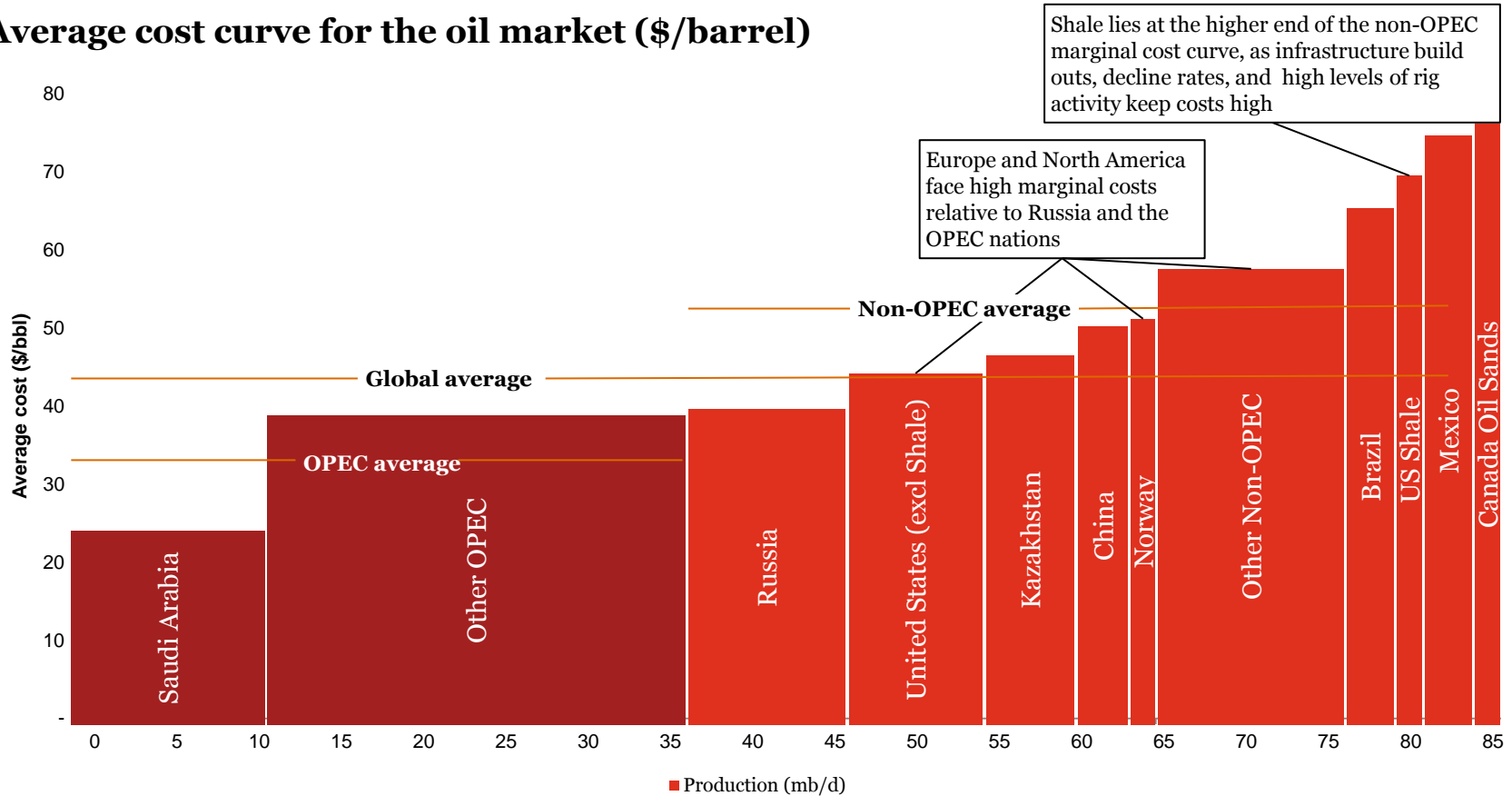
N American numbers does not include GoM

Source: Baker Hughes

***II. Implications for upstream,
downstream, OFS.
Who is facing the greatest risk?***

