

VALUE FOCUS

Energy



SEGMENT FOCUS

Exploration & Production

2015

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Special Supplement
Fairness Opinions: Evaluating a Buyer's Shares from the Seller's Perspective

Q1: Exploration & Production
 Q2: Midstream Operations
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Segment Focus

Exploration & Production

2015 First Quarter

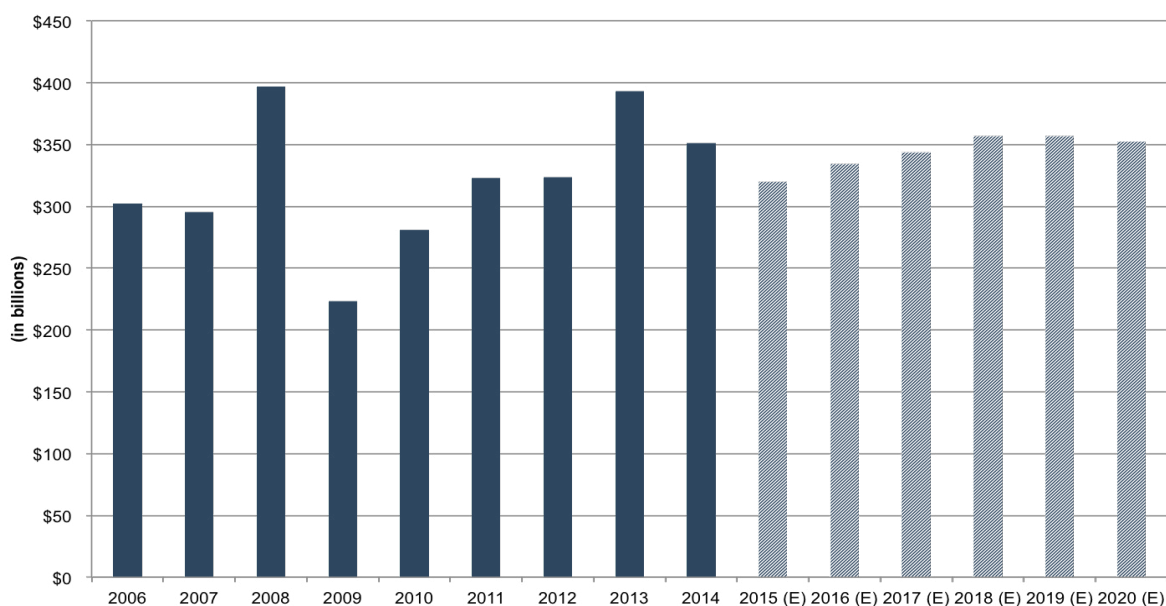
Exploration & Production Overview

In 2015, oil and gas exploration & production activities in the US are expected to generate \$320.0 billion in revenue.¹ This represents an 8.8% decline from 2014, but a 13.9% increase from 2009's nadir. Industry revenues peaked in 2008 due to record-high oil prices, but declined precipitously in 2009 as prices dropped, driven by declining energy demand resulting from lower levels of economic activity during the recession.

Industry revenues have generally increased since that time as the economy and oil prices recovered, but are expected to decline this year due to low oil prices.

After declining in 2015, industry revenues (as estimated by IBISWorld) are expected to rise over the next several years due to technological advances, higher oil prices, and higher levels of production.

Exploration & Production U.S. Revenues



Source: IBISWorld

¹ Sourced from "IBISWorld Industry Report 21111: Oil Drilling & Gas Extraction in the US" by James Crompton

Domestic Oil & Gas Production Activity

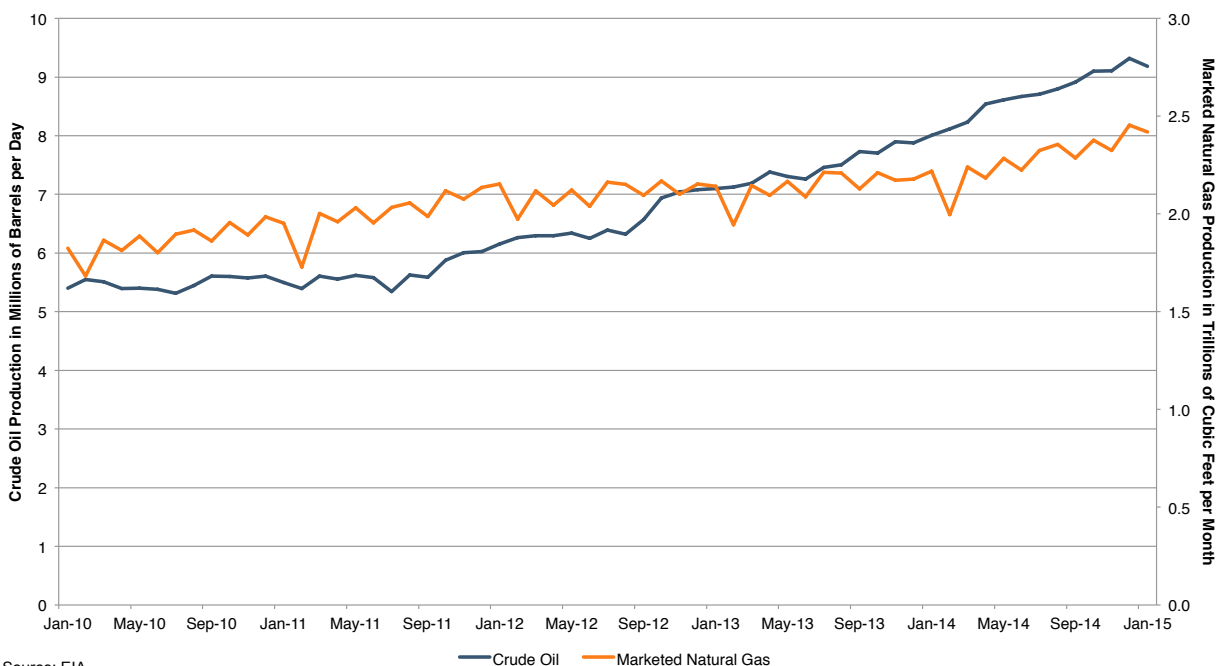
Domestic crude oil and natural gas production have increased over the past several years. According to the U.S. Energy Information Administration (EIA), U.S. crude oil production averaged approximately 9.2 million barrels per day (bbl/d) in January 2015. Despite lower oil prices, the EIA expects continued production increases, with output reaching 9.3 million bbl/d in 2015 and 9.5 million bbl/d in 2016.²

Technological improvements, most notably hydraulic fracturing and horizontal drilling, have increased the efficiency and profitability of tight oil production. Multi-well drilling pads and "walking" drilling rigs have decreased the overall time it takes to drill a well. Additionally micro-seismic imaging has increased the accuracy, therefore, productivity, of hydraulically fractured wells.

Domestic natural gas production hit a record level in December 2014 despite low natural gas prices and a general decline in gas drilling activity (as measured by active oil rigs), but declined slightly in January 2015. Marketed natural gas production during January totaled approximately 2.4 trillion cubic feet. The EIA forecasts increases in marketed natural gas production of 3.8% and 2.2% in 2015 and 2016, respectively.

Overall, the EIA projects declines in both crude oil and natural gas imports as domestic production continues to grow.

U.S. Crude Oil and Natural Gas Production



² U.S. Energy Information Administration's "Short-Term Energy Outlook" for February 2015

Rig Counts

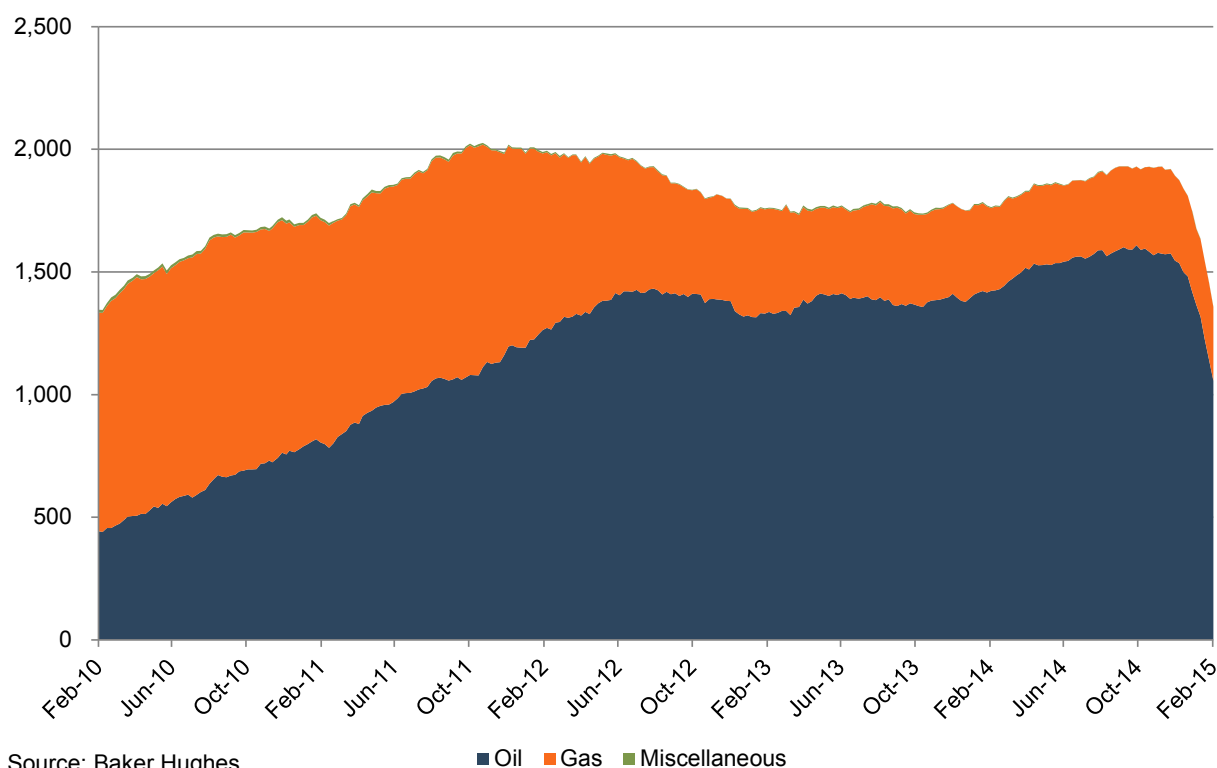
Baker Hughes collects and publishes information regarding active drilling rigs in the United States and internationally. The number of active rigs is a key indicator of demand for oilfield services & equipment. Factors influencing rig counts include energy prices, investment climate, technological changes, regulatory activity, weather, and seasonality. The number of active rigs in the United States as of February 13, 2015, stood at 1,358, representing a 23% decrease from the same period in 2014. The decline primarily reflects a slowdown in activity due to lower oil prices.³

