# PERMIAN BASIN PETROLEUM ASSOCIATION
# STATE OF PLAY: WHERE ARE WE GOING

James K. Wicklund, Managing Director

Stephens Energy Investment Banking

April Fools 2021

Stephens

# An Independent Financial Services Leader

Stephens Inc.

| Investment Banking | Institutional Sales & Trading | Equity Research | Wealth Management | Principal Investing | Public Finance | Insurance |
|---|---|---|---|---|---|---|

**1200+**
Stephens Employees(1)

**220+**
Investment Banking Professionals(1)

**11**
Corporate Finance Offices(1)

**9**
Industry Groups

**500+**
Companies Covered

**338+**
M&A Transactions

**225+**
Equity Offerings

**110+**
Debt Offerings

(1) Includes affiliates

Note: Stephens statistics since 2010

# Schlumberger and Halliburton to Merge

- The two companies announced this morning a blockbuster deal that puts the two largest OFS companies together
- The Deal creates a **$100 billion company** that will dominate every sector in which the combined companies play
- Operating synergies are expected at $1 billion just by reducing management headcount
- "Now we get to see what a real monopoly looks like!" – Wall St. Analyst
- Two CEOs will compete for the top job. **Arm wrestling** or **cattle roping** have been suggested
- Baker Hughes complains, why not us?!?!?!?

**Happy April Fools!!!!!**

# Stark Realities

- *Oil prices will be whatever they need to be* so that supply and demand are met
- The US can bring production on *faster* than any country *but* ***not at the lowest price***
- $20/bbl is too low and $150/bbl is too high.  Somewhere in between is **balance**
- **Losses for the sake of production growth** are *not likely to be subsidized as routinely* this time
- Democratic regimes typically increase rules, regulations and ultimately oil prices and *higher oil prices* are **generally goo**d for the industry
- Oil demand growth is expected to be **stable to lower** over the next several years
- Natural gas was originally hailed as a "*bridge fuel*" from hydrocarbon to renewable but its abundance, low cost and efficiency should **keep it mainstream** for some time
- US LNG has gone from rejected cargoes and $1.80/mcf landed Asia prices as recently as August, to now selling at *record levels of $20-$30/mcf*.
- If you buy a Tesla in Dallas, **more coal** will be required to power your car.  If you live in some West Coast areas, you are not allowed to directly use natural gas but must by electricity generated by natural gas at twice the price.  ***There are still issues.***

# Who Wants to Play?

**The E&P industry** cannot survive without access to capital.  The timing of cash needs for pre-production (pre-cash flow) means some advance is required, which increases risk

I**nvestors** have typically "rented" stocks in the oil & gas sector rather than being long-term owners because it is a cyclical (hyper-cyclical!) industry so bad behavior often got bailed out, and investors could make windfalls depending on the time

Over the last 10-year, the oil shale boom, *the **21 public E&P companies*** during that time, boosting oil production to 13mmbopd, *outspent cash flow more than seven years* to accelerate the recognition of value.  Over that period, the 21 companies in aggregate *lost $100 billion in value* and *$36 billion in net income*

