Pareto Securities

May 2014

OSV Market Outlook 2014

Presentation for Malaysia OSV Owners' Association

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The Oil Services market will be resilient in the short term, but the macro story is starting to become challenging

Signals	Drivers		Trend Insights
	Flat E&P spending	–	E&P spending to increase 1.7% y/y in 2014e, down from 8.9% y/y in 2013; concerns that the existing oil price (USD 109/bbl) is insufficient to support cashflows; NOCs have warned OSV companies of cost concerns.
	Weaker Seimsic and Floater market	–	Despite positive long-term fundamentals supporting a 22% floater orderbook (68 units), flat exploration budgets for 2014 have curtailed demand and UDW rig dayrates have fallen, as have share prices of rigs.
	Yard capacity increasing & more efficient	–	While blue water yards have been securing new offshore orders subsidised by the Chinese government; the newbuilding supply situation have not been as bad as feared – the orderbook has not changed materially and orders are muted.
	Secondhand market pressure	–	Newbuilding prices have put pressure on secondhand values and transactions.
	Non-transparent steady OSV orderbook	–	553 OSVs (16% of total fleet of 3,439) on order with 388 PSVs (27% orderbook) and 165 AHTSs (8% orderbook); while 850 OSVs (25%) are older than 25 years. Slippage currently at 40% (419 deliveries scheduled for 2013 but only 178 actually delivered). This compares to the 26% total rig orderbook (195 rigs).
	Utilisation levels & charter rates	O	Overall term utilisation is at ~77%, up 2% over the past six months. Increasing AHTS demand (74% term) still has some way to go compared to PSVs (80% term) which was flat. Dayrates are at a 5-year high, but valuations are flat.
	Cabotage advantages	+	Cabotage regulations in certain markets allows owners to enjoy premium rates – but all markets go to excess, we already see this in Malaysia.
	Opex inflationary pressures easing	+	Costs are stabilising after doubling over the past five years (caused by shortage in qualified DP mariners). Some owners are benefiting from the stronger USD.
	Financing challenges remain	+	Alternative financing (bonds / SNL) increasingly popular; and we expect companies to be more discerning in the deploy of most capital.
	Active shallow water activity	+	80% of offshore oilfields to be developed are in shallow waters; a shortage of near-term oil leads to increased focus on production from marginal fields.
	Strong Jackup market & utilisation	+	Jackup fleet's orderbook currently at 28% (127 units); up 8% (13 units) over the past six months; production spending has to continue in the near-term – Jackup utilisation is strong at 97%, dayrates likely to increase to USD 180,000.
	Subsea & IMR activity	+	OSV demand for pipe laying, decommissioning, subsea, seabed mining activity all at an all-time high. New frontier activity requires more advanced vessels.
	Demand from offshore gas projects	+	Healthy demand for small to mid-sized AHTS and PSV, for extraction, processing and transportation of offshore gas projects.
	Technical obsolescence	+	Aging vessels: 28% of AHTSs and 22% of PSVs above 25 years but are all small sizes. The difference in utilisation between new and old vessels remains at 35%.

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Oil companies cost focus has intensified dramatically

BP sees profits fall

Profits dip: BP chief executive Bob Dudley

Josh Lewis 29 October 2013 07:41 GMT

UK supermajor BP saw profits fall in the third quarter of the year despite a rise in revenue as expenses increased.

Shell cuts $9bn from capex

13 March 2014 08:15 GMT

Shell is chopping its capital expenditure this year as it sets its sights on restructuring its unconventionals activities in North America.

The Anglo-Dutch supermajor could make $15 billion of asset sales in the next two years as it looks to rein in its growth ambitions.

"In 2014, we will make hard decisions about our next phase of projects," chief executive Ben van Beurden said in the company's latest strategic report, published on Thursday.

SHARE STORY

Chevron fourth-quarter net income slides as production declines

Posted on January 31, 2014 at 6:30 am by Bloomberg in Finance/Earnings

By Joe Carroll
Bloomberg News

Chevron Corp., the world's third-largest oil company by market value, said profit fell 32 percent as production declined amid slumping international crude prices.

