



May 2010

## Oilfield Services and Equipment Sector Market Opportunity Update

- **Introduction and executive summary**
- Global energy industry and oilfield services trends
- Value flows: Oilfield services sub-sectors
- Oilfield services and equipment mergers and acquisition activity
- Oilfield services customer needs and investment priorities

## Executive summary

### Oil service industry trends

- The global financial markets have stabilized and oil demand and prices and capital spending are recovering
  - Given that oilfield services activity and investment are highly correlated to commodity prices, the sector's revenues and profitability have begun to recover
  - Global E&P spending is forecasted to rebound by 11% in 2010, partly reversing a 15% slump in 2009
  - In the long term, oil demand will continue to expand and the oil & gas service sector will continue to grow
- The combination of NOCs restricting access to easier-to-reach reserves, elephant-sized field potential and technological improvement has made deepwater development a critical source of international and national oil company growth in some portions of the globe
- The push to more challenging reservoirs (deeper, higher pressure and temperature wells) is yielding more robust and expensive equipment and services. However, operators are frustrated with some of the quality assurance /quality control inadequacies existing in service providers creating opportunities for superior service providers.
- Oilfield services M&A activity has plunged to its lowest level since 2005 due to a lack of available debt capital and high volatility in valuations within the sector
  - Both asset and corporate deal values have fallen year-over-year
  - As a result, oilfield service company valuations are at near record lows relative to replacement costs and Net Asset Values (NAVs)

### Investment considerations

- Value will be created where business designs are constructed that take advantage of industry trends and do a superior job of meeting customers' (producers') unmet and future needs
- According to operators, oilfield service company equipment is often fairly equivalent for many providers and this not a differentiator – the differences are personnel expertise, project management acumen, and having local expertise in the area

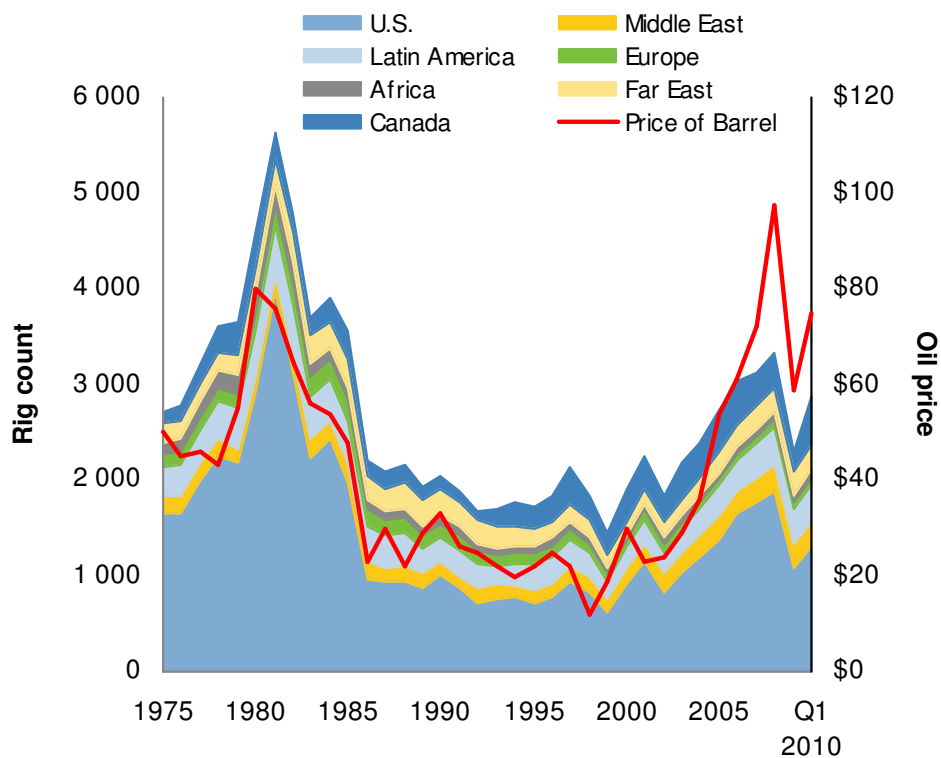
 **There are compelling opportunities today for private equity to consider in the oilfield services industry**

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# Global E&P spending is forecasted to rebound in 2010

## Evolution of worldwide drilling activity and oil prices (1975-2009)



Sources: Baker Hughes, EIA, Barclays Capital, Oliver Wyman analysis.

