

Energy Industry Data & Trends

THE **LOW TIDE** OF ENERGY IPOS

The oil price downturn put a major damper on IPOs in the oil and gas space. After several steady years of many companies going public, successful energy IPOs were few and far between from early 2015 to late 2016. Public markets had little appetite for existing firms, and minimal interest in any new companies. The companies that wished to go public chose to wait until market conditions improved.

Much the same way that volatile oil prices left buyers and sellers unable to agree on the value of assets in M&A transactions, companies felt they would not be able to realize a fair valuation if they tried to go public. Investors, meanwhile, worried about taking positions in companies that might not be able to weather the storm.

With the exception of a pair of companies in January 2016, no firm was able to successfully go public from early 2015 through mid-2016. Ten companies began the public offering process in this period, but diminished investor interest meant these were withdrawn. The growth in commodity prices brought market attention back to the energy industry, and IPO activity experienced a surge.

From August 2016 through August 2017 a total of 33 companies attempted to go public. This rate is comparable to the level of IPOs seen before the downturn and allowed many companies that waited for the chance to go public to do so. Most that attempted to go public in this period succeeded, as out of the 33 that began the process in that year, 21 are now traded.

In this Report – KEY SUMMARY POINTS:

- The surge in IPO activity from late 2016 through mid-2017 has died down
- Average value offered to public markets has fallen sharply
- Current market sentiment does not favor the average IPO company
- Uncertainty regarding future commodity prices makes agreeing on valuations difficult
- Current stage in business cycle does not favor E&P companies
- E&P companies historically dominate energy IPOs
- Service companies have been more important than usual after the downturn
- IPO performance mixed, but some companies significantly outperform
- Investing in each energy IPO since the downturn would beat E&P and service indices
- Recent major IPO offerings have offered 25% to 35% of the business, using proceeds to pay down debt

Energy IPOs

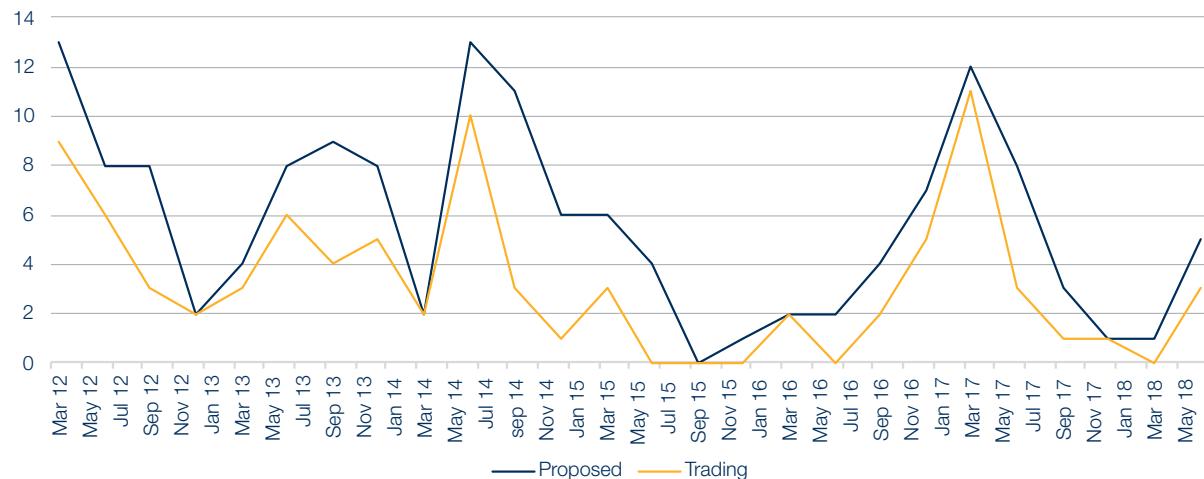
Source: EnerCom Analytics



However, market sentiment has since turned, and IPOs have slowed significantly. Only seven companies have begun the IPO process since August 2017, and only four of these are trading.

