

Navigating Downturn: Succeeding in an Environment of Constraint

Basil Karampelas
Managing Director and Natural Resources Lead
BDO Business Restructuring Services

May 2017 - COPAS Education Day



BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms.





Presenter

Basil Karampelas

Managing Director -
Consulting - BRS

bkarampelas@bdo.com



Basil Karampelas is a Managing Director in the Houston office. He leads firm's Business Restructuring Services practice for the Natural Resources sector. He has over 25 years of experience in corporate restructuring, raising capital, executing M&A transactions, and providing financial and operational leadership to companies in the energy, chemical and renewable sectors.

Basil is a frequent speaker and moderator at energy and cleantech conferences and has been featured in several industry publications, including *The Wall Street Journal*.

Prior to joining BDO, he was president of a renewable energy startup and previously spent several years managing portfolio companies in a multi billion dollar hedge fund.

Basil has held leadership positions at BP, Enron, and Koch Industries. He began his career as an investment banker at Salomon Brothers and Wasserstein Perella.



Outline

- Overview - the Concept of Corporate Needs
- Evolution of Models of Corporate Needs
- Example - The Oil and Gas Sector
- Consequences for Companies in the Sector
- Applicability of Model in Other Industries
- Succeeding in a Constrained Business Environment
- Questions You Can Ask Clients and Prospects
- Potential Opportunities for New Business