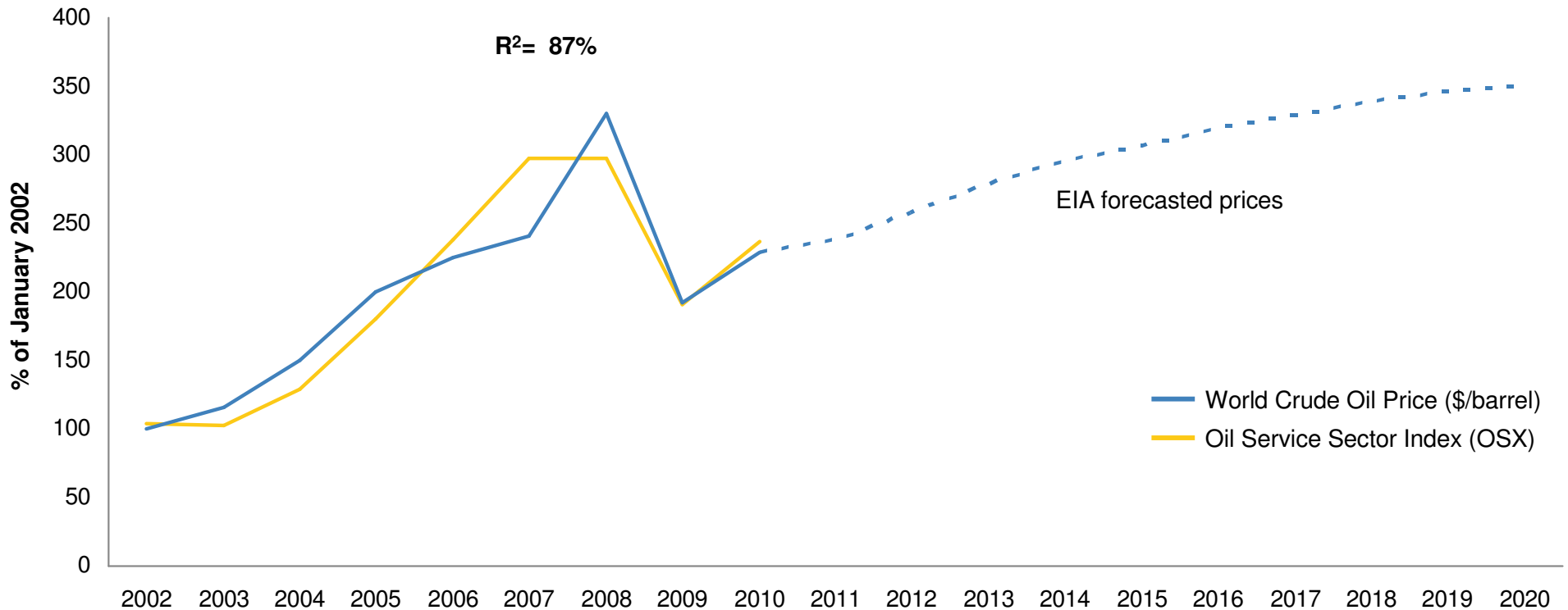
## Key observations

- Global E&P spending is forecasted to rebound by 11% in 2010, partly reversing a 15% slump in 2009, according to Barclays Capital's most recent semi-annual spending survey.
  - A strong rebound is forecasted for North America, which saw the biggest budget cuts in the past year. US spending is seen up 12% , while Canadian budgets are seen climbing 23%
  - Capex budgets outside of NA will be led by the national oil companies, who as a group are expected to increase spending by 10%
  - Companies based in Asia, Africa, Russia and the Middle East are planning the biggest spending increases, while European companies are keeping their budgets relatively flat from 2009
- The increase in spending is attributed to recent increases in commodity prices and loosening credit markets
- On average, companies are basing their 2010 budgets on an oil price of \$70.16 per barrel and gas prices of \$5.21 per thousand cubic feet
- About 45% of the companies said they expect to spend a greater share of their budgets on exploration this year than they did in 2009, up from 16% in 2009. That is good news for the seismic and oil-service industries
- The companies listed horizontal wells and fracturing and stimulation as the most important technologies for 2010, both of which are important in shale gas production, with 3D and 4D seismic considered the third most important

# EIA forecasted oil prices suggest improving market values for oilfield service companies

## World crude prices versus OSX index<sup>1</sup>

Monthly, January 2002 – February 2010 (\$USD)



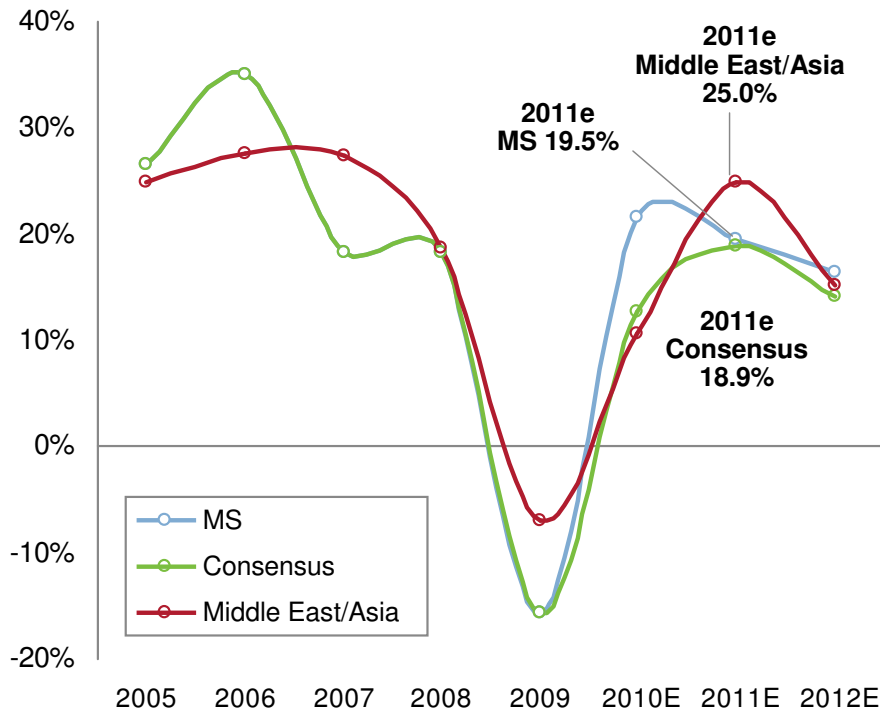
Source: Compustat, Energy Information Administration, OW analysis.

<sup>1</sup> OSX Index: Baker Hughes, Inc., BJ Services Co., Cameron International Corporation, Global Industries, Ltd., Halliburton Company, Nabors Industries, Inc., Noble Corp., National Oilwell Varco, Inc., Oceaneering International, Inc., Rowan Companies, Inc., Transocean, Inc., Smith International, Inc., Schlumberger Ltd., Tidewater, Inc., Weatherford Int'l Inc. All prices indexed at 100 starting in Jan 2002.

## Oilfield services revenue and EBIT margins

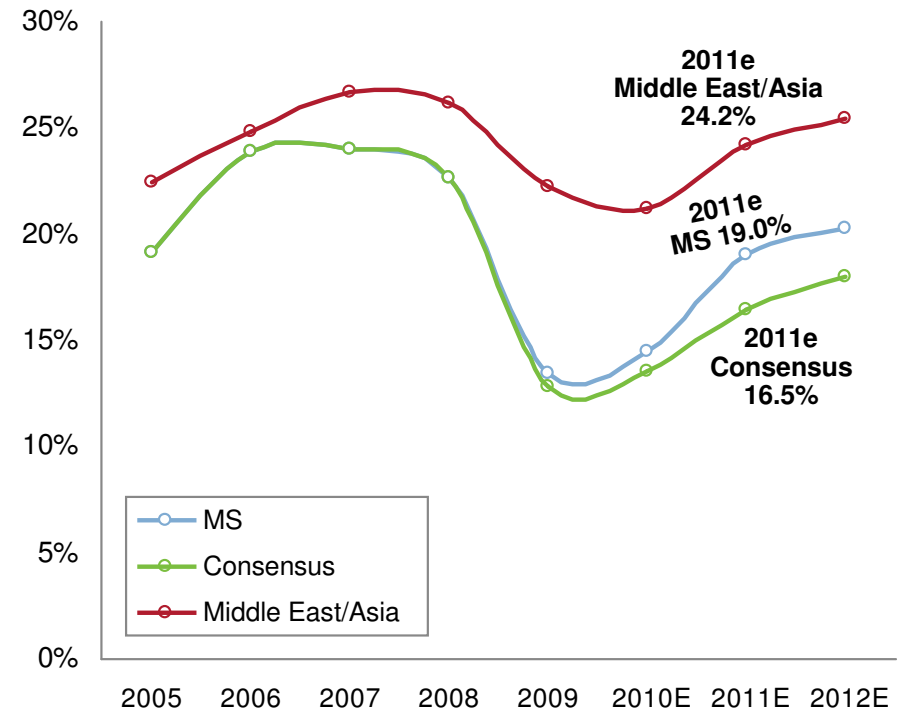
Increasing oil prices have led to increased drilling activity, and oilfield services revenues and margins have begun to rebound as quickly as they collapsed

### Oil Services Large-Cap: Revenue Growth



Note: Includes historical figures and MS vs. consensus projection of top line growth for the average of SLB, HAL, WFT and BHI.

