



Ghost in the Machine -

Risk in the Oilfield Services Sector



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14 December 2011

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Introduction

- Oilfield services companies have increased in their number and popularity
- Mega-mergers in the 1990's have led to cost-cutting drives
- Key operations in oil & gas exploration and production were outsourced, with the promise of future financial benefits
- The result turned out differently, with an outflow of key mid-career talent and increasing complexity around JV operations
- Rising prominence of oilfield services companies means the risks they face have become risks to the whole sector

This presentation explores these oilfield services risks and the potential ways of mitigating them

The nature of oilfield services risks

- Service companies cover a range of services with key competitive edges
- The oilfield services sector is intensely competitive and cyclical because of diversity of services provided and relatively low entry barriers (in certain areas)
- An individual company's competitive position also reflects its management's strategy, and attitude toward financial risk
- An individual oilfield service company's vulnerability to demand fluctuations is determined by
 - customer base
 - growth strategy
 - financial durability

The key competitive edges of an oilfield services company are usually around availability, performance, quality, reliability, technical support and service and the price of equipment, materials and manpower

The nature of oilfield services risks

Operational risk in an oilfield services company can be increased or lowered by the presence or absence of:

Developing and deploying **technology**

- increases exploration & production success rates
- reduces costs

Extensive **coverage of activities**

- mitigates financial exposure to the risks of a single market
- makes a more reliable subcontractor
- provides opportunities for related follow-on sales
- creates a more sustainable platform for growth in profits and cash flow

Operating in more than one **geography**

- internal hedge against demand fluctuations
- higher capability to serve large customers

As most oilfield services companies are unable to cover the entire spectrum of exploration or production activities, they are vulnerable, to a greater or lesser degree, to cyclical swings in the oil and gas industry

Mitigating general oilfield services risks

- **Industry risk** - Exposure to fluctuations in core commodity prices and demand for services
- **Country risk** - Exposure to external country factors inherent in the environments in which services companies operate
 - Security
 - political risk
 - legal risk and transparency
 - bribery and corruption
 - exchange rates
 - local infrastructure
- **Project specific risk** – Risk of executing projects to customer specification
 - technical risk
 - budget and schedule risk
 - performance guarantee levels
 - safety risk
 - environmental risk



Mitigating general oilfield services risks

- Risks should be managed by relevant project teams, and should be central to reviewing all new business proposals before any formal obligations are entered into
- The review process ensures that there is constant focus and attention on maintaining and improving execution capability
- There should be well-established procedures for
 - assessing and reviewing risks in relation to prospective projects
 - managing risks in relation to existing projects
- Significant new projects and investments should be reviewed by a corporate risk review committee by the Board directly, depending on the risk profile of the opportunity

These risks should be directly managed by the relevant project teams, and be core to a process which reviews all new business proposals before any formal obligations are entered into

Mitigating specific oilfield services risks

Key risks that could lead to a significant loss of reputation, or prevent an oilfield services company from executing its strategy and creating shareholder value include

- Level of demand for services
- Oil & gas commodity prices
- Availability of essential manpower
- Security
- Business continuity
- Exchange rates
- Changes in sovereign laws and contract enforcements
- Breach of legal or regulatory code

Oilfield services companies are potentially exposed to natural hazards, acts of terrorism, war and civil unrest that could impact infrastructure, through the unavailability of physical assets or access to systems and data

Conclusion

- The link between E&P companies and oilfield service companies gives rise to a significant number of shared industry and business risk drivers.
- The business outlook for oilfield service companies is significantly affected by the level of energy industry spending on exploration of oil and natural gas reserves.
- Oilfield service companies are as good at managing risk as their clients
- The increasing degree of interdependence between the two necessitates a heightened level of oilfield risk awareness

The business outlook for oilfield service companies is significantly affected by the level of energy industry spending on exploration of oil and natural gas reserves



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