Texas remains the most active state for drilling, followed by Oklahoma. North Dakota has seen the largest increase in

activity, with the number of active rigs up more than 50% during the past five years. This is primarily attributable to drilling in the Bakken formation.

The increase in active drilling rigs over the past several years has been driven by horizontal drilling. Horizontal wells, coupled with hydraulic fracturing, are particularly well suited for many of the tight oil and gas plays recently discovered in the United States. Unlike traditional vertical drilling, in which wells are drilled down to a pooled reservoir of hydrocarbons, in tight oil and gas plays the hydrocarbons are trapped in rock formations. Horizontal drilling allows for greater exposure to the formations containing oil and gas, and thus more efficient production.

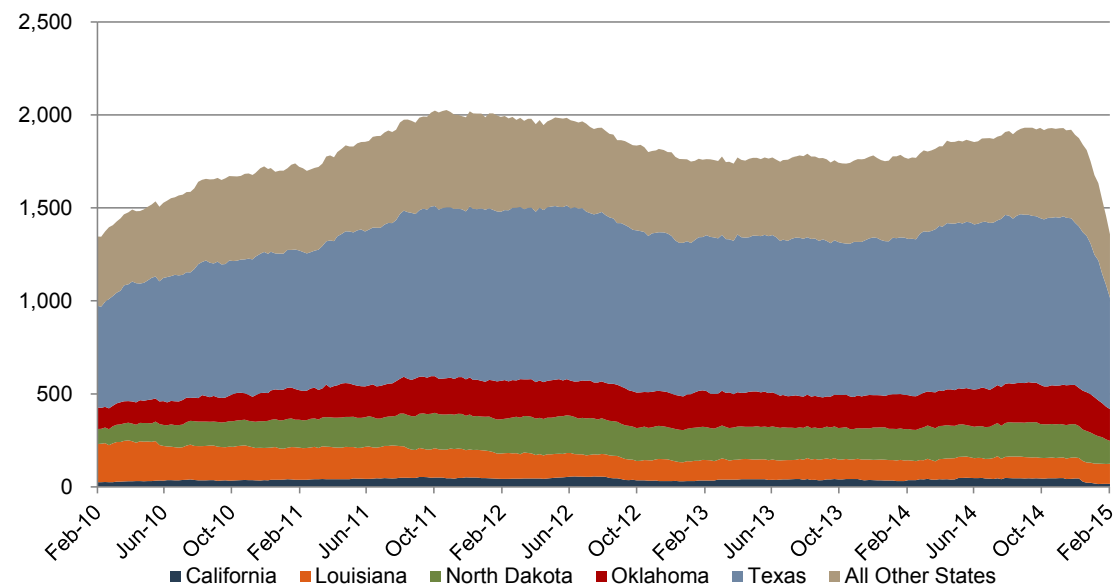
U.S. Rig Count by Oil vs. Gas



³ Data provided by Baker Hughes. See <http://www.bakerhughes.com/rig-count>

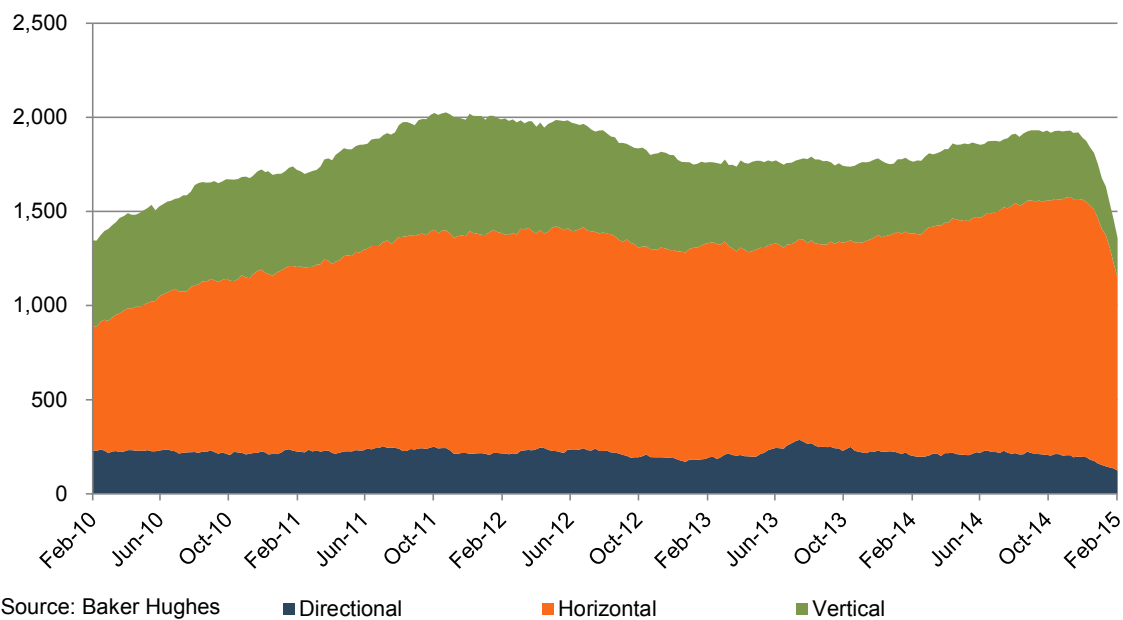
Rig Counts (cont.)

U.S. Rig Count by State



Source: Baker Hughes

U.S. Rig Count by Trajectory



Source: Baker Hughes

Directional

Horizontal

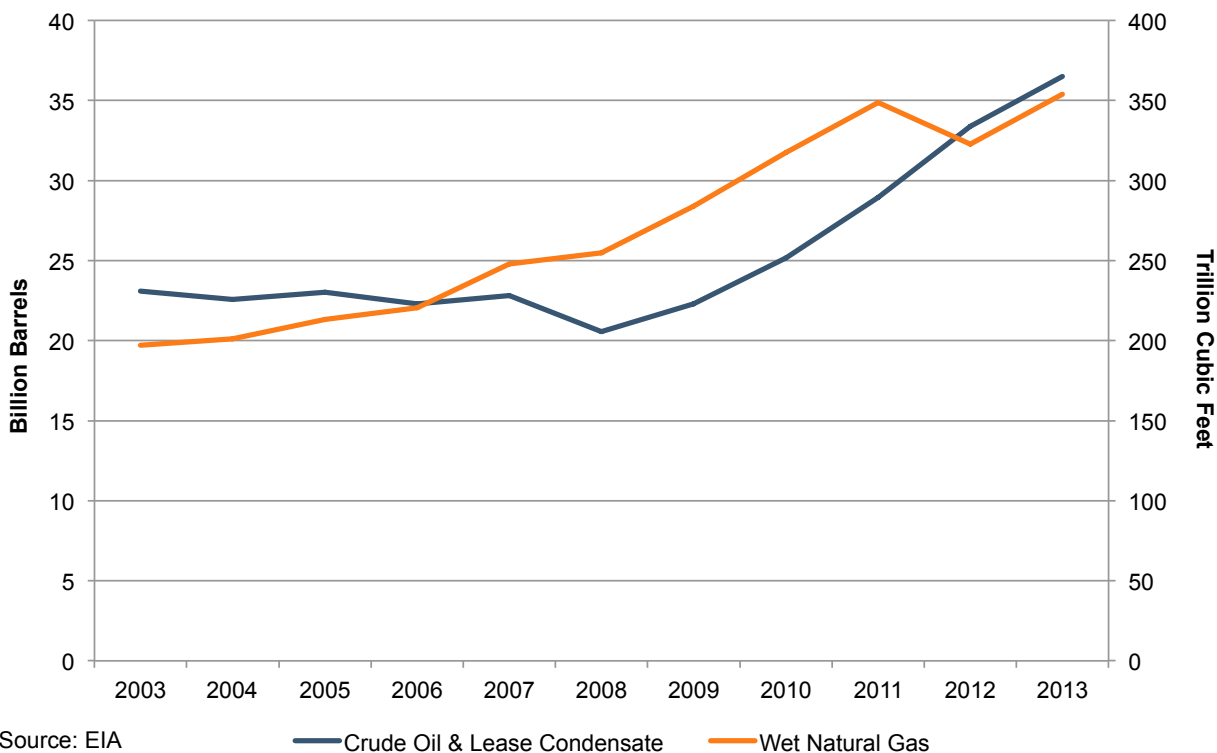
Vertical

Proved Reserves

The EIA defines proved reserves as the “estimated volumes of hydrocarbon resources that analysis of geologic and engineering data demonstrates with reasonable certainty are recoverable under existing economic and operating conditions.” The following chart shows recent trends in U.S. oil and natural gas proved reserves. The following charts detail changes in proved reserves

between 2012 and 2013 (the most recent timeframe available).⁴ The recent growth in proved reserves is driven in large part by horizontal drilling and hydraulic fracturing in various tight oil plays as additional reserves of crude oil and natural gas have become technically and/or economically feasible to produce.

