STOUT
Investment Banking

Energy

INDUSTRY UPDATE | Q2 2017

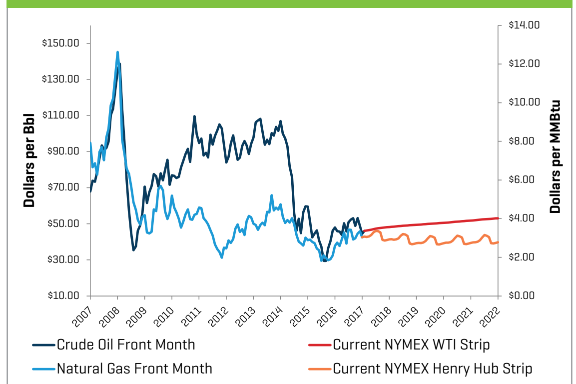
Two Steps Forward, One Step Back

THE WAITING GAME

The energy service and equipment market has meaningfully rebounded since bottoming out in mid-2016. The U.S. land rig count has increased by 539 rigs or 142% since that time, and well complexity (lateral lengths) and service intensity (pad drilling, tighter cluster spacing, and more frac stages) have continued to accelerate. These have been driven by higher crude oil prices (compared to 2016 levels), enhanced drilling and completion efficiency, and OPEC (and others) production cuts.

However, this recovery has been tempered by fears of a U.S.-led production glut and prolonged supply/demand imbalance. While a number of energy producers can generate profits at current commodity price levels, a further deterioration could stifle development and blunt the recovery in the oilfield service industry, as evidenced by the recent slip in commodity prices (sliding back into the mid-$40's), which has caused activity to pullback slightly in Q2 2017. Both E&P companies and investors are likely waiting for longer-term trends in production and inventory trends before committing additional capital to the segment, even as significant amounts of energy targeted capital waits on the sidelines.

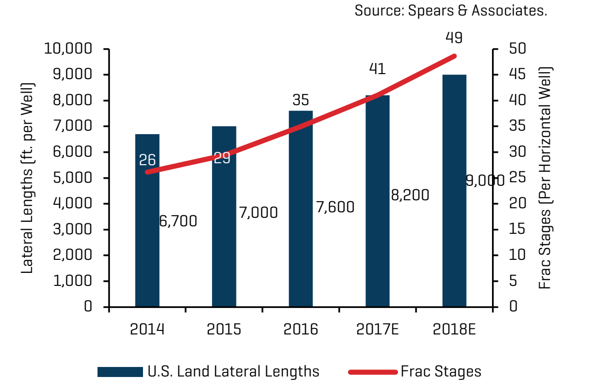
CRUDE OIL (WTI) AND NATURAL GAS (HENRY HUB) PRICES



Source: Bloomberg as of June 30, 2017.

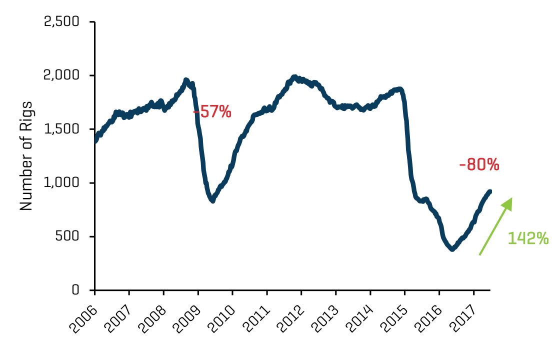
U.S. LATERAL LENGTHS AND FRAC STAGES

Source: Spears & Associates.



U.S. HISTORICAL LAND RIG COUNT

Source: Baker Hughes as of June 30, 2017.



About This Piece

This Energy Industry Update is authored by **Todd Parsapour**. Todd is a Managing Director and Head of the Energy practice within Stout's Investment Banking group. Mr. Parsapour has more than 14 years of experience providing advice on a wide range of corporate finance transactions including 12 years within the energy sector.

