

OIL & GAS

Newsletter

April Edition: A Look Downstream

The midstream O&G industry has traditionally garnered the interest of investors due to its relatively predictable revenue streams, which depend on the gathering, storage, and transportation of crude oil, gas, and other petroleum liquids (i.e., the “toll roads” of the industry) rather than directly on the price of the underlying commodity. However, the recent changes in the supply/demand dynamics of the U.S. O&G industry add an additional layer of attractiveness for the midstream industry, which stands to benefit in more ways than one. In this month’s *Newsletter*, we discuss the factors impacting the midstream O&G market and the outlook for companies across the value chain.

► Greater resilience in a downturn.

Compared to upstream operators and service companies close to the drill bit, midstream companies are better positioned for the shifting dynamics in the O&G industry due to i) increased transportation demand caused by crude production growth, ii) increased storage demand due to slower than expected demand for refined products, iii) increased focus on industrial projects benefitting from lower input costs, and iv) opportunities to capitalize on regions underserved due to geographic location and/or refining abilities. With the outlook for the O&G industry remaining uncertain, we expect an increased investor focus on midstream companies in the near-term.

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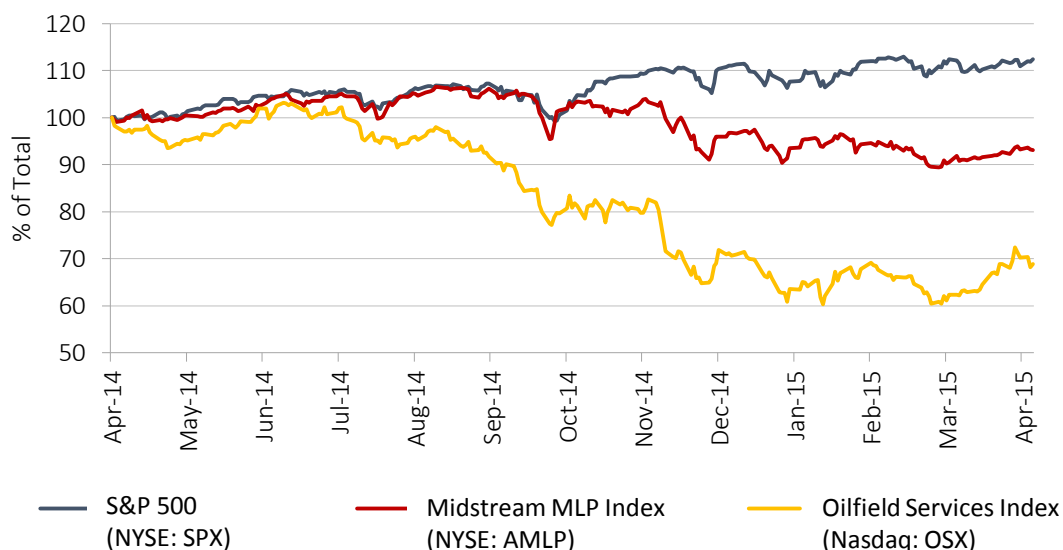
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Relative Performance of Midstream MLP Index (AMLP)



► Surplus crude production drives transportation demand.

Domestic crude oil production averaged 9.33mm bbls/d in March, the highest yet, and is expected to reach a peak of 9.46 bbls/d in 2015. Though this has negative implications for E&Ps and upstream service providers, rising U.S. production is a tailwind for midstream companies which, on average, receive 70% of revenues from the transportation of oil from point A to point B.

► **Slower than expected growth in demand for refined products means lower refinery throughput and increased storage demand.**

With demand for refined products growing slower than expected, increases in refinery capacity and utilization will lag behind crude production growth. Further, with the market anticipating an eventual rise in crude prices, producers are incentivized to store today's crude for tomorrow's sale. With supply and demand out of balance, storage space has become an increasingly coveted asset, and midstream companies with exposure to crude oil storage stand to benefit as excess storage capacity dwindles and storage rates rise accordingly.

► **Low natural gas prices drive capital investment in petrochemical, LNG, & industrial projects.**

Natural gas liquids are the primary feedstocks in petrochemical processes, and low domestic prices provide competitive advantages for U.S. petrochemical facilities relative to global peers (though the gap has narrowed with the recent fall in oil prices). LNG export plants, which can capitalize on price arbitrage opportunities in international markets, and industrial projects ranging from fertilizer plants to paper product plants stand to benefit from lower domestic prices as well. The recent boom in announced investments in these industries, with a particular concentration in the Gulf Coast region, will provide increased infrastructure demand.