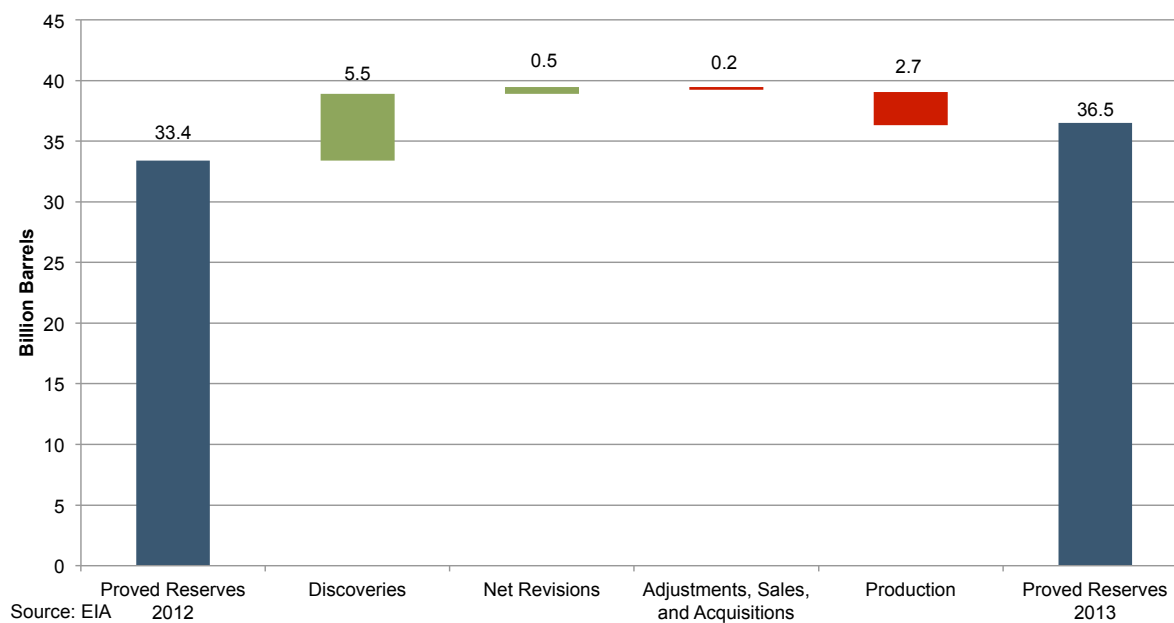
U.S. Proved Reserves



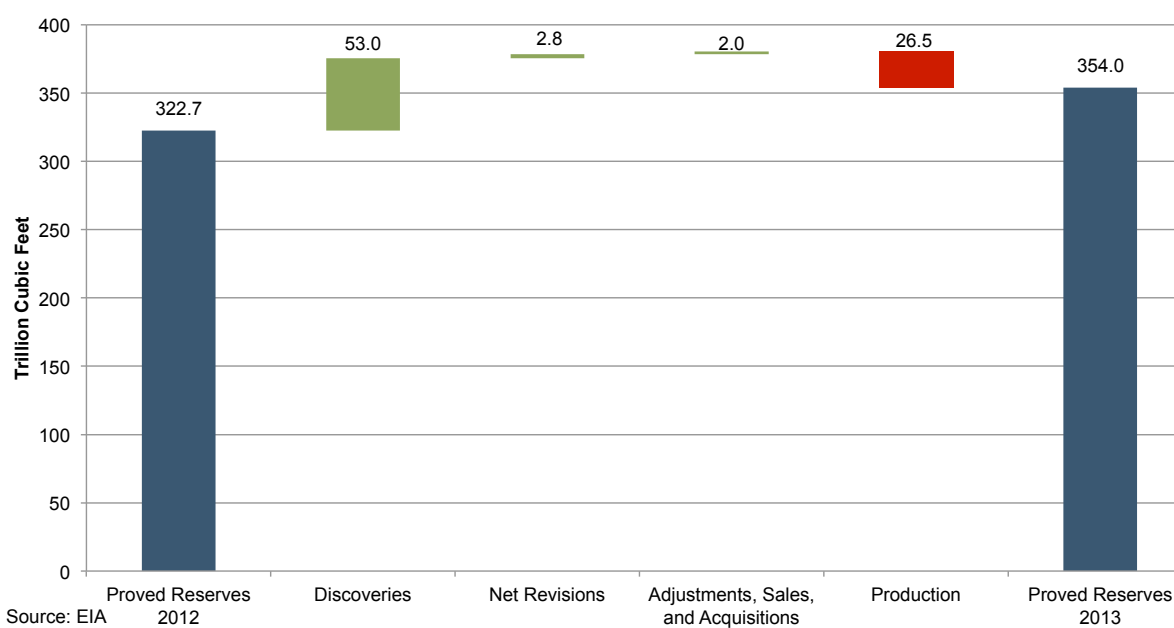
⁴ U.S. Energy Information Administration's "U.S. Crude Oil and Natural Gas Proved Reserves, 2013"

Proved Reserves (cont.)

Change in US Crude Oil and Lease Condensate Proved Reserves

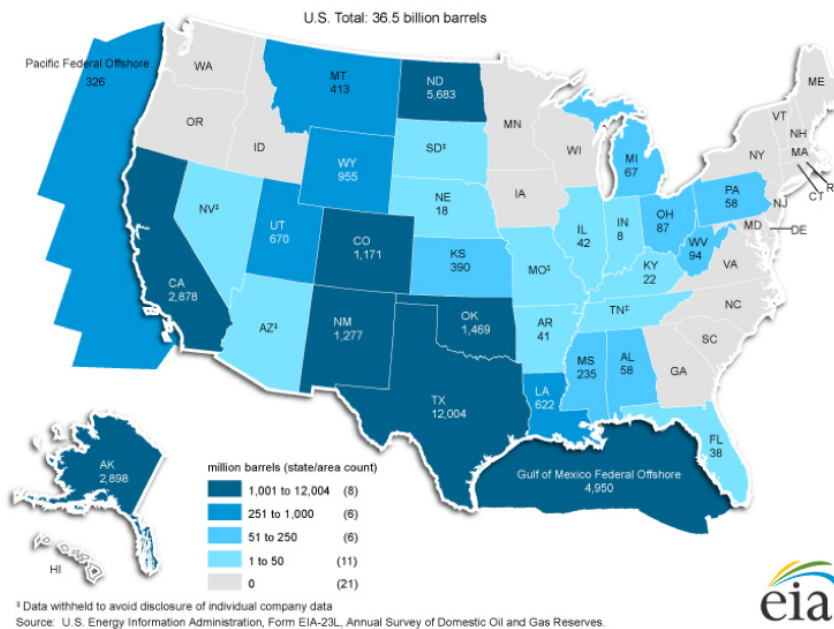


Change in US Wet Natural Gas Proved Reserves

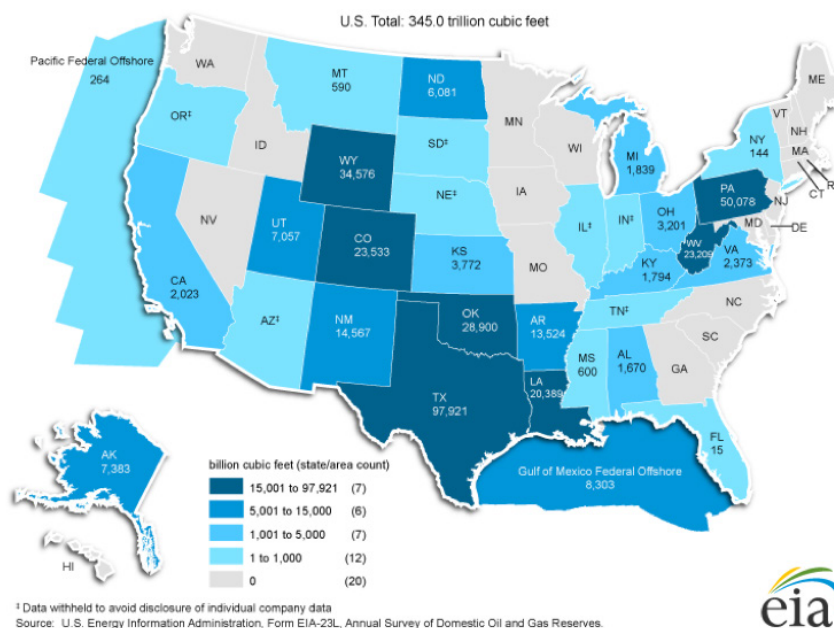


Proved Reserves (cont.)