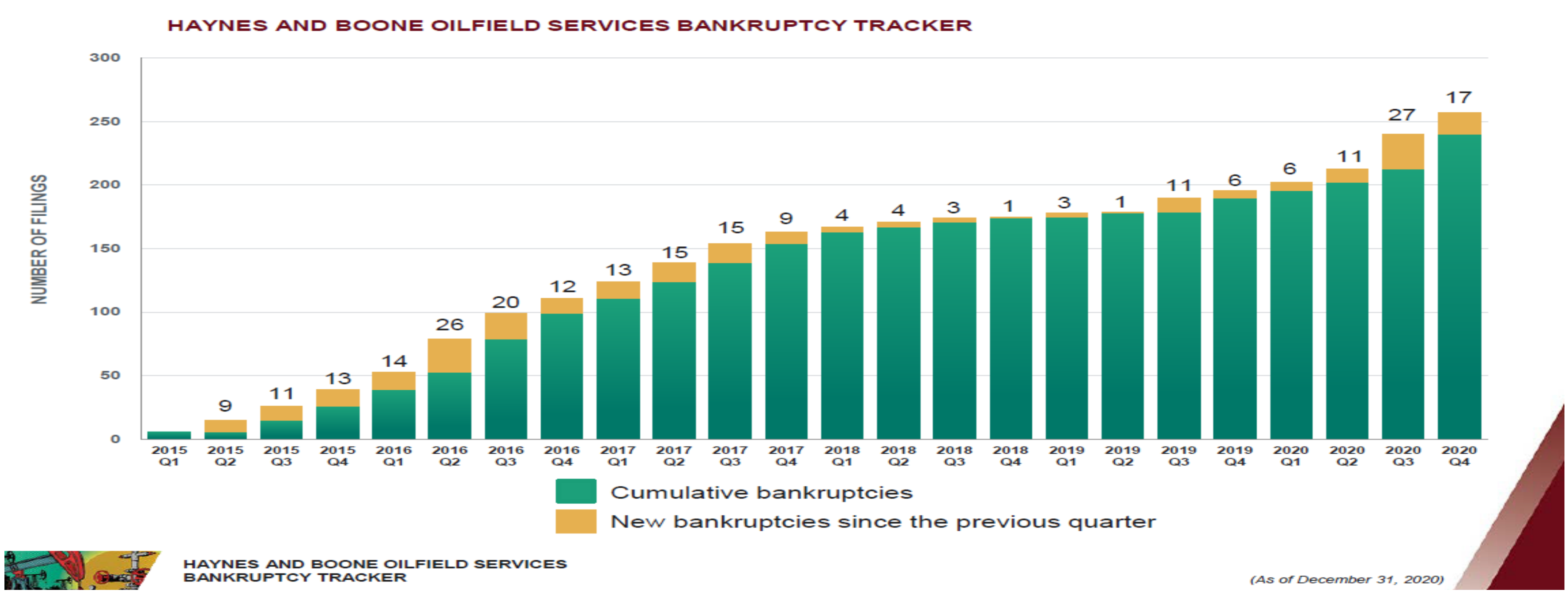
If a company cannot at least ***earn its cost of capital*** and *return some cash to investors*, who would provide capital considering the history, unless they change how they operate

**Scale matters** in a consolidating world and there are over 45 public OFS companies with market capitalizations under $200 million, which is microcap.