► **Underserved geographic regions attract new investment.**

The rapid growth in U.S. energy production has been the result of improved technology that has allowed operators to extract oil & natural gas from previously inaccessible or uneconomical regions. Developing these unconventional reservoirs highlight that certain regions are undersupplied with the requisite infrastructure to transport produced oil and natural gas to end users. The Bakken shale formation of North Dakota, for example, sees the majority of its produced oil transported via rail due to the lack of pipeline infrastructure. As the midstream industry plays catch up, companies with a geographic presence in proximity to underserved shale formations stand to benefit the most.

► **Transportation methods & capacity.**

The growth in U.S. production preceded further infrastructure investment, not only in remote areas but also in established areas like the Eagle Ford shale where existing infrastructure was not initially able to accommodate the increased transportation demand. Currently, approximately 70% of crude oil and petroleum products produced in the U.S. are transported via pipeline, 23% via tankers and barges over water, 4% via trucking, and just 3% via rail. Transportation via rail has been rising in popularity due to greater flexibility in pickup and delivery points with lower upfront capital investments, but is taking a toll on operators due to higher operating costs. Rail transportation also raises environmental concerns as accidents/spills become more commonplace. In 2013, more crude oil was spilled in U.S. rail incidents than was spilled in the previous 37 years combined.

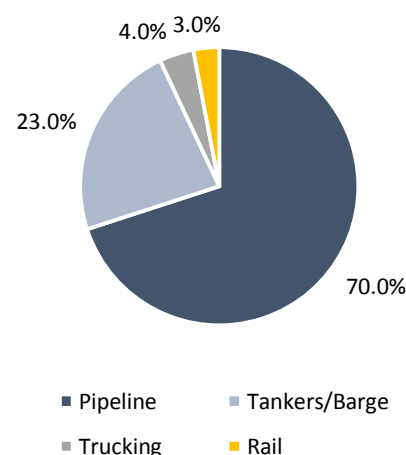
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Because U.S. oil can't be sold abroad, it is trapped inside the U.S., where storage tanks are full to the brim because refiners can't use it fast enough...

”

- DOW JONES BUSINESS NEWS

U.S. Midstream Transportation Methods



“

By frequency of spills [rail related], 2014 set a new high with 141 'unintentional releases'.

”

- PIPELINE AND HAZARDOUS MATERIALS SAFETY ADMINISTRATION

► **Retrofitting refineries & shifting trade routes.**

An all too ignored dynamic in the midstream and downstream industries is the inability of many refineries to process the lighter, sweeter grades of crude produced domestically. Many existing refineries were constructed to process heavy, sour crudes which are more common in the international markets and comprise the bulk of the U.S.'s crude imports. Because of this, refining capacity for the growing domestic production is lagging more so than may be readily apparent, and is acting as a limiting factor on the U.S.'s ability to displace its imported crude with domestic production. As the industry adjusts to the new environment, many refineries are undergoing costly retrofitting processes, and midstream companies are targeting investments in assets that can solve the issue by effectively shifting supply of heavier grades of crude to regions more apt to refine them.

“ Refiners have been scrambling to figure out how to process domestic crude that’s lighter grade than the heavier hydrocarbons typically imported from overseas...” ”

- Jim Jones, SVP, Turner, Mason and Co.

► **Closing Remarks.**

With the current uncertainty in the markets, companies engaged in the transportation and storage of oil & natural gas are better positioned for the downturn, though they are still susceptible to the downturn in the industry as a whole. With the recent pullback in upstream activity, the increased demand for transportation and storage space that the midstream companies are enjoying may begin to relax in the longer term, but in the near-term they are among the few with a positive outlook.