The fall in oil price will hit producers with the highest costs first

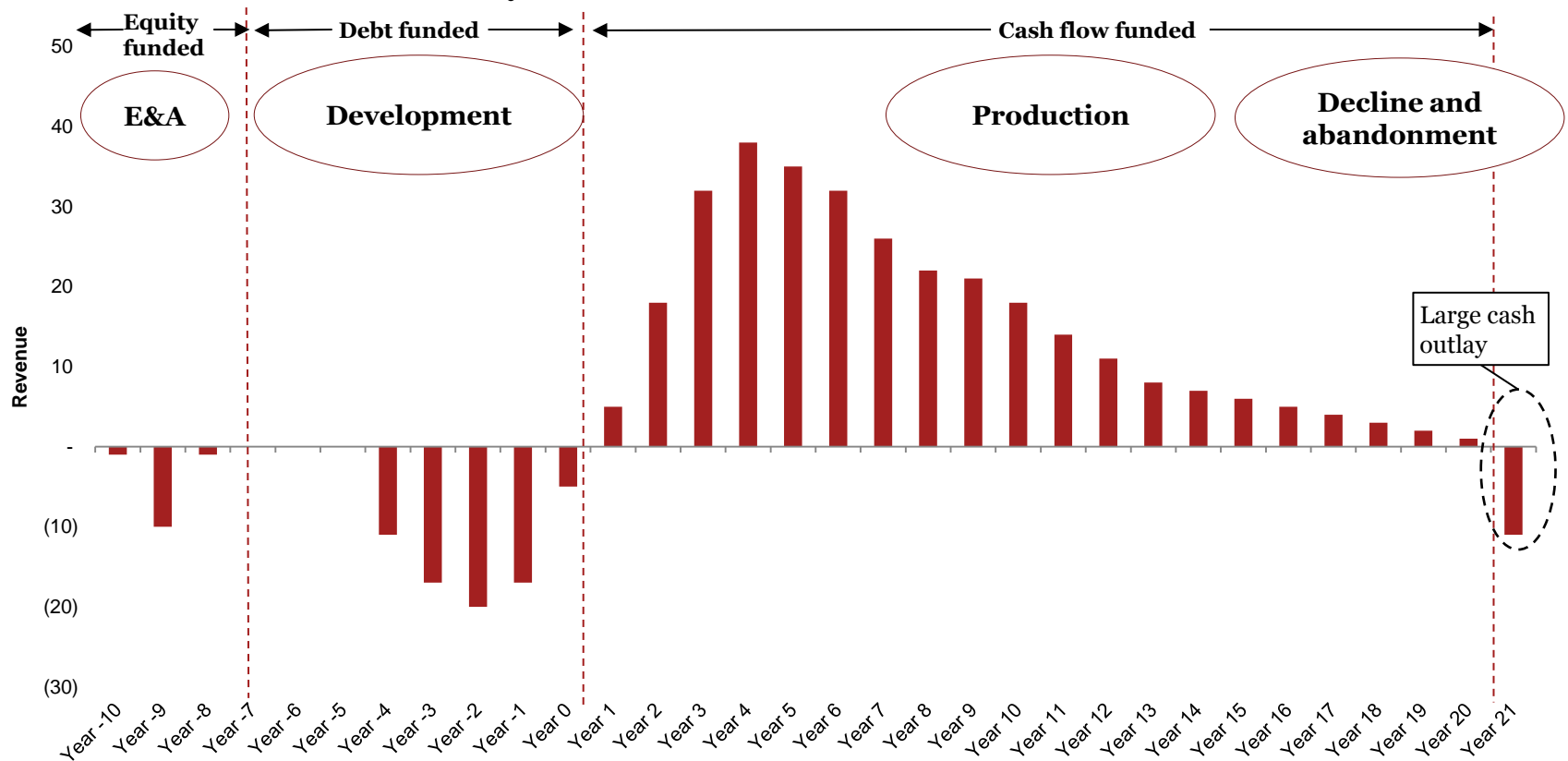
Average cost curve for the oil market (\$/barrel)