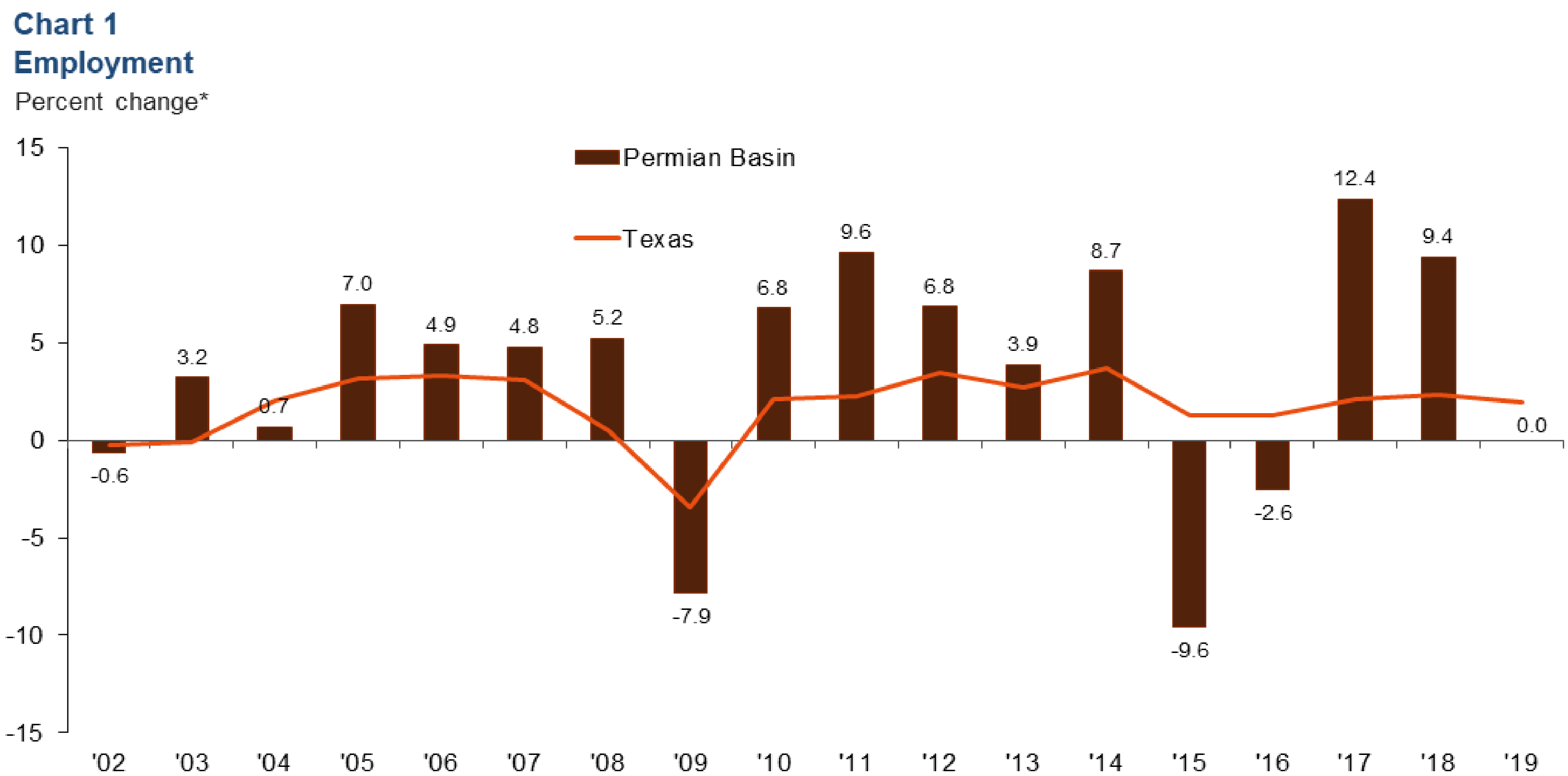
# The Sector has Struggled

- Since the beginning of 2015 through December 31, 2020, Haynes and Boone has tracked the filing of **257 oilfield services (OFS) bankruptcies**.
- Including E&P, there have been over **600 bankruptcies** filed in North American over that period.
- The aggregate debt for North American oilfield services companies in 2020 was **$45 billion**, which was the highest in the past six years, while the second highest was **$35 billion in 2017**.

