Weekly Energy Tracker

Current Business and Legal Issues in the Oil and Gas Market

7/21/2020

Due to a technical issue, there will be no recording posted for today's call. We apologize for the inconvenience. Next week's call should be posted as normal. If you would like to attend future calls, or if you have any questions, please email energyevents@haynesboone.com.

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Introduction

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Fintech and advisory for commodity and rate hedging

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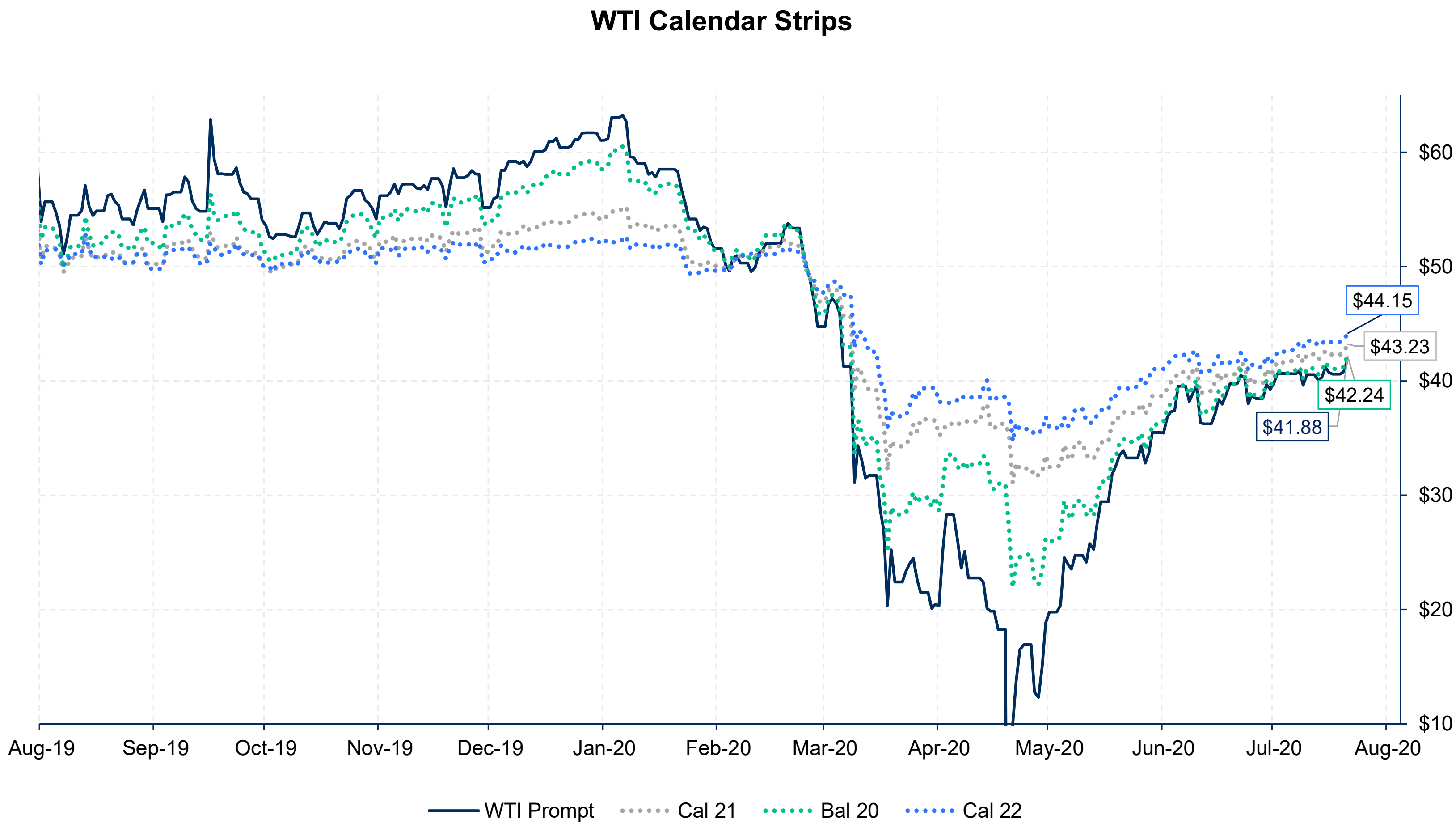
AEGIS