US Crude Oil and Lease Condensate Proved Reserves Map



US Wet Natural Gas Proved Reserves Map



Market Valuations & Transaction Activity

Public Company Valuation Multiples

As shown in the "Selected Public Company Information" section, valuation multiples for exploration & production companies are widely dispersed, though measures of central tendency range from approximately 7.5-9.5x (on an enterprise value to EBITDA basis).

As shown in "Historical Valuation" section, valuation multiples compressed going into year-end 2014, but have rebounded somewhat in early 2015.

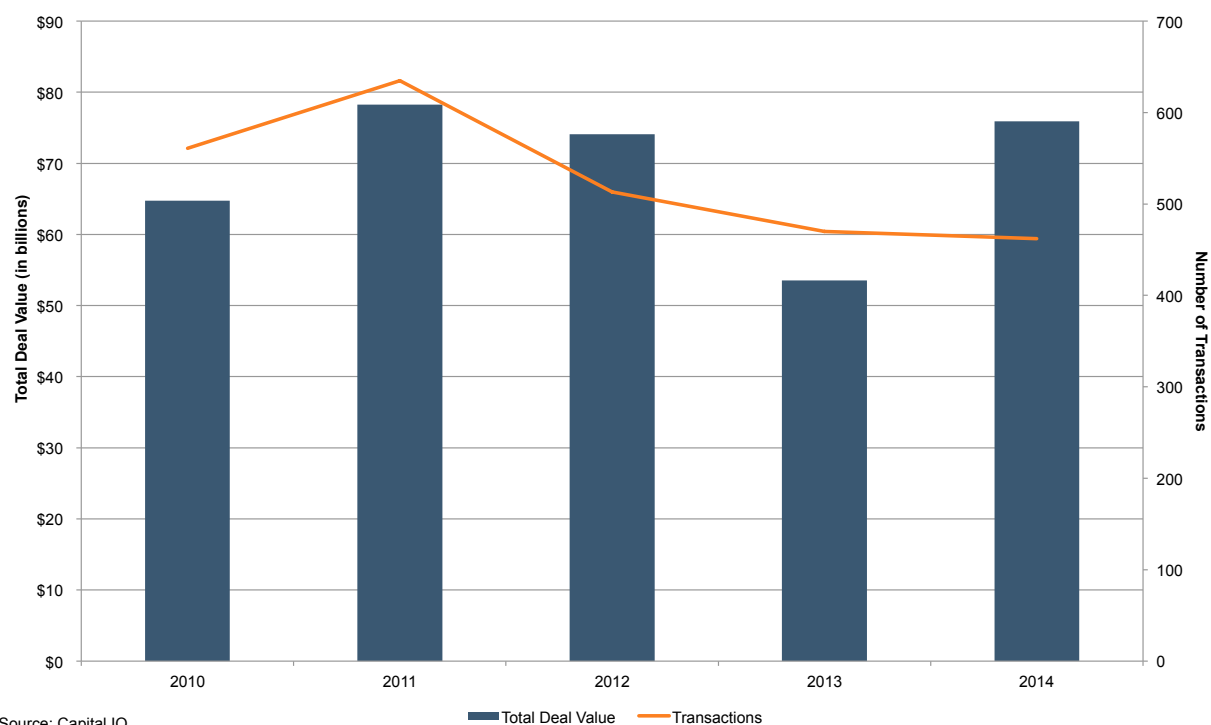
Transaction Activity

After peaking in 2011, transaction activity (in terms of both announced transactions and deal value) declined in 2012 and 2013. While deal count in 2014 was slightly lower than 2013's level, the total deal value increased to nearly \$76 billion.

Encana's \$7 billion acquisition of Athlon Energy will give the Canadian operator access to Athlon's Permian Basin acreage. The combination Whiting Petroleum and Kodiak Oil & Gas will make the combined company the largest producer in the Bakken.

Selected individual transaction data (including implied valuation multiples) is shown in the table, "Selected Exploration and Production Transactions."

U.S. Exploration & Production Transaction Activity



Selected Exploration and Production Transactions

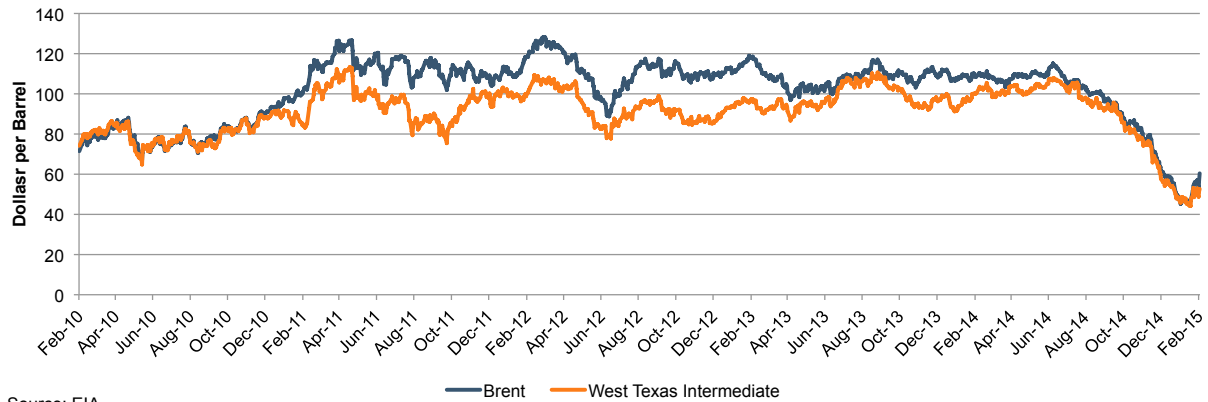
Enterprise Value to:

Target Name	Transaction Announcement Date	Transaction Value	Implied Enterprise Value	LTM		EBITDA Margin	Revenues	EBITDA
				Revenues	EBITDA			
Apco Oil & Gas International Inc.	10/3/14	\$432.7	\$407.9	\$147.3	\$90.3	61.3%	2.8x	4.5x
Athlon Energy Inc.	9/29/14	6,980.3	6,737.0	421.6	246.0	58.4%	16.0	27.4
Dune Energy Inc.	9/18/14	126.2	119.9	49.8	42.4	85.2%	2.4	2.8
QR Energy, LP	7/24/14	2,843.5	2,837.1	501.2	136.1	27.1%	5.7	20.8
Kodiak Oil & Gas Corp.	7/13/14	6,128.2	6,117.0	1,123.1	691.1	61.5%	5.4	8.9
EPL Oil & Gas, Inc.	3/12/14	2,187.4	2,178.5	693.0	398.3	57.5%	3.1	5.5
Average		\$3,116.4	\$3,066.2	\$489.4	\$267.4	58.5%	5.9x	11.6x
Median		\$2,515.4	\$2,507.8	\$461.4	\$191.1	59.8%	4.3x	7.2x

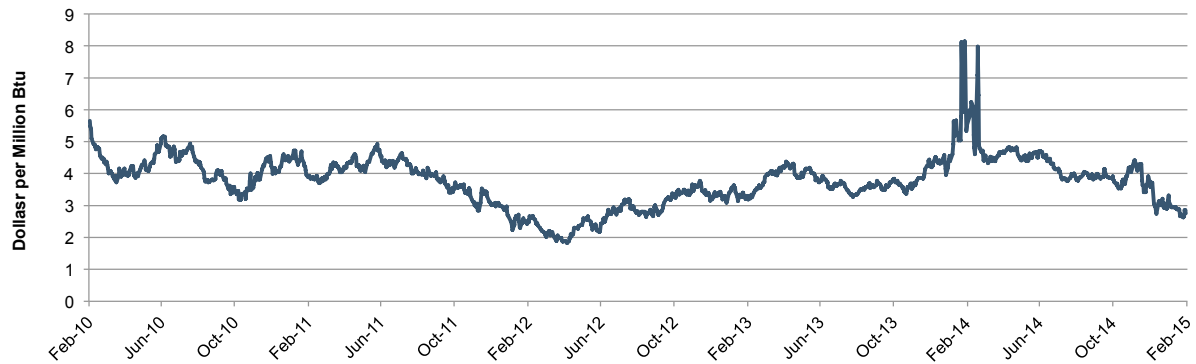
Presented in \$000,000s
Source: Capital IQ