Fourth-quarter net income dropped to $4.93 billion, or $2.57 a share, from $7.25 billion, or $3.70, a year earlier, San Ramon, California-based Chevron said in a statement on Business Wire today. The results matched the per-share earnings estimate average of 18 analysts.

PetroChina cuts capex in value drive

PTTEP Slashes 2013 Capex by Half

JULY 11, 2013 PROJECTS & CAPEX, REGION - ASIA, HEADLINES

Reuters reports:

PTTEP announced a 46% reduction in its 2013 investment budget to THB 54.6 billi

The company had previously allocated THB 100.9 billion for 2013 capex. PTTEP als

Most of the reductions are in planned foreign investments and in some Thai project

Big Oil faces pressure from shareholders over costs

By Andrew Callus and Anna Driver
LONDON/HOUSTON | Thu Oct 31, 2013 4:30pm EDT

(Reuters) - Oil industry shareholders concerned about poor returns and costly projects urged executives from Big Oil this week to return cash to shareholders - and at least one of the world's top five petroleum companies fully acquiesced.

As they posted third-quarter results, the leading oil companies vowed to control spending and to put cash in the pockets of investors through asset sales, share buybacks or dividends while analysts grumbled about lagging stock prices.

Sinopec to cut capital spending as fourth quarter profit drops

Not rated yet

Sinopec storage tanks stand in Hong Kong. The state-run oil group said it would cut capital expenditure to $25.96bn this year.

Source: Pareto Research; Upstream, Reuters

Leading to more challenging market headwinds

Oil industry tries to put cap on soaring costs

Producers turning sour on mega-projects costing $1b and more

By John Kemp, Reuters
Published: 12:23 March 20, 2014

GULF NEWS

TradeWinds

Offshore slump idles $2.17bn of ships in Bergen

The North Sea saw 35 anchor-handlers sitting idle this week, with 18 hugely expensive vessels waiting in Bergen alone (pictured this week). Owners' biggest worry is that the spot market's strong chances of a tight summer may be ruined by outsiders entering the arena Page 30

Oil drillers face pain of oversupply, majors' capex austerity (reuters.com)

Thursday, February 6th, 2014 at 6:46 am

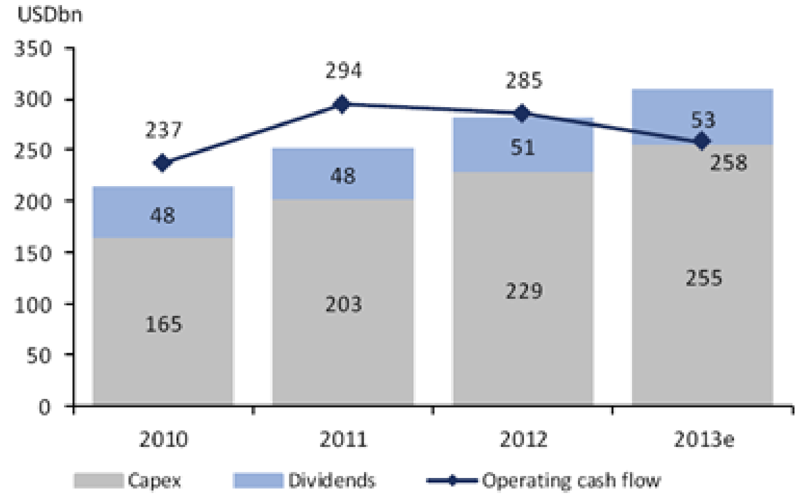
Shamsul warns of declining charter rates