Source: IEA

The nature of the oil field life cycle dictates that companies with committed spend have less scope to cut costs

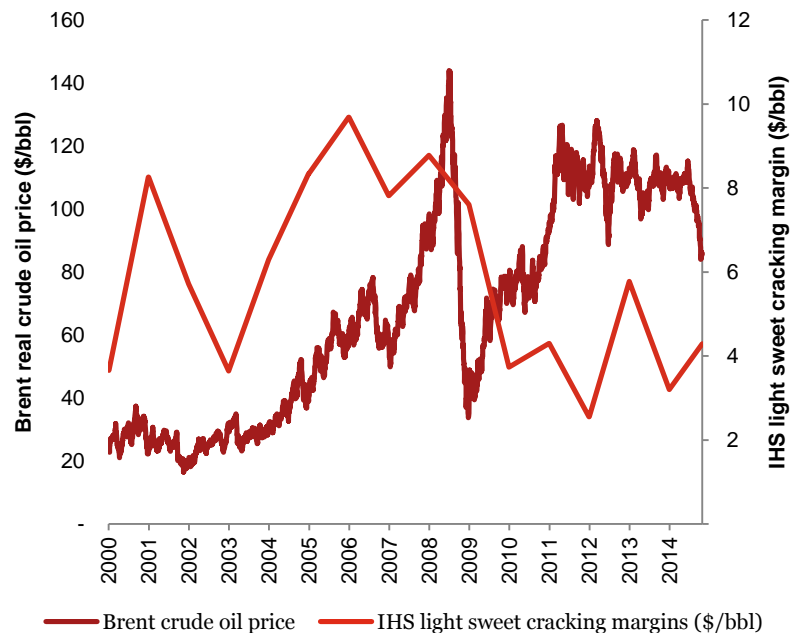
Revenue over Oil Field Life Cycle (Indicative*)



* Note: this is for an individual field – a basin will comprise many overlapping development cycles and may produce for 50 years or more

We are still negative on the margin outlook – the oil price story does not change our view on fundamentals

Brent crude oil price vs. refinery margins (in real terms, 2000-2014)



- ▶ Low oil prices do not have a significant impact on gross refining margins
- ▶ A minor improvement in net refining margins can be expected
- ▶ Improved net margins may result in troubled refiner's holding on for longer

Source: IEA, Federal Reserve Economic Data

We see OFS preparing for mid-term pain, but not yet in distress

Oil price fall has been extremely rapid

- Producers have been distracted
- No time or space to renegotiate yet
- Contracts are still running and may not have break clauses (average rig contract 7-8* months)

OFS firms able to absorb short term pain

- Much Q1/Q2 activity is constricted
- Years of high profitability mean OFS firms may have reserves, funding lines or goodwill with banks
- Scope to cut costs or staff numbers
- Pain passed down further to smaller Tier 2 or 3 suppliers

Pain not necessarily visible yet

- Cuts so far have been in discretionary or uncommitted spend
- Reporting cycle not yet flushing things out – many smaller companies are private held or VC backed

*Little incentive for OFS firms to engage yet
Eventually pushing pain down will reach a limit*