Commodity Prices

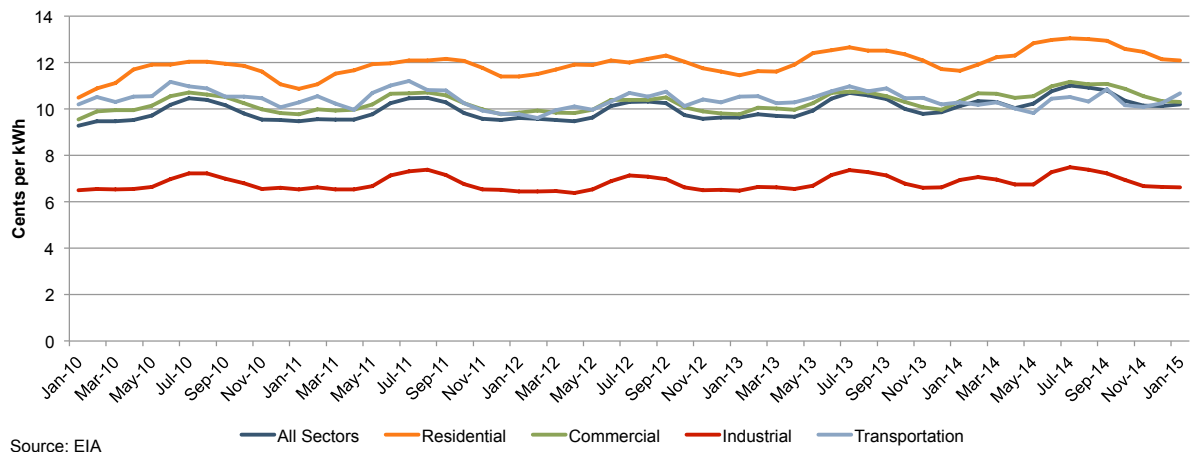
Crude Oil Spot Prices



Henry Hub Natural Gas Spot Price



U.S. Electricity Prices



Selected Public Company Information

Exploration & Production

Company Name	Ticker	LTM		EBITDA Margin	Enterprise Value @ 2/15/15	EV/EBITDA Multiple
		Revenues	EBITDA			
Anadarko Petroleum Corp	APC	\$18,470	\$9,953	53.9%	\$55,613	5.6x
Apache Corp	APA	13,551	7,082	52.3%	37,919	5.4
Approach Resources Inc	AREX	261	176	67.6%	722	4.1
Antero Resources Corp	AR	1,945	1,046	53.8%	15,778	15.1
Bill Barrett Corp	BBG	473	138	29.1%	1,287	9.3
Bonanza Creek Energy Inc	BCEI	556	179	32.2%	2,224	12.4
Cabot Oil & Gas Corp	COG	2,035	600	29.5%	13,337	22.2
Carrizo Oil & Gas Inc	CRZO	697	507	72.8%	3,765	7.4
Chesapeake Energy Corp	CHK	19,557	4,998	25.6%	25,812	5.2
Cimarex Energy Co	XEC	2,438	1,630	66.9%	10,867	6.7
Comstock Resources Inc	CRK	555	346	62.4%	1,360	3.9
Concho Resources Inc	CXO	2,732	1,251	45.8%	16,844	13.5
Continental Resources Inc/OK	CLR	4,724	3,159	66.9%	23,602	7.5
Denbury Resources Inc	DNR	2,419	1,353	56.0%	6,601	4.9
Devon Energy Corp	DVN	17,632	6,083	34.5%	41,777	6.9
Diamondback Energy Inc	FANG	508	395	77.7%	5,185	13.1
Energen Corp	EGN	1,555	799	51.4%	6,154	7.7
EOG Resources Inc	EOG	16,814	8,525	50.7%	56,936	6.7
EV Energy Partners LP	EVEP	\$339	\$83	24.5%	\$1,840	22.1
EXCO Resources Inc	XCO	673	404	59.9%	2,090	5.2
Gulfport Energy Corp	GPOR	671	493	73.5%	4,315	8.7
Halcon Resources Corp	HK	1,161	493	42.5%	4,741	9.6
Hess Corp	HES	13,702	6,150	44.9%	26,628	4.3
Laredo Petroleum Inc	LPI	823	502	61.0%	3,676	7.3
Magnum Hunter Resources Corp	MHR	375	(337)	-89.8%	1,832	nm
Marathon Oil Corp	MRO	11,604	4,571	39.4%	23,896	5.2
Matador Resources Co	MTDR	373	256	68.6%	2,062	8.1

Presented in \$000,000s
Source: Bloomberg L.P.

Selected Public Company Information

Exploration & Production (cont.)

Company Name	Ticker	LTM		EBITDA Margin	Enterprise Value @ 2/15/15	EV/EBITDA Multiple
		Revenues	EBITDA			
Murphy Oil Corp	MUR	\$5,478	\$3,301	60.3%	\$10,536	3.2x
Newfield Exploration Co	NFX	2,248	1,453	64.6%	7,302	5.0
Noble Energy Inc	NBL	4,973	2,549	51.3%	23,367	9.2
Northern Oil and Gas Inc	NOG	424	307	72.4%	1,331	4.3
Oasis Petroleum Inc	OAS	1,422	1,090	76.6%	4,361	4.0
PDC Energy Inc	PDCE	542	94	17.4%	2,413	25.5
Pioneer Natural Resources Co	PXD	4,468	2,236	50.0%	25,152	11.2
QEP Resources Inc	QEP	3,522	258	7.3%	5,128	19.9
Range Resources Corp	RRC	2,024	1,402	69.2%	11,649	8.3
Rex Energy Corp	REXX	347	35	10.1%	938	26.8
Rosetta Resources Inc	ROSE	1,022	710	69.4%	3,453	4.9
Sanchez Energy Corp	SN	673	264	39.3%	2,164	8.2
SandRidge Energy Inc	SD	1,619	828	51.1%	6,064	7.3
SM Energy Co	SM	2,515	1,350	53.7%	5,639	4.2
Southwestern Energy Co	SWN	4,038	2,315	57.3%	17,434	7.5
Stone Energy Corp	SGY	776	62	8.0%	1,987	31.9
Ultra Petroleum Corp	UPL	1,182	805	68.1%	5,770	7.2
Vanguard Natural Resources LLC	VNR	786	564	71.8%	3,788	6.7
W&T Offshore Inc	WTI	962	576	59.8%	1,832	3.2
Whiting Petroleum Corp	WLL	3,025	1,271	42.0%	12,029	9.5
Average		\$3,802	\$1,751	47.9%	\$11,685	9.5x
Median		\$1,555	\$799	53.7%	\$5,639	7.4x

Presented in \$000,000s
Source: Bloomberg L.P.

Selected Public Company Information

Midstream Operations

Company Name	Ticker	LTM		EBITDA Margin	Enterprise Value @ 2/15/15	EV/EBITDA Multiple
		Revenues	EBITDA			
Blueknight Energy Partners LP	BKEP	187	61	32.6%	652	10.7
Boardwalk Pipeline Partners LP	BWP	1,234	687	55.7%	7,806	11.4
Buckeye Partners LP	BPL	6,620	692	10.4%	13,276	19.2
Crestwood Midstream Partners L	CMLP	2,566	404	15.8%	5,447	13.5
DCP Midstream Partners LP	DPM	3,638	560	15.4%	6,689	11.9
Enbridge Energy Partners LP	EEP	7,965	1,545	19.4%	24,269	15.7
Energy Transfer Partners LP	ETP	51,158	3,605	7.0%	49,161	13.6
EnLink Midstream Partners LP	ENLK	3,494	634	18.1%	10,064	15.9
Enterprise Products Partners L	EPD	47,951	4,877	10.2%	89,640	18.4
EQT Midstream Partners LP	EQM	362	287	79.2%	5,966	20.8
Genesis Energy LP	GEL	3,846	223	5.8%	5,866	26.3
Holly Energy Partners LP	HEP	333	217	65.2%	2,988	13.8
Magellan Midstream Partners LP	MMP	2,304	1,136	49.3%	21,224	18.7
MarkWest Energy Partners LP	MWE	2,149	783	36.4%	16,441	21.0
Martin Midstream Partners LP	MMLP	1,642	137	8.3%	1,968	14.4
Memorial Production Partners L	MEMP	494	207	41.8%	3,104	15.0
MPLX LP	MPLX	548	234	42.6%	6,877	29.5
NuStar Energy LP	NS	3,075	539	17.5%	7,596	14.1
Oiltanking Partners LP	OILT	256	175	68.5%	3,919	22.4
MPLX LP	MPLX	535	231	43.3%	5,626	24.3
NuStar Energy LP	NS	3,179	532	16.7%	7,337	13.8
Oiltanking Partners LP	OILT	256	175	68.5%	4,229	24.2

Presented in \$000,000s
Source: Bloomberg L.P.

Selected Public Company Information

Midstream Operations (cont.)