Quarterly Public Offerings

Source: EnerCom Analytics

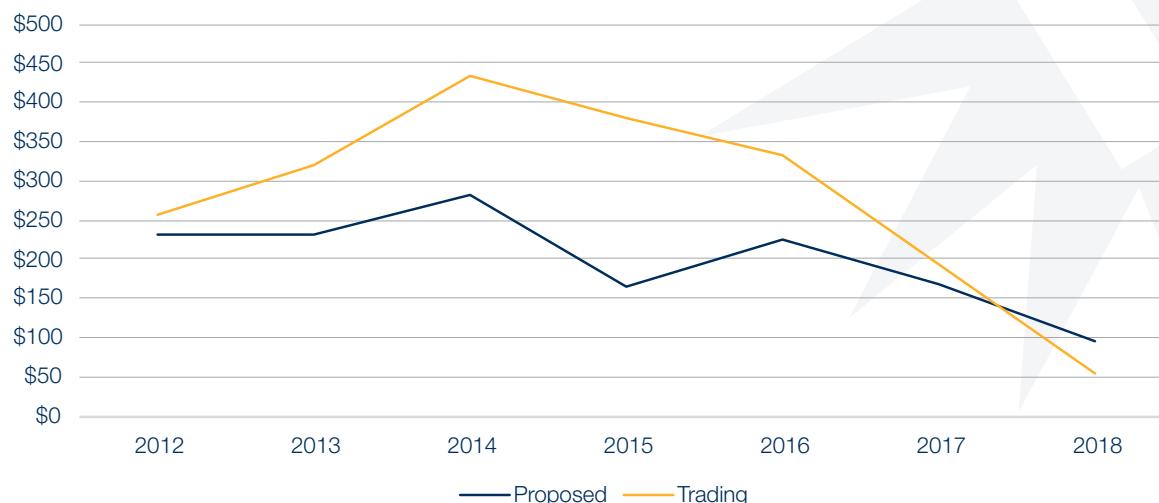


The average size of public offerings has also shifted significantly in the past few years. Before the downturn the average company going public offered approximately \$250 million. This average fell in 2015 to \$165 million per company, but recovered to \$225 million in 2016, as companies that waited for an upswing began going public late in the year. This trend held in early 2017, as the average public offering was valued at \$240 million.

The turn of market sentiment affected the average value of public offerings, which fell throughout the rest of 2017. Recently proposed IPOs have all been small, only AFG Holdings, which plans to offer about \$325 million in its IPO, is comparable to the average pre-downturn IPO offering.

Average Size of Offering (\$ Million)

Source: EnerCom Analytics



Multiple trends discourage IPO efforts

The decline in investor appetite for new public oil and gas firms has several roots. As noted in previous reports, investors are currently prioritizing cash flow generation over growth in most cases. This preference is not good for companies looking to go public. The majority of firms that wish to tap public markets are in the early portion of a company's life cycle, and are not in a position to generate cash at the levels demanded by investors at present. They are, rather, typically positioned to grow rapidly. This was an attractive business plan before the downturn, when investors generally prioritized growth, but is viewed less favorably now.

Continued uncertainty regarding the future of commodity prices has also played a part. If companies and investors have meaningfully different expected oil and gas prices, this can result in large differences in the expected value of any company that wishes to go public. In this situation a company may decide the market is not willing to provide an acceptable valuation and instead wait for better times. This exact mechanic is one of the main reasons the much-predicted surge in oil and gas M&A did not occur during the downturn.