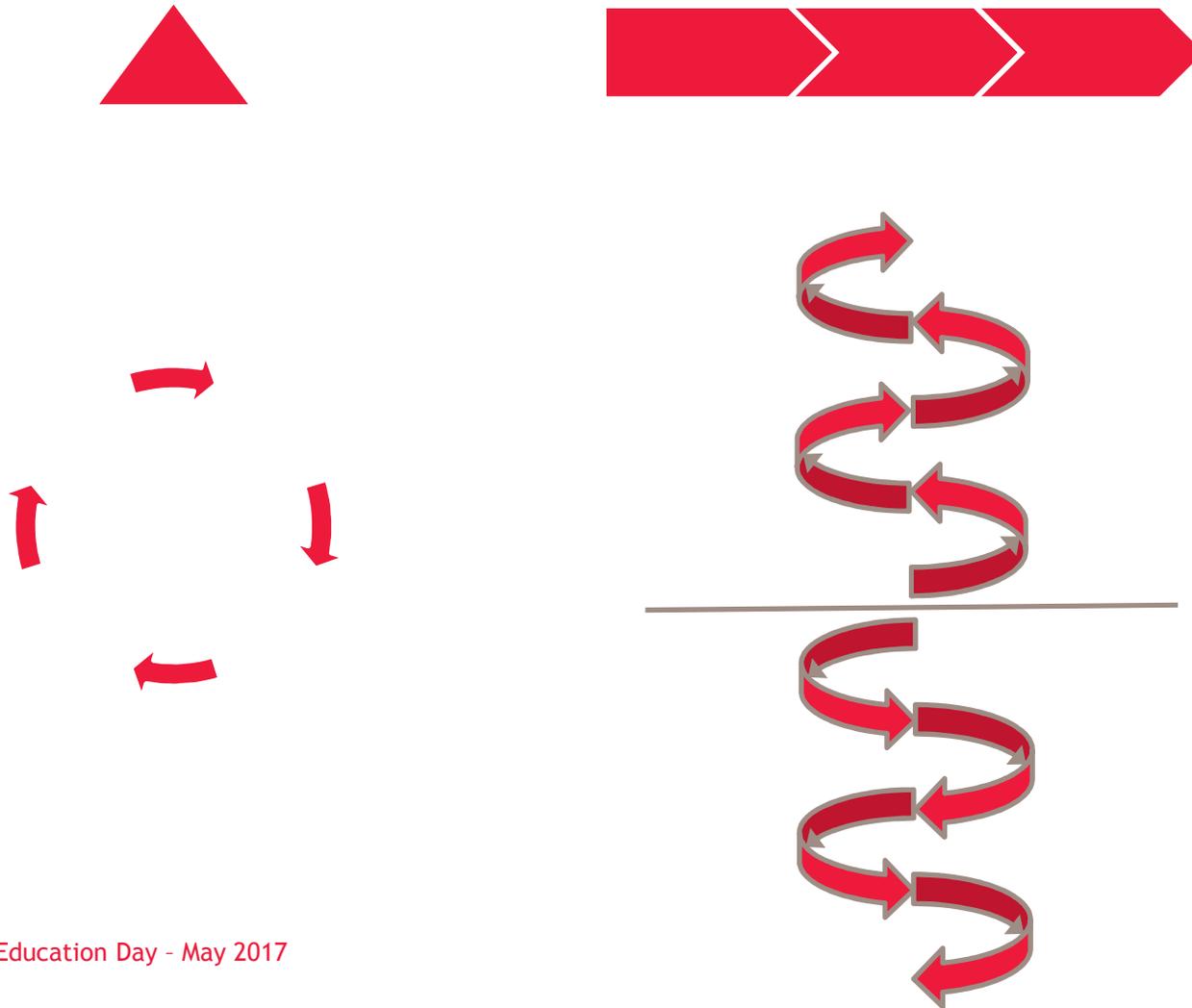


Overview

- Companies are typically faced with four fundamental needs
 - Capital
 - People
 - Opportunity
 - Profitability
- Depending on the stage in a company's life cycle, the dynamics and interplay of these needs will vary
- **Another important and often overlooked dimension is whether the overall environment is one of expansion or constraint**
 - The two dimensional “cycle of need” really becomes a three dimensional “spiral of need”
 - This will have significant consequences for the company in whether or not it addresses these scarcities properly in the context of
 - Operational restructuring
 - Financial restructuring
 - Strategic alignment
- Successful companies navigate this difficult process by applying their breadth of skills and depth of experience operating in challenging environments

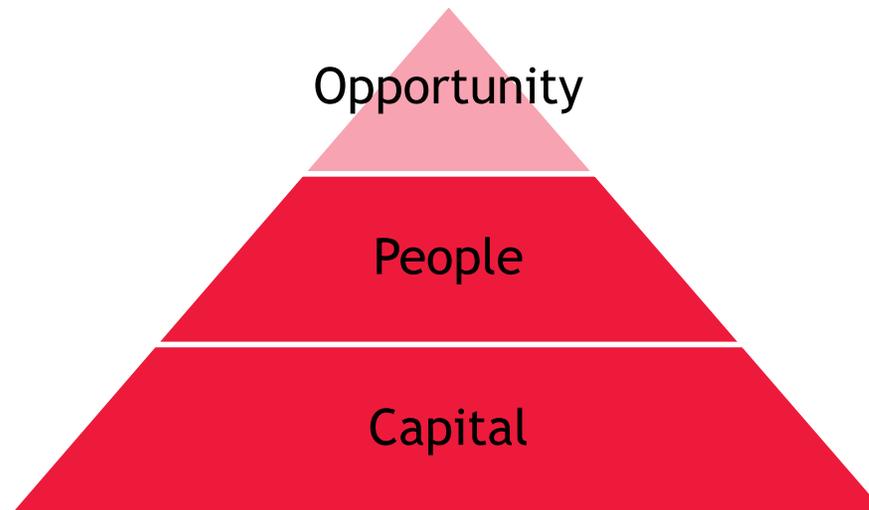
Evolution of the Model of Corporate Needs

From Zero to Three Dimensions



Model of Corporate Need

Stage 1 - “Stacked Need” - indicative of startup companies



- Money needs to be raised and people need to be hired to pursue the corporate opportunity
- Typically this is solved by a combination of seed investment and human capital contributed by “angel” investors
- The opportunity at this stage is still being fleshed out
- The goal, at this stage, is to raise enough money to get company to next stage of investment

Model of Corporate Need

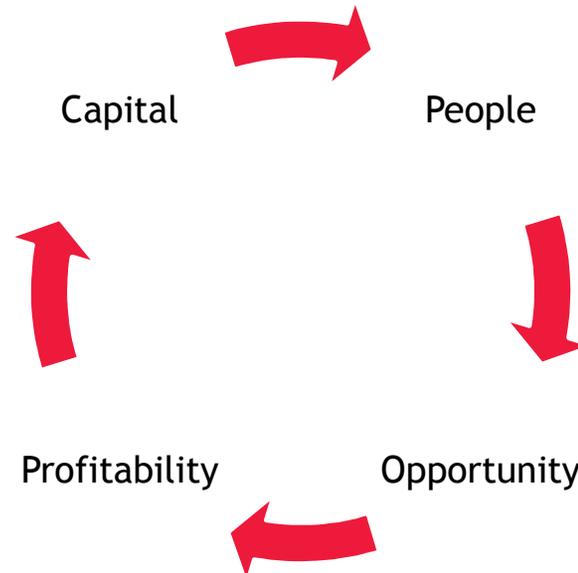
Stage 2 - “Sequential Need” - indicative of small private companies



