

2018 SIMMONS UK ENERGY FORUM RECAP

Connecting Our Industry for the Future



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INTERNATIONAL

ENERGY SPECIALISTS OF PIPER JAFFRAY

The inaugural Simmons UK Energy Forum was held in glorious St. Andrews on 16 and 17 May 2018.

The theme was “Connecting our Industry for the Future” and we were joined by over 180 senior executives from across the industry.

We would like to take the opportunity again to thank all of our moderators, panellists and interviewees for contributing to such a high quality discussion over the 2 days. Also to Kirstin Gove who controlled proceedings from the opening Conversation in the Clubhouse with Deirdre Michie, Jonathan Roger and Paul Warwick to the closing interview with Robin Watson and ensured that our 4 panels: E&P, Private Equity, Oil Services and The Future ran to time.

The Forum was conducted under “Chatham House Rules” and we appreciated the open and frank commentary from all our panellists and interviewees. We felt that “Chatham House” contributed hugely to the success of the event and are conscious of all it implies. The discussions were so informative and thought provoking however, that we wanted to capture some of the broader themes and topics covered as a reminder of some of the challenges and opportunities ahead.

Key takeaways from our perspective were as follows:

The North Sea is Back

If you subscribe to the view that US shale, Russia and Saudi tell you all you need to know about the oil industry then turn away now!

Despite an almost 4 year downturn, the North Sea has seen significant recent investment and new commitments from majors, independents and new entrants alike. Across the industry there is a mood of determined optimism.

Capex and opex costs have reduced to such an extent that the UKCS is now one of the most economically attractive offshore basins globally. Production efficiency has risen for 5 consecutive years to 74% in 2017 and as a result there are now believed to be an additional 2.8bn barrels of reserves to recover compared with 2014.

Added to that, we have a “Carlsberg” regulator in the OGA which is focused on getting the right assets in the right hands to drive overall activity, production efficiency and maximise the recoverability of the basin.

So despite the challenges, the North Sea is back and it is here to stay if we do it right.

Oil Companies Are Seeking Sustainability And Modernisation

We heard from a full range of E&P companies from majors to independents and new entrants and there is a similar range of approaches from different oil companies in the current market.

Across the board, operating costs have halved since 2014 and the recent commodity price rises have given oil company coffers a real boost. As a result of that confluence of factors, operators are making more money at \$70 oil than they made when the price was \$140!

Against that however, there remains a broad sense of conservatism and a concern at emerging price inflation. Regardless of scale or approach, the oil companies are wary of the recent past (“where did all the money go?”) and focused on controlling costs as the sector improves. There was also a genuine concern from across the E&P community that oil price is artificially high and includes an unsustainable political premium for the first time in recent years.

There is a common goal to keep the basin competitive and attractive from a capital allocation perspective and a shared view from the E&P community that sustainability is key to long term prosperity of the North Sea although there is also some dread that lessons have not been learned and at the potential inevitability of the next boom and bust cycle.

While a lot has been achieved through the downturn in terms of enhanced production efficiency there is still a lot of room for improvement – some exploration activity would be nice! The oil and gas sector has been 40% less efficient than other sectors and there was a call for modernisation, standardisation and collaboration to drive long term efficiency.

This will require a new approach and learning from outside the industry and our E&P panel encouraged diversity, in thinking as well as people, to ensure we meet that challenge.

Private Equity Has A Significant Role to Play

The downturn created opportunities for Private Equity: where industry was scared of capex commitments, private equity has stepped in. We heard from investors in upstream assets and oil services, and the approach taken is different in many respects between the two. In upstream, the oil price is a direct driver of revenue and value and investors at the bottom of the cycle have enjoyed a windfall as the commodity price has doubled; in the service sector, investors base their decision on activity levels and focus on businesses with a structural growth opportunity rather than seeing oil price recovery as the main driver.

There are similarities between the two however as quality of assets and management team are fundamental to private equity investment decisions while survivability in a down cycle is also a key factor in investor thinking.

Private equity is focused on generating value. Funds will look for efficiencies and opportunities to deploy capital where there is a clear return and can support companies trying to manage the challenge of capital allocation with competing demands from across their business.

There was a warning shot for UK private equity with regard to the industry standard approach of taking no contractual risk on exit. It was noted that this may be unsustainable in the oil industry and not aligned with global/international practice for private equity.