► M&A Activity

Announced Date	Target/Issuer	Buyers/Investors	Transaction Value (\$USDmm)
04/20/2015	Exterran Energy Solutions, L.P., Customer Contracts Covering 217,000 Horsepower of Compressor Units	Exterran Partners, L.P. (NasdaqGS:EXLP)	102.3
04/13/2015	Bayside Petroleum Company, Inc.	iSeeAutomation, Inc.	-
04/10/2015	640energy, LLC	Intercept Energy Services Inc. (TSXV:IES)	0.258
04/09/2015	Quality Energy Solutions, LLC	Start Scientific, Inc. (OTCPK:STSC)	2.93
04/07/2015	Horizon Marine Inc.	Collection Localisation Satellites SA	-
04/07/2015	Certain Fracking Assets and Related Services	GASFRAC Energy Services, Inc. (TSX:GFS)	-
04/06/2015	*Eagle Automation Limited	Panhandle Oilfield Services, Inc.	-
03/31/2015	Premier Utility Services, LLC	USIC Locating Services, Inc.	51
03/17/2015	Pelagic Tank, LLC	Legacy Measurement Solutions, Inc.	-
03/13/2015	Inspection Oilfield Services	LB Foster Co. (NasdaqGS:FSTR)	230
03/12/2015	*Timco Services, Inc.	Frank's International, Inc.	95
02/18/2015	The Oil & Gas Asset Clearinghouse L.L.C.	CenterGate Capital, L.P.	-
02/13/2015	Claim Post Resources Inc. (TSXV:CPS)	Kluskus Holdings Ltd	-
02/12/2015	Proline Systems, Inc.	Precision IBC, Inc.	-
02/03/2015	J-Mac Tool, Inc.	Forum Energy Technologies, Inc. (NYSE:FET)	-
02/02/2015	C & C Technologies, Inc.	Oceaneering International, Inc. (NYSE:OII)	230
02/02/2015	Amik Oilfield Equipment & Rentals Limited	PCM S.A.	-
01/22/2015	Cimarron Acid Services, Inc.	Quintana Energy Services LP	80
01/15/2015	Tenax Energy Solutions, LLC, OrBIT Completion Drill Bit Product Line	Hard Rock Solutions, LLC; Extreme Technologies, LLC	2.3
01/05/2015	Chemtec Energy Services, LLC	LB Foster Co. (NasdaqGS:FSTR)	-

*Indicates that the Principals of Founders Investment Banking acted as sole advisor in the transaction.

► Commodity Prices

Crude Oil - WTI



	Price per Barrel			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Crude Oil	\$56.61	\$48.43	\$103.65	16.9%	(45.4%)

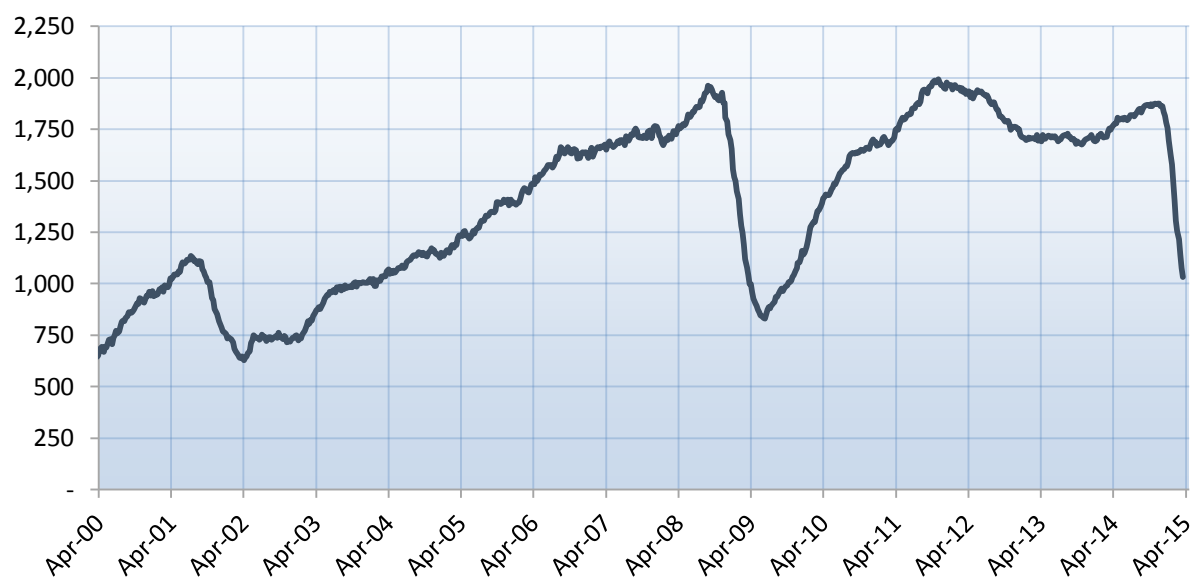
Natural Gas - Henry Hub



	Price per Mmbtu			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Natural Gas	\$2.62	\$2.80	\$4.74	(6.5%)	(44.7%)

