Energy Sector

SUMMER 2015

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Agenda

- Overview
- Business Analysis
- Economic Analysis
- Financial Analysis
- Valuation Analysis
- Recommendation
Overview
Sector Size

S&P 500 Weight

- Info Tech: 2.82%
- Health Care: 3.13%
- Consumer Staples: 9.43%
- Consumer Discretionary: 10.09%
- Energy: 12.80%
- Industrials: 15.42%
- Utilities: 16.63%
- Financials: 19.63%

SIM Weight

- Info Tech: 2.25%
- Health Care: 2.27%
- Consumer Staples: 3.00%
- Consumer Discretionary: 8.39%
- Energy: 12.61%
- Industrials: 16.16%
- Utilities: 17.76%
- Financials: 20.79%
- Materials: 7.37%
- Telecom: 3.42T
Industries

Energy Equipment & Services ($349.38B)
Down 35.91% over the past year

Oil, Gas, and Consumable Fuels ($3.07T)
Down 23.30% over the past year
Sector Companies (41 Members)

Energy Equipment & Services (11)
- Schlumberger ($106B)
- Haliburton ($35B)
- Baker Hughes ($26B)
- National Oil Well Varco ($17B)
- Cameron International ($10B)
- FMC Tech ($9B)
- Helmerich & Payne ($7B)
- Transocean ($5B)
- Ensco ($5B)
- Noble Corp ($3B)

Oil, Gas, and Consumable Fuels (30)
- Exxon Mobil ($344B)
- Chevron ($176B)
- Kinder Morgan ($83B)
- ConocoPhillips ($73B)
- Occidental Petroleum ($56B)
- EOG Resources ($46B)
- Phillips 66 ($44B)
- Williams Cos Inc ($43B)
- Anadarko ($38B)
- Valero Energy ($33B)
Sector Performance

Brent Crude PPB Increase from prior week: $4.57
Brent Crude PPB Increase from prior month: $10.86
Brent Crude PPB decrease from prior week: $5
Brent Crude PPB decrease from prior month: $5.50
Business Analysis
Business Cycle

- Consumer Non-Cyclicals
- Consumer Cycicals (durable and non)
- Health Care
- Financials
- Technology
- Basic Industry
- Capital Goods
- Transportation
- Energy
- Utilities
- Precious Metals

Peak

Recession

Trough

Expansion

Energy
Industry Drivers

The overall Energy industry is driven by the demand for energy

What drives the demand for energy?

- GDP Growth;
  - When GDP is growing countries are investing. Investments often require energy (especially infrastructure investments)
  - Increased customer base (Consumers of planes, trains, and automobiles, all of which require energy)
- Regulation
# Leading Indicators of Profitability/Industry Health

<table>
<thead>
<tr>
<th>Energy Equipment and Services:</th>
<th>Oil, Gas, and Consumable Fuels</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rig count, projected rig count, and rig utilization:</td>
<td>The global price per barrel of oil:</td>
</tr>
<tr>
<td>• Rigs require a lot of people to operative</td>
<td>• Higher price means more revenue</td>
</tr>
<tr>
<td>• Rigs also require a lot of equipment and products to stay operational</td>
<td>• More opportunities to invest in technology allowing access to more wells and or better hit rates.</td>
</tr>
<tr>
<td>• The more rigs the more opportunities to increase revenue</td>
<td>• Refinery costs and efficiency</td>
</tr>
<tr>
<td>• Less rigs, less opportunities</td>
<td>Drilling Success Rate:</td>
</tr>
<tr>
<td>The global price per barrel of oil:</td>
<td>• E&amp;P is expensive. The higher the success rate the greater the profitably per BOE</td>
</tr>
<tr>
<td>• Higher price typically means more capital investments by the E&amp;P companies</td>
<td>• Industry average 59%</td>
</tr>
<tr>
<td>• Lower price discourages investment and development of wells in high cost areas (higher breakeven point)</td>
<td></td>
</tr>
</tbody>
</table>
Consumption Trends (Demand)

YOY CONSUMPTION BY REGION

YOY CONSUMPTION VS GDP

Chinese YOY GDP Growth dropped from 24% to 13%
Consumption by Source

Projected Primary consumption by source
US Reserves (Capacity)

Figure 1. U.S. oil and natural gas proved reserves, 1973-2013

U.S. crude oil and lease condensate proved reserves
billion barrels

U.S. total natural gas proved reserves
trillion cubic feet

Global Reserves YOY Growth (Capacity)

-5.00% | 0.00% | 5.00% | 10.00% | 15.00% | 20.00%


Natural Gas | Oil

Canadian Oil Sands Discovery

Qatar Natural Gas Discovery
Production & Consumption

Divergence between production and consumption
Energy Sector Operating Margin

Divergence between production and consumption
Brent Crude Spot Price

Divergence between production and consumption
Porters 5 Forces

Rivalry: High
Similar, commodity products across sector

High Barriers to Entry
Capital intensive & Specialty Industry Knowledge

Moderate Threat of Substitutes
Increasingly efficient use of renewables

Low Bargaining Power of Buyers

Moderate Bargaining Power of Suppliers
High concentration of suppliers
Economic & Financial Analysis
Regression Analysis

The industry is correlated with the price per BOE
P/E TTM VS S&P 500
P/S VS S&P 500
Operating Margin VS S&P 500
EBITDA TTM Margin VS S&P 500
Valuation Analysis
Valuation Analysis

### S&P Energy Multiples

<table>
<thead>
<tr>
<th>Basis</th>
<th>High</th>
<th>Low</th>
<th>Median</th>
<th>Current</th>
</tr>
</thead>
<tbody>
<tr>
<td>P/E</td>
<td>19.51</td>
<td>5.84</td>
<td>12.76</td>
<td>16.83</td>
</tr>
<tr>
<td>P/B</td>
<td>3.24</td>
<td>1.49</td>
<td>2.22</td>
<td>1.85</td>
</tr>
<tr>
<td>P/S</td>
<td>1.55</td>
<td>0.51</td>
<td>1.01</td>
<td>1.53</td>
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<tr>
<td>P/EBITDA</td>
<td>8.13</td>
<td>5.79</td>
<td>5.79</td>
<td>7.88</td>
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</tbody>
</table>

### Energy relative to S&P 500

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<th>Low</th>
<th>Median</th>
<th>Current</th>
</tr>
</thead>
<tbody>
<tr>
<td>P/E</td>
<td>1.09</td>
<td>0.45</td>
<td>0.78</td>
<td>0.90</td>
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<tr>
<td>P/B</td>
<td>1.30</td>
<td>0.59</td>
<td>0.92</td>
<td>0.64</td>
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<tr>
<td>P/S</td>
<td>1.13</td>
<td>0.55</td>
<td>0.76</td>
<td>0.81</td>
</tr>
<tr>
<td>P/EBITDA</td>
<td>1.10</td>
<td>0.58</td>
<td>0.80</td>
<td>0.77</td>
</tr>
</tbody>
</table>
Industry Valuation Overview

- 2016E P/E
- TTM P/E
- P/C
- TTM P/S
- P/B

- Gas Utilities
- Independent Oil & Gas
- Major Integrated Oil & Gas
- Oil & Gas Drilling & Exploration
- Oil & Gas Equipment & Services
- Oil & Gas Pipelines
- Oil & Gas Refining & Marketing
Technical Analysis
Recommendation
Recommendation

- Add at least 50 bps of exposure to match S&P
- Industry is significantly undervalued relative market and historical performance
- Opportunity to enter near bottom of business cycle