BY RISEN JAYASEELAN

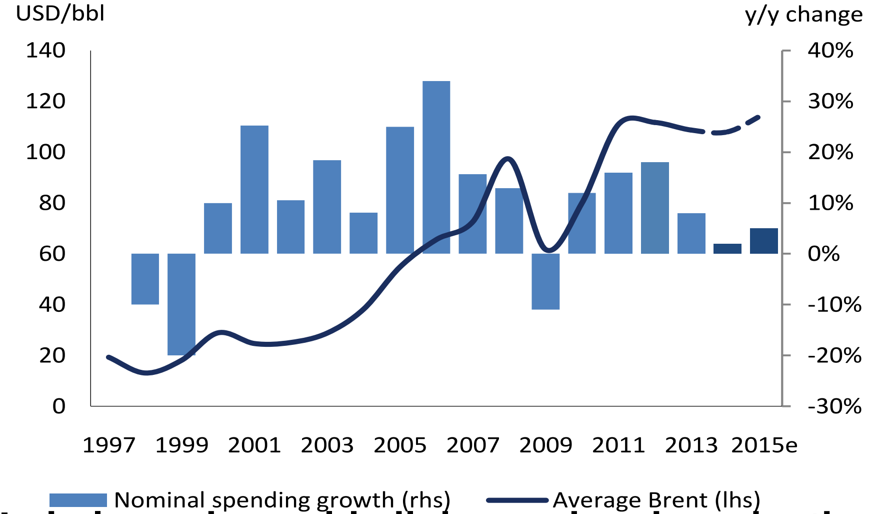
President & Group Chief Executive Officer Tan Sri Datuk Shamsul Azhar Abbas and Chairman Tan Sri Mohd Sidek Hassan at press conference and announcement of Q2 2013 financial performance.