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Recent Capital Markets Trends

IMPROVING FINANCIAL METRICS, BUT...

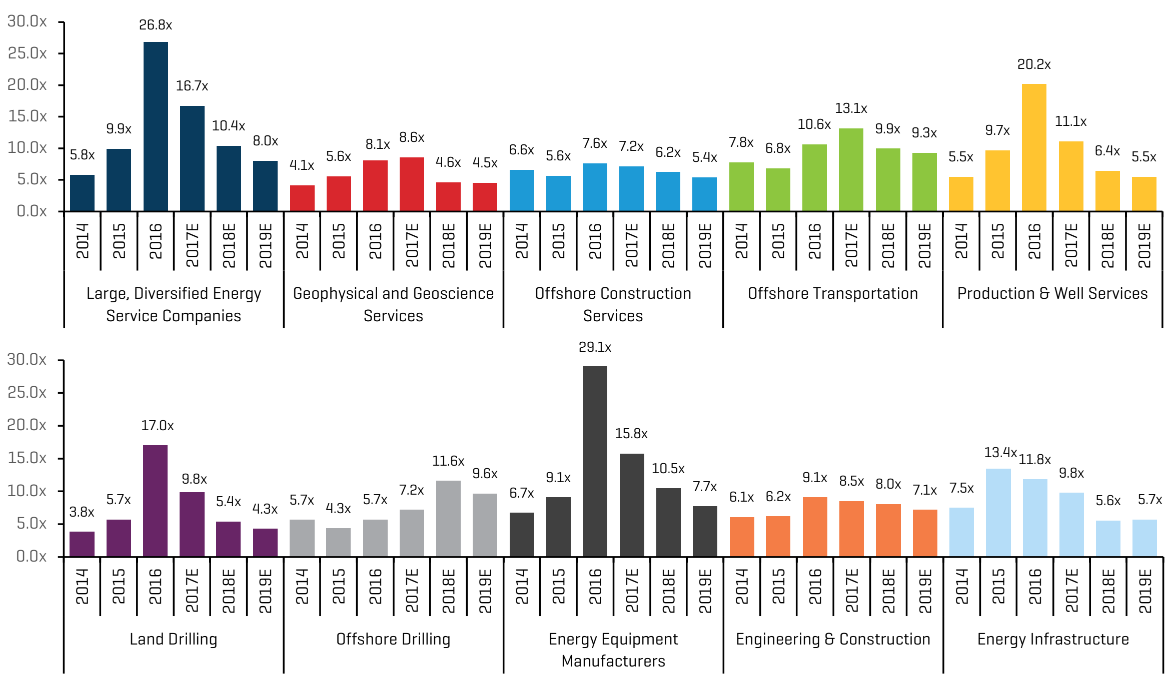
While many energy service and equipment companies have seen activity (and revenue) improve, margins have not recovered to sufficient levels for the long term health of the sector. Q1 2017 revenue for production and well service companies increased 16% and 23% compared to Q4 2016 and Q1 2016 levels, respectively. Average Q1 2017 EBITDA margins moved to 6% from 1% and -0.2% in Q4 2016 and Q1 2016, respectively. However, historical EBITDA margins averaged approximately 20% from 2011 to 2015.

Certain segments, driven by increases in well complexity and service intensity, such as pressure pumping, frac sand, chemicals, and downhole equipment businesses have witnessed more pronounced improvement. Many energy service and equipment companies have also faced challenges financing emerging growth opportunities. Traditional bank financing has not been available for many of the private companies, generally regardless of the health of their respective balance sheets and cash flows, due to the increase in oilfield services bankruptcies (more than 120 since 2015) and regulation-based energy financing scrutiny. This has forced a number of companies to fund working capital and growth capital expenditures through factoring receivables and alternative lenders.