2015-2020 CUMULATIVE NORTH AMERICAN OILFIELD SERVICES BANKRUPTCY FILINGS



# Need a Job??

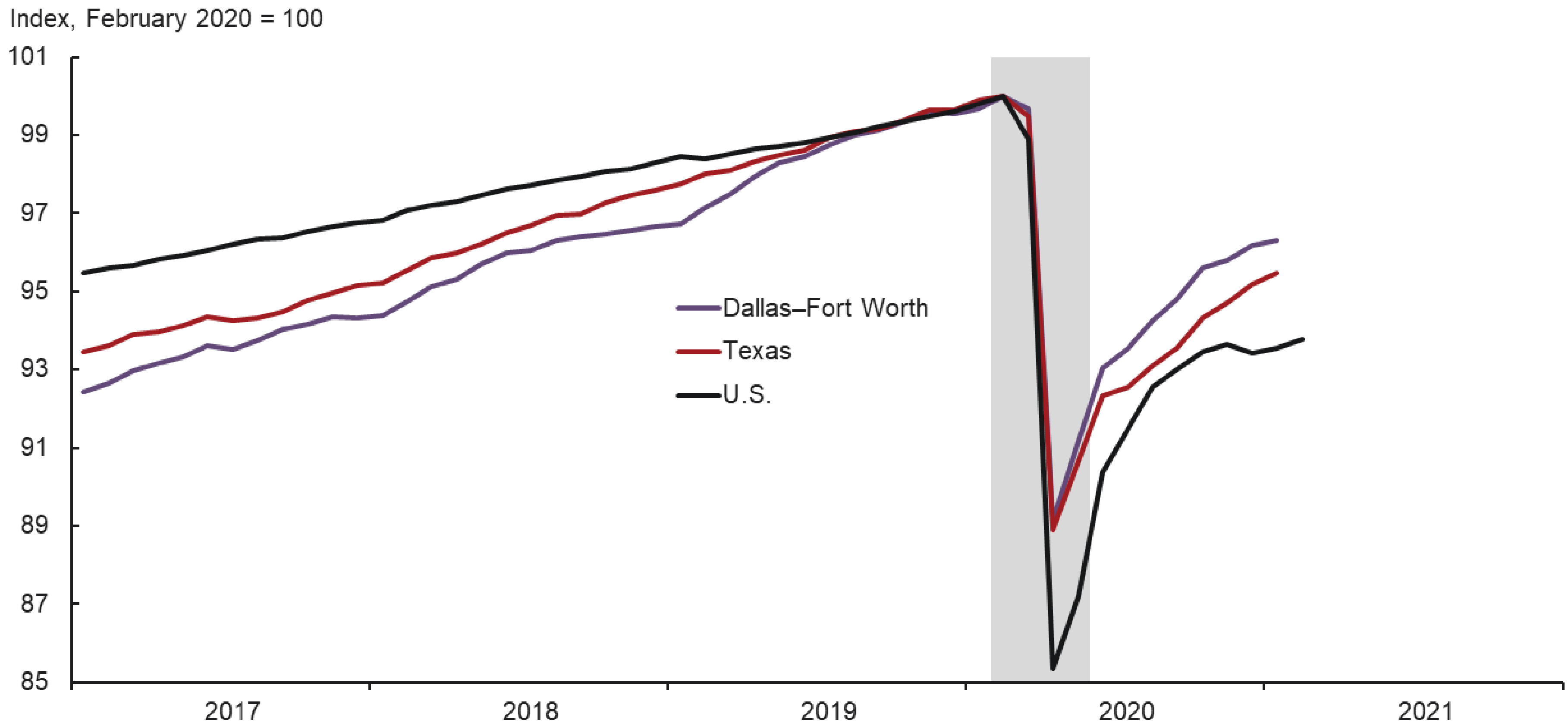



*Seasonally adjusted.
NOTE: Last data point is annualized November 2019/December 2018.
SOURCE: Texas Workforce Commission; Dallas Fed; author's calculations.

While the Texas economy is growing at a healthy pace and has posted solid job gains, the **Permian Basin labor market is sluggish**. Data through November 2019 show that Permian employment is unchanged at 0.0 (Chart 1). This marks the first time since 2016 that Permian Basin employment has lagged Texas job growth.

# What Recovery Looks Like

**Chart 1**
**Employment Growth**

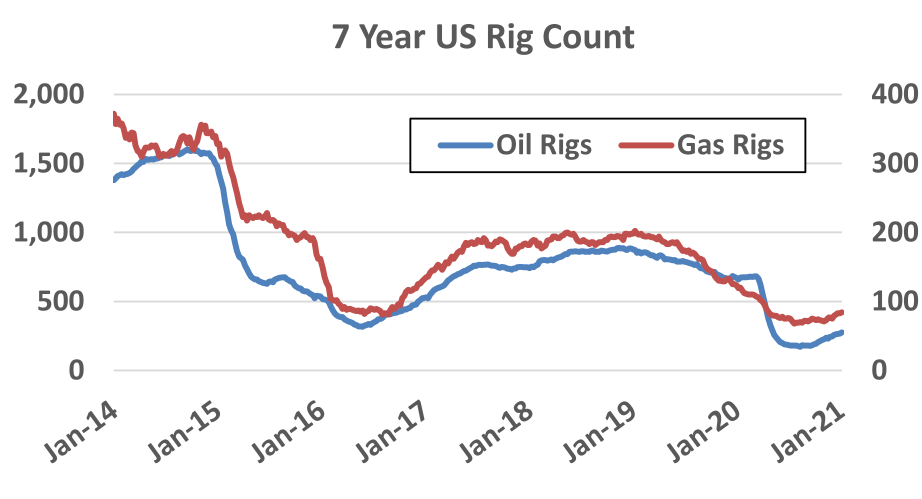



NOTE: Shaded bar indicates Texas recession.
SOURCE: Bureau of Labor Statistics; Texas Workforce Commission; seasonal and other adjustments by the Dallas Fed.