EnergyRisk Awards 2020 Winner

Hedging advisory firm of the year

Proprietary market analysis, price opinion, & decision support for hedge strategy and execution

Price Action – Crude Oil



Fundamentals – Crude Oil

OIL

What if OPEC+ Keeps Producing to Match Returning Demand?

By Jay Stevens | July 17, 2020

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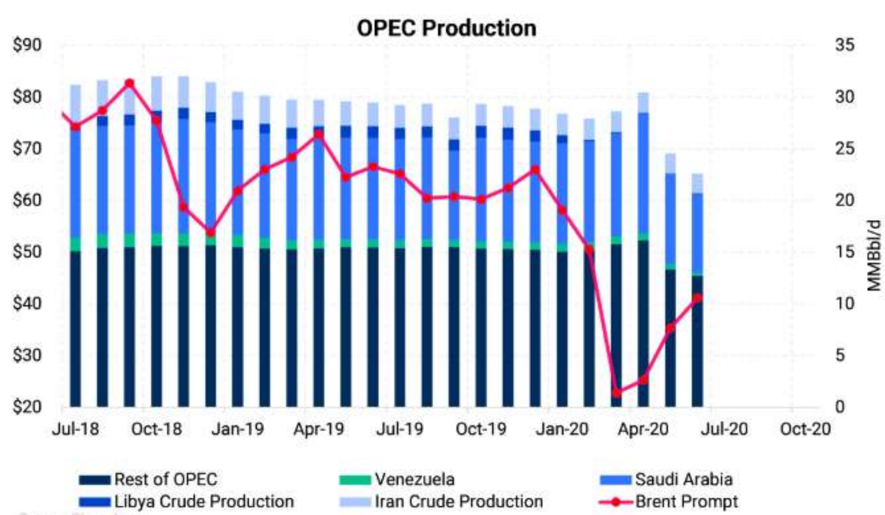
The cartel has enough spare capacity to match demand barrel for barrel through 2021. They could slowly open the taps on supply as demand slowly returns to pre-COVID-19 levels. This type of OPEC+ policy could keep crude oil prices trading in a tight range by not allowing supply and demand to separate.

Global oil demand has risen dramatically from April lows as governments reduce or remove mandatory lockdowns that kept many from using petroleum products. Demand is still not near pre-COVID levels but continues to climb.

OPEC+ this week signaled it would increase supply in August, because demand was recovering. Continuing this policy, of supplying more crude into the market as demand increases, implies OPEC+ would match supply cuts evenly with returning demand.

The group has been curbing supply by up to 9.7 MMBbl/d since April, and will carry those cuts through the end of July. In August, the oil cartel will start to unwind a portion of those cuts. *(see OPEC+ Plans 2 MMBBl/d Production Increase for August)*.



Source: Bloomberg

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Founded in 1994, EnerCom, Inc. was built with a vision of being a trusted advisor to the global energy industry and energy capital markets. Our industry knowledge supports the delivery of our high-quality, value added services. Our clients trust our experience delivering integrated marketing and corporate branding programs.