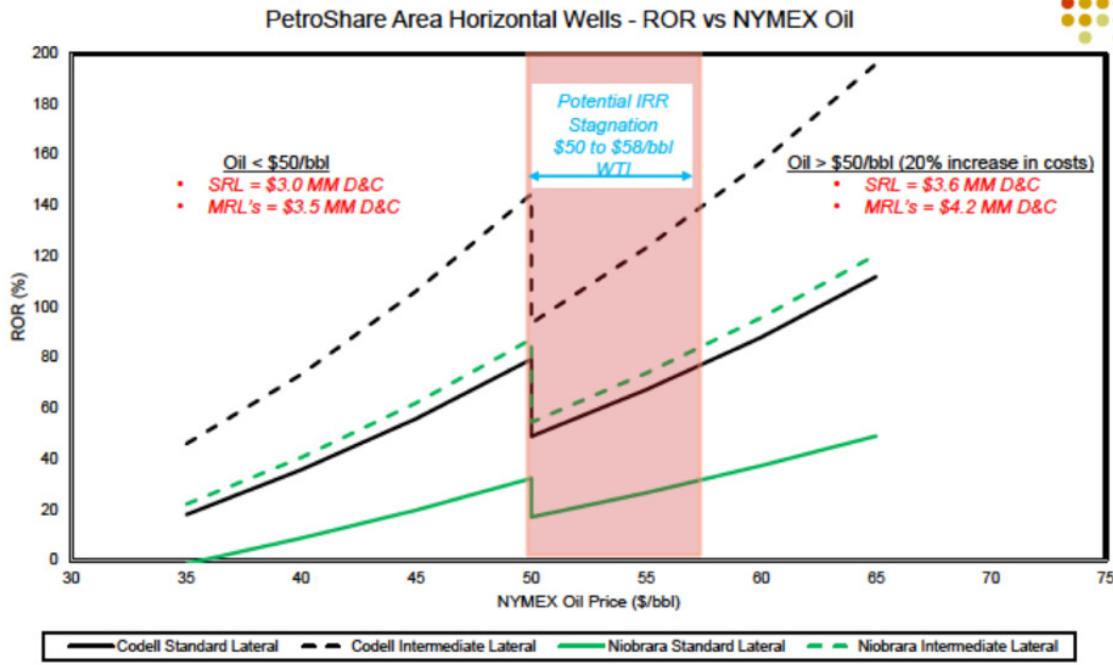
Finally, the stage of the overall oil and gas business cycle is hindering E&P public offerings. While commodity prices have risen in the past year, which would seem to support producers, higher margins do not necessarily mean higher returns. Service companies have increased margins in the past year, moving to grab a piece of the bounty stronger oil prices brings. Expanding service margins can have a major impact on any E&P company's returns. One operator, for example, estimated in a presentation last year that growing service company margins could essentially cancel out \$8/bbl of IRRs.

Team Focused on Sensitivity to Service Price & CAPEX Escalation



ROR vs NYMEX Oil

Source: PetroShare



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Companies are waiting for the opportunity to tap markets

The dearth of companies going public in 2018 does not mean firms do not wish to do so. There is, rather, a large group of companies that are looking to go public in the near future. One needs to look no further than EnerCom's Oil and Gas Conference to see names that may end up going down the public company path.

Some companies, finding equity markets less supportive than required, have used other means to become public. Fifth Creek Energy, for example, looked to go public in late 2017 as a small cap E&P producer. Sufficient investor support was not available, however, so instead the company merged with Bill Barrett in December. The resultant company, HighPoint Resources, allowed Fifth Creek to access public equity markets as a better-established company without going through the IPO process.

The backlog of public offerings has implications for established companies as well, even though they are not the ones going public. In theory, there is a capital pool for all oil and gas companies, and while the pool of capital can expand and contract as investor sentiment shifts, companies must always compete for what money is available.

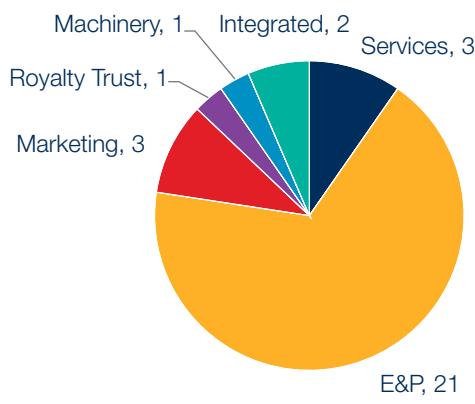
Firms going public tends to dilute this pool of capital, adding another company for established firms to compete with. This will, in theory, have a deleterious effect on valuations for the overall pool of oil and gas companies as limited capital is split in increasing directions.