## Texas fared relatively well – an 8th floor drop versus 10th

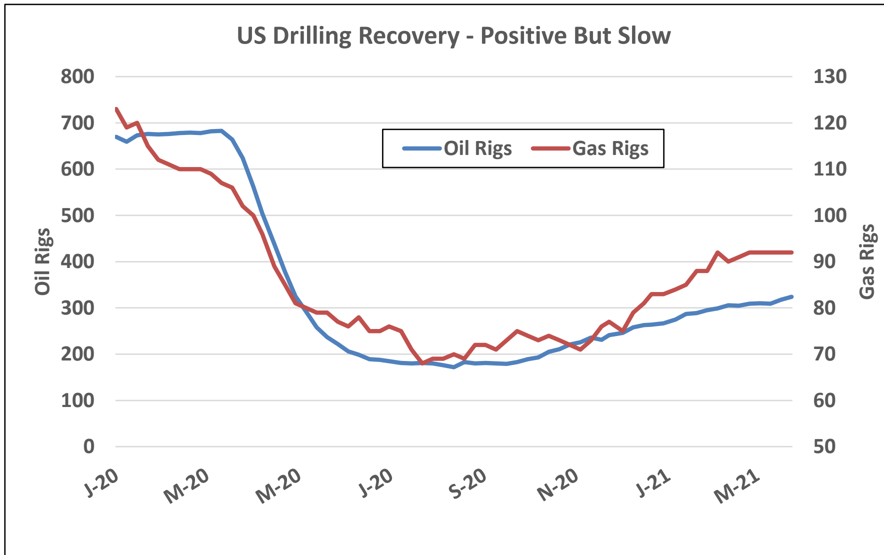
# Lift-Off (At a Fairly Low Angle Slope)

**The lowest rig count in recorded history was seen in 2020**




Source: BKR

**The expectation is for some level of continued improvement**




The US rig count is still a shell of its former self. In August 2014, the US rig count hit **1,931 rigs drilling**. Today's rig count is 360, down 82% from 7 years ago. But it is **up 47% from the bottom** of less than 6 months ago.

The key is that on an absolute basis, the rig and frac spread counts **are rising**, commodity prices are supportive and while fluctuations will exist, everything points to US onshore activity improving off an all-time bottom low