- These needs are typically solved sequentially, e.g., raise money, hire people once money is raised, etc.
- Larger capital raise as more money is needed to start executing on business plan and begin to convert opportunities to profits
- The goal, at this stage, is to get the company in a position where either it does an IPO, or ultimately generates sufficient cash flows to be self-funding

Model of Corporate Need

Stage 3 - “The Cycle of Need” - indicative of larger private companies and public companies

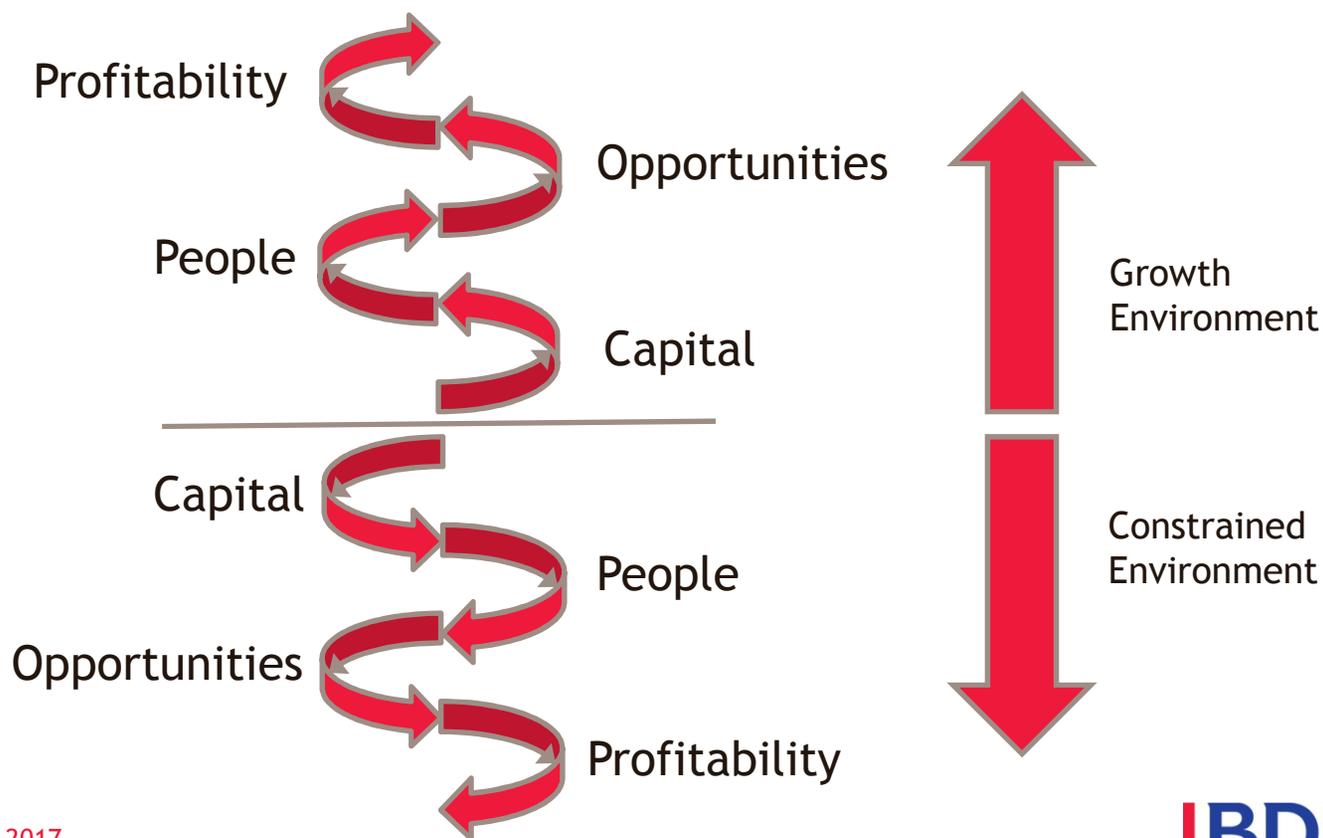


- This model pre-supposes that the challenges are cyclical and each iteration is simply a larger version of the last, as the company grows and expands its business
- Because the cycle is two-dimensional, it does not take into account either the macro-level business environment or the micro-level situation at the company
- This can be a dangerous assumption to make during challenging macro and/or micro conditions