* Average contract duration between 2000 -2010
Sources: Riglogix 2011

III. Industry response – what we see

The industry and investors are adjusting in real time



**U-shaped oil
price recovery**



**Acquisition funds
being raised**



**Signs of distress
emerge**



**Business plan
reconsideration**



**Financial
contagion**



**Change in liquidity
of supply**

Companies have pulled a number of levers to reduce cost

Response by Sector Players to Oil Price Drop: Selected Examples in Recent Months

Company	Reduction 2015 Capex	Pay Freeze	Reduction in Headcount	Reduction in Contractors	Renegotiate OFS Rates	Investments Deferred / Abandoned	Change in Business Model
Apache			✓				
Baker Hughes	✓		✓				
BP	✓	✓	✓				
ConocoPhillips	✓		✓				
Halliburton			✓				
Petronas	✓					✓	
Premier				✓	✓	✓	
Santos	✓			✓			
SBM Offshore			✓				
Schlumberger	✓		✓			✓	
Shell	✓					✓	
Statoil						✓	
Talisman Sinopec			✓				
Total	✓					✓	
Weatherford							✓

To date there has been limited consolidation across O&G sector, but this may change

Major M&A Deals in Oil & Gas Selected Nov. 2014 – Jan. 2015

<i>Target</i>	<i>Buyer</i>	<i>Deal Value</i>	<i>Comments</i>
Talisman	Repsol	US\$8.3bn	Announced in Dec. 2014. Successful purchase of distressed assets
Baker Hughes	Halliburton	US\$38bn	Announced in Nov. 2014. Creation of market leader
EDC	Schlumberger	US\$1.7bn	In Jan. 2015 Schlum. invests in troubled Russian driller

Oil sector keen not to repeat historic mistake of mass redundancies and losing capabilities across the board

Industry is already dealing with challenge of 'Big crew change'

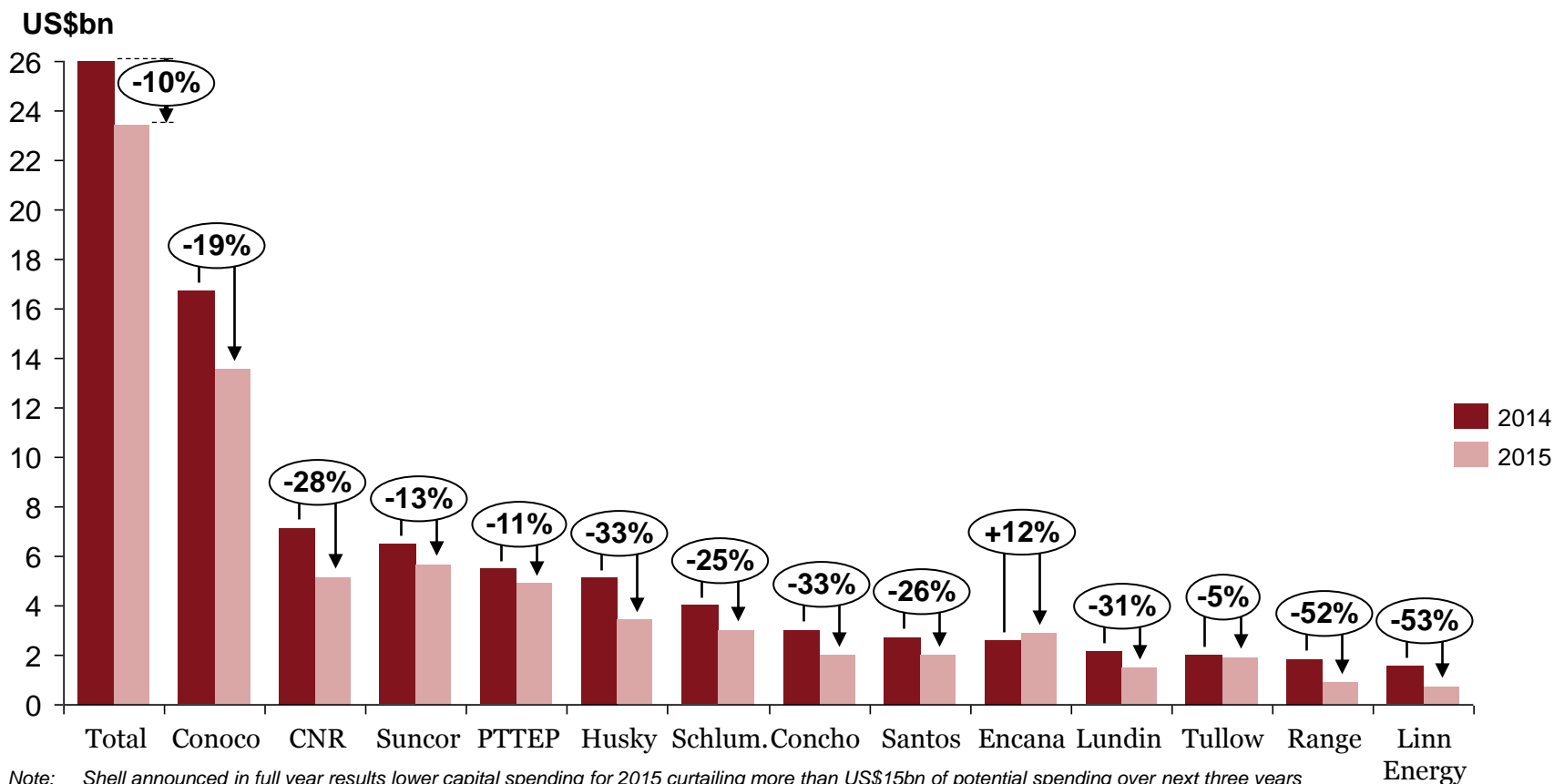
Industry is keen to hang on to engineers and geologists