Furthermore, from an investor psychology standpoint new IPOs may lead to a decrease in valuations of established companies. A new enticing company can attract investor attention away from existing companies, shifting money in equity markets. This can possibly lead to diminished valuations for existing firms.

Service company popularity rose in downturn

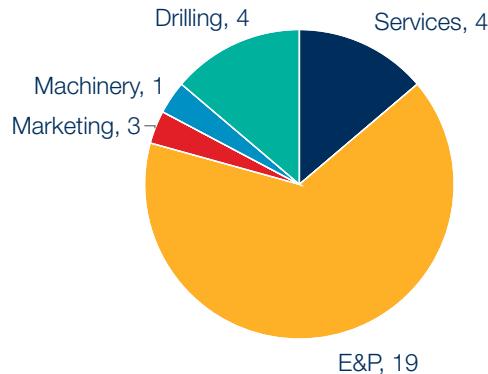
The type of company beginning the public offering process has shifted over the years. Before the downturn most companies moving to go public were E&P firms. Riding on top of strong oil prices, positive market sentiment for E&P companies allowed an average of 22 firms to begin the public offering process in each year from 2012 through 2014. Market appetite for E&P companies seems to peak in 2014, when 26 firms went to markets and received an average value of \$280 million. Service companies were typically the second-most common new company to tap equity markets, and on average received \$230 million in IPOs before the downturn.

**2012 Volume (Left)
2012 Value
(\$Million)(Right)**



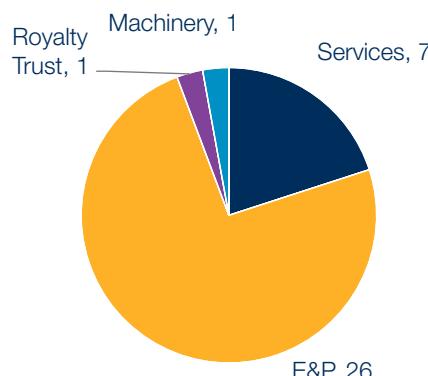
Source: EnerCom Analytics

**2013 Volume (Left)
2013 Value
(\$Million)(Right)**

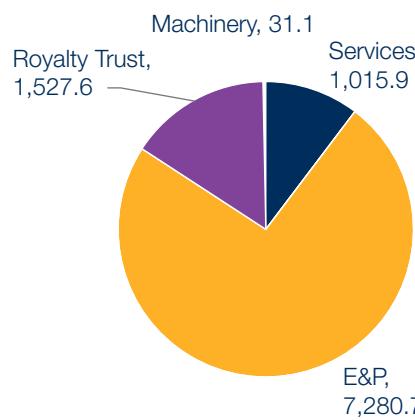
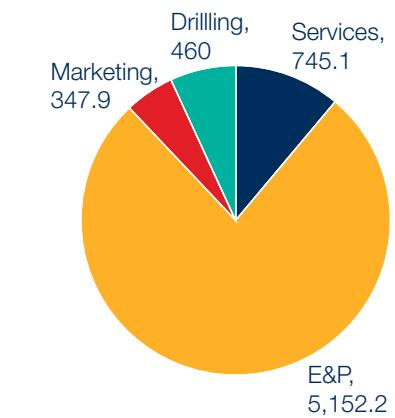
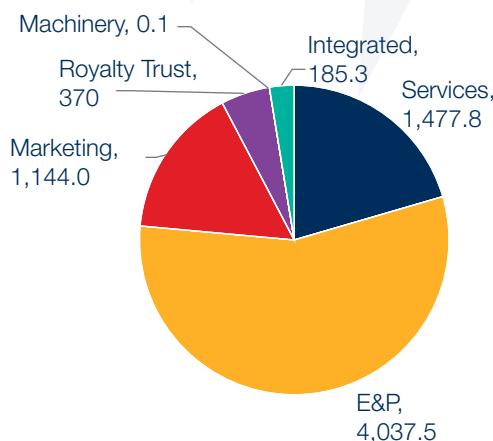