Model of Corporate Need

Stage 4 - “The Spiral of Need” - a more accurate portrayal that takes into account business environment and company-specific factors

The top and bottom halves of the spiral are mirror images of each other

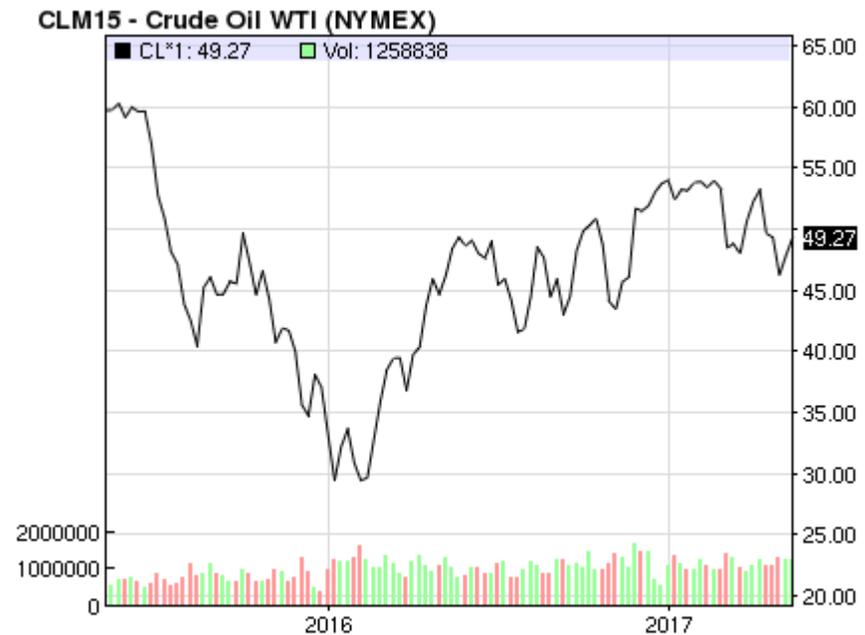


Example - The Oil and Gas Sector



State of the US Oil and Gas Market

- The situation is Dickensian, but the novel has morphed from “Bleak House” to “Great Expectations” to “A Tale of Two Cities”
 - Permian/Delaware Basins vs. everywhere else
 - Companies with access to capital AND who can deploy technology AND in the right basins are at a huge competitive advantage, e.g., EOG
- The V-shaped recovery in oil prices has stalled somewhat, with some recent upward movement post-OPEC output cut
- Big question whether output cuts “stick”
- Forward curve in oil is in distinct contrast to research analyst pricing predictions