► Rig Counts

Onshore Rig Count



	Rig Count			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
U.S. Onshore	921	1,077	1,778	(14.5%)	(48.2%)

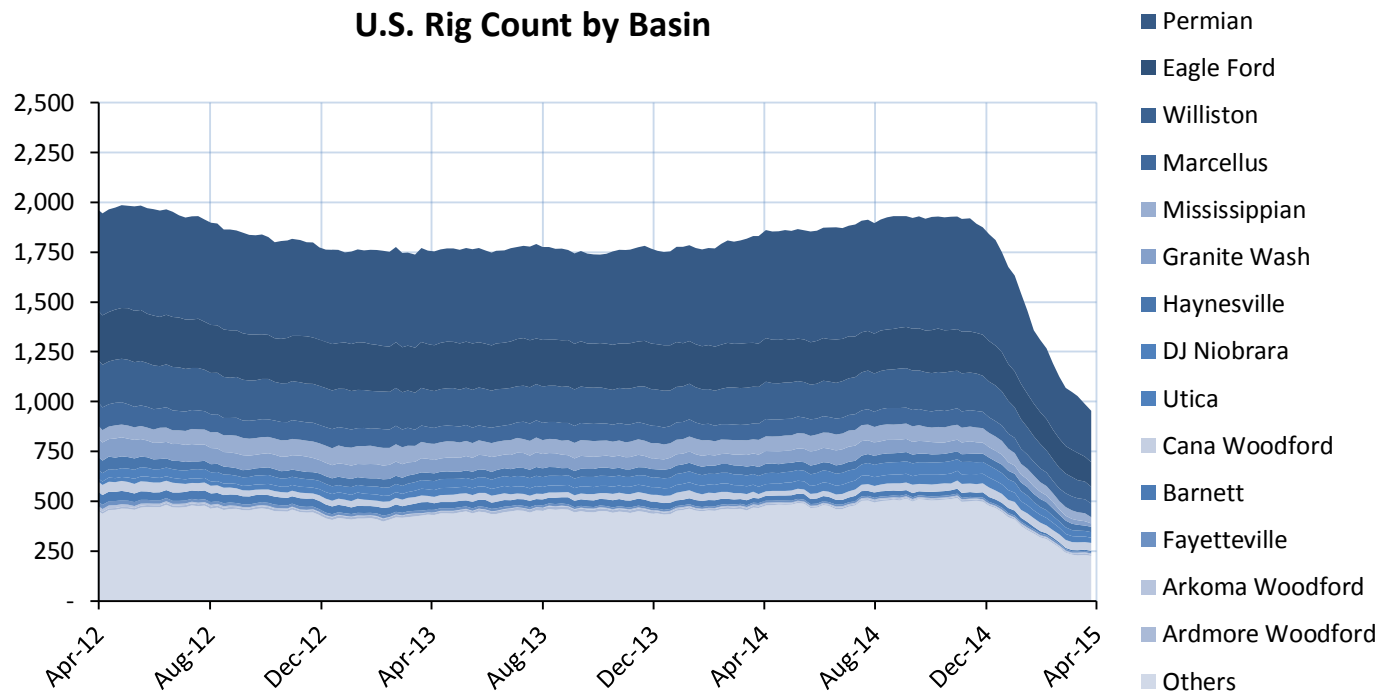
Offshore Rig Count



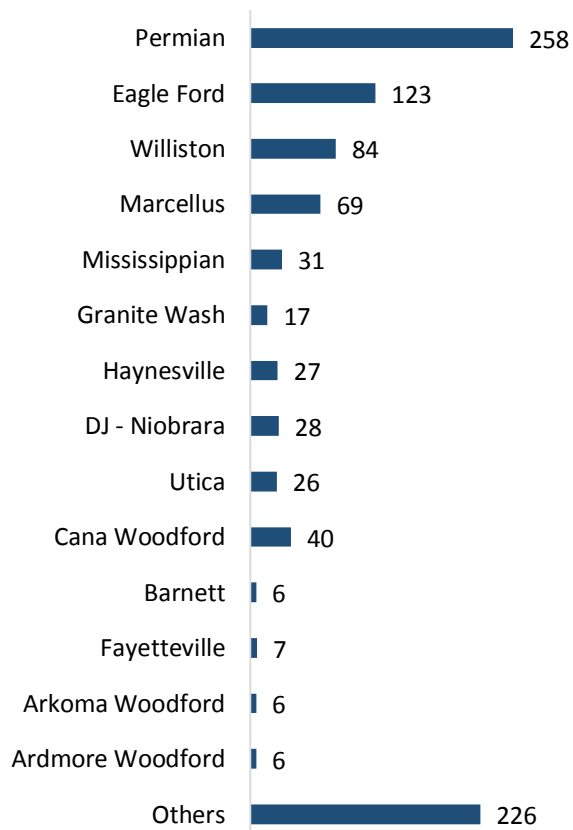
	Rig Count			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
U.S. Offshore	33	48	53	(31.3%)	(37.7%)

