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BDO 2015 ENERGY OUTLOOK

ENERGY CFOs CAUTIOUS FOLLOWING TURBULENT END OF 2014

2014 served as a reality check for the U.S. oil & gas industry.

According to the ***BDO 2015 Energy Outlook Survey*** of 100 oil & gas chief financial officers, the tumultuous second half of 2014—marked by steep oil price declines and growing tensions with OPEC—has left CFOs concerned about their companies' ability to remain profitable amid proliferating near-term challenges. However, our study also found that energy executives view these current conditions as temporary, and that long-term growth prospects remain bright for nimble companies who successfully navigate these turbulent times.

OIL PRICE DECLINES RATTLE CFOs

With the *Washington Post* reporting that oil prices had dropped 40 percent between June and December of 2014, CFOs are conservative in their planning for 2015. Our survey found that 45 percent of CFOs expect low oil and gas prices to be their greatest financial challenge in the upcoming year, a 55 percent increase over the number expressing similar sentiments in last year's study. At the same time, the number of CFOs citing price declines as the top factor inhibiting industry growth grew by about 68 percent, from 22 percent in 2014 to 37 percent this year.

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These findings are from the ***BDO 2015 Energy Outlook Survey***, which examined the opinions of 100 chief financial officers at U.S. oil and gas exploration and production companies. The nationwide survey was conducted from September through November 2014.

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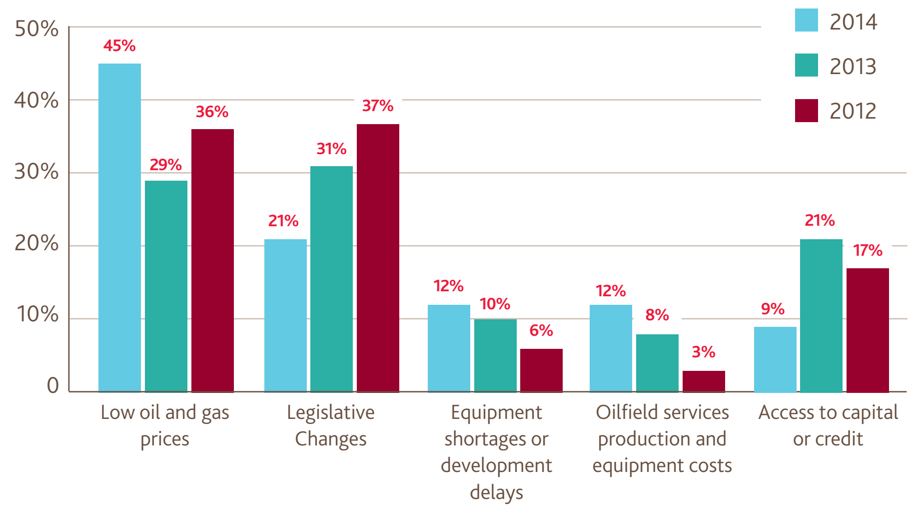
2014 saw a year of robust global production, buoyed by the U.S. shale boom. However, demand has not kept pace, causing oil prices to dip below $60 per barrel for the first time since 2009. And CFOs are not optimistic that this trend will abate in the near future: Only 37 percent expect global demand to increase in 2015, down from 65 percent last year.

Amid ongoing commodity price volatility, U.S. companies are looking to hedge against future fluctuations. Nearly one-third of CFOs say that they will pursue cost reduction programs to improve value for stakeholders, and 56 percent say they will seek efficiencies in conjunction with these programs to bolster profitability in 2015.

Top Financial Challenges



"The past six months have seen the oil markets return to the volatility that has historically characterized the industry," said Charles Dewhurst, partner and leader of the Natural Resources practice at BDO. "However, while headlines may be saying these price declines herald the end of the shale boom, U.S. companies have been preparing for a return to fluctuations and are well-equipped to navigate through this transitional period."