Layoffs may prove more costly than retaining workers

Oil companies are reluctant to stop hiring altogether

Across the industry companies have announced substantial capex reductions, with global E&P capex forecast to shrink by ~10%

Recent Capex announcements Selected Examples



Note: Shell announced in full year results lower capital spending for 2015 curtailing more than US\$15bn of potential spending over next three years

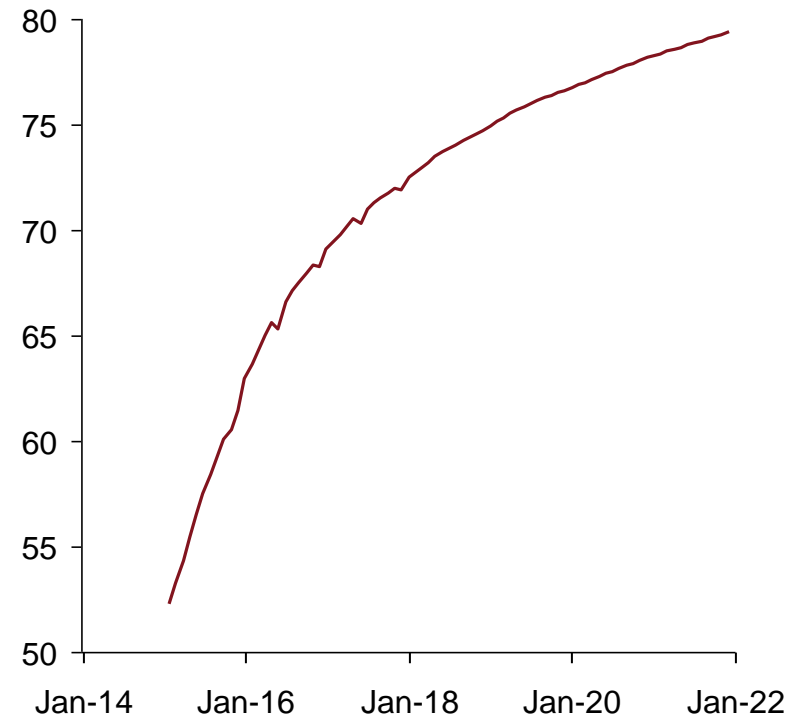
Source: Bloomberg; Press; Strategy & Research