Company Name	Ticker	LTM		EBITDA Margin	Enterprise Value @ 2/15/15	EV/EBITDA Multiple
		Revenues	EBITDA			
ONEOK Inc	OKE	12,195	1,450	11.9%	21,352	14.7
Phillips 66 Partners LP	PSXP	227	149	65.5%	6,252	42.1
Plains All American Pipeline L	PAA	43,465	2,184	5.0%	28,856	13.2
Regency Energy Partners LP	RGP	4,951	878	17.7%	16,904	19.3
SemGroup Corp	SEMG	2,123	151	7.1%	3,948	26.1
Spectra Energy Partners LP	SEP	2,269	1,432	63.1%	22,500	15.7
Sunoco Logistics Partners LP	SXL	18,088	921	5.1%	14,087	15.3
Tallgrass Energy Partners LP	TEP	362	101	27.9%	3,714	36.8
Targa Resources Partners LP	NGLS	8,736	1,000	11.4%	8,187	8.2
TC PipeLines LP	TCP	336	252	75.0%	6,288	25.0
Teekay LNG Partners LP	TGP	403	278	68.9%	5,015	18.1
Teekay Offshore Partners LP	TOO	1,020	455	44.6%	4,137	9.1
Tesoro Logistics LP	TLLP	596	287	48.3%	7,476	26.0
TransMontaigne Partners LP	TLP	150	64	42.7%	843	13.2
Western Gas Partners LP	WES	1,274	577	45.3%	11,649	20.2
Williams Partners LP	WPZ	1,379	724	52.5%	33,191	45.8
Average		\$6,672	\$786	33.5%	\$13,410	19.1x
Median		\$2,136	\$497	30.3%	\$7,177	15.8x

Presented in \$000,000s
Source: Bloomberg L.P.

Selected Public Company Information

Alternative Energy

Company Name	Ticker	LTM		EBITDA Margin	Enterprise Value @ 2/15/15	EV/EBITDA Multiple
		Revenues	EBITDA			
Solar						
Enphase Energy Inc	ENPH	\$344	\$4	1.1%	\$619	161.6
First Solar Inc	FSLR	3,392	670	19.8%	3,120	4.7
Real Goods Solar Inc	RGSE	95	(40)	-42.4%	23	nm
SolarCity Corp	SCTY	255	(238)	-93.2%	6,990	nm
SunEdison Inc	SUNE	2,484	(179)	-7.2%	13,320	nm
SunPower Corp	SPWR	3,027	360	11.9%	4,013	11.1
Average		\$1,600	\$96	-18.3%	\$4,681	59.1x
Median		\$1,414	(\$18)	-3.1%	\$3,567	11.1x
Wind Turbine Manufacturing						
Suzlon Energy Ltd	SUEL	3,348	32	1.0%	3,301	103.0
Gamesa Corp Tecnologica SA	GAM	3,781	373	9.9%	2,855	7.6
Xinjiang Goldwind Science & Te	2208 HK	2,857	401	14.0%	6,404	16.0
Sinovel Wind Group Co Ltd	601558 CH	704	(211)	-30.0%	4,167	nm
Average		\$2,672	\$149	-1.3%	\$4,182	42.2x
Median		\$3,102	\$203	5.4%	\$3,734	16.0x

Presented in \$000,000s
Source: Bloomberg L.P.

Selected Public Company Information

Alternative Energy (cont.)

Company Name	Ticker	LTM		EBITDA Margin	Enterprise Value @ 2/15/15	EV/EBITDA Multiple
		Revenues	EBITDA			
Biofuels						
Amyris Inc	AMRS	\$43	(\$85)	-196.1%	\$355	nm
FutureFuel Corp	FF	342	65	19.0%	317	4.9
Gevo Inc	GEVO	28	(35)	-123.5%	64	nm
Green Plains Inc	GPPE	3,236	347	10.7%	1,206	3.5
Pacific Ethanol Inc	PEIX	1,107	105	9.4%	223	2.1
Renewable Energy Group Inc	REGI	1,274	101	7.9%	579	5.7
REX American Resources Corp	REX	572	139	24.3%	396	2.8
Solazyme Inc	SZYM	60	(129)	-214.3%	202	nm
Average		\$833	\$63	-57.8%	\$418	3.8x
Median		\$457	\$83	8.7%	\$336	3.5x
Alternative Energy Overall						
Average		\$1,497	\$93	-32.1%	\$2,675	29.4x
Median		\$906	\$49	4.5%	\$913	5.7x

Presented in \$000,000s
Source: Bloomberg L.P.

Selected Public Company Information

Oilfield Services & Equipment

Company Name	Ticker	LTM		EBITDA Margin	Enterprise Value @ 2/15/15	EV/EBITDA Multiple
		Revenues	EBITDA			
Diversified						
Baker Hughes Inc	BHI	\$24,551	\$4,673	19.0%	\$30,318	6.5x
Halliburton Co	HAL	32,870	7,223	22.0%	43,043	6.0
Schlumberger Ltd	SLB	48,580	11,813	24.3%	118,740	10.1
Weatherford International PLC	WFT	14,911	1,876	12.6%	16,544	8.8
Average		\$30,228	\$6,396	19.5%	\$52,161	7.8x
Median		\$28,711	\$5,948	20.5%	\$36,681	7.7x
Contract Drilling						
Atwood Oceanics Inc	ATW	\$1,241	\$567	45.7%	\$3,807	6.7x
Diamond Offshore Drilling Inc	DO	2,815	1,029	36.6%	6,824	6.6
Ensco PLC	ESV	4,811	(2,080)	-43.2%	11,541	nm
Helmerich & Payne Inc	HP	3,887	1,664	42.8%	7,319	4.4
Hercules Offshore Inc	HERO	900	82	9.2%	1,150	14.0
Nabors Industries Ltd	NBR	6,804	742	10.9%	7,514	10.1
Noble Corp plc	NE	4,125	1,281	31.1%	10,200	8.0
Parker Drilling Co	PKD	969	265	27.4%	937	3.5
Patterson-UTI Energy Inc	PTEN	3,182	1,002	31.5%	3,599	3.6
Pioneer Energy Services Corp	PES	1,055	203	19.3%	786	3.9
Rowan Cos Plc	RDC	1,824	156	8.5%	5,451	35.0
Transocean Ltd	RIG	9,174	(254)	-2.8%	14,900	nm
Unit Corp	UNT	1,586	628	39.6%	2,460	3.9
Vantage Drilling Co	VTG	876	420	48.0%	2,805	6.7
Average		\$3,089	\$407	21.7%	\$5,664	8.9x
Median		\$2,320	\$493	29.2%	\$4,629	6.7x

Presented in \$000,000s
Source: Bloomberg L.P.

Selected Public Company Information

Oilfield Services & Equipment (cont.)

Company Name	Ticker	LTM		EBITDA Margin	Enterprise Value @ 2/15/15	EV/EBITDA Multiple
		Revenues	EBITDA			
Equipment						
Cameron International Corp	CAM	\$10,555	\$1,590	15.1%	\$11,714	7.4x
Dresser-Rand Group Inc	DRC	2,812	381	13.5%	7,131	18.7
Dril-Quip Inc	DRQ	931	310	33.3%	2,597	8.4
Exterran Holdings Inc	EXH	2,900	605	20.9%	4,344	7.2
FMC Technologies Inc	FTI	7,943	1,301	16.4%	10,301	7.9
Forbes Energy Services Ltd	FES	449	72	16.0%	304	4.2
Forum Energy Technologies Inc	FET	1,740	308	17.7%	2,113	6.9
National Oilwell Varco Inc	NOV	22,328	4,395	19.7%	22,685	5.2
Tesco Corp	TESO	543	89	16.3%	378	4.3
Average		\$5,578	\$1,006	18.8%	\$6,841	7.8x
Median		\$2,812	\$381	16.4%	\$4,344	7.2x
Services						
Basic Energy Services Inc	BAS	\$1,491	\$276	18.5%	\$1,166	4.2x
C&J Energy Services Ltd	CJES	2,253	953	42.3%	1,643	1.7
Helix Energy Solutions Group I	HLX	1,107	371	33.5%	2,089	5.6
Hornbeck Offshore Services Inc	HOS	635	285	44.9%	1,631	5.7
Key Energy Services Inc	KEG	1,427	(3)	-0.2%	1,050	nm
McDermott International Inc	MDR	2,301	111	4.8%	935	8.4
Newpark Resources Inc	NR	1,118	173	15.4%	926	5.4
Oceaneering International Inc	OII	3,660	858	23.4%	5,619	6.5
RPC Inc	RES	2,337	634	27.1%	3,135	4.9
Superior Energy Services Inc	SPN	4,557	1,199	26.3%	4,561	3.8
TETRA Technologies Inc	TTI	1,078	69	6.4%	1,725	24.9
Willbros Group Inc	WG	2,027	33	1.6%	605	18.1
Average		\$1,999	\$413	20.4%	\$2,090	8.1x
Median		\$1,759	\$280	21.0%	\$1,637	5.6x

Presented in \$000,000s
Source: Bloomberg L.P.