PUBLIC VALUATIONS HAVE RETREATED FROM EARLIER LEVELS

A number of public energy service company valuations reached elevated levels during the first half of 2017. This led to 12 public equity offerings in the energy service and equipment industry (including five IPOs) from January to May 2017, which is a significant shift from the almost two-year drought in listings beginning in late 2014 through late 2016. The IPOs were priced at implied valuations of approximately 10.2x 2017P EBITDA and 4.6x 2018P EBITDA, as analysts expect the recently listed companies to experience significant recovery from 2016/17P trough levels.

MEDIAN ENTERPRISE VALUE/EBITDA BY ENERGY SERVICES SECTOR



*Multiples based on historical EV and forward EBITDA estimates as of June 30, 2014, 2015, 2016, and 2017 (2017E, 2018E, 2019E).
Note: Many multiples implied from 2016 EBITDA not meaningful due to low or negative measures.

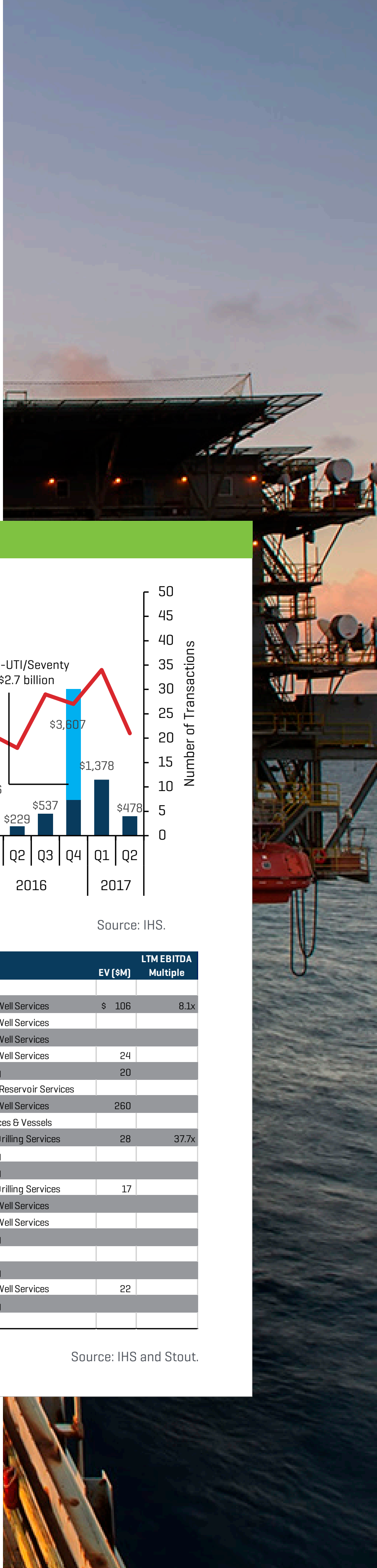
Source: Capital IQ and Stout.

Offering activity subsequently slowed as crude oil prices declined and valuation multiples contracted. There has not been an energy service & equipment offering since early-May, although there are currently four IPOs in backlog. An uptick in crude prices (and the energy outlook) or sustained positive trends in activity for the listing and publicly traded companies would likely facilitate these and other currently sidelined public equity transactions.