E&P spending outlook has softened: the current oil price is too low

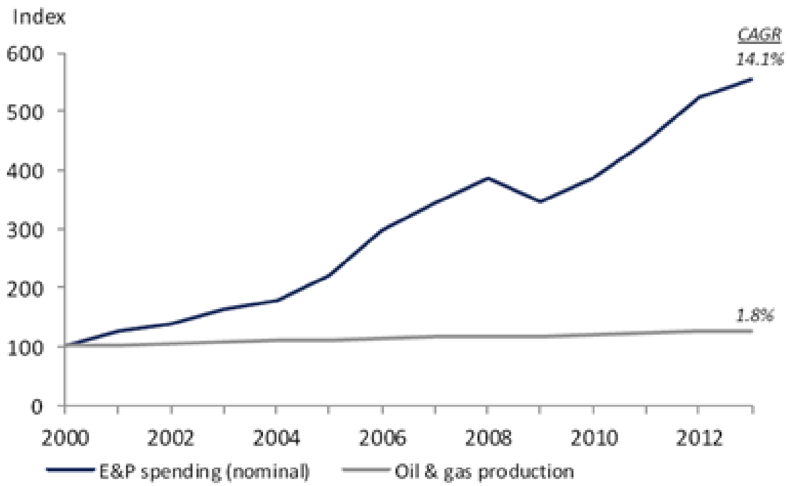
E&P companies cash flow overview*



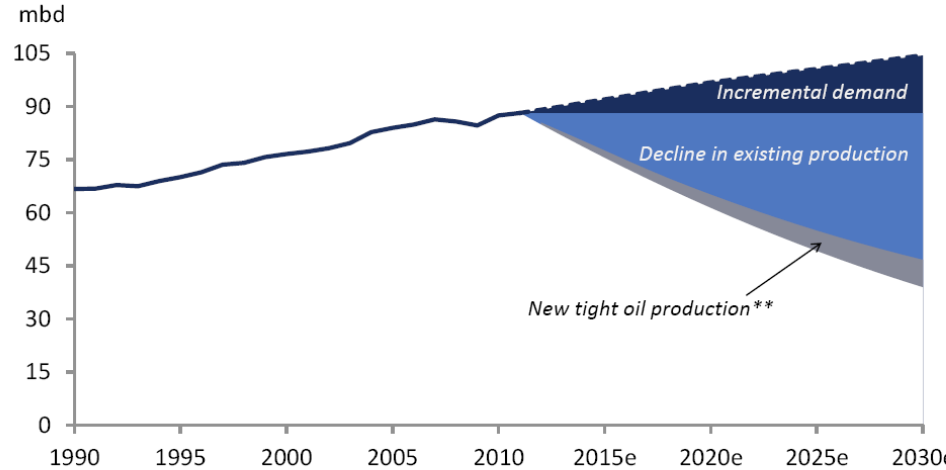
E&P spending to be flat in 2014/2015e



The inelasticity of oil production



Imbalance in world oil demand and production



* Statoil, Shell, Total, ENI, COP, Exxon, Chevron, Lukoil, PTTEP, Apache, OXY, BG, MROI, Husky, Murphy, Lundin, EnQuest
** Average of demand forecasts from IEA, EIA, OPEC, Exxon and BP; 4.5% decline p.a. on average in existing production
Source: Pareto Research; BP; IEA; Bloomberg

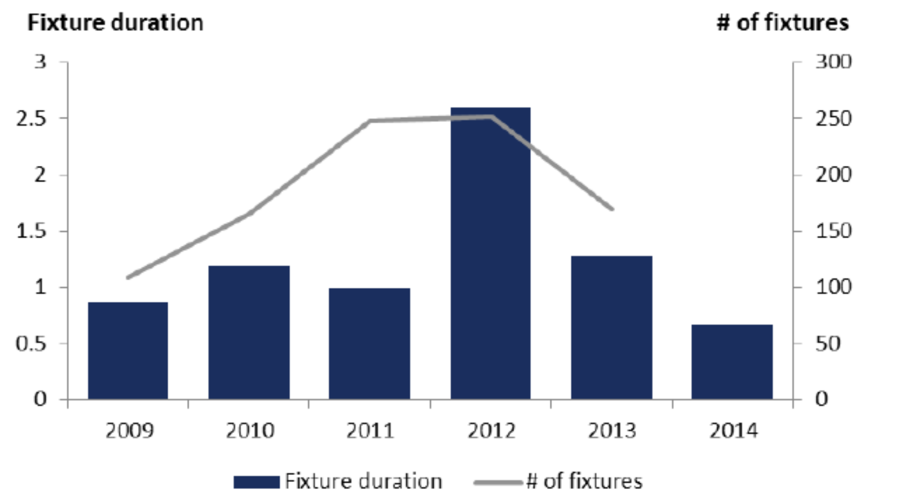
1.7% E&P spending growth budgets announced by the oil companies

Type	Company	Δ13e	Δ14e
Major	ExxonMobil	-1%	-3%
Major	ConocoPhillips	2%	4%
Major	BP	13%	5%
Major	Chevron	13%	5%
Major	Repsol	13%	7%
Major	Shell	19%	-8%
Major	Total	18%	-7%
NOC	Petrobras	20%	8%
NOC	Statoil	6%	5%
NOC	Ecopetrol	32%	11%
NOC	PTTEP	8%	11%
NOC	CNOOC Ltd	30%	16%
NOC	Pemex	7%	5%
Major	BG Group	8%	-5%
Ind	Apache	2%	-16%
Ind	Tullow Oil	-4%	22%
Ind	Lundin	83%	25%
Ind	Marathon	-4%	13%
Ind	Husky	2%	-5%
Ind	Hess	-17%	-14%
Ind	Noble Energy	8%	23%
Ind	Santos	7%	-13%
Ind	DONG	3%	11%
Ind	BHP Billiton	-14%	-2%
Ind	Galp Energia	26%	65%
Ind	Anadarko	13%	8%
Onshore	Forest Oil	-48%	-6%
Onshore	Rosetta Resources	4%	43%
Onshore	Newfield	0%	0%
Onshore	Nexen	32%	-9%
Onshore	Kodiak Oil & Gas	26%	-8%
Onshore	Cimarex	0%	13%
Onshore	CNR	9%	16%
Onshore	EnCana	-9%	-27%
Onshore	Suncor	-19%	18%
Onshore	Continental Resources	20%	13%
Onshore	Sandridge	-33%	2%
Onshore	Chesapeake	6%	-22%
Onshore	Southwestern Energy	18%	2%
Total Onshore		**1%**	**0.9%**
Total NOCS, Majors & Indies		**10%**	**1.7%**
Total		**8.9 %**	**1.7%**