Source: EnerCom Analytics

**2014 Volume (Left)
2014 Value
(\$Million)(Right)**



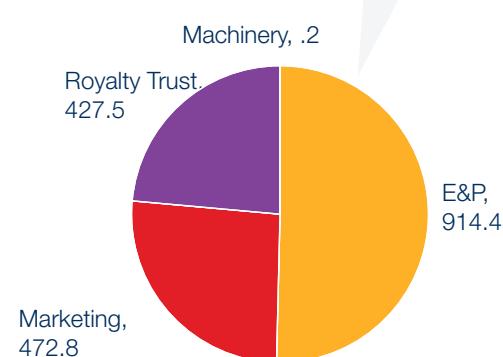
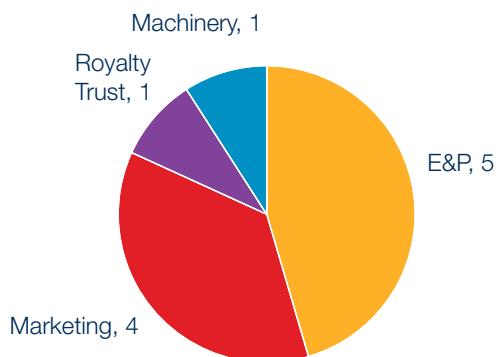
Source: EnerCom Analytics



As noted above, the downturn caused investor appetites for new companies to collapse. This decline particularly affected E&P and service firms in the early portion of the downturn. Only five E&P companies tried to go public in 2015, less than one fifth of the 26 that did in 2014. Zero service companies began the public offering process in 2015, as established companies were struggling for survival and equity markets had little interest in bringing any new ones into the space. Several marketing firms and one royalty trust were able to go public, receiving relatively high proportions of the overall energy IPO market in 2015.

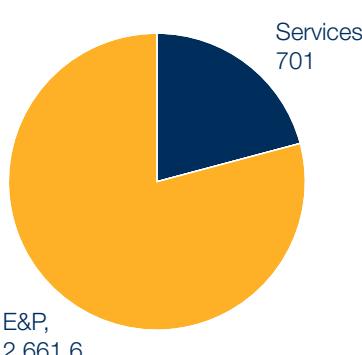
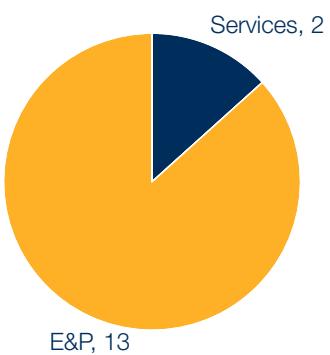
**2015 Volume (Left)
2015 Value
(\$Million)(Right)**

Source: EnerCom Analytics



**2016 Volume (Left)
2016 Value
(\$Million)(Right)**

Source: EnerCom Analytics

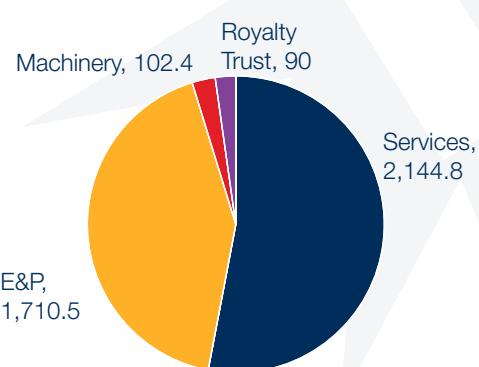
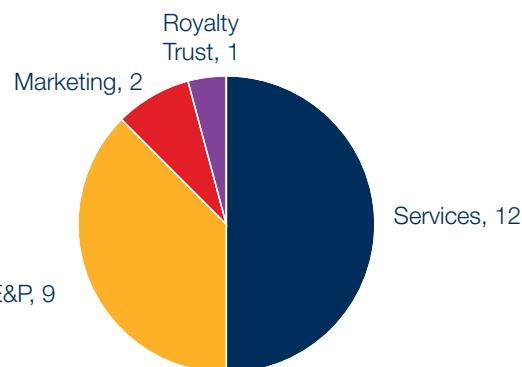