Selected Public Company Information

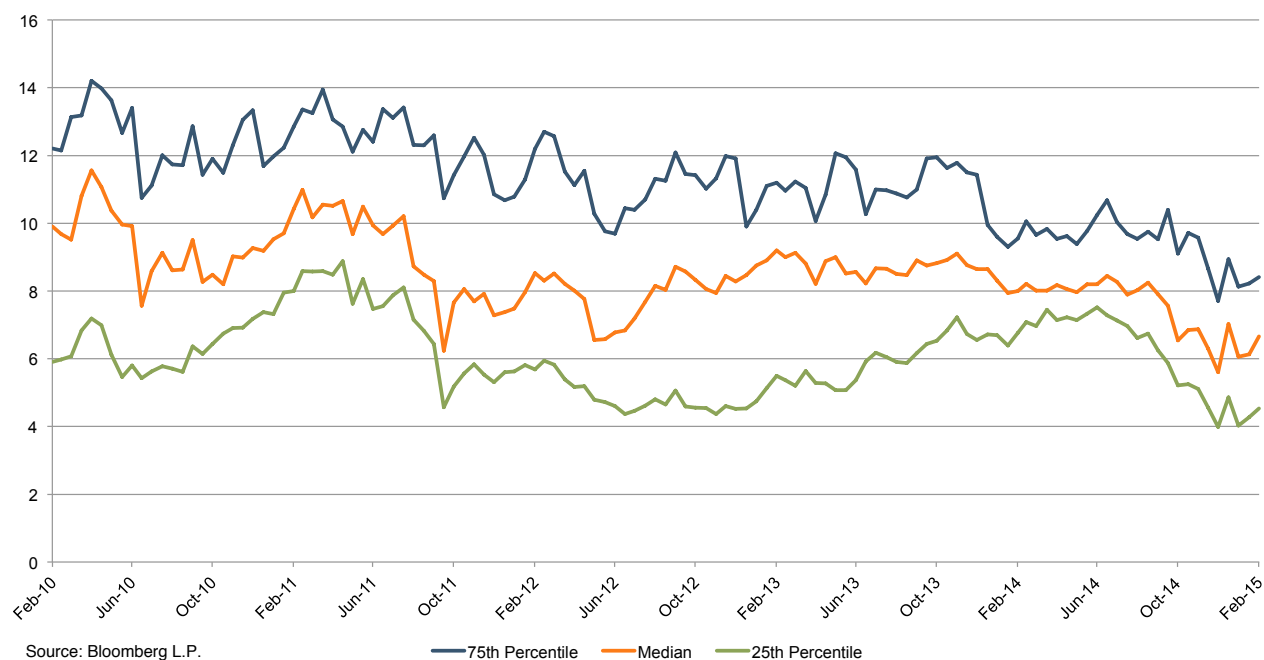
Oilfield Services & Equipment (cont.)

Company Name	Ticker	LTM		EBITDA Margin	Enterprise Value @ 2/15/15	EV/EBITDA Multiple
		Revenues	EBITDA			
Geophysical Services						
Dawson Geophysical Co	DWSN	\$119	\$6	4.7%	\$151	27.0x
Geospace Technologies Corp	GEOS	157	26	16.9%	202	7.6
ION Geophysical Corp	IO	510	(26)	-5.1%	436	nm
Average		\$262	\$2	5.5%	\$263	17.3x
Median		\$157	\$6	4.7%	\$202	17.3x
Oilfield Serv. & Equip. Overall						
Average		\$5,694	\$1,079	19.3%	\$8,938	8.7x
Median		\$2,140	\$376	18.8%	\$2,970	6.7x

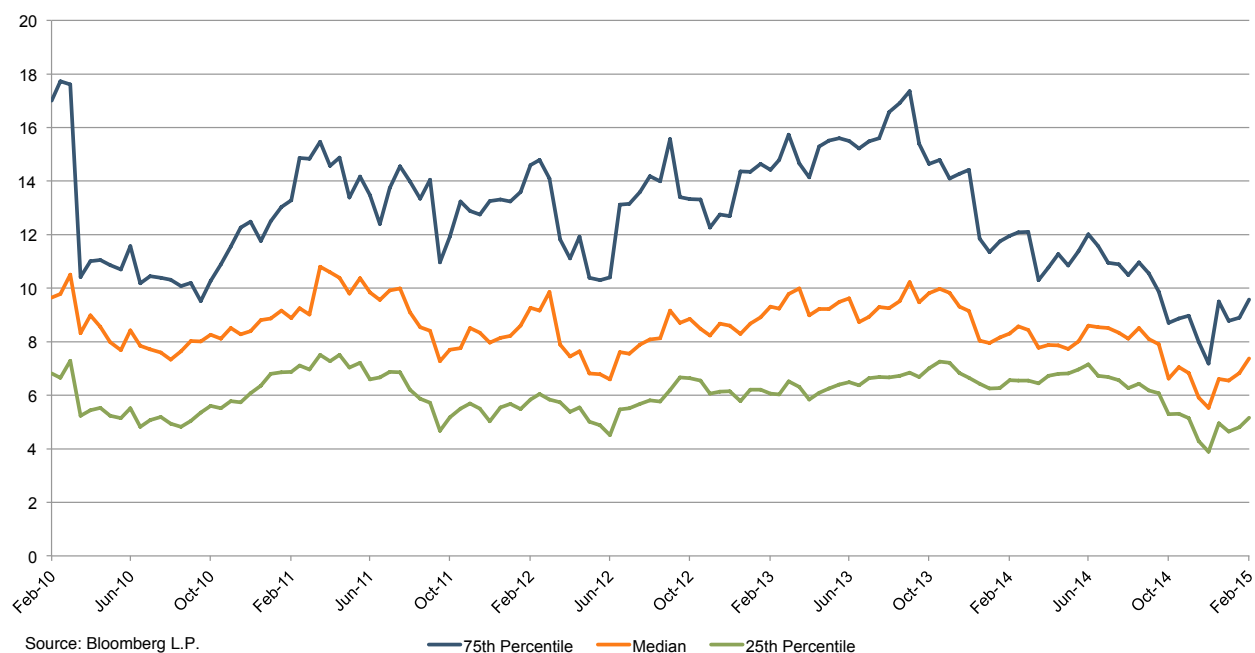
Presented in \$000,000s
Source: Bloomberg L.P.