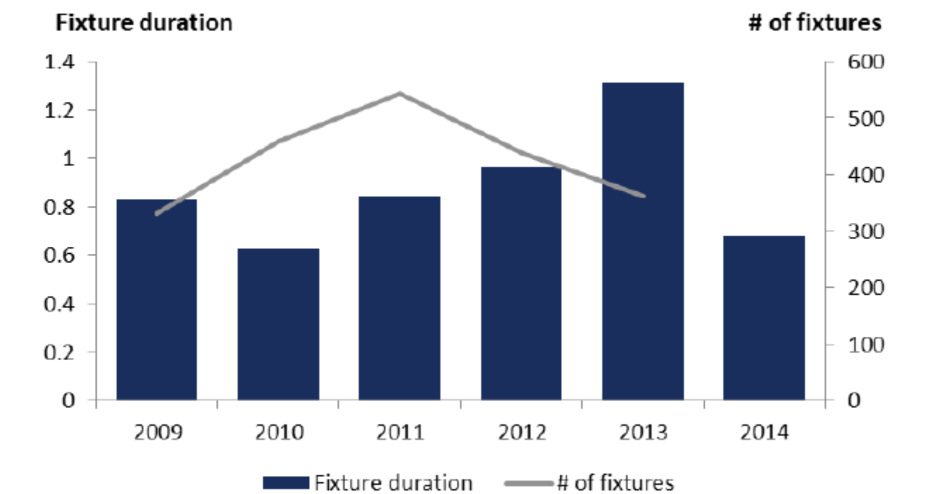
Source: Pareto Research; Company Data

Strength of rig market is the leading indicator for the OSV market – Jackups are OK but Floaters are weakening