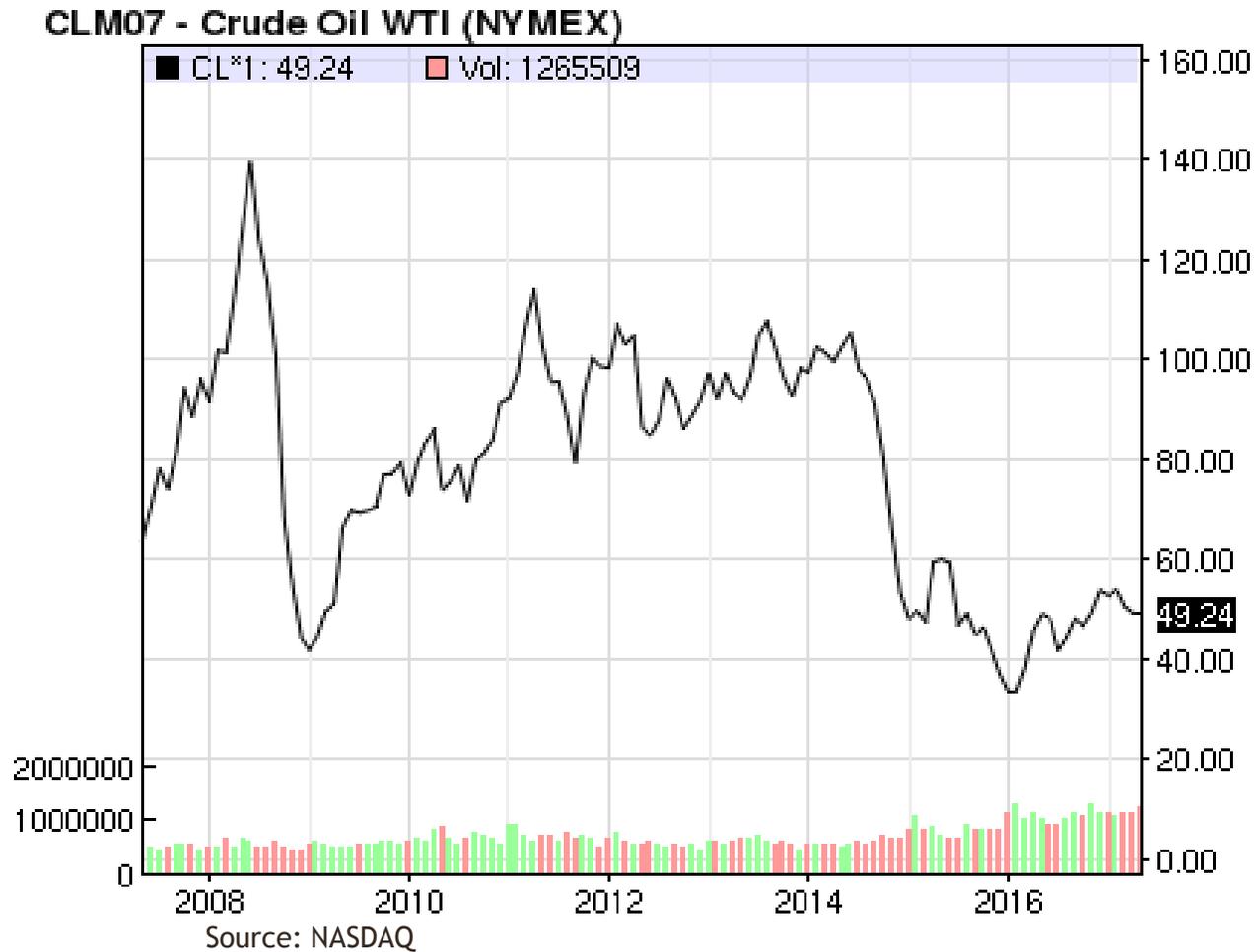
Source: NASDAQ



State of the Market (continued)

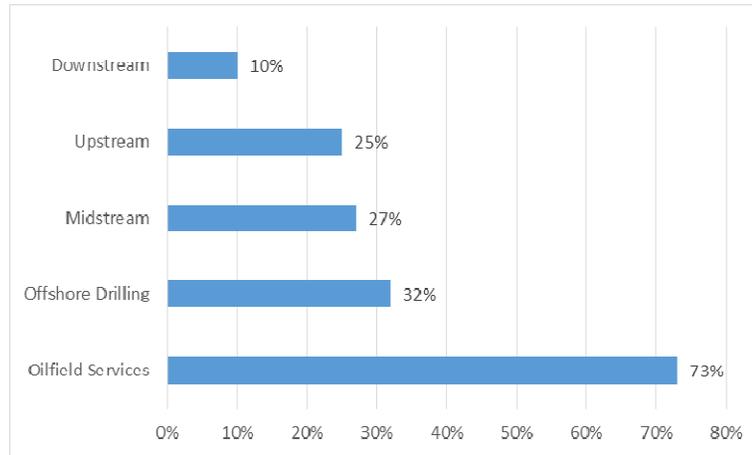
- A number of companies are continuing to file for bankruptcy in the space
- Rotation from E&P bankruptcies to other sub-sectors
 - Power generation
 - Midstream
 - Shipping
 - Oilfield Services
- Expectation that many of the “light” restructurings will have to be redone
- This trend is expected to continue as many companies have their hedge protection roll off during the remainder of the year
- Large amounts of private equity sitting on the sidelines waiting for the true bottom
- **Other PE firms faced with the dilemma of dealing with existing investments that are under water before deploying new capital**