### Oil Services Large-Cap: EBIT Margins



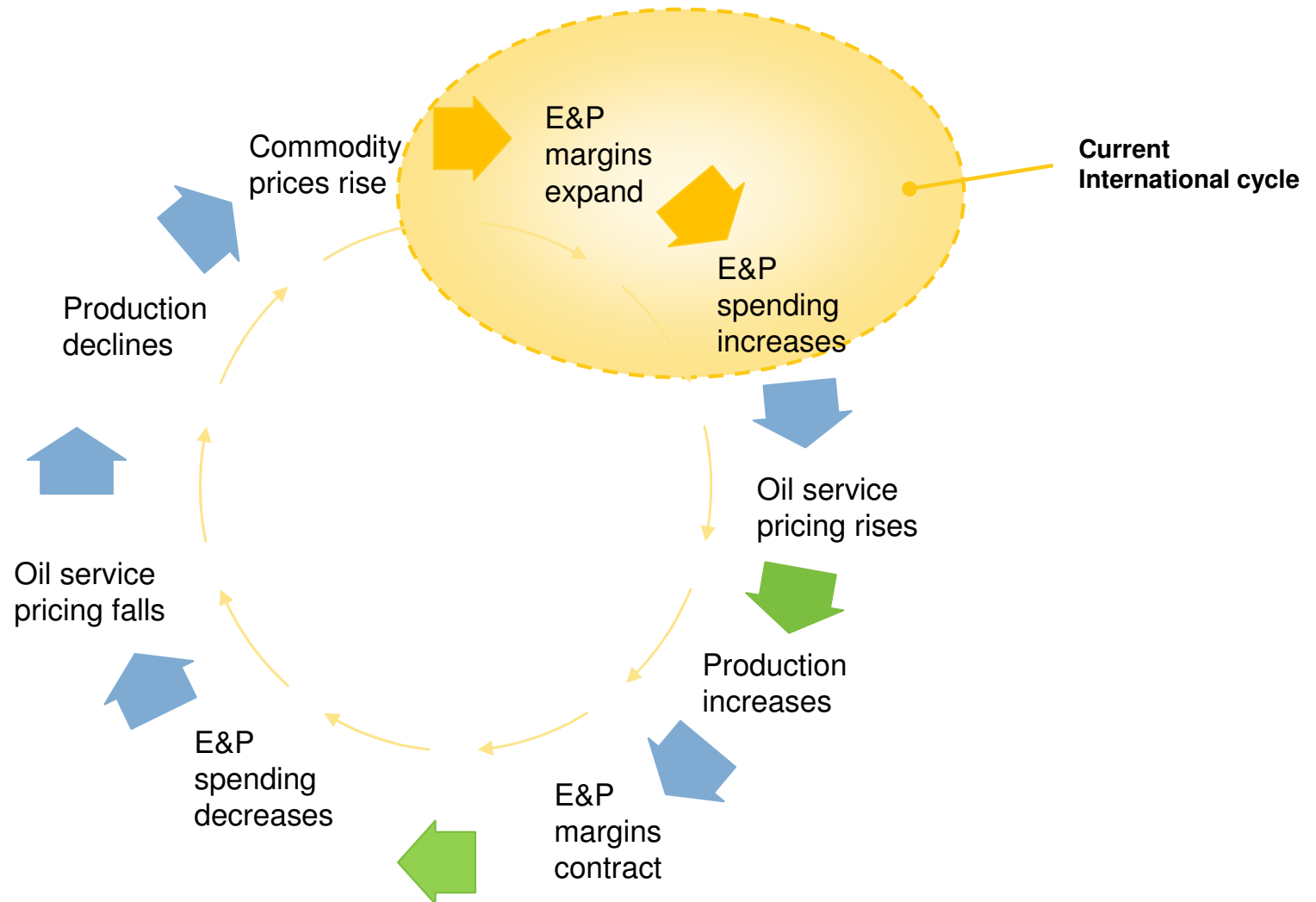
Note: Includes historical figures and MS vs. consensus projection of EBIT margins for the average of SLB, HAL, WFT and BHI.

**Middle East/Asia is projected to have relatively high revenue growth and EBIT margins relative to other regions.**

Source: Morgan Stanley.

## Exploration and production spending cycle

In large part, commodity prices determine the cash flow of producers which is followed by increasing cash flows to service and equipment providers

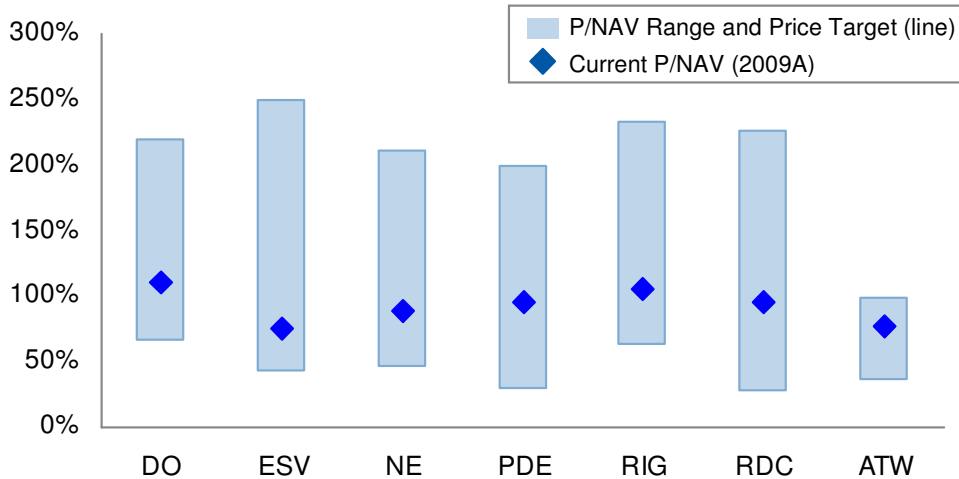


► Cyclical inflection points are driven by the expected returns from drilling.