With oil price in contango, there are storage opportunities plays for traders

Brent ICE Feb. 2015 Futures Contract

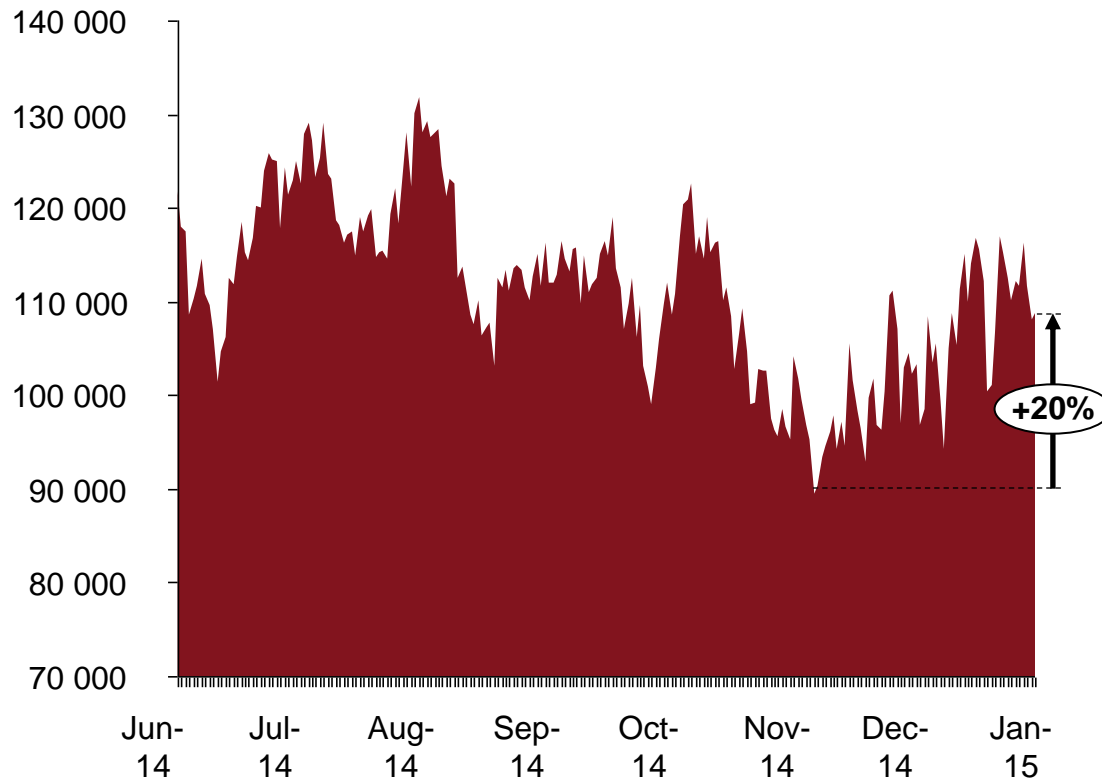
Jan. 2015 – Dec. 2021

US\$/bbl



In fact, since November 2014 floating storage has seen volume increase by 20% to reach ~110m bbls