Perspective is Everything - 10 year WTI

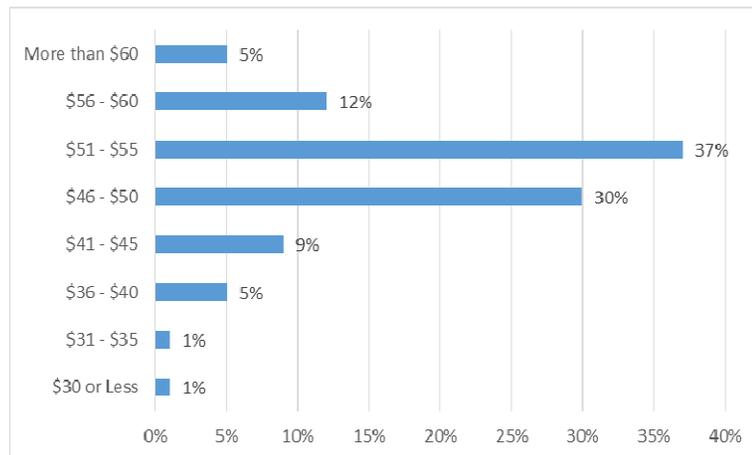


Subsector Rotation and Price Expectations

What areas of the oil and gas industry will see the most restructurings in 2017 (select up to two)



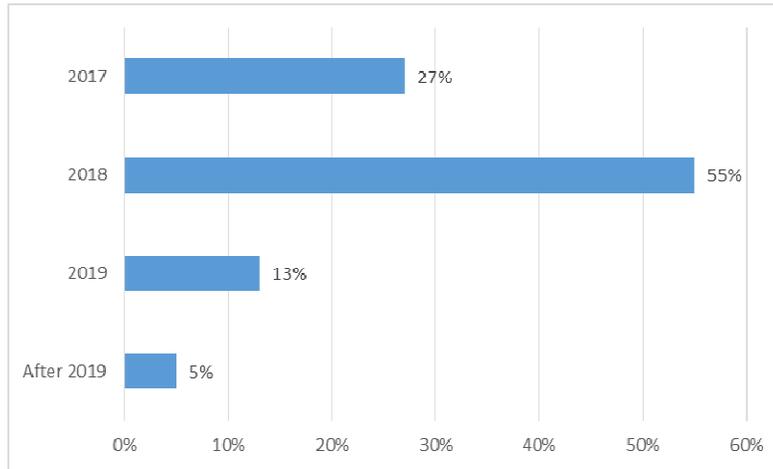
Where do you think the price of oil (Brent) will be at end of 2017?



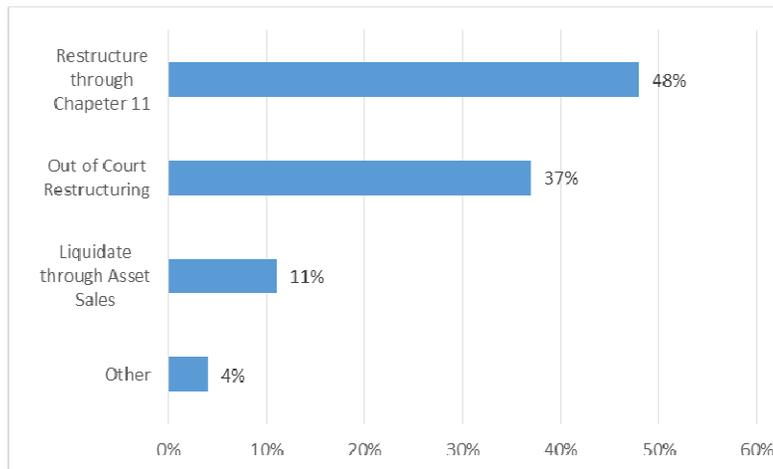
Sample average \$49.97

Expectations Driving Viewpoints on Restructuring

When will the industry begin to stabilize?



How will companies in distress tackle their financial problems?