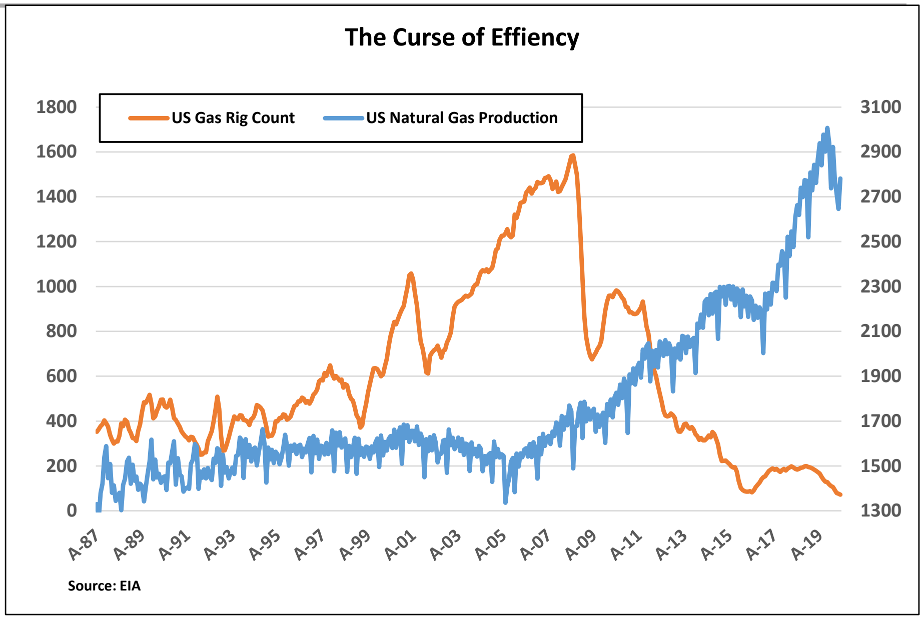
# We Aren't Going Back to the Old Days

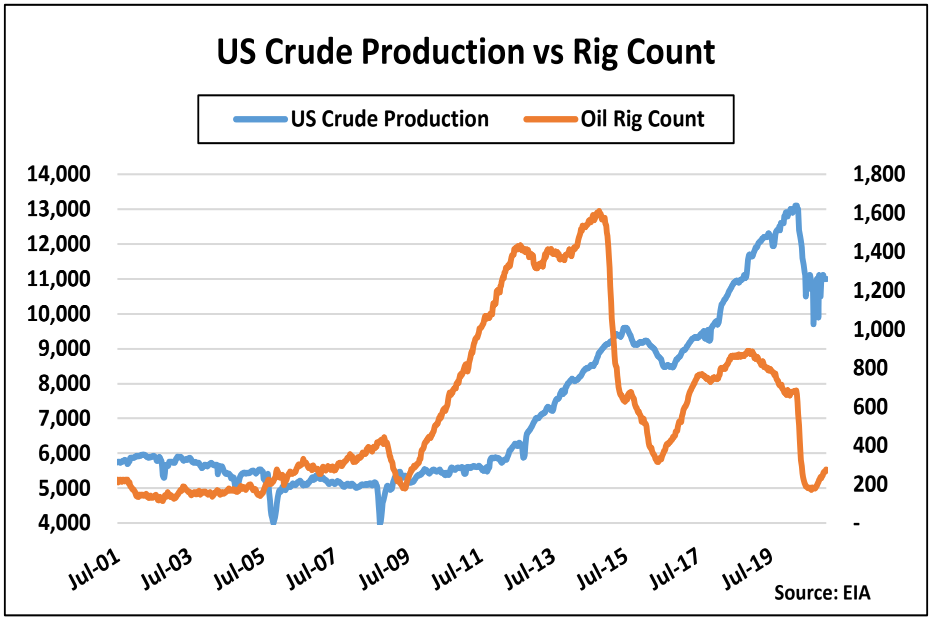
- **Doing More with Less**
- **Automation**
- **Increased Efficiency**

The **Buzzwords** of the industry over the last 6 years, every since the collapse of oil prices in 2014

Oil going to $70/bbl would dramatically accelerate the shift away from hydrocarbons and while the world cannot spin without them *now*, let's not hope for a hurried future.

**Make money.** Run a profitable business. Generate a positive return to all *stakeholders*



# Energy Stocks are No Longer Growth Stocks

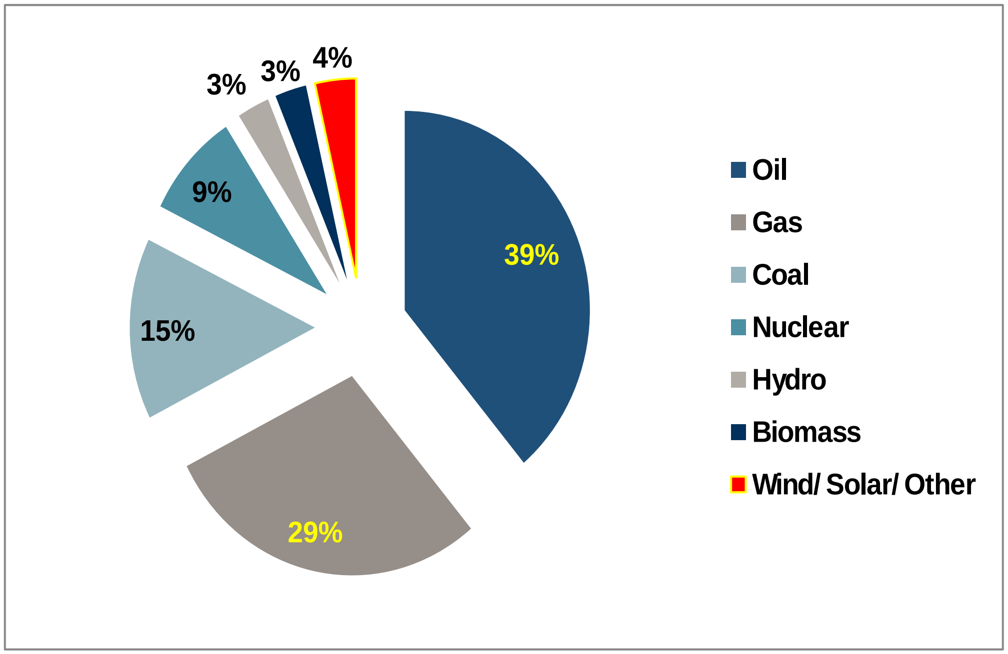
- **It is a mature industry and <u>no longer a growth industry</u>**
- **Ownership reflects the difference and the owner sets the rules**
- **It changed the strategic direction of Majors and Independents**