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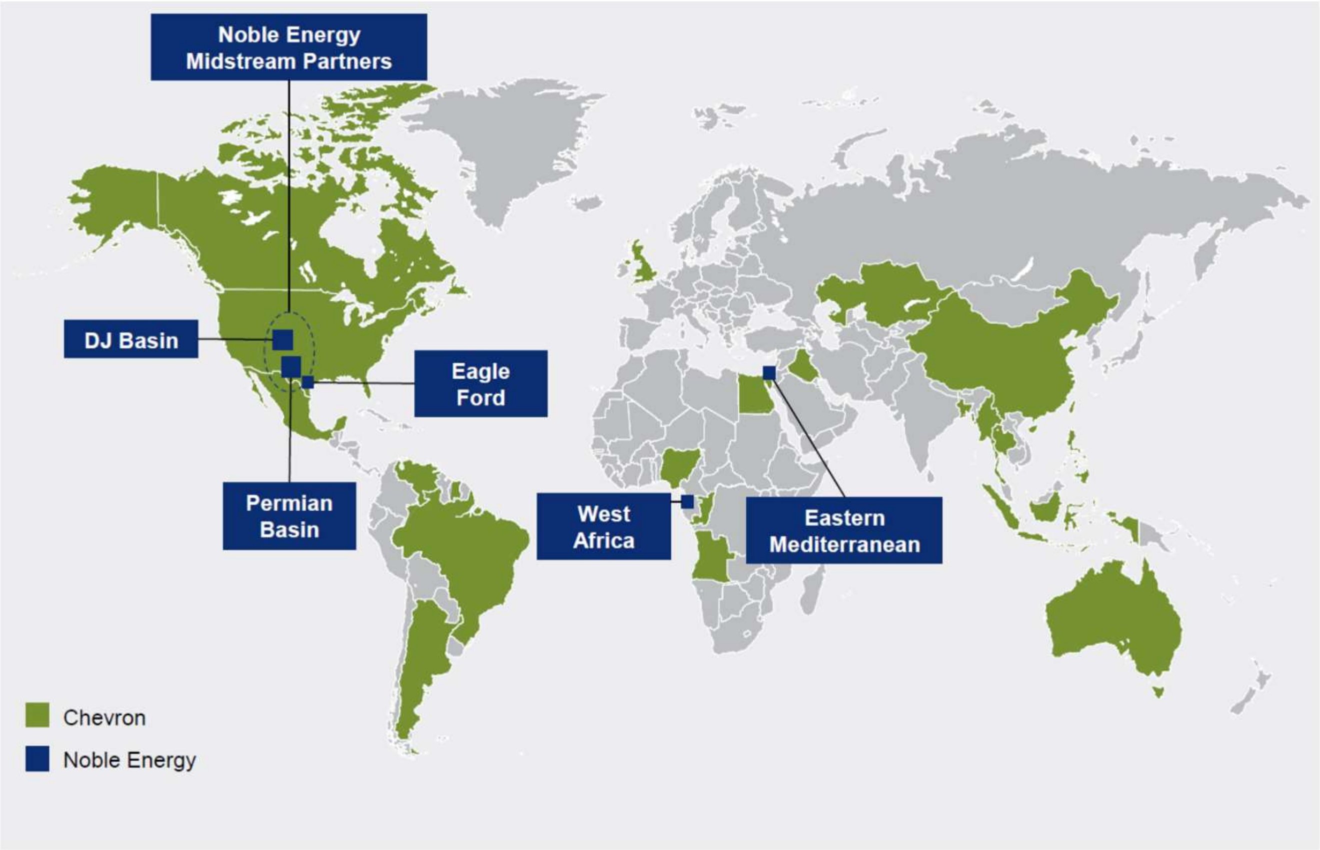
Chevron and Noble Energy Transaction