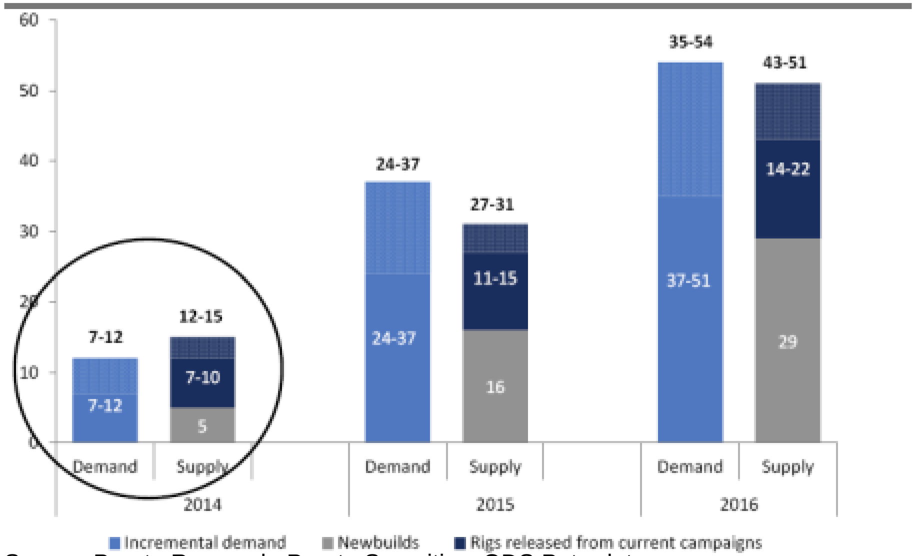
Floaters activity slowing down



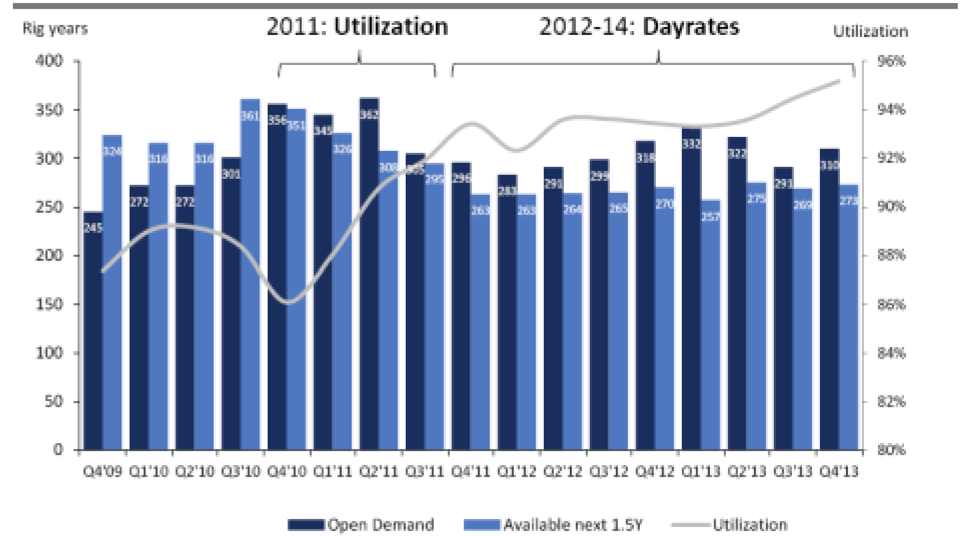
Jackups still fairly strong



Incremental UDW supply/demand



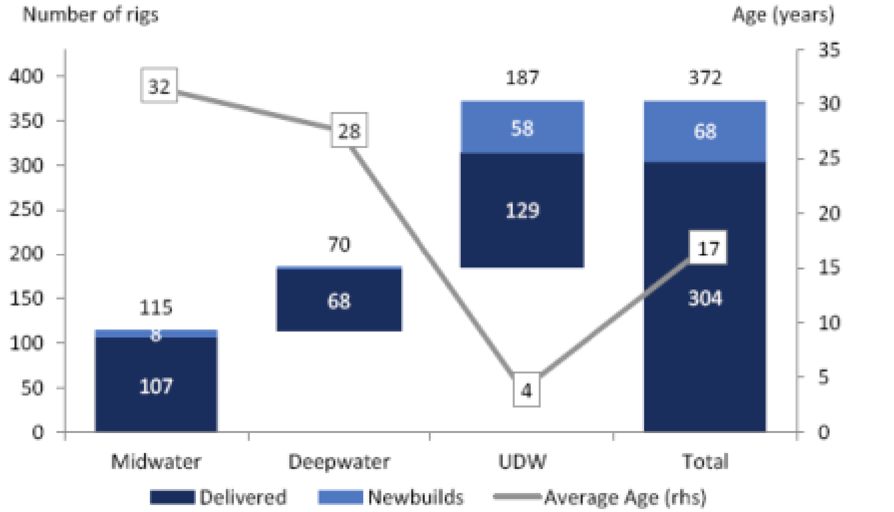
Jackup supply/demand momentum to continue



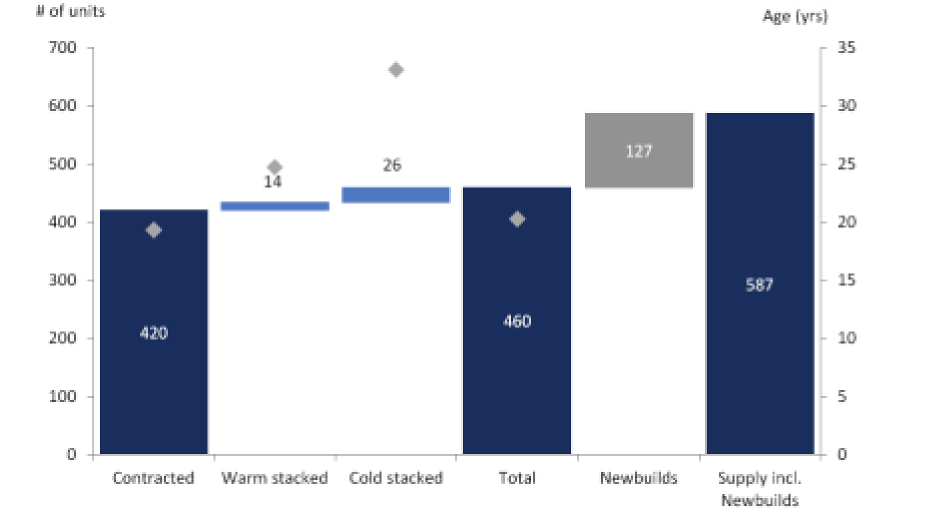
Source: Pareto Research, Pareto Securities, ODS Petrodata