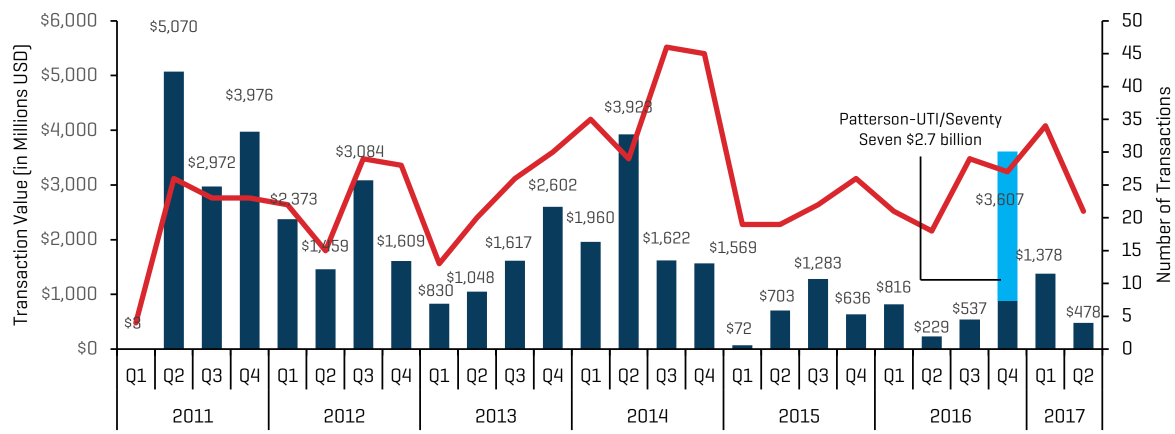
Recent M&A Trends

CRUDE PRICES SLOW M&A ACTIVITY

M&A activity has slowed in Q2 2017, as commodity prices slipped and uncertainty crept back into the market. However, activity levels have rebounded from prior year levels as energy service and equipment M&A activity through the first half of the year reached 55 transactions, compared to 39 in the first half of 2016 (+41%). These transactions continue to be funded with cash on hand and equity as credit markets remain difficult for energy service companies.



NORTH AMERICAN (NAM) M&A ACTIVITY



Source: IHS.

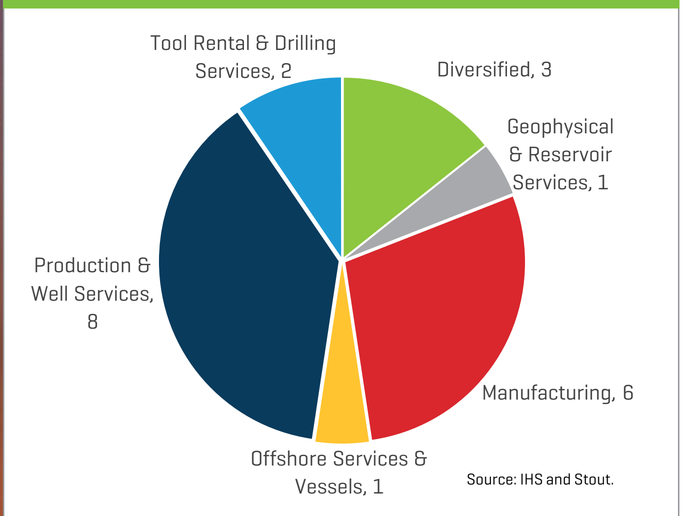
Ann. Date	Target	Acquirer (Ownership)	Sector	EV ($M)	LTM EBITDA Multiple
6/19/2017*	Integrity maintenance platform of EMS USA, Inc.	First Reserve Corporation	Diversified		
6/19/2017*	Mesa Compression, LLC	Enerflex (TSX:EFX)	Production & Well Services	$ 106	8.1x
6/15/2017	Black Mountain Disposal	Goodnight Midstream (Tailwater Capital)	Production & Well Services		
6/14/2017	Produced water infrastructure of EnCana Oil & Gas (USA)	H2O Midstream (EIV Capital)	Production & Well Services		
6/13/2017	Key Energy Services, Frac stack and well testing assets	Covenant Testing Technologies, LLC (The Catapult Group)	Production & Well Services	24	
6/7/2017	LeROI Gas Compressors	Gardner Denver, Inc. (NYSE: GDI, KKR)	Manufacturing	20	
6/1/2017	Earth Exploration Inc.	Terracon Srl	Geophysical & Reservoir Services		
5/18/2017	RockPile Energy Services, LLC	Keane Group Inc. (NYSE: FRAC, Cerberus Capital)	Production & Well Services	260	
5/12/2017	Marine Clean Ltd.	Envirosystems Inc. (TorQuest Partners)	Offshore Services & Vessels		
5/11/2017*	Lonestar West Inc.	Clean Harbors, Inc. (NYSE:CLH)	Tool Rental & Drilling Services	28	37.7x
5/8/2017	Choice Completions Systems	Rubicon Oilfield International (Warburg Pincus)	Manufacturing		
5/5/2017	VanZandt Controls, LLC	OFS Energy Fund	Manufacturing		
5/2/2017	Flotek Industries, Inc. Drilling Technologies segment	National Oilwell Varco (NYSE: NOV)	Tool Rental & Drilling Services	17	
4/27/2017	Two oilfield service companies (Canada and US)	Collaborative Energy Services	Production & Well Services		
4/27/2017	West Texas H2O	GlobeLTR Energy Inc. (Altpoint Capital Partners)	Production & Well Services		
4/25/2017	PetroTech, LLC	SPATCO Energy Solutions (CapitalSouth Growth Fund)	Manufacturing		
4/19/2017	TVC Solutions	American Innovations Ltd.	Diversified		
4/17/2017	Cobra Sampling, Inc.	Sentry Equipment Corp.	Manufacturing		
4/17/2017	Canadian division of a production chemical business	Secure Energy Services (TSX: SES)	Production & Well Services	22	
4/3/2017	Avalanche Metal Industries Ltd.	Hyduke Energy Services (NYSE: HYD)	Manufacturing		
4/3/2017	OEL Projects Ltd.	McIntosh Perry Consulting Engineers (Signal Hill Equity Partners)	Diversified		