► Rig Counts (*continued*)

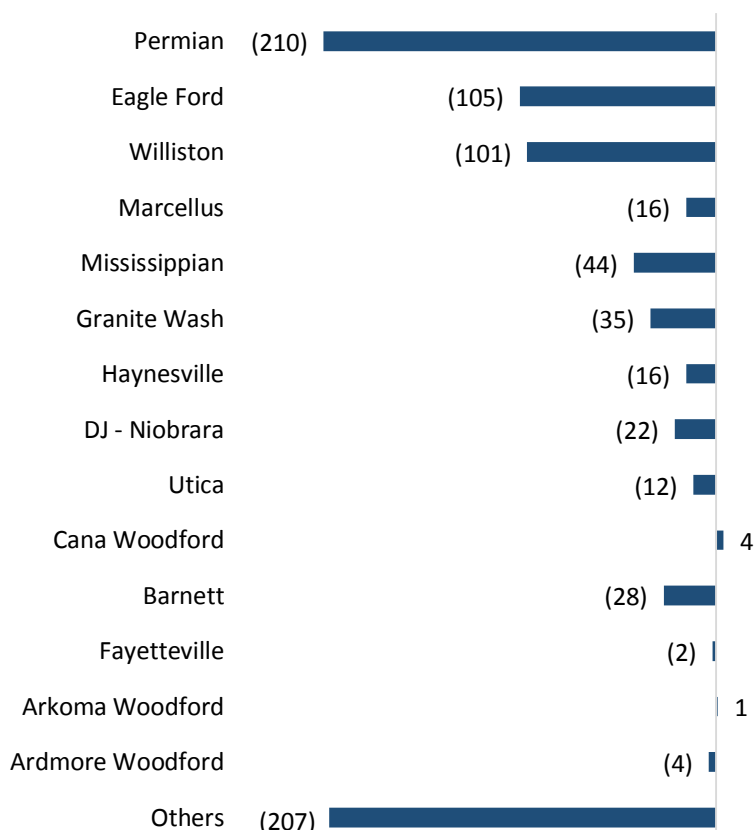
U.S. Rig Count by Basin



U.S. Rig Count by Basin

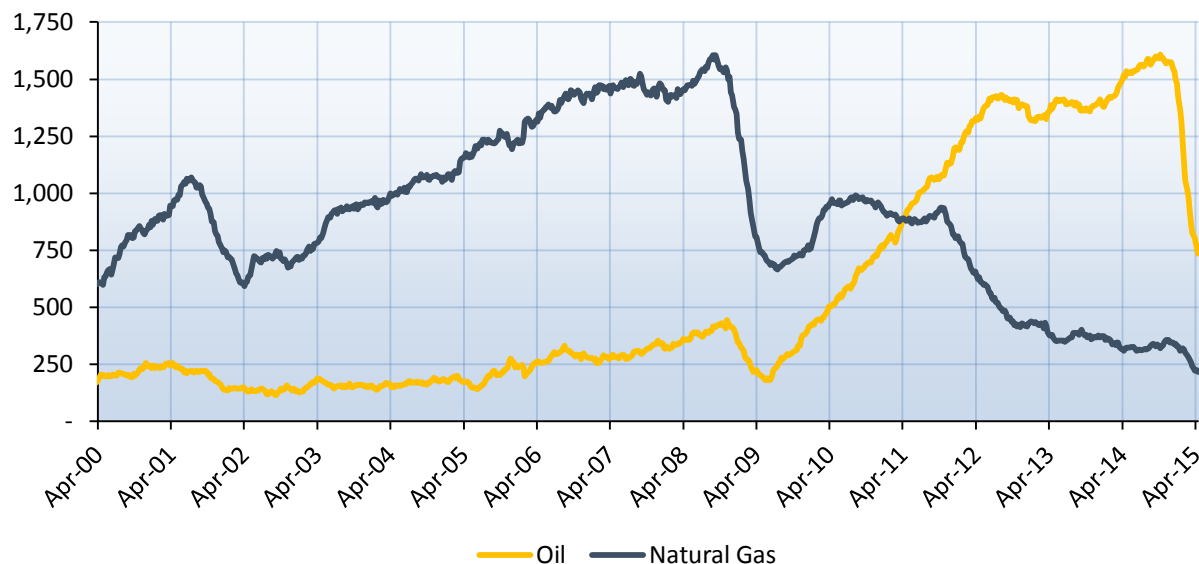


U.S. Rig Count by Basin YTD Change



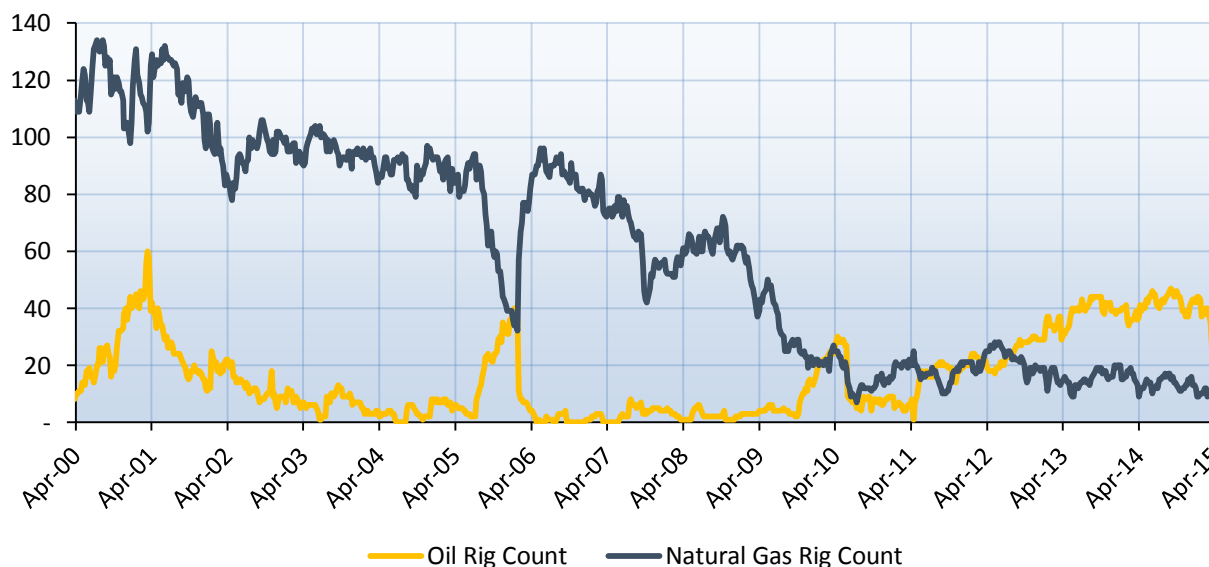
► Rig Counts (continued)

U.S. Oil vs. Natural Gas Rig Count



	Rig Count			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Oil	734	866	1,517	(15.2%)	(51.6%)
Natural Gas	217	257	310	(15.6%)	(30.0%)