**It is here to stay**

- **Return on and return of capital will continue to be a trend**
- **Return on Invested Capital (ROIC) above the cost of capital is the objective**
- **<u>Consolidation is a requirement, not a choice</u>**
- **The equity and debt markets are close to <u>being closed to industry</u>**
- **<u>ESG issues are increasingly important</u>**

**The market can stay irrational longer than you can stay solvent – John Keynes**

# Is the Oil & Gas Industry Still Even Relevant??




- In a word, **YES**
- Oil as a transportation fuel (gasoline) will be the first phased out
- PetroChem is the highest value add
- Natural gas is a clear winner
- But we are not loved

# Light at the End of the Tunnel

- Assets will move to the most efficient operators, with the less efficient ones going away
- The number of companies will be reduced, lowering total industry SG&A
- OFS assets will wear out, become obsolete and generally be reduced
- The E&P and OFS companies that remain and survive will be strong, with returns above capital costs
- Investors **will** "rediscover" the sector
- The "full cycle" economics of renewables will challenge their rate of adoption
- The industry will return to economic health
- It will be a smaller industry, with fewer people and companies
- US Oil production may never hit 13mmbopd again but the industry must grow to keep production flat
- It will be more profitable, focused on higher returns and lower growth

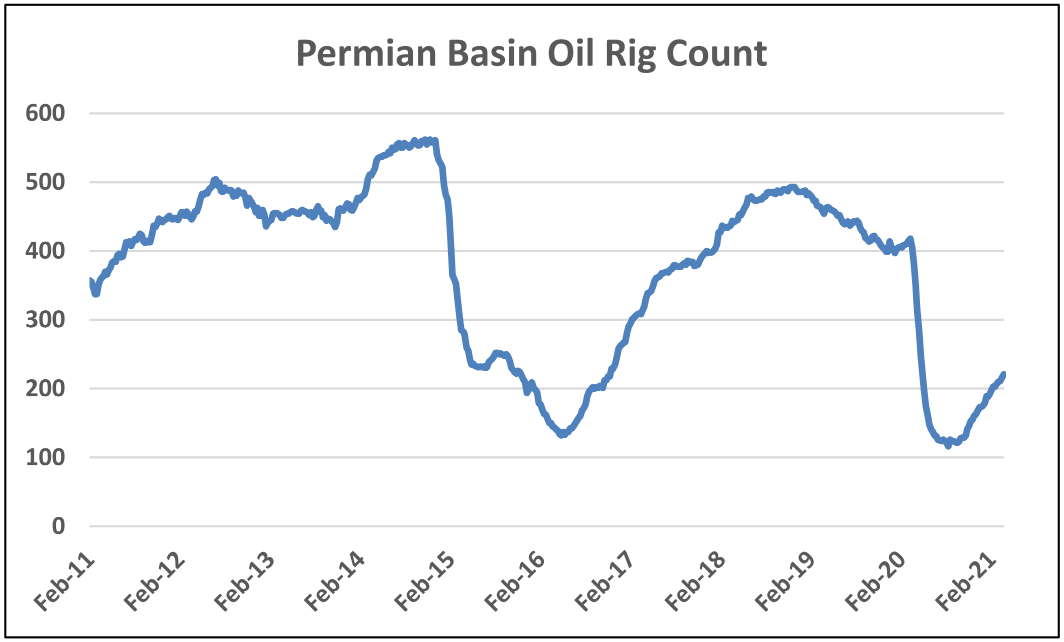
# The Dallas Federal Reserve Bank Speaks