## Market values recovering but still at low end of trading ranges

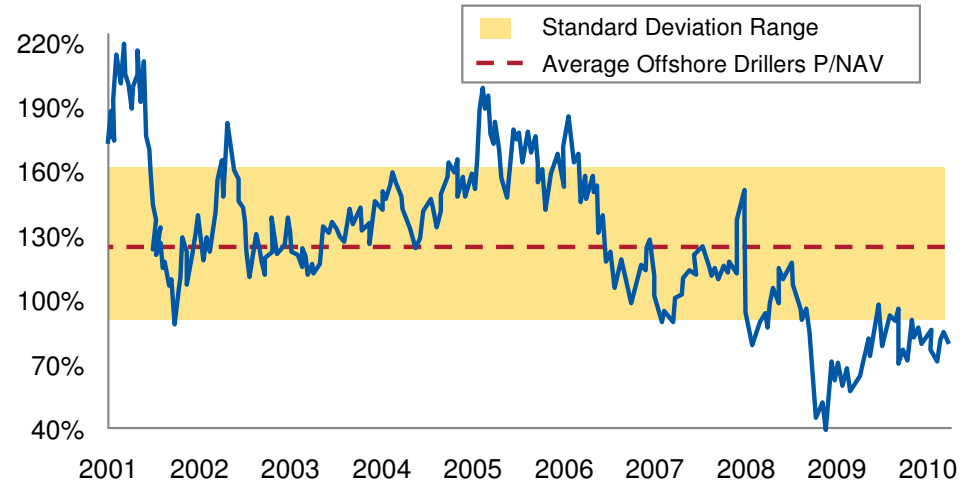
The price-to-net asset value, price-to-book, and price-to-sales for oilfield services companies are at or near historic lows

### Price/NAV Range (since 2001)



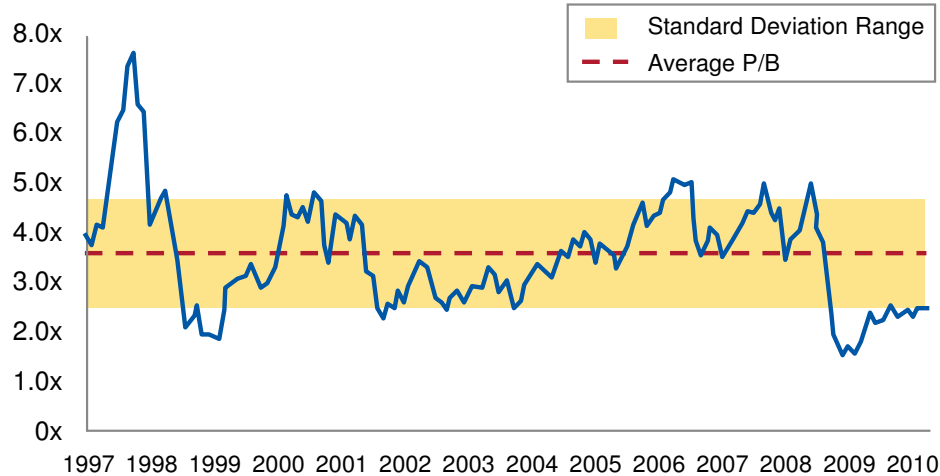
Source: FactSet, Morgan Stanley Research.

### P/NAV Trading Range average for NE/ESV/RDC



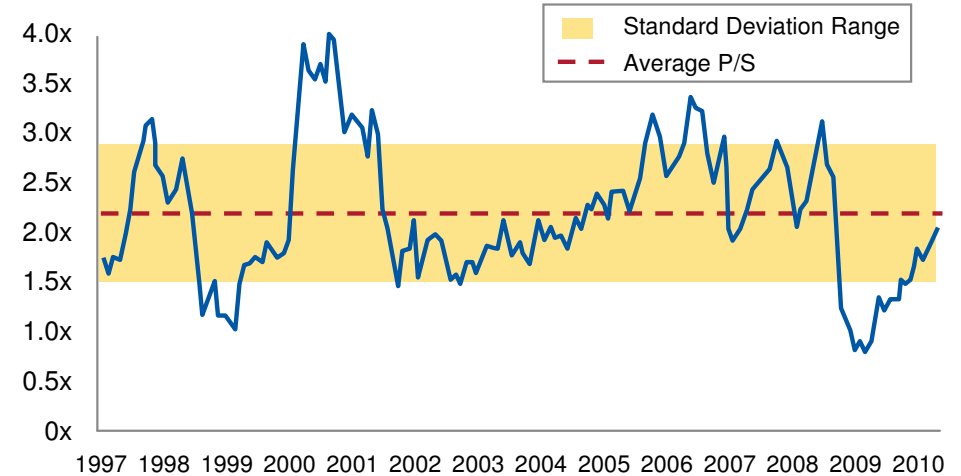
Source: FactSet, Morgan Stanley Research, companies included: DO, ESV, NE, PDE, RDC, and RIG.

### Oil Services and Equipment: Price/Book



Source: FactSet, Morgan Stanley Research, Includes Services, Equipment and Land Drillers.

### Oil Services and Equipment: Price/Sales



Source: FactSet, Morgan Stanley Research, Includes Services, Equipment and Land Drillers.