Good news: rig fleet still growing both in the short-term to mid-term

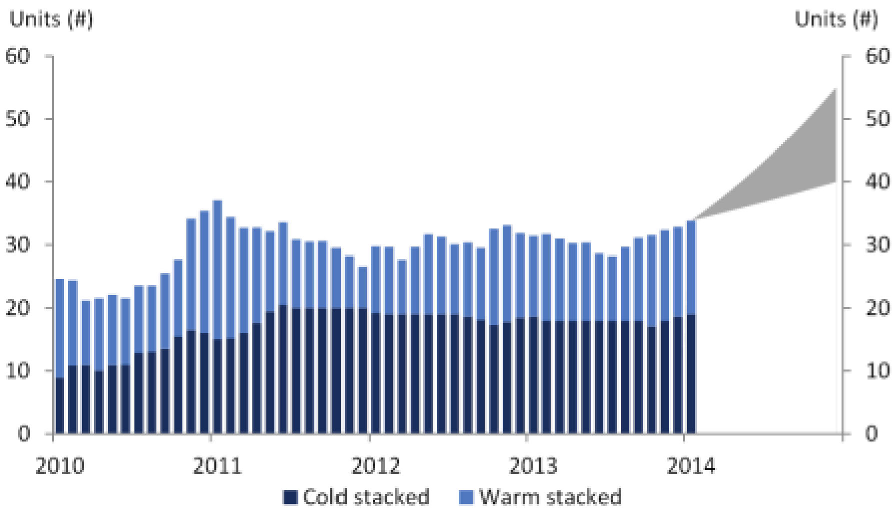
Floaters fleet profile – 22% orderbook



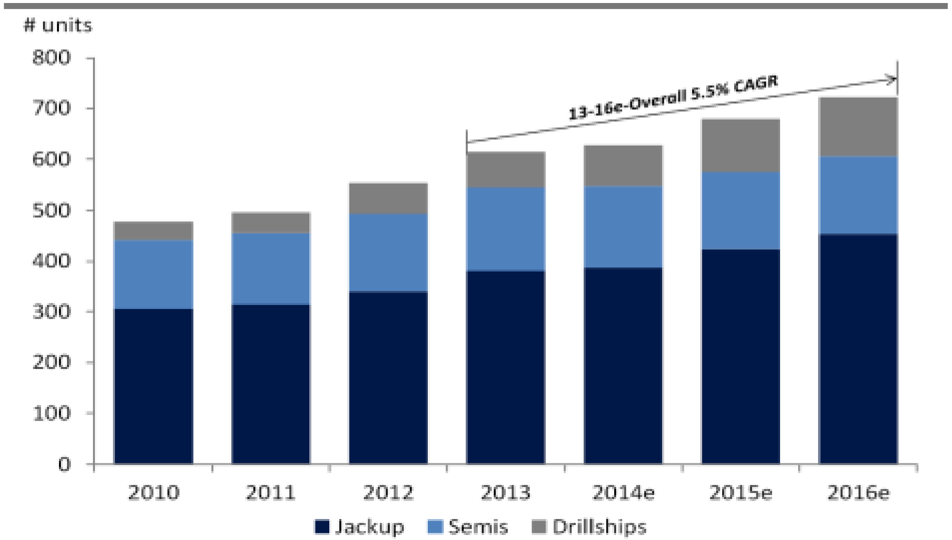
Jackup fleet profile – 28% orderbook



Cold and warm stacked floaters monthly