▶CFOs MORE CONFIDENT IN NATURAL GAS, BUT STILL WARY

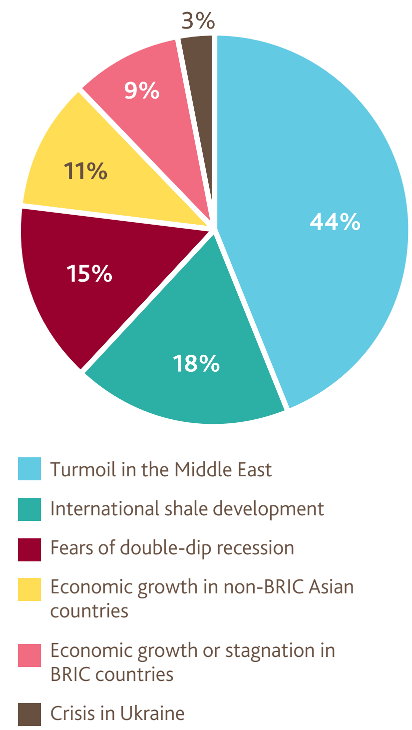
In contrast to oil, CFOs generally expect natural gas production to grow in 2015. Nearly two-thirds of CFOs expect the domestic supply of natural gas to increase in the coming year, while the majority expect both global and domestic demand to increase, as well (notably, no CFOs expect demand to decrease in 2015). However, all of these projections are less optimistic than those captured in last year's study, suggesting that depressed natural gas prices and difficulties accessing the global markets continue to decelerate growth.

Nevertheless, CFOs remain hopeful that liquefied natural gas (LNG) will foster future growth, with 69 percent anticipating that exports will increase in the coming year. Additionally, of the CFOs surveyed whose companies operate in the LNG market, 44 percent say they expect to increase their investment in LNG processing technologies.

▶TURMOIL IN THE MIDDLE EAST STOKES COMMODITY PRICE ANXIETIES

Unsurprisingly, when asked what factors other than supply or demand had the greatest impact on oil price volatility in 2014, a plurality of CFOs (44 percent) cite unrest in the Middle East as the top influencer. Oil production in the region remains both prodigious and uncertain as countries, such as Libya and Iran, seek to grow production, while conflicts in others, such as Syria and Iraq, threaten to interrupt supply. Amid the unrest, the Organization of Petroleum Exporting Countries (OPEC) has resisted calls to reduce its production quotas, contributing to the global supply glut currently driving prices down.

Factors Impacting Oil Prices



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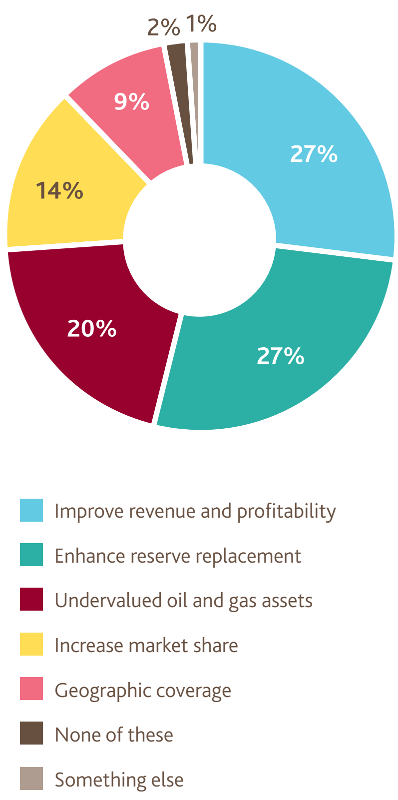
▶DESPITE SHORT-TERM STRUGGLES, CFOs EXPECT LONG-TERM PROSPERITY

Though commodity prices continue to worry CFOs, executives see considerable long-term growth potential for the industry. In particular, executives expect to see deal activity ramp up in the year ahead, with more than half (56 percent) of CFOs projecting growth in M&A activity, a 30 percent increase over the number expressing similar sentiments last year.

CFOs believe revenue and profitability and reserve replacement enhancement will catalyze deal flow this year, with 27 percent of respondents citing each as the main driver of activity. And while cost reduction programs remain energy companies' favored method for improving value for stakeholders, one-fifth of respondents say they will pursue a merger or acquisition to increase stakeholder ROI.

M&A Drivers



"The industry might be anxious in the near-term about price volatility, but its optimism toward deal flow suggests that the long-term outlook is bright," said Dewhurst. "The recent oil price drop is but a blip on the radar in the bigger picture. Natural gas remains strong and investors are hungry for smart natural resources opportunities, all of which point to a strong future for the sector."

▶PRIVATE EQUITY EXTENDS ITS INDUSTRY REACH

The projected acceleration of deals is good news for the private equity industry. This year, half of the CFOs surveyed indicate that they plan to secure outside capital from private equity funds, a 25 percent increase since 2014.