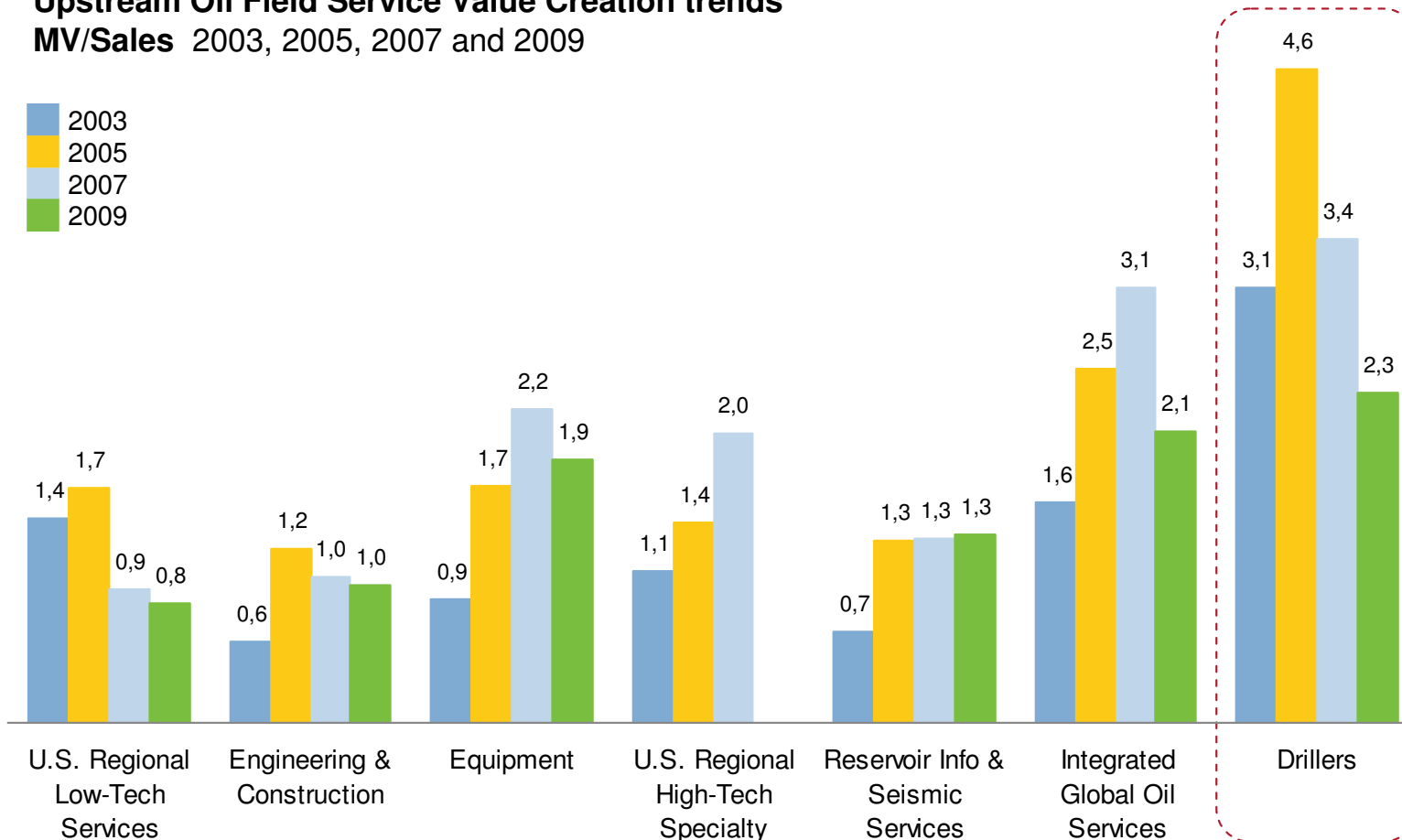
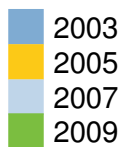
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## Business design value creation across upstream services

Oliver Wyman analysis has shown that each services segment has its own value creation characteristics and outcomes

### Upstream Oil Field Service Value Creation trends MV/Sales 2003, 2005, 2007 and 2009



▶ *Within any segment, there are market and value creation opportunities driven by both the segment and the specific business designs competing in the segment*

Source: Compustat, Oliver Wyman analysis

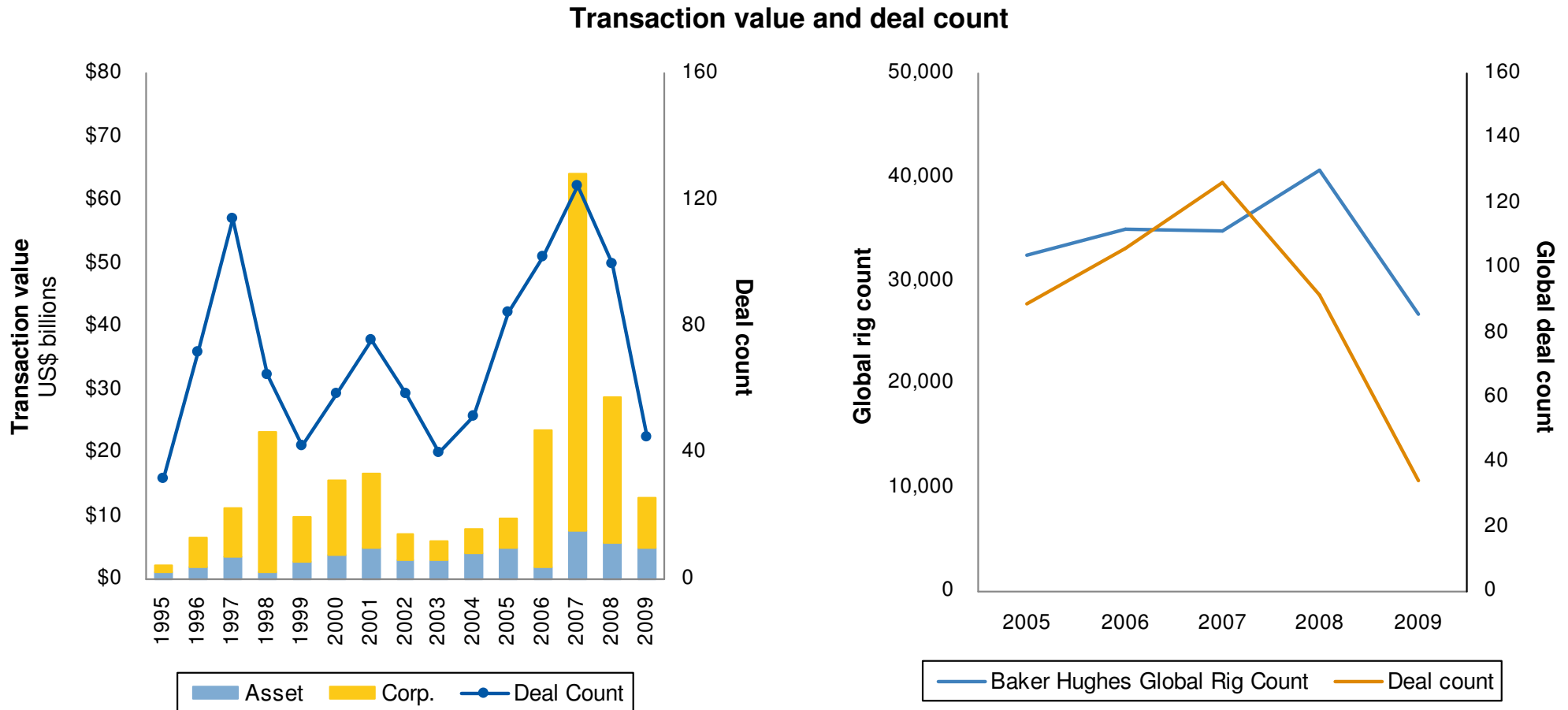
Notes: Market values are as of December 31. Sales are for full year, except for 2009 which is annualized Q1-Q3