Only two service companies went public in 2016, both late in the year, but this foreshadowed a major shift in early 2017. As oil prices showed stability around \$50/bbl in the first months of 2017, the outlook for service companies significantly improved.

Improving oil prices supported growing production for the industry, meaning demand for service companies, particularly fracturing firms, grew rapidly. As discussed last year, the large inventory of drilled uncompleted wells provides even further potential demand. Further stoking equity market interest in service companies was the potential for improved margins, as strengthening commodity prices filtered through the overall oil and gas space.

**2017 Volume (Left)
2017 Value
(\$Million)(Right)**

Source: EnerCom Analytics

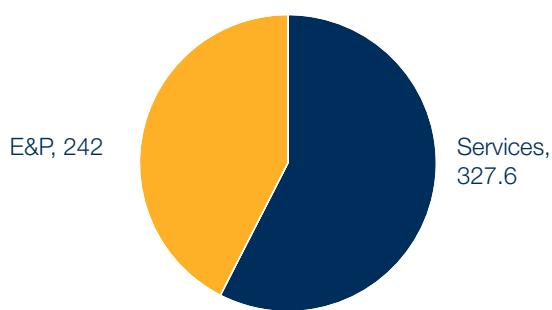
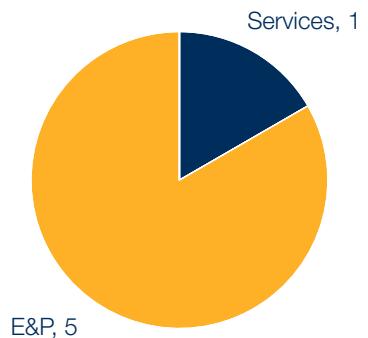


This interest led service company public offerings to dominate the markets in 2017. Half of all companies moving to go public last year were service companies, the highest proportion since at least 2000. Service company offerings account for more than half of the total deal value in 2017, the largest share since 2008.

While the overall market for public offerings of energy companies is diminished in 2018, oilfield service still dominates the space in terms of total value offered. This is because the E&P companies currently moving to go public are all offering very small values, an average of only \$48 million each, 17% of the average value seen in 2014.