"Unsurprisingly, companies often look to court private equity buyers during times of strong industry performance—and over the past five years, the U.S. energy sector has been booming," said Brad Ross, director with BDO's Transaction Advisory Services. "The recent price declines may have put a temporary damper on their enthusiasm, but many executives remember how quickly the industry rebounded after the last big price drop in 2009. If the industry follows the same pattern again this year, we may still see that projected uptick in exits."

Amid growing enthusiasm for private equity, however, fewer CFOs express interest in securing additional debt financing, with 34 percent indicating that it is their financing source of choice—down approximately 24 percent from last year. At the same time, Master Limited Partnerships (MLPs)—once a growing source of equity for many companies—have declined in popularity, with only 8 percent of CFOs citing them as a preferred capital source.

▶CFOs ARE CONFIDENT ABOUT ACCESS TO CAPITAL

Deal flow is not the only industry bright spot this year. According to our survey, an overwhelming majority of survey respondents—80 percent—say that they feel better about their access to capital and credit than last year. The number of CFOs citing decreased access to capital as the top factor inhibiting growth decreased by half to 3 percent, and only 9 percent of respondents say that their ability to secure funding will be a leading financial challenge in 2015. This suggests that investors and creditors remain willing to open their coffers for well-planned, promising oil & gas projects in the coming year—and that they see more industry growth on the horizon.

▶LEGISLATIVE AND TAX CONCERNS PERSIST

Industry executives continue to experience uncertainty surrounding pending legislation in Washington. A plurality (38 percent) cite more restrictive government regulations as their top political concern for 2015, while 43 percent say that legislative and regulatory changes remain the top factor inhibiting overall industry growth. Taxes also remain a perennial concern for executives, with nearly two-thirds citing the loss of the intangible drilling costs deduction as a leading tax issue this year.

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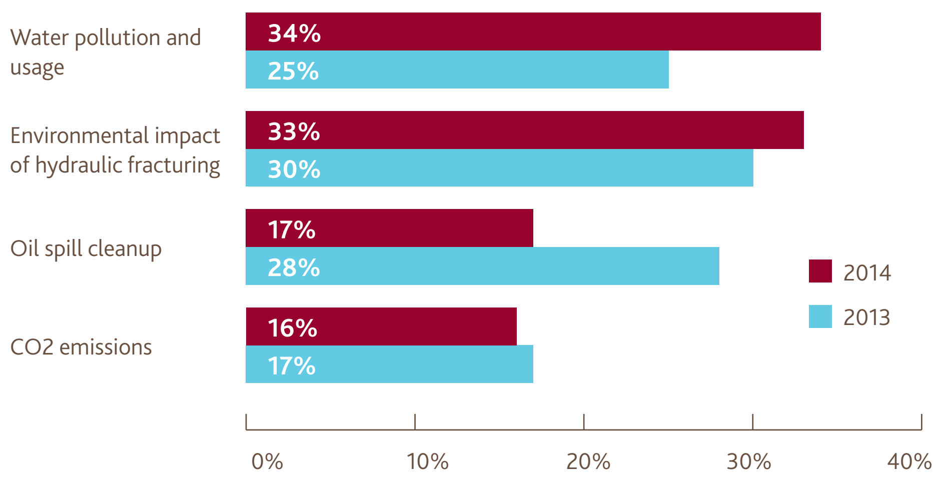
"Legislative and regulatory changes will always be top of mind for industry executives, as the oil and gas industry is one of the most heavily regulated in the country," said Clark Sackschewsky, partner with BDO's Natural Resources practice. "Taxes are of particular concern, as incentives like the IDC are instrumental in fostering industry growth and, by extension, economic growth."

But perhaps the most pressing regulatory issue facing the oil & gas industry in 2015 is managing the environmental impact of its operations. CFOs are looking to proactively address the environmental risks associated with drilling activities in the face of growing pressure from policymakers and the public: Nearly two-thirds of executives (61 percent) say they will focus their risk management activities on environmental regulation in 2015. CFOs remain particularly cognizant of minimizing the effects of shale extraction activities, citing water pollution and usage (34 percent) and the environmental impact of hydraulic fracturing (33 percent) as priority areas.

Top Environmental Concerns



▶INDUSTRY WALKS A RAZOR'S EDGE WITH ITS LABOR FORCE

As we found in our *2014 Oil & Gas RiskFactor Report*, U.S. oil & gas companies are concerned about retaining skilled workers. This year, a majority (53 percent) of CFOs say that they anticipate labor costs will increase; however, only 35 percent say that headcounts will increase in tandem.