Everyone Wants to See Technology Development But The Challenge Is To Deliver The Ambition

All our operators seemed willing to embrace new technology and better ways of doing things however, there was a disconnect with the view from service companies trying to get new technology in the field. That challenge was recognised by all sides and while there are technology champions in oil companies who are keen to be first rather than second adopter, they are not always easy to identify. Equally there is the challenge of 'Frenemies' in the supply chain – big service companies focused on retaining market share or margin who can offer a large distribution footprint but can also block the introduction of technology by the smaller players.

On the other side, there is a sense that small companies often set about trying to create game changing technologies whereas many of the industry's best productivity improvements come from incremental gains - doing things slightly differently or from better practices/business models. New technology needs to be focused on customer need rather than intellectual development in order to succeed.

Trust Not Collaboration

The "C" word was in evidence across our panels and whilst we have been cynical about the existence of genuine collaboration in the industry, it was clear that there are real examples which go beyond normal contracting.

What became evident however was that much of that "real" collaboration has taken place between operators themselves rather than between oil companies and the service sector. There are some noteworthy exceptions to that however, particularly involving new entrants whose business model relies heavily on partnership with the supply chain.

It was suggested that “Collaboration” had become just a buzz word which was often not married with actions and what is actually needed is “Trust” across the whole energy segment, especially between upstream and the supply chain. This would enable simplification of operations and consolidation of the supply chain and both sectors should work together to reduce interfaces rather than continue with “man marking”. This could also lead to significant reductions in “customer enforced waste”.

The “60 Day Club”

Amid all the talk of trust and collaboration it was noted that from a supplier perspective the biggest single improvement that could be made is customers adhering to standard payment terms. Big guys using the little guys’ credit by stretching payment terms or tactically disputing invoices will put companies out of business. As the industry recovers this would be a travesty and it needs to be addressed. Now.

Decommissioning Is Like An Aberdeen Taxi

No-one is quite sure when it is coming or what state it will be in when it arrives! Our panellists viewed decommissioning as part of the oilfield lifecycle and not a separate industry. Dedicated decommissioning service providers may beg to differ but there remains a sense of tomorrow’s opportunity.

Oil and Gas is a Critical Component of Future Energy Mix but the World Is Changing Fast

Renewable energy is becoming mainstream today. The UK is the world leader in offshore wind and across that sector they are making huge efficiency gains which could lead to subsidy free developments in the near term and a global export business.

Renewables needs to be recognised as a competitor to oil and gas operators for future energy supply and for people. However, there is a big opportunity in offshore wind for oil sector technology and space for contractors which means the two can sit side by side. Renewables has a far better public image than the oil and gas sector and as a result, finds it easier to attract young people.

Shale has transformed the US energy landscape - it has become an exporter of gas as a result. Fracking is just a completion technology but has an image problem which continues to severely handicap a potentially significant UK shale industry.

The Fourth Industrial Revolution is upon us fusing physical and social factors and shaping the whole way of life. Speed of change is like nothing we have seen connecting the whole world. As we move through energy transition we see 3 industries converging - automotive, electricity and oil and gas. Oil and gas will have an important role for at least the next 30 years but there is a real prize in efficiency and from embracing change.

Summary Thoughts

As we reflect on these issues and the discussion at the Forum, it is clear that we are entering a critical period for the industry and the North Sea in particular and there are some interesting challenges for all constituents to consider:

Challenge for the oil companies

Oil companies believe they have done a great job in cutting costs and improving efficiency but how permanent or sustainable are these cost reductions? Many service companies feel operators have taken advantage of the supply chain and if these cost metrics are to be sustainable there needs to be a new culture of trust. The discussion needs to move from a procurement driven view of cost and price to one of value and partnership to reward innovation and eliminate waste.

Challenge for the service companies

With hindsight, the service sector became inefficient but it played to the rules. In this new era, the rules are all about sustainability. Can service companies adapt again to ensure that increased profits are driven by delivering value not just capitalising on inefficiency? Can the pressure of shareholder returns today be balanced with a need for long term industry stability?

Challenge for private equity

Private Equity provides much needed capital but gets accused of asset stripping or focussing on short term growth in preparation for sale. It owns, drives and controls businesses yet doesn't stand behind the legal risks on a sale. The risk is passed to management and the buyer but we heard that Warranty & Indemnity Insurance does not always offer a sufficient answer. How can Private Equity continue to invest in and grow businesses but manage the desire to achieve value for exits with a limited appetite risk?