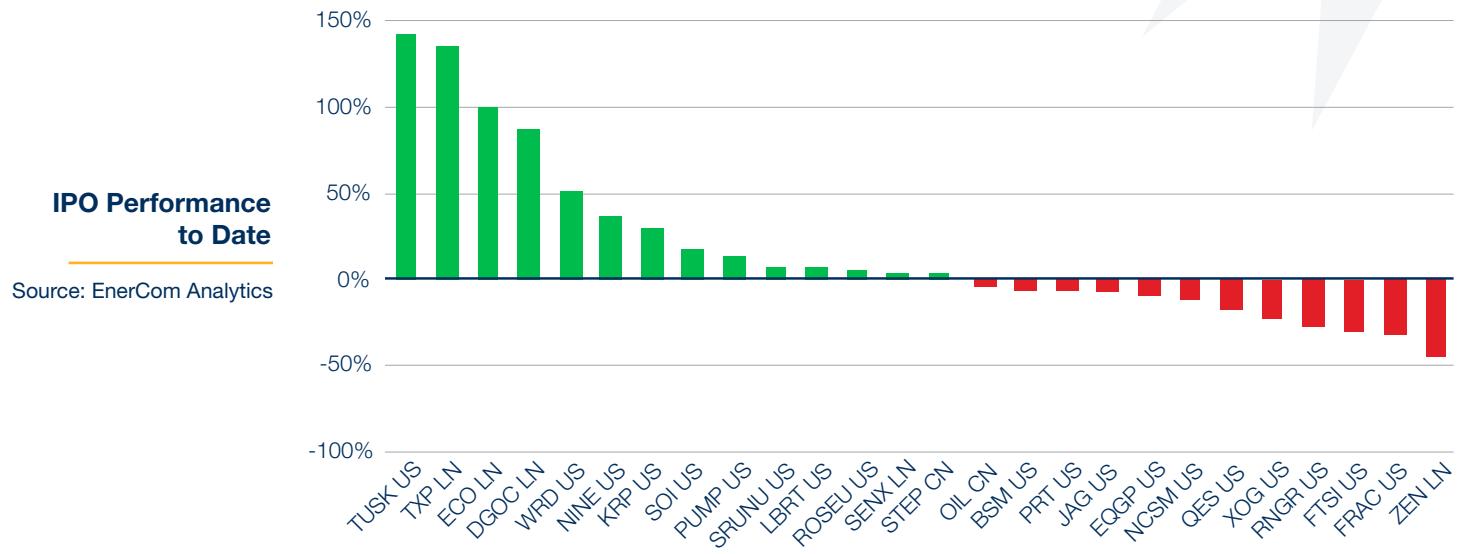
**2018 Volume (Left)
2018 Value
(\$Million)(Right)**

Source: EnerCom Analytics



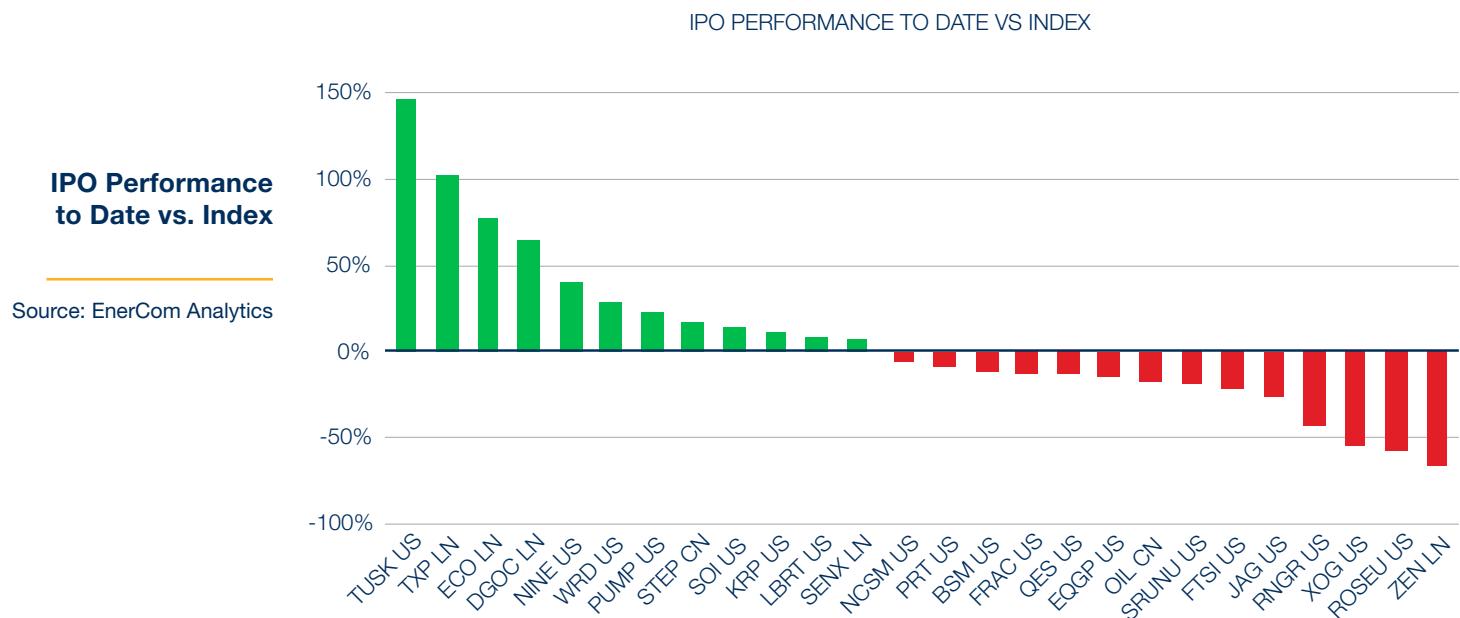
IPO performance mixed, but several firms massively outperform