At the executive level, compensation appears steadier. Sixty percent of CFOs believe employee bonuses for fiscal year 2014 will be consistent with fiscal year 2013 levels, and about half of CFOs believe their own compensation will not change in 2015.

▶SHALE REMAINS A LEADING AREA OF INVESTMENT

When asked about their investment plans for 2015, CFOs indicate that shale will continue to be a priority in the coming year: Forty-seven percent of CFOs plan to increase their investment in non-conventional plays. And amid growing concerns about the environmental impact of shale extraction methods, 35 percent of respondents say they will also grow their investment in environmentally friendly exploration and processing technologies. Meanwhile, offshore exploration continues to struggle nearly a half decade after the Deepwater Horizon disaster, with only 6 percent of CFOs citing offshore drilling as an area of investment.

"Energy companies have been taking extraordinary measures to attract and keep a highly qualified pool of technical and professional workers," said Lance Froelich, senior director of compensation consulting in the Global Employer Services group and a member of BDO's Natural Resources practice. "Powerful competitive forces both within the sector and other industries, such as tech, have forced their hand toward more generous compensation and benefits packages in recent years. It will be interesting to see, however, if recently depressed oil prices will alter this calculus."

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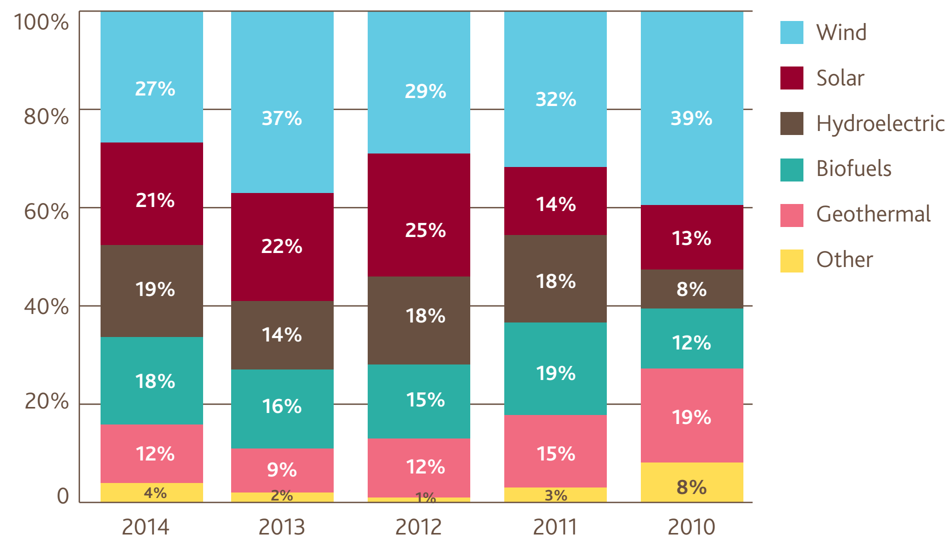
▶FUTURE OF ALTERNATIVE ENERGY REMAINS UNCLEAR

With natural gas growing as the most viable clean alternative to traditional fuels like coal and oil, CFOs have become increasingly uncertain about which forms of alternative energy are poised to dominate the market. Wind continues to lead the pack, with 27 percent of CFOs citing it as the form of alternative energy positioned to contribute most to the world's energy needs through 2020. However, this represents a significant decline since 2009, when it was cited by nearly half of energy CFOs.

At the same time, the proportion of CFOs citing other alternative fuels—solar, hydroelectric, biofuels and geothermal energy—has largely equalized, with a roughly equal number of CFOs mentioning each as leading alternatives.

2015 may bring a range of challenges the U.S. energy industry hasn't faced in many years. However, the results of our study suggest that CFOs feel prepared for turbulence ahead and remain optimistic that long-term, the energy sector will continue to thrive, grow and drive the American economy.

Alternative Fuels Expected to Contribute Most to Future Energy Needs



The ***BDO 2015 Energy Outlook Survey*** is a national telephone survey conducted by Market Measurement, Inc., an independent market research consulting firm, whose executive interviewers spoke directly to CFOs at a sample of oil & gas exploration and production firms (with revenues ranging between $76,000 and $323 million and an average revenue of $26.7 million) from September through November 2014.

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