- **The total equity acquisition value is ~$5 billion**
- 100% stock consideration - Noble shareholders should own approximately 3% of the combined company
- Total consideration of $10.38 per share, ~12% premium based on 10-day average, ~8% vs. Friday
- Analyst Commentary:
  - "**M&A has been widely anticipated in the E&P space**, CVX's agreement to acquire NBL in an all-stock transaction that values NBL at a 7% premium to last week's closing price is neutral for the sector at best, in our view, **if it does not solicit a competing offer**." – Stifel
  - "A good transaction for both sides, in our view… Importantly, we believe the acquisition of Noble Energy **adds high-quality complementary assets at a relatively low-cost/low-risk to Chevron**." – Wells Fargo
  - "We note that this is **the first major M&A transaction in the energy space since the lows of the COVID-19** driven oil price rout. However, the **small premium suggests that this deal was opportunistically-driven**, rather than by a strong appetite for consolidation." – TD Securities
  - The acquisition provides CVX **complementary assets** in the Delaware Basin and internationally**, while establishing an asset position in the DJ Basin**… This is an opportune acquisition as it essentially eliminates (significantly dilutes) NBL's cost-of-capital disadvantage given the company's concentration of perceived higher business risk assets in Colorado/eastern Mediterranean." – MKM Partners
  - "Given transaction is essentially in-line with our price target, we like the deal and believe **investors can participate through the upside in CVX** which remains a top pick in the integrated space." - Tudor, Pickering, Holt & Co

What is Chevron Buying?



- Lower 48 NBL adds:
  - ~92k Permian acres
  - ~ 336k DJ Basin acres
  - ~35k Eagle Ford acres
- International NBL adds:
  - 39.6% interest in Leviathan
  - 25% interest in Tamar
  - Exploration blocks in Egypt
  - Legacy production in Equatorial Guinea

Bam! It’s Earnings Season Again

Halliburton:

- HAL delivered strong 2Q’20 operating results highlighted by better-than-expected margins due to excellent progress on its recent cost-cutting measures, and strong FCF
- Halliburton recognized $2.1 billion of pre-tax impairments and other charges to further adjust its cost structure to current market conditions. These charges consisted primarily of non-cash asset impairments, mainly associated with pressure pumping equipment and real estate, as well as inventory write-offs, severance, and other costs.
- International will be more resilient near-term:
    - **International** revenue in the second quarter of 2020 was $2.1 billion, **a 17% decrease** when compared to the first quarter of 2020
    - **North America** revenue in the second quarter of 2020 was $1.0 billion, a **57% decrease** when compared to the first quarter of 2020.

What does Tomorrow’s OFS Company Look Like?

- Halliburton, Microsoft and Accenture announced a five-year strategic agreement to advance Halliburton’s digital capabilities in Microsoft Azure. Under the agreement, Halliburton will complete the move to cloud-based digital platforms and strengthen our customer offerings by enhancing real-time platforms for expanded remote operations; improving analytics capability utilizing machine learning and artificial intelligence; and accelerating the deployment of new technology and applications for overall system reliability and security.

Oilfield Services Bankruptcies

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Alternatives to RBL Financing