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# Oilfield services and equipment mergers and acquisition activity

Both asset and corporate deal value falling year-over-year



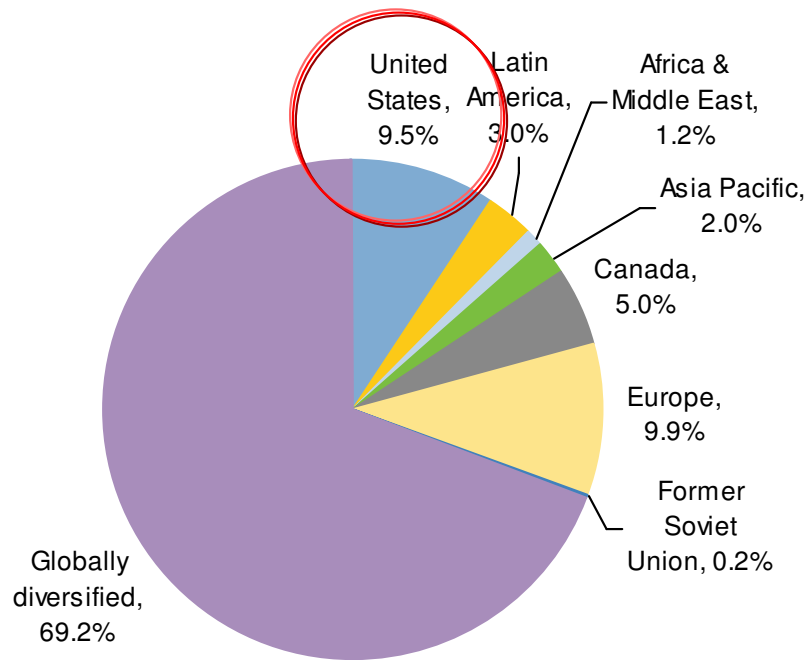
► **With financial operating margins under pressure and important North American land rig counts at recent historic lows, total dollar transaction value plunged to its lowest level since 2005**

Source: Thomson Datastream, Baker Hughes, Oliver Wyman analysis.  
 Note: Figures represent all acquisition, merger and swap reserve transactions >US\$10MM.

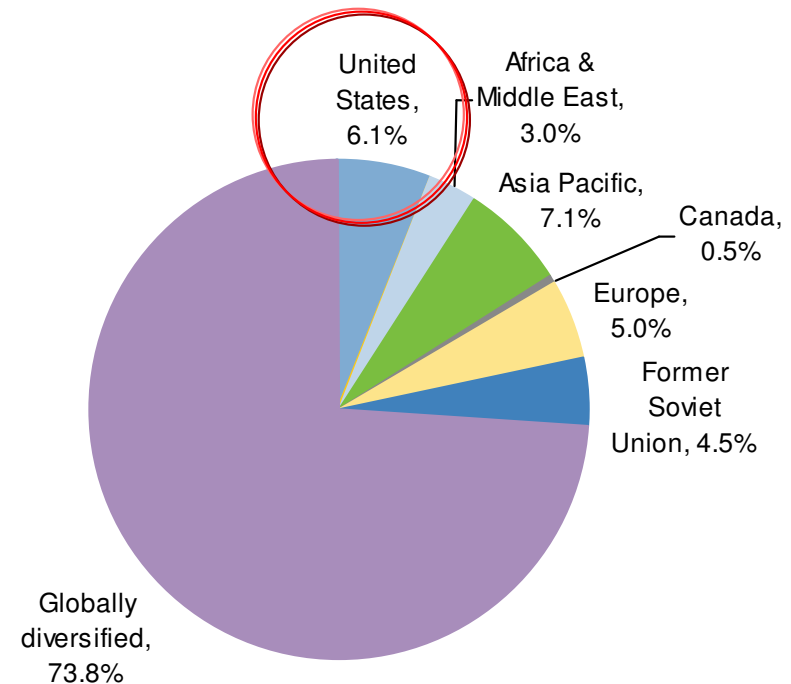
## Oilfield services and equipment mergers and acquisition activity: Geographies

Deal values for exclusively U.S. companies make up a relatively small, and declining portion of global oilfield services M&A

2005-2008 % of deal value by global region



2009 % of deal value by global region



Source: Thomson Datastream, Oliver Wyman analysis.

Note: Figures represent all acquisition, merger and swap reserve transactions >US\$10MM.

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## Oil and Gas Customers (Operators): Representative needs

### Current Needs

- Reliability
- Advanced technology
- Responsible commitment
- Scale
- Customer-aligned organization
- Good safety record

### Future / Unmet Needs

- Lower cost and time for well completions
- Reduced risk, cost, & complexity of exploration and development drilling
- Improvements to conserve rig time
- Higher reliability downhole systems requiring less frequent intervention
- Better HP/HT designs to enable drilling and production in more severe environments
- Integrated solutions that are flexible for different applications
- Enhanced seismic imaging in sand dune areas and for more effective production management
- Improved formation evaluation capabilities, especially in carbonates
- Enhanced recovery methods
- Enhanced water management
- Enhanced sand management
- Enhanced well testing and multi-stage completion/stimulation
- Enhanced reservoir characterization and asset management
- More IWS applications
- Better flow assurance capabilities