Out of the 26 companies that have successfully gone public since 2014, 14 have gained value and 12 have lost value. The overall balance of returns is also skewed positively. The largest drop seen among recently offered companies has been a decline of 43%. While this is certainly significant, the greatest success story of publicly offered companies since the downturn, Mammoth Energy Services, has more than doubled in value since its launch date.



Accurately evaluating the performance of any specific company requires comparing it to an index of peers, however, as some price movements are caused by overall market dynamics and some are caused by the specifics of an individual company.

When compared to the relevant E&P or service index, recently offered companies have not performed as well. Fourteen have underperformed the overall market, only 12 have delivered better results than their sector. Most underperforming companies are E&P firms, while a disproportionate amount of service firms have outperformed.



While the majority of recent energy IPOs have underperformed, the few that have significantly outperformed the market outweigh the laggards. In total, the 26 energy offerings have outperformed the indices by a combined 165%. Investing in each energy IPO since the downturn at launch, then, would have been a successful strategy if one was looking to beat the overall oil and gas market.

The strongest-performing recently offered company, Mammoth Energy Services, is primarily benefiting from its non-oil and gas operations. While the firm does have pressure pumping, proppant and drilling services, it also is active in the construction and maintenance of energy infrastructure. This business line has been the most important for the company, as it has received several large contracts for infrastructure work in Puerto Rico.

Several cases of E&P companies underperforming the index may be a result of the shifts in investor sentiment seen in the past two years. The aforementioned increased preference for free cash generation affects both potential and existing public companies. Most of the E&P companies that have gone public since the downturn are not in the free cash generation stage of their life cycle and were particularly affected by the shift in priorities.

Further underperformance may be attributed to timing. Several Permian-based E&P firms took advantage of the "Permian fever" in late 2016 and early 2017 by going public, receiving high valuations. While firms in the basin still receive strong valuations, as was investigated in last month's report, they are no longer receiving a premium simply for being in the Permian.

There are several commonalities among the major public offerings since the downturn. Most of the important offerings sold a similar-sized stake in the business, 20% to 35% of existing capital. Alta Mesa Resources offered more than double this level, but Alta Mesa went public through a Special Purpose Acquisition Company (SPAC), which often offer large stakes when going public. Rosehill Resources, for example, also went public through a SPAC, which offered 100% of the equity in the business when it went public.

An additional similarity between major recent energy IPOs is the use of proceeds. Every large company that has gone public since the downturn has used at least part of the money it raised to pay down debt. In most firms, strengthening the balance sheet was the main priority, only Jagged Peak and WildHorse identified other uses such as funding capital spending as the primary use of their proceeds.

The move to strengthen the balance sheet makes sense, based on the factors that equity markets examine when valuing an oil and gas company. As the analysis of EnerCom's 5 Factor Model last month showed, while debt has declined somewhat in importance as commodity prices rose over the past two years, it continues to be a key metric in valuations. In most cases, the remaining proceeds would primarily go toward capital expenditures, funding upcoming growth.

Overall, the trends discouraging private oil and gas companies from going public are very difficult for individual companies to overcome. A meaningful shift in investor sentiment, or a stabilization in commodity price prospects, could provide the opportunity for another surge of IPO activity similar to that seen in late 2016-2017, but for now private firms must either be patient, look to other means to tap markets or accept lower than hoped valuations.

A Word of Thanks

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