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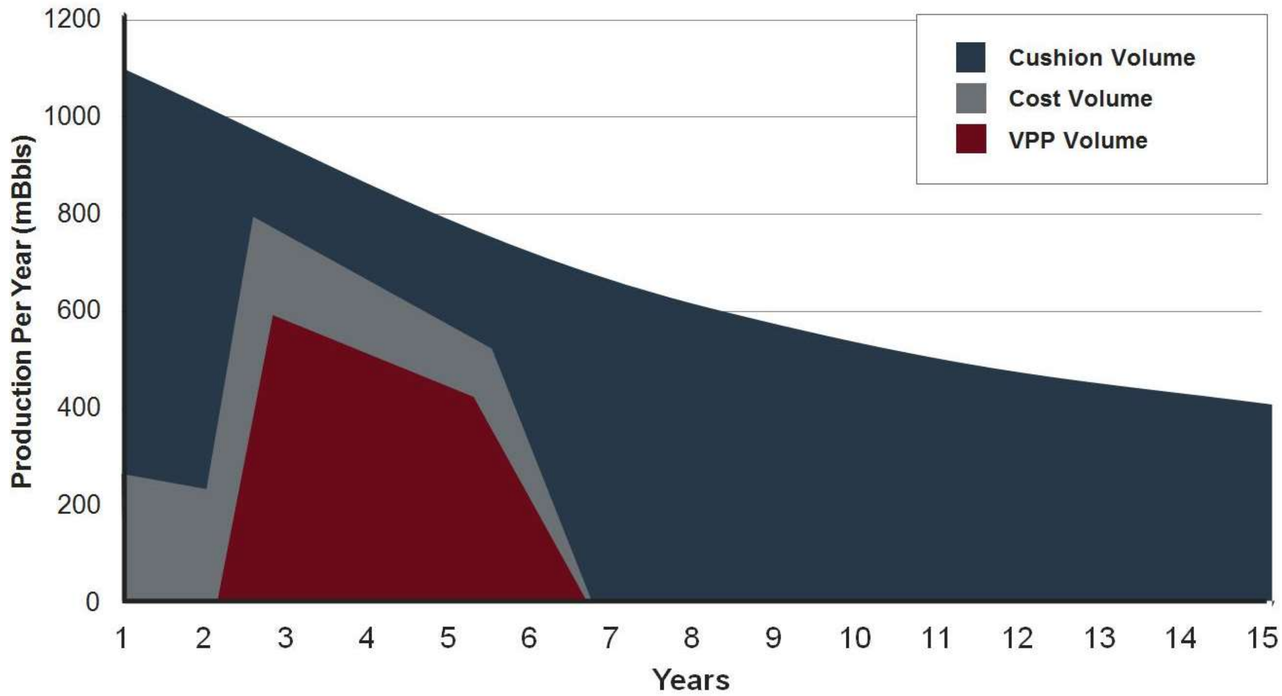
Alternatives to RBL Financing

Structure Types	RBL	VPP	Working Interest Securitization
Structural Considerations	• Asset-backed, senior secured loan that encumbers all the borrower's oil & gas reserves (not just PDPs) • Loan "renews" every six months under a borrowing base redetermination • Normally a revolver with commitments by a syndicate	• Grants the buyer a set volume of hydrocarbons per period for a specified term • "True sale" asset conveyance under an ORRI carved out from lessee's working interest • One-time advance • Non-operating, non-expense bearing interest • Producer manages assets pursuant to a production and marketing agreement • Off balance sheet of seller but debt for tax purposes • Difficult to add assets over time	• SPV is conveyed a working interest in PDP reserves which secures notes • The SPV pays operating expenses, which may include capex for workovers • Operating expenses are senior and subject DSCR cushion • Typically one-time advance, but can allow for leveraging of additional assets in the future
Risk Profile	• Hedge 50% (or more) of production on a rolling 24-month basis	• Hedge 100% of production • Producer is obligated to buy 100% of VPP volumes using a prescribed price formula ongoing proceeds from sale of VPP volumes are used to settle hedges and to pay principal and interest • Catch-up mechanism whereby shortfalls in volume are made up in the following month (adjusted for commodity price and interest)	• Hedge 75-85% of production • Production revenue flows through waterfall (hedges, LOE, opex, maintenance capex, P&A, interest, amortization, ECF, reserve funding, etc.) before excess distributed to sponsor
Collateral	• First lien on substantially all assets (including PUD assets) • More focused on value of the assets	• VPP conveyed to buyer • Seller's retained interest is usually mortgaged to buyer to secure ongoing operating obligations	• First lien on substantially all assets within the securitization pool • More focused on the offtake/hedge provider • Usually PDPs only

