Helping our clients achieve their goals,
and then set new ones.

BOEM Decommissioning Requirement Solutions
May 2016
Background:

HBW Resources is an integrated strategic consulting and advocacy firm focused on energy, environment, and transportation issues. The firm brings a multidisciplinary approach to identifying challenges and opportunities for clients. Specializing in creating and executing innovative coordinated strategies, HBW Resources is known for working effectively at the cross-section of public policy, regulatory policy, and the political arena to win public relations and policy battles.

Mission Statement:

“We help our clients achieve their goals, and then set new ones.”
Energy, Environment, & Transportation
Issues Management

• Strategic Planning
• Issue Tracking & Management
• State Advocacy
• Federal Advocacy
• Coalition Management
• Communications & Media
• Grassroots Mobilization
• Grasstops Engagement
• Campaign Management
PRIME+ Risk Management Methodology

Risk Identification

Risk Quantification And Qualification

Risk Mitigation

Communication and consultation

Establishing the context

Risk Assessment

Risk identification

Risk Analysis

Risk Evaluation

Risk Treatment

Monitoring and Review
Summary

What are we solving for? Tailored plan for decommissioning liability >10%
Building a reserve structure – costs and impacts
Working around funding at once
Reserve effects on compliance, covenants, stakeholders, and enterprise risk

Bonding is available and still a solution
However, bonding has
1) exposure limitation and
2) will closely underwrite asset quality
3) Potential for an increase in premium pricing

Need to look at alternative solutions

Disclaimer:
No names will be used
No size fits all, this is a bespoke approach
What are we solving for? Tailored plan for decommissioning liability >10%
Decommissioning liability >10% of tangible net worth
Quantifying Tangible Net Worth and Decommissioning Liability

Tangible Net Worth may vary with Revenue, Profitability and asset impairment

The decommissioning Cost Liability remains fixed
Variability in Tangible Net Worth and Decommissioning Liability

Original Coverage:
- Assets $650mm
- Equity $250mm

New Coverage:
- Assets $550mm
- Equity $150mm

Coverage Shortfall:
- Gap $100mm

Adjusted Company NW:
- During market turmoil
- Can still qualify for bonding
Lease Portfolio Focus Priority – phase in approach, work priorities backwards

**New Lease – 10 years**
- Active vs Non-Active
- No reserve necessary for inactive wells.
- Possibility to satisfy reserve requirements over time.

**Existing Lease – 5-9 years**
- Crux of tailored plan.
- Assess deviation from current decommissioning coverage.

**Terminating Lease – 5+ years**
- Immediate focus. Is there enough coverage to satisfy P&A.
- Credit given to existing capital reserve.
- Credit given to CapEx to date.
Additional Bonds Evaluation Criteria: 30 CFR Part §556.53

- **Financial Capacity**: Based on most recent independently audited financials (<12 months)
- **Projected Strength**: Estimated value of existing OCS lease production and proven reserves of future production
- **Business Stability**: Five years of continuous operation and production on the OCS or onshore
- **Reliability**: Must be rated by Moody’s, Standard & Poor’s or Dunn & Bradstreet
- **Record of Compliance**: Compliance records: laws, regulations relating to civil penalties, cancelation of leases, debarment, non-payment, revocation of ownership
Additional bonding: Building a reserve structure – costs and impacts

• Acceptable security(ies):
  • Surety Bond
  • US Treasury
  • Abandonment Account
  • Third Party Guarantee(s)
• Alternative forms of security (if approved)
  • Zero coupons
  • Letters of Credit
  • Pooled portfolio credit
  • Reinsurance Bond Structure
Cost of raising debt BBB-BB S&P 500:

Source: BofA Merrill Lynch
research.stlouisfed.org
Cost of raising debt BB-CCC S&P 500:

Source: BofA Merrill Lynch
research.stlouisfed.org
Building a reserve structure – costs and impacts
Funding the reserve account Cost of Carry:

Issue $100mm Bond Issuance @ 5%
- Held in cash ($5mm) annual expense negative carry
- Held in UST @2% Yield ($3mm) lower annual expense negative carry

### Bonding Discussion

#### Overview

<table>
<thead>
<tr>
<th>BONDS</th>
<th>3mo</th>
<th>6mo</th>
<th>9mo</th>
<th>1yr</th>
<th>2yr</th>
<th>3yr</th>
<th>5yr</th>
<th>10yr</th>
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<tbody>
<tr>
<td>U.S. Treasury</td>
<td>0.29%</td>
<td>0.47%</td>
<td>0.57%</td>
<td>0.80%</td>
<td>0.95%</td>
<td>1.11%</td>
<td>1.43%</td>
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<td>U.S. Treasury Zeros</td>
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<td>0.36%</td>
<td>0.44%</td>
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<td>0.86%</td>
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<td>1.47%</td>
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<tr>
<td>Agency/GSE</td>
<td>0.59%</td>
<td>0.61%</td>
<td>0.71%</td>
<td>1.00%</td>
<td>1.29%</td>
<td>1.52%</td>
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<tr>
<td>Corporate (Aaa/AAA)</td>
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<td>0.46%</td>
<td>--</td>
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<td>1.16%</td>
<td>1.63%</td>
<td>1.83%</td>
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<td>2.92%</td>
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AS OF 05/21/2016.
Building a reserve structure – costs and impacts
Funding the reserve account Cost of Carry:

**Issue $82mm Bond Issuance @ 5%**
- Held in Zero Cpn UST @2% Yield $100mm maturity value ($4.1mm) annual expense

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<thead>
<tr>
<th><strong>BONDS</strong></th>
<th>3mo</th>
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<td>81.71%</td>
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<td>2.92%</td>
<td>74.83%</td>
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AS OF 05/21/2016.
Tailored Plan Funding = Debt + Equity + L of C + Surety Bonding

Reserve effects on compliance, covenants, stakeholders, and enterprise risk
Balance sheet and Income Statement
  Managing Liquidity
Project IRR and Returns
Bank covenants and compliance
Ratings Impact
Enterprise Risk Management
### Financial Ability to Carry Out Obligations (30 CFR § 556.53(d))

#### Independent Companies

<table>
<thead>
<tr>
<th>Performance</th>
<th>Top Quartile</th>
<th>Bottom Quartile</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBITDA Margin (EBITDA/Revenue), [Ratio]</td>
<td>0.85</td>
<td>0.56</td>
</tr>
<tr>
<td>Return on Assets (Net income/Total Assets), [%]</td>
<td>8.10</td>
<td>3.20</td>
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<tr>
<td>Cash Flow from Operations/CAPEX, [Ratio]</td>
<td>0.88</td>
<td>0.66</td>
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<table>
<thead>
<tr>
<th>Leverage</th>
<th>Top Quartile</th>
<th>Bottom Quartile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Debt/Capital, [Ratio]</td>
<td>0.25</td>
<td>0.43</td>
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<tr>
<td>Times Interest Earned (EBIT/Interest), [Ratio]</td>
<td>16.00</td>
<td>5.70</td>
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<tr>
<td>Total Debt/Average Daily Production Value, [Ratio]</td>
<td>125</td>
<td>172</td>
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<tr>
<td>Total Debt/Proven Reserves Value, [Ratio]</td>
<td>0.06</td>
<td>0.10</td>
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<tr>
<td>Total Proved Reserves Value/Asset Retirement Obligations, [Ratio]</td>
<td>188</td>
<td>64</td>
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</table>

<table>
<thead>
<tr>
<th>Liquidity</th>
<th>Top Quartile</th>
<th>Bottom Quartile</th>
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</thead>
<tbody>
<tr>
<td>Current Ratio (Current Assets/Current Liabilities), [Ratio]</td>
<td>1.49</td>
<td>0.78</td>
</tr>
<tr>
<td>Cash Flow from Operations/Current Liabilities, [Ratio]</td>
<td>1.68</td>
<td>1.00</td>
</tr>
</tbody>
</table>

#### Integrated Companies

<table>
<thead>
<tr>
<th>Performance</th>
<th>Top Quartile</th>
<th>Bottom Quartile</th>
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</thead>
<tbody>
<tr>
<td>Total Revenue, [$ Million]</td>
<td>$282,800</td>
<td>$25,500</td>
</tr>
<tr>
<td>Total Equity, [$ Million]</td>
<td>$108,000</td>
<td>$23,400</td>
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<tr>
<td>Return on Capital, [%]</td>
<td>9.3</td>
<td>4.7</td>
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<tr>
<td>Intangible Assets/Revenue, [Ratio]</td>
<td>0.01</td>
<td>0.08</td>
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<tr>
<td>Gross Margin (Gross Profit/Revenue), [%]</td>
<td>40.5</td>
<td>18.5</td>
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</table>

<table>
<thead>
<tr>
<th>Leverage</th>
<th>Top Quartile</th>
<th>Bottom Quartile</th>
</tr>
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<tbody>
<tr>
<td>EBITDA Interest Coverage, [Ratio]</td>
<td>44.00</td>
<td>12.75</td>
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<tr>
<td>Net Debt to EBITDA, [Ratio]</td>
<td>0.66</td>
<td>1.33</td>
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<tr>
<th>Liquidity</th>
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<th>Bottom Quartile</th>
</tr>
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<tbody>
<tr>
<td>Basic Defense Interval (Current Assets/Daily Operational Expense), [Days]</td>
<td>156</td>
<td>34</td>
</tr>
<tr>
<td>Asset Turnover, [Ratio]</td>
<td>1.04</td>
<td>0.57</td>
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<tr>
<td>Payables/Receivables, [Ratio]</td>
<td>1.54</td>
<td>1.06</td>
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