- On average, respondents expect a WTI oil price of **$61 per barrel by year-end 2021**, with a range of $45 to $85. They expect Henry Hub prices **of $2.80/Mcf at year-end.** During the period of the survey, WTI averaged $64 and natural gas $2.59.
- The index for capex increased from **12.5 to 31.0**, indicating **an acceleration in capital spending among E&P firms**. The index for the expected level of capex next year came in at 49.5, signaling **firms have increased their capital spending plans for 2022**.
- Oilfield services firms **reported improvement in all indicators**. The equipment utilization index ***surged***, jumping 57 points to 63.2 in the first quarter.
- Operating margins improved, with the index **moving into positive territory**—increasing from -31.9 to 14.0.
- **However**, the index for input costs also rose notably—from -4.3 to 36.0—suggesting **mounting cost pressures**.

Data were collected March 10–18, and 155 energy firms responded. Of the respondents, 104 were exploration and production firms and 51 were oilfield services firms.

# Major Impact – Typical of Its Kind

- Chevron set its 2021 capital and exploratory spending budget at **$14 billion** and **lowered its long-term guidance to $14 to $16 billion** per year through 2025versus **previous guidance of $19-$22 billion** per year. **A big budget, that stays pretty flat.**
- In 2021 Chevron will increase investments in **Permian Basin**, other unconventional basins and Gulf of Mexico conventional oil. **So the bias of activity is *higher*.**
- The 2021 budget includes **$2 billion** for the Permian Basin, accounting for 17% of total capex. International is 56% and 26% other assets. **17% onshore US by a major is a significant shift over 10 years.**
- Permian budget is 40 percent of U.S. exploration and production budget. **It stays the most important basin.**




Source: Baker Hughes

# Another Major

- "Exxon Mobil Corp. is slashing spending to a four-year low and delaying major projects as the oil titan reverses course on a massive investment drive to keep its financial footing during the worst oil-price rout in decades." – Last year
- Exxon will **reduce this year's spending by 30%** to $23 billion, the company said in a statement Tuesday. It previously planned to spend $33 billion this year.
- It will be the **second-largest budget cut** in the company's modern history, overshadowed only by 2016, when crude markets last collapsed.
- 2021 capital spending guidance in a range from **$16 billion to $19 billion**, with the flexibility meant to accommodate oil revenue variations. That is down from **$21 billion in 2020** and from **$31 billion in 201**9.
- The pre-Covid capital investment plan for 2020 originally called for $33 billion capital spending.

**While reducing this year has hurt, the company expects to spend on average more over the few years, providing a modest but positive growth profile.**

# Light at the End of the Tunnel

- Assets will move to the most efficient operators, with the less efficient ones going away
- The number of companies will be reduced, lowering total industry SG&A
- OFS assets will wear out, become obsolete and generally be reduced
- The E&P and OFS companies that remain and survive will be strong, with returns above capital costs
- Investors **will** "rediscover" the sector
- The "full cycle" economics of renewables will challenge their rate of adoption
- The industry will return to economic health
- It will be a smaller industry, with fewer people and companies
- US Oil production may never hit 13mmbopd again but the industry must grow to keep production flat
- It will be more profitable, focused on higher returns and lower growth

# There is Little Choice But to Be Optimistic About the Future

- It is the oil business, we are resilient and necessary
- The technology is much greater than most anyone imagines
- We are all consumers, wanting clear air and water, but we are realistic about the business as well
- Oil & Gas are depleting resources and must be continually development
- Carbon Neutral is achievable, Carbon Free will take a lot longer
- The evolution of the industry will continue and "transition" has been ongoing for years
- Just as the industry has evolved, so will the people in it and their skill sets
- It will be smaller – it already is – but profitable and critical are both good

*"Prediction is very difficult, especially if it's about the future."*

- Niels Bohr (physicist)