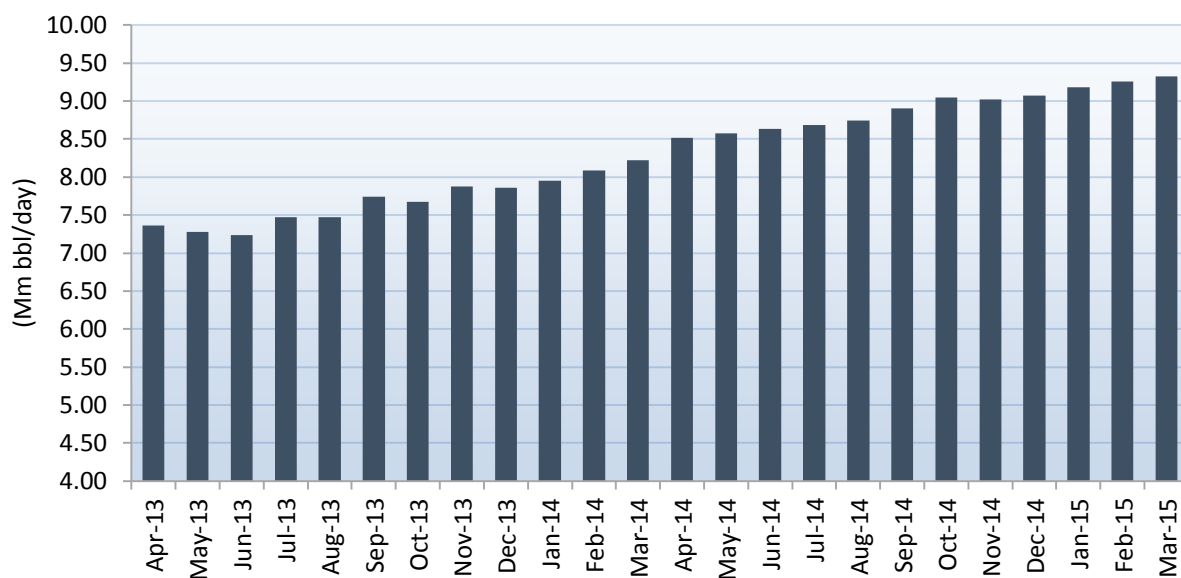
Gulf of Mexico Oil vs. Natural Gas Rig Count



	Rig Count			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Oil	24	35	41	(31.4%)	(41.5%)
Natural Gas	8	11	11	(27.3%)	(27.3%)

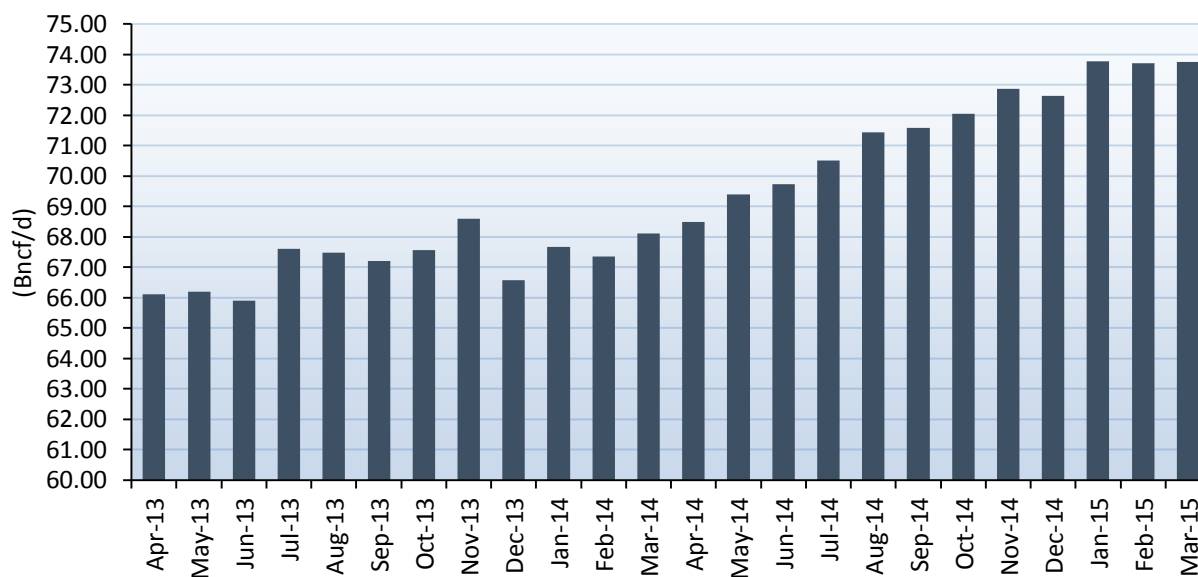
► Domestic Production

Crude Oil Production



	Million Barrels per Day			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Crude Oil	9.33	9.26	8.22	0.7%	13.4%

Natural Gas Production



	Billion Cubic Feet per Day			Change from	
	Current	Prior Month	Prior Year	Prior Month	Prior Year
Natural Gas	73.76	73.72	68.11	0.0%	8.3%

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Guests at the recent Founders' Forum enjoy a Cajun cuisine at the family lodge in Cameron Meadows, LA.

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