Challenge for industry bodies and government

Industry bodies and government set the framework and should have a role to establish best practice. We have the best regulator in world and some hugely influential industry bodies but the boom and bust has left companies hurting. What more can be done? Is there a role to enforce technology adoption or industry wide payment terms? What about the long term future – incentives for exploration? Why won't the UK look at a variation of the Norwegian model?

Challenge for all of us

Can the next phase of the industry be successful regardless of the oil price? The biggest obstacle is short memories. We saw with global financial crisis that banks which had barely survived soon resumed lending at aggressive levels of leverage. In North America, costs have rebounded as activity has increased. Will it happen in the North Sea? Can it be controlled? And if we don't, will we be able to survive another "bust" cycle?

We hope that you enjoyed the Forum and that we have captured accurately the key themes which emerged and given food for thought with our questions.

We saw real value in connecting people from across our industry and starting the discussion about the future - both immediate and longer term. There is a huge opportunity for the offshore industry and specifically the North Sea but it won't be captured in silos. To avoid boom and bust we need fresh thinking. Making money is a good thing across the energy cycle and it doesn't need to be done in phases as the pendulum shifts. So let's focus on value and efficiency gains, not only cost.

The challenge for bigger organisations is to convert senior management desire and strategy into execution at the coal face. To that end we need to be careful with the instruction. Standardisation and simplification of the supply chain is a good thing but watch squeezing the little guy. So much origination and innovation comes from the smaller service companies we need to ensure it isn't lost in a drive for efficient supply chain.

We are really grateful for the feedback that we have received and are pleased to confirm that we are making plans for future Energy Forums.





Special Thanks to All Our Forum Speakers, Moderators and Panellists

A Conversation in the Clubhouse

Deirdre Michie, Chief Executive, Oil and Gas UK

Jonathan Roger, Chief Executive, Siccar Point Energy

Paul Warwick, Executive Chair, Whalsay Energy

E&P Panel

Neil McCulloch, Technical & HSE Director, Spirit Energy (Moderator)

Tony Durrant, Chief Executive, Premier Oil PLC

Leigh-Ann Russell, Head of Function, Upstream PSCM, BP

Graham Stewart, Chief Executive, Faroe Petroleum

Tom Wheeler, Director of Regulation, Oil and Gas Authority

Private Equity Panel

Simon Evers, Managing Director, Warburg Pincus International LLC (Moderator)

Nicholas Gee, Partner, Buckthorn Partners LLP

Mustafa Siddiqui, Senior Managing Director, Blackstone Group

Martin Somerville, Director, Blue Water Energy

Oil Services Panel

Walter Thain, Chief Executive North Sea, Three60 Energy (Moderator)

Dave Blackburn, Senior Vice President, Operations Services, Petrofac

Bob Drummond, Chief Executive, Hydrasun

John Evans, Chief Operating Officer, Subsea7

Joe Rovig, President, Rig Technologies, NOV

Eric Swanson, Senior Director, Corporate Development, Halliburton

Futures Panel

Colette Cohen, Chief Executive, The Oil & Gas Technology Centre (Moderator)

Hugh McNeal, Chief Executive, RenewableUK

Jim Pearce, Partner, A.T. Kearney Limited

Ian Roche, Managing Director, Aurora Energy Resources

Dinner Interview

Robin Watson, Chief Executive, Wood

And our Forum Host

Kirstin Gove, Media Consultant, Kirstin Gove Media Consultancy

Agenda

Wednesday 16th May

- 17.30 Welcome Reception
St. Andrews Bar & Grill
(located in the Clubhouse, Fairmont St. Andrews)
- 18.30 Clubhouse Chat: Kirstin Gove with Deirdre Michie, Jonathan Roger
and Paul Warwick
- 19.45 BBQ Buffet

Thursday 17th May

- 07.00 Coffee, tea and breakfast rolls served in the conference centre
(ground floor)
- 08.00 Opening remarks
- 08.10 – 09.10 E&P Panel
- 09.20 – 10.20 Private Equity Panel
- 10.20 – 10.50 Coffee and Comfort Break
- 10.50 – 11.50 Oil Services Panel
- 12.00 – 13.00 Futures Panel
- 13.00 – 13.45 Lunch
- 14.00 onwards Various activities
- 19.00 Pre dinner drinks
Atrium on ground floor
- 19.45 Closing dinner
The Ballroom
- Keynote Speaker: An Interview with Robin Watson

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