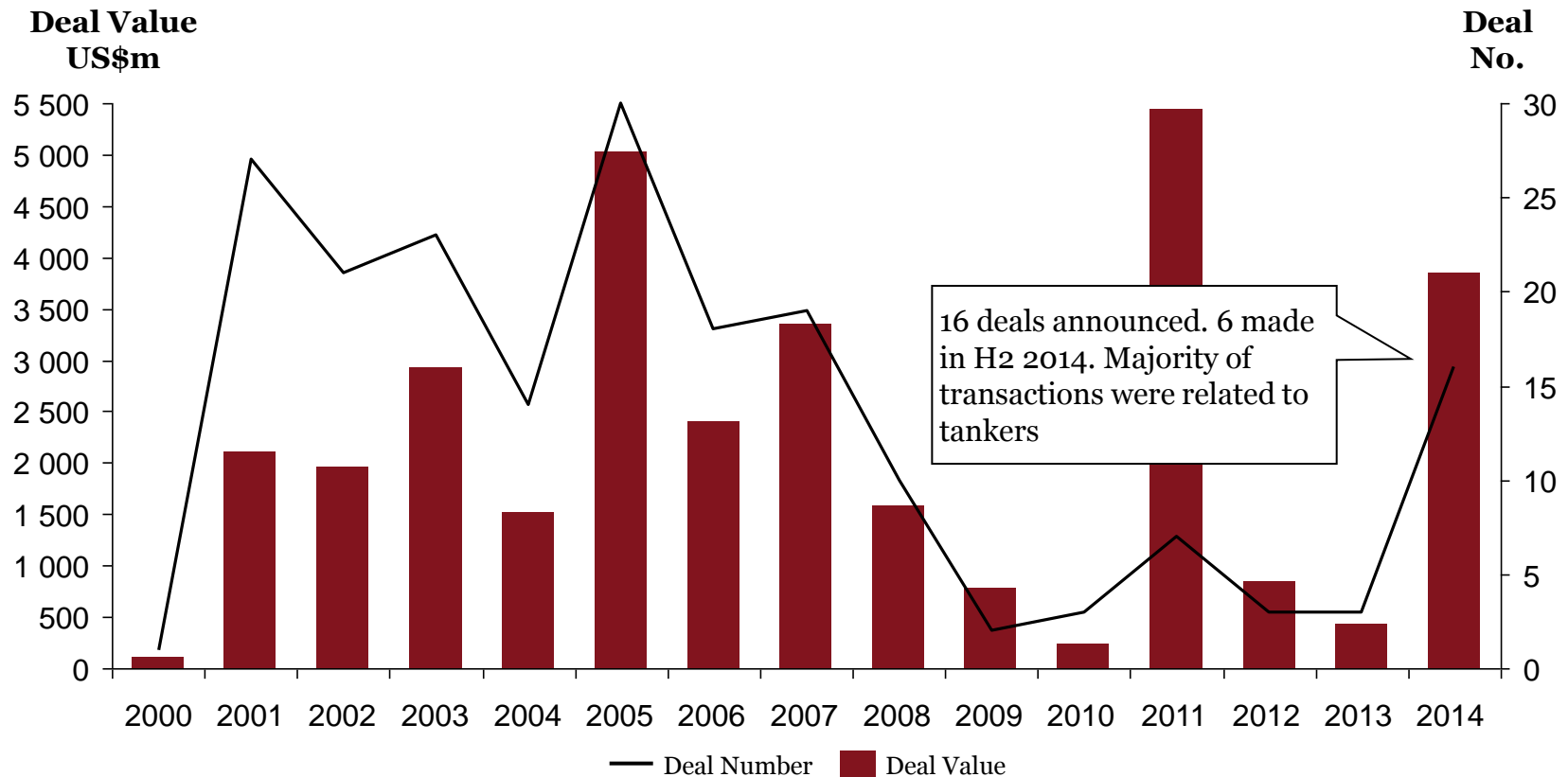
Global Floating Oil Storage June 2014 – January 2015
000s bbls



Source: Bloomberg; Lexis Nexis

In terms of M&A, 2014 already witnessed an increase in deal activity for tanker and storage assets

Global Midstream Asset M&A for Storage & Tankers 2000 - 2014



Note: All deals US\$10m+, all geographies covered, assets only (not Corporate) and across Storage and Tankers only. All gas assets excluded. Oil and NGL captured
Source: Strategy& research

Moreover, as IOCs shift into ‘austerity’ mode they will seek to squeeze OFS providers for savings and explore options

Reduced capex spend = less construction activity upstream => adverse impact on OFS activity levels

Some IOCs are already exploring other options in oil services + pushing for increased standardisation for components

IOCs likely to negotiate even more on pricing with OFS players

Eni has gone one step further recruiting some 2000 employees to bring EPC work in house

Failure to review and adjust rates downwards => future loss of orders

Source: Bloomberg; Strategy& research

Thank you!

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