Alternatives to RBL Financing

Structure Types	RBL	VPP	Working Interest Securitization
Tenor	• 3 – 5 years	• 3 – 7 years	• 3 – 7 years (target of 5 – 7 years)
Commodity Pricing	• Bank's forward curve	• Market hedgeable price embedded in VPP price	• Market hedgeable price for tenor
Financial Covenants	• Advance limited by Borrowing Base • Debit/EBITDAX • Current Ratio	• None	• DSCR • Rapid amortization tied to financial metrics • LTV • Production volume targets
Leverage (Proceeds / Asset Value)	• 65% of PDP	• 65% to 80% of PDP • Sized based on production and expense coverage from VPP seller's retained interest	• Based on DSCR (typically ~65%)
Lenders	• Banks and Bank Affiliates	• Rated: Broad investor base: insurance companies, etc. (Rated); • Unrated: Banks Affiliates, Specialty Finance	• Rated: Broad investor base: insurance companies, etc. • Unrated: Bank Affiliates, Specialty Finance
Credit Rating Considerations	• Structure not individually rated, ratings based on borrower's rating (to the extent borrower is rated)	• Guidance is available as rating agencies have experience with structure • Can structure into multiple tranches with higher ratings senior to subordinate tranche	• Combine VPP based criteria with project finance analysis (potentially penalizing risk) • Requires increased due diligence and focuses on operating expenses / capex costs, utilizes independent engineer's reserve report

VPP Coverage



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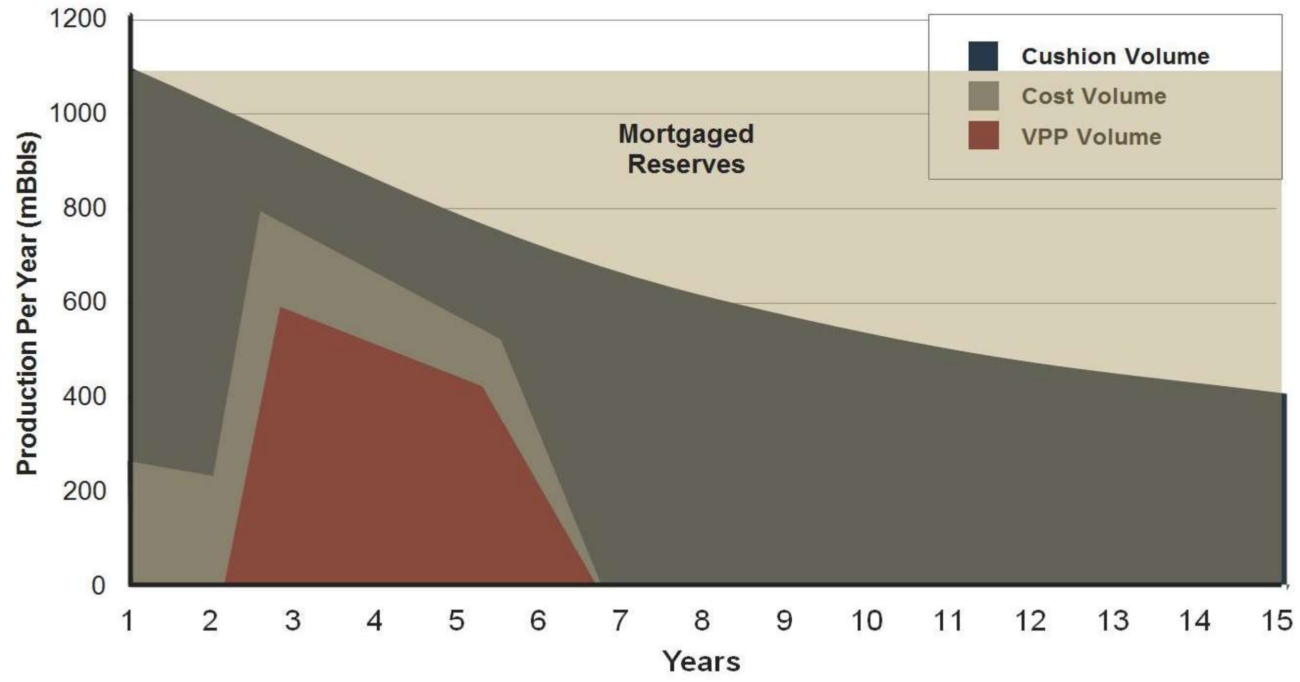
Versus RBL Collateral Coverage



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Q&A

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