Historical Valuations

Oilfield Services & Equipment EV/EBITDA Multiples

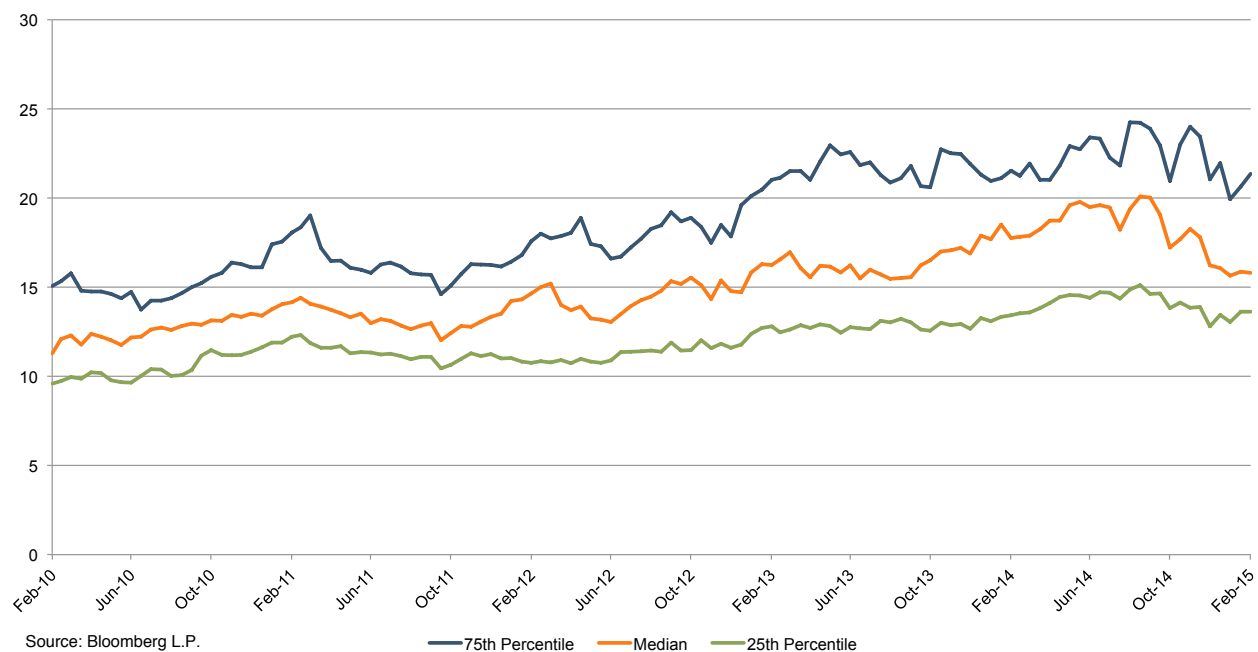


Exploration & Production EV/EBITDA Multiples

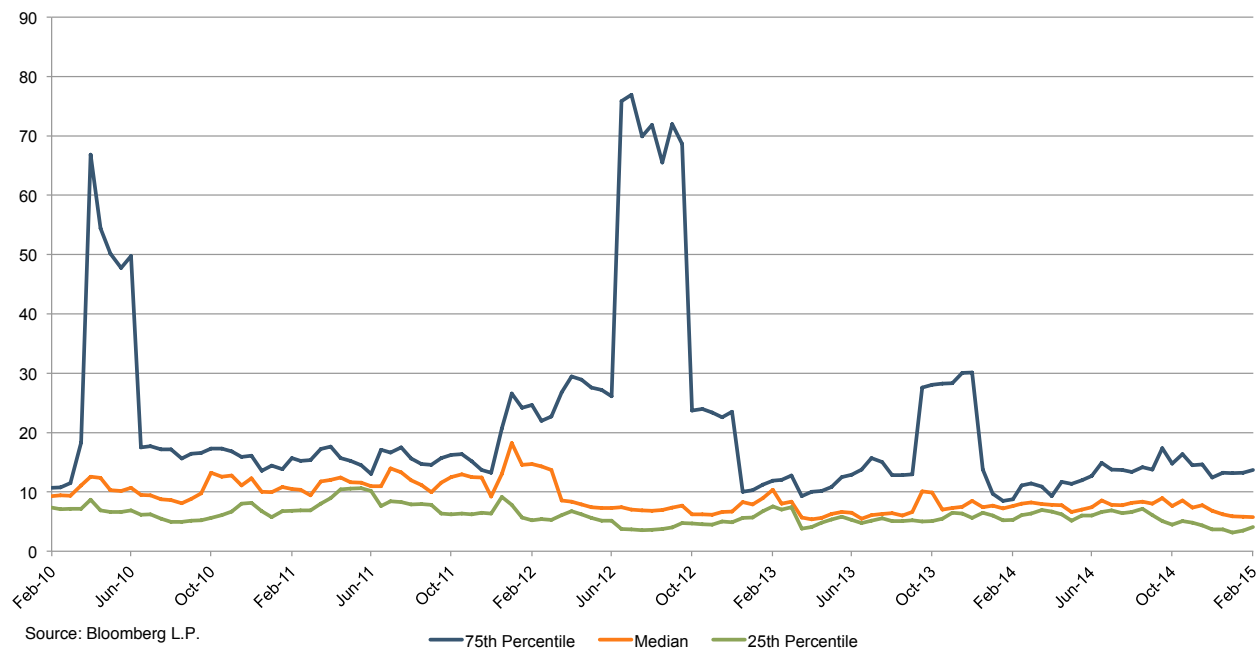


Historical Valuations (cont.)

Midstream EV/EBITDA Multiples



Alternative Energy EV/EBITDA Multiples



Stock Performance



Source: Bloomberg L.P.

Note: Performance shown on a total return basis

Segment indices are as follows:

- » S&P 500 – S&P 500 Total Return Index (SPXT)
- » Oilfield Services & Equipment – S&P Oil & Gas Equipment and Services Select Industry (SPSIOSTR)
- » Exploration & Production – S&P Oil & Gas Exploration and Production Select Industry Index (SPSIOPTR)
- » Midstream – Alerian MLP Index (AMZX)
- » Alternative Energy – Credit Suisse Alternative Energy Index (CSAETRUS)

Mercer Capital

Energy Industry Services

Mercer Capital has expertise providing business valuation and financial advisory services to companies in the energy industry.

Industry Segments

Mercer Capital serves the following industry segments:

- Exploration & Production
- Oil Field Services
- Midstream Operations
- Alternative Energy

Services Provided

- Valuation of energy companies
- Transaction advisory for acquisitions and divestitures
- Valuations for purchase accounting and impairment testing
- Fairness and solvency opinions
- Litigation support for economic damages and valuation and shareholder disputes

Contact a Mercer Capital professional to discuss your needs in confidence.

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Fairness Opinions

Evaluating a Buyer's Shares from the Seller's Perspective

M&A activity in the U.S. (and globally) has accelerated in 2014 after years of gradual improvement following the financial crisis. According to Dealogic, M&A volume where the target was a U.S. company totaled \$1.4 trillion YTD through November 10, the highest YTD volume on record and up 43% from the same period last year. Excluding cross-border acquisitions, domestic-only M&A was \$1.1 trillion, which represented the second highest YTD volume since 1999 and up 27% from last year. Healthcare and telecommunications were the first and second most targeted sectors.

The improvement has taken a long time even though corporate cash is high, financing costs are very low and organic revenue growth in most industries has been sluggish. Aside from improving confidence, another key foundation for increased M&A activity fell into place in 2013 when equity markets staged a strong rally as the S&P 500 rose 30% (32% with dividends) and the Russell 2000 increased 37% (39%). The absence of a meaningful pullback in 2014 and a 12% advance in the S&P 500 and 2% in the Russell 2000 have further supported activity.

The rally in equities, like low borrowing rates, has reduced the cost to finance acquisitions because the majority of stocks experienced multiple expansion rather than material growth in EPS. It is easier for a buyer to issue shares to finance an acquisition if the shares trade at rich valuation than issuing "cheap" shares. As of November 24, the S&P 500's P/E based upon trailing earnings (as reported) was 20.0x compared to 18.2x at year-end 2013, 17.0x at year-end 2012 and 14.9x at year-end 2011. The long-term average P/E since 1871 is 15.5x (Source: <http://www.multpl.com>).

High multiple stocks can be viewed as strong acquisition currencies for acquisitive companies because fewer shares have to be issued to achieve a targeted dollar value. As such, it is no surprise that

the extended rally in equities has supported deal activity this year. However, high multiple stocks may represent an under-appreciated risk to sellers who receive the shares as consideration. Accepting the buyer's stock raises a number of questions, most which fall into the genre of: what are the investment merits of the buyer's shares? The answer may not be as obvious as it seems, even when the buyer's shares are actively traded.

Our experience is that some, if not most, members of a board weighing an acquisition proposal do not have the background to thoroughly evaluate the buyer's shares. Even when financial advisors are involved there still may not be a thorough vetting of the buyer's shares because there is too much focus on "price" instead of, or in addition to, "value."

A fairness opinion is more than a three or four page letter that opines as to the fairness from a financial point of a contemplated transaction; it should be backed by a robust analysis of all of the relevant factors considered in rendering the opinion, including an evaluation of the shares to be issued to the selling company's shareholders. The intent is not to express an opinion about where the shares may trade in the future, but rather to evaluate the investment merits of the shares before and after a transaction is consummated.

Key questions to ask about the buyer's shares include the following:

- » **Liquidity of the Shares.** What is the capacity to sell the shares issued in the merger? SEC registration and even NASDAQ and NYSE listings do not guarantee that large blocks can be liquidated efficiently. Generally, the higher the institutional ownership, the better the liquidity. Also, liquidity may improve with an acquisition if the number of shares outstanding and shareholders increase sufficiently.

- » **Profitability and Revenue Trends.** The analysis should consider the buyer's historical growth and projected growth in revenues, and operating earnings, (usually EBITDA or EBITDA less capital expenditures) in addition to EPS. Issues to be vetted include customer concentrations, the source of growth, the source of any margin pressure and the like. The quality of earnings and a comparison of core vs. reported earnings over a multi-year period should be evaluated.
- » **Pro Forma Impact.** The analysis should consider the impact of a proposed transaction on revenues, EBITDA, margins, EPS and capital structure. The per share accretion and dilution analysis of such metrics as earnings, EBITDA and dividends should consider both the buyer's and seller's perspectives.
- » **Dividends.** In a yield starved world, dividend paying stocks have greater attraction than in past years. Sellers should not be overly swayed by the pick-up in dividends from swapping into the buyer's shares; however, multiple studies have demonstrated that a sizable portion of an investor's return comes from dividends over long periods of time. If the dividend yield is notably above the peer average, the seller should ask why? Is it payout related, or are the shares depressed? Worse would be if the market expected a dividend cut. These same questions should also be asked in the context of the prospects for further increases.
- » **Capital Structure.** Does the acquirer operate with an appropriate capital structure given industry norms, cyclicity of the business and investment needs to sustain operations? Will the proposed acquisition result in an over-leveraged company, which in turn may lead to pressure on the buyer's shares and/or a rating downgrade if the buyer has rated debt?
- » **Balance Sheet Flexibility.** Related to the capital structure should be a detailed review of the buyer's balance sheet that examines such areas as liquidity, access to bank credit, and the carrying value of assets such as deferred tax assets.
- » **Ability to Raise Cash to Close.** What is the source of funds for the buyer to fund the cash portion of consideration? If the buyer has to go to market to issue equity and/or debt, what is the contingency plan if unfavorable market conditions preclude floating an issue?
- » **Consensus Analyst Estimates.** If the buyer is publicly traded and has analyst coverage, consideration should be given to Street expectations vs. what the diligence process determines. If Street expectations are too high, then the shares may be vulnerable once investors reassess their earnings and growth expectations.
- » **Valuation.** Like profitability, valuation of the buyer's shares should be judged relative to its history and a peer group presently as well as relative to a peer group through time to examine how investors' views of the shares may have evolved through market and profit cycles.
- » **Share Performance.** Sellers should understand the source of the buyer's shares performance over several multi-year holding periods. For example, if the shares have significantly outperformed an index over a given holding period, is it because earnings growth accelerated? Or, is it because the shares were depressed at the beginning of the measurement period? Likewise, underperformance may signal disappointing earnings, or it may reflect a starting point valuation that was unusually high.
- » **Strategic Position.** Assuming an acquisition is material for the buyer, directors of the selling board should consider the strategic position of the buyer, asking such questions about the attractiveness of the pro forma company to other acquirers.
- » **Contingent Liabilities.** Contingent liabilities are a standard item on the due diligence punch list for a buyer. Sellers should evaluate contingent liabilities too.

The list does not encompass every question that should be asked as part of the fairness analysis, but it does illustrate that a liquid market for a buyer's shares does not necessarily answer questions about value, growth potential and risk profile.

We at Mercer Capital have extensive experience in valuing and evaluating the shares (and debt) of financial and non-financial service companies garnered from over three decades of business. Feel free to contact us to discuss your situation in confidence.



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