The Importance of Reserves Audits & CPRs to the Small Independent E&P Company

SPEE Meeting, London, 9th March 2017
Company overview

- Production and development focused UKCS E&P independent
- Owned by a fund managed by leading oil & gas private equity investor HitecVision
- Experienced management team and lean organisation (14 staff)
- Aim to create a quality and sustainable UKCS oil & gas company through deal making, and innovative development and efficient production
- Low cost reserve base of 8 mmboe at three oil producing fields – Boa, Duart and Cormorant East
- Production of 2,000 boepd, expected to grow to 3,400 boepd in 2018
- Strong financial position – and significant remaining unallocated Fund VI capital
- Tax loss pool – no taxes expected payable on existing reserve base
Strategy and growth plan

- UK consolidation player
- Initial focus on production - capture development opportunities as production base grows
- Smart engagement with supply chain
- Capacity to operate large scale assets
- Scale provides more exit options and clout with regulator and “big oil”

*UKCS offers an attractive growth opportunity with 10-20 billion boe remaining resources, declining unit costs and a large M&A opportunity set*
### Strong owner in HitecVision

<table>
<thead>
<tr>
<th>30</th>
<th>150</th>
<th>80%</th>
<th>37</th>
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<tbody>
<tr>
<td>years of experience in the oil and gas industry</td>
<td>companies invested in, acquired or established – over 100 exited</td>
<td>of companies sold to industry</td>
<td>person investment team</td>
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#### Company
- Operating in the oil & gas industry since 1985
- Specialist oil & gas private equity investor since 2002
- Headquartered in Stavanger with offices in Oslo and Houston
- Five active funds with USD 5 billion in committed capital

#### Team
- Partner team with average industry experience of 20 years
- Combines industry expertise, transaction experience, operating capabilities and extensive international network to progress companies
- Proven tools and techniques for value creation continue to generate unique opportunities and attractive returns

#### Awards
- **#1** The largest PE house in Norway
- **#1** The largest sector focused fund manager in Europe
- **#6** The 6th largest energy focused fund manager globally
AND NOW FOR SOMETHING COMPLETELY DIFFERENT

[Intentionally unexpected sentence case in the narrative arc]
A Warning From History!

- Standard DCA - harmonic, hyperbolic and exponential
  - Anonymised dataset, RAR outputs based on $b=1, 0.5, 0$
  - Natural infinite acting aquifer, gas lift, constant liquid rate
The Small Independent Model

• The business model is about growth
  – Small Independents are amongst the few growing
    • Chrysaor, Siccar Point, Neptune, Verus etc.
  – Typically private equity backed
    • GNRI, NGP, BlueWater, Blackstone, Carlyle, HitecVision etc.
  – Using debt and equity

• Growth comes from debt
  – Based on existing and target assets
  – Using cash thrown off to part fund the next deal

• Debt comes from reserves audits & CPRs
  – To achieve growth, these need to reflect true value
A Warning From History!

- One year on……...
- Oops!
Reserves Audits & CPRs?

• Reserves Audits
  – Annual cycle
  – Predictable
  – Routine corporate management
  – Compliance with established debt facilities

• CPRs
  – Ad hoc
  – Asset acquisitions – or company sale
  – Short time fuse, weeks
  – Corroborates company evaluation – assurance for PE & banks
The Impasse

• Debt is tightly controlled in this new reality
  – Whether from banks, private equity or markets, recent losses make new debt difficult to obtain
  – There have been a few notable cases where asset owners have presented only the data which supports their preferred outcome
  – This has resulted in Competent Persons, debt providers and asset purchasers making decisions on misleading data
  – It is not how we should behave

• We need a new way of working
  – Gaming reserves is unsustainable for small oil, Competent Persons AND the banks
Going Forward

• Consider the team
  – Some have full subsurface and commercial expertise in-house
    • They know their assets well
    • Acquisition targets will likely have been intensively worked
    • This means that by the time the competent person sees the profiles, they may have been audited as part of the internal due diligence process
  – Others don’t – their profiles’ provenance needs to be examined
  – Some just use the vendor’s sales case

• The Auditor
  – and the client need to agree whether an audit or a fully independent derivation is required
    • Existing assets tend towards audit
    • Acquisition targets tend towards independent evaluation
The Importance of RARs & CPRs to Small Oil

• What do we want?
  – To engage with the CPR to represent our assessment
  – To agree a technically robust set of profiles and reserves
  – RARs & CPRs which recognise the true value of the assets

• What don’t we want?
  – A cook book solution
  – The wheel re-invented
  – A negotiation
  – Discounted profiles and reserves “because you are a new client”
    • on top of discounted price decks and cover ratios from banks’ credit committees doesn’t leave us with much debt
A Warning From History!

- So, where were we?
- Let’s zoom in on the action
A Warning From History!

• The next five years……..

• Oh dear!
A Warning From History!

• What would we do differently?
• Exponential was obviously the right answer!
A Warning From History!

- Of course not, we know it had to be Hyperbolic?
- Maybe Harmonic?
In Conclusion

• The future of the North Sea is increasingly in the hands of Small Oil

• In order to grow, Small Oil needs debt based on the true value of it’s assets with transparent risking

• Small Oil and Competent Persons need to work in a new way, more openly
  – The green shoots are there