Consequences of this Dynamic for Companies in the Energy Sector

- Capital - Your access to traditional sources of capital may be reduced or, in some cases, nonexistent
 - Capital markets may be unavailable and collateral value may have declined concurrently
- People - You may have personnel with the wrong skill set in certain jobs
 - “Crisis fatigue” may be affecting your leadership team
- Opportunities - Your corporate opportunity set may have changed dramatically
 - It’s also difficult to chase opportunities if you are in a state of crisis management
- Profitability - The path to future profitability may be elusive or unknown



Model Applicable not just for Commodity Price Downturn

- It takes into account the “gear shifting” that must take place when the business environment changes for a variety of reasons
- Examples of these changes could include the following:
 - Slowing overall economy
 - Change in consumer preferences
 - Changes in industry structure and/or dynamics
 - New competitive threats
 - Change in regulatory environment
- Both exogenous or internal factors can push the spiral “up” or pull it “down”



Other Recent Examples of Industries Dealing with Headwinds

- Retail
 - The demise of the mall
 - Rise of online shopping
 - Specialty retailing versus department stores
- Restaurants
 - Rotation from one form of restaurant being popular to another
 - The shift to organics and locally sourced food
- Renewables
 - Policy changes and expected changes
 - Knock on effect from low conventional energy prices
 - Technology issues



Succeeding in a Constrained Resource Environment

Dealing with Each Constraint in Turn

- Capital
 - Identify alternative capital sources and stabilize short term liquidity
 - Categorize assets that are core vs. non-core (available for monetization)
 - Create a capital spending plan that is right-sized for the market environment
 - Fixed cost reduction; Operating and overhead cost consolidation
 - Financial management, e.g., hedging, as a liquidity tool
 - Tax savings strategies
- People
 - Ensure you have a team of seasoned professionals with experience leading companies through challenging market environments
 - Address the “Crisis Fatigue” that can afflict incumbent management
 - Management reorganization to better address current challenges
- Opportunities
 - Identify opportunities that are relevant given the current environment
 - Innovation as a tool for both cost reduction and revenue growth
 - Objectively assess current opportunities being pursued in order to prune out marginal activities
 - Re-examine the risk profile associated with current opportunity set and whether that is an acceptable level of risk given the current environment



Succeeding in a Constrained Resource Environment (continued)

- Profitability
 - Create a holistic road map for path to profitability
 - Determine appropriate company footprint
 - Create a detailed business plan that has measureable, meaningful and realistic goals and objectives
 - Have a road map whose foundations are rooted in current market realities but flexible enough to change if the environment does
 - Focus on high performance/high value competitive positioning
 - High value people
 - High quality assets
 - High performance systems
 - Innovation
 - Position the company for future success



Questions that You Can Ask Your Clients and Prospects

- Has your access to capital changed?
- How have your HR needs changed in light of the changes your company/industry is undergoing?
- Has the change in situation created any specific accounting or tax challenges for your company?
- Are you contemplating a comprehensive review of your businesses and priorities?
- Are there new opportunities that have emerged for you?
- Are you considering M&A activity?
- Are you considering selling any assets or business that no longer fit with your strategy?
- What is your biggest long term challenge?
- What are your “now” problems?



Potential Opportunities for New Business

- Prospects could become clients because you took the time to ask the questions
- Existing client relationships could become deeper and or broader
- Provides you and your team to demonstrate your subject matter expertise
- Gives you a reason to be in front of a client/prospect
- Companies like to take meetings if you can provide
 - Information that they don't have
 - Contacts that they are not aware of
 - Leads that can grow their business or make it more profitable
- Discussions will help you broaden your own knowledge base about a company and its representative industry
- Information that is gathered could help you decide how you want to position your firm for success in terms of
 - Geography
 - Industry
 - Sub-sector
 - Practice area



Thank you



Basil Karampelas
BDO Consulting, Business Restructuring Services
bkarampelas@bdo.com

About BDO Consulting

BDO Consulting, a division of BDO USA, LLP, provides clients with Financial Advisory, Business Advisory and Technology Services in the U.S. and around the world, leveraging BDO's global network of more than 67,000 professionals. Having a depth of industry expertise, we provide rapid, strategic guidance in the most challenging of environments to achieve exceptional client service.

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, advisory and consulting services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through more than 60 offices and over 500 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multi-national clients through a global network of 1,400 offices across 158 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information please visit: www.bdo.com.

Material discussed is meant to provide general information and should not be acted on without professional advice tailored to your firm's individual needs.

© 2017 BDO USA, LLP. All rights reserved.