*Transaction Pending. EV=Enterprise Value.

Source: IHS and Stout.

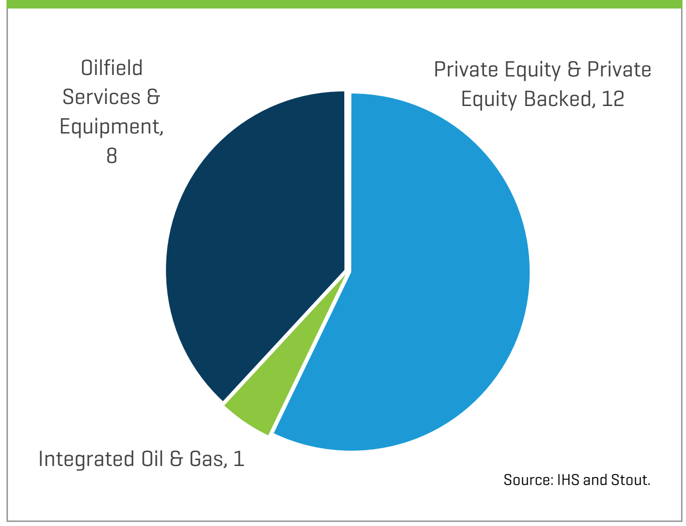
In the first half if 2017, strategics continued to represent the largest buyer group, although in Q2 private equity buyers, primarily through existing platform companies, were responsible for just over half of the total transactions in the quarter. Even amid recent commodity price uncertainty, energy service and equipment M&A activity is expected to increase due to the significant availability of assets for sale, including older vintage sponsor-backed investments (2011 and prior), as well as an increasing number of companies seeking liquidity to fund working capital and capex.

Q2 2017 NAM TRANSACTION COUNT BY SECTOR



Source: IHS and Stout.

Q2 2017 NAM TRANSACTION COUNT BY BUYER PROFILE



Source: IHS and Stout.

About Stout Energy

Stout professionals have extensive experience across the entire value chain of energy service and equipment related companies, including the following sub-verticals within the sector:

- Large, Diversified Energy Service Companies
- Geophysical and Geoscience Services
- Offshore Construction Services
- Offshore Transportation
- Production & Well Services
- Production & Well Services
- Land Drilling
- Offshore Drilling
- Energy Equipment Manufacturers
- Energy Infastructure

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