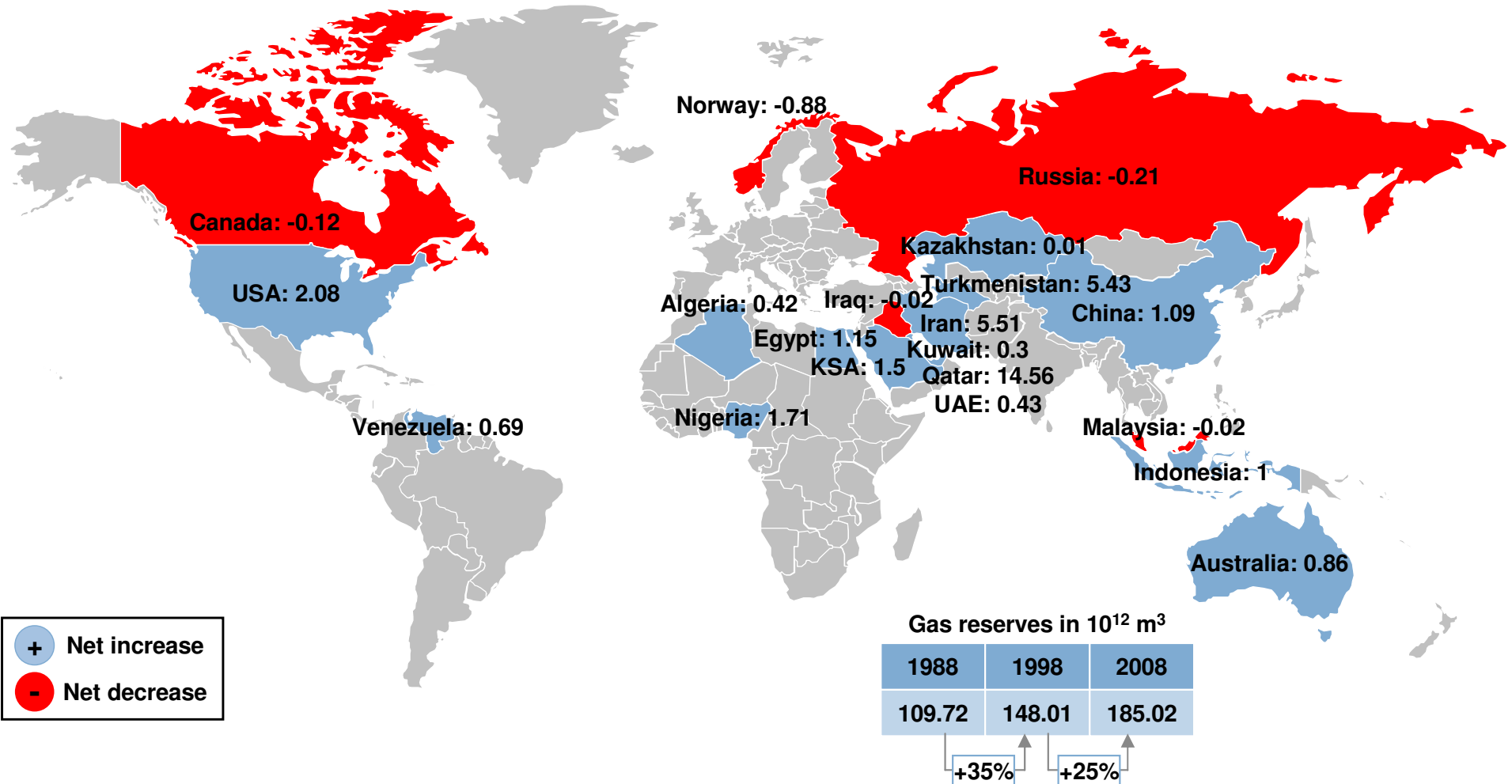
**The extent to which equipment and service providers are successful in the future depends on how well their future business designs address customers' unmet needs.**

Source: Oliver Wyman interviews.

## E&P environment drivers for oilfield services demand

It is also critical to understand the oil and gas resource map and potential to identify E&P hot spots for services and trends that will impact current and future oilfield service markets

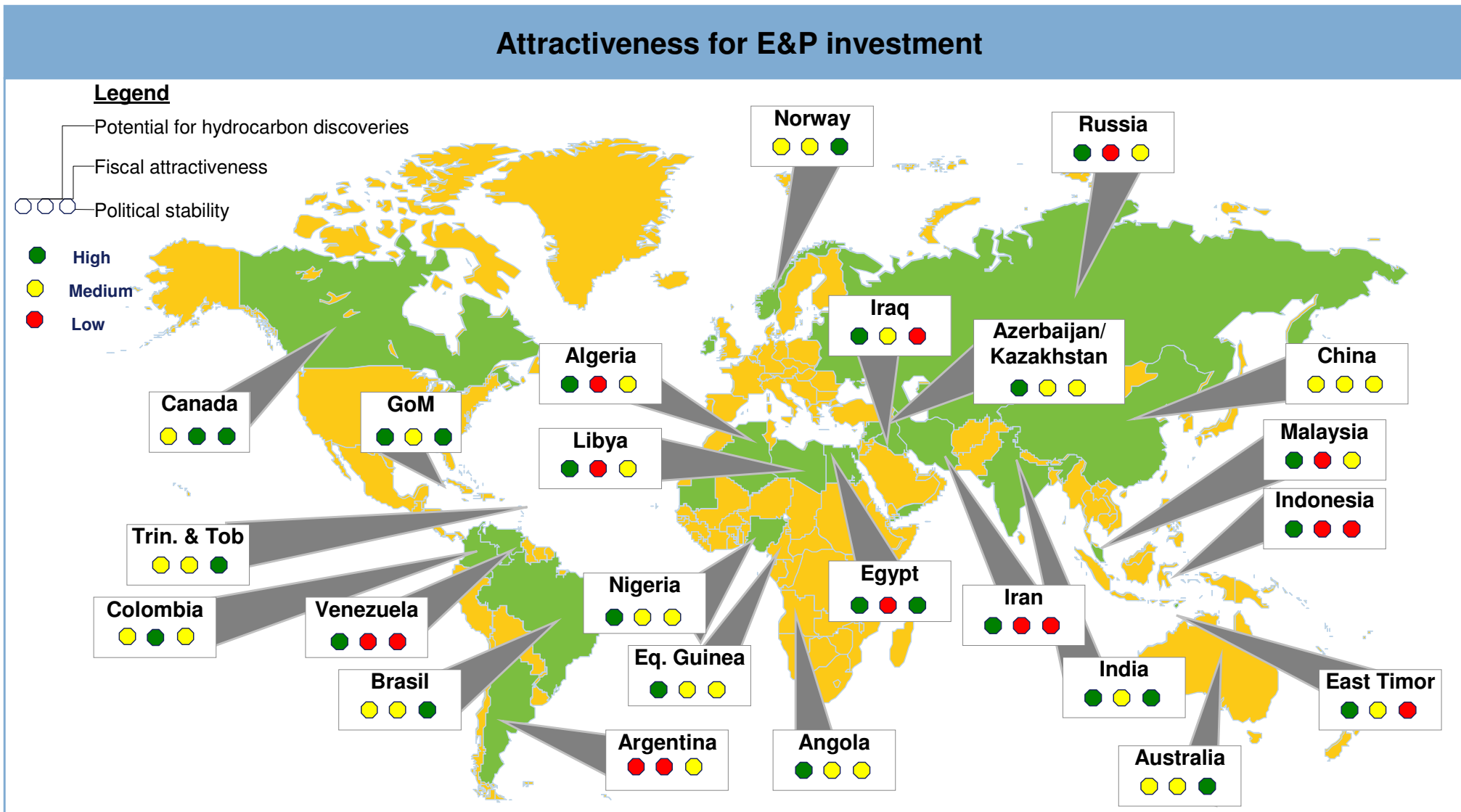
Difference between proven gas reserves 1998 - 2008 in  $10^{12} \text{ m}^3$



Source: BP Statistical Review 2008, Oliver Wyman analysis.  
 Note: Top 20 countries displayed.

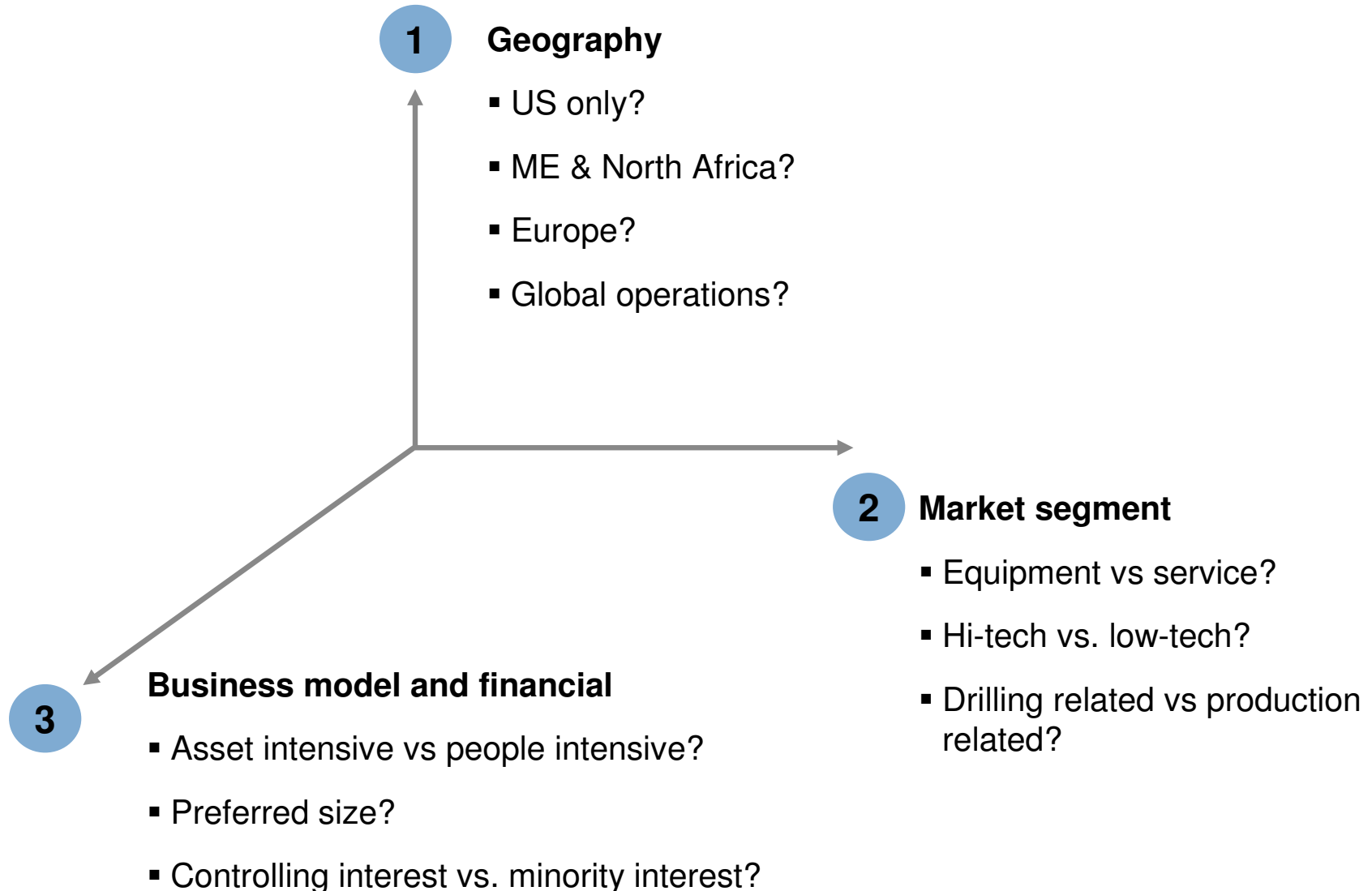
## E&P environment drivers for oilfield services demand

Investment in E&P worldwide will continue to focus on prospectivity, terms and stability; shortage of new unexplored frontiers is shifting attention to mature assets



Source: EIA, IFP, PEPS, Oliver Wyman analysis.

## Discussion: Opportunity assessment preferences



► **Most investment firms need to set their preferences to ensure focus and alignment of firm capabilities to manage any investment ultimately made**

# Oliver Wyman Oil and Gas

Oliver Wyman's oil & gas practice works with companies in all elements of the value chain.

## Industries / Clients Served

Oil Field Services and Equipment	Upstream	Midstream Transport and Logistics	Natural Gas Marketing and Supply	Downstream	Investors
<ul style="list-style-type: none"><li>▪ Rig, drilling, and seismic</li><li>▪ Engineering, procurement and construction</li><li>▪ General oil field and well servicing</li></ul>	<ul style="list-style-type: none"><li>▪ Independent E&amp;P's</li><li>▪ Major integrated oil</li><li>▪ National oil</li></ul>	<ul style="list-style-type: none"><li>▪ Pipelines</li><li>▪ Terminals / storage</li><li>▪ Trucking and distribution</li></ul>	<ul style="list-style-type: none"><li>▪ Gas marketing</li><li>▪ Liquefaction and regasification</li><li>▪ Other LNG infrastructure providers</li></ul>	<ul style="list-style-type: none"><li>▪ Fuels marketing</li><li>▪ Lubricants marketing</li><li>▪ Refiners</li><li>▪ Convenience retailers</li><li>▪ Marketers / jobbers</li></ul>	<ul style="list-style-type: none"><li>▪ PE/VC firms</li><li>▪ Strategics</li><li>▪ Investment banks</li></ul>

## Practice Capabilities and Focus Areas

- Strategic planning
- Network and portfolio optimization
- Growth strategy
- Business design
- Customer experience and site operations
- Post -transaction integration
- Acquisition due diligence
- Cost improvement
- Operations effectiveness
- Operational and financial planning
- Industry investment opportunity scans
- Asset value maximization
- Optimization of capital deployment
- Pricing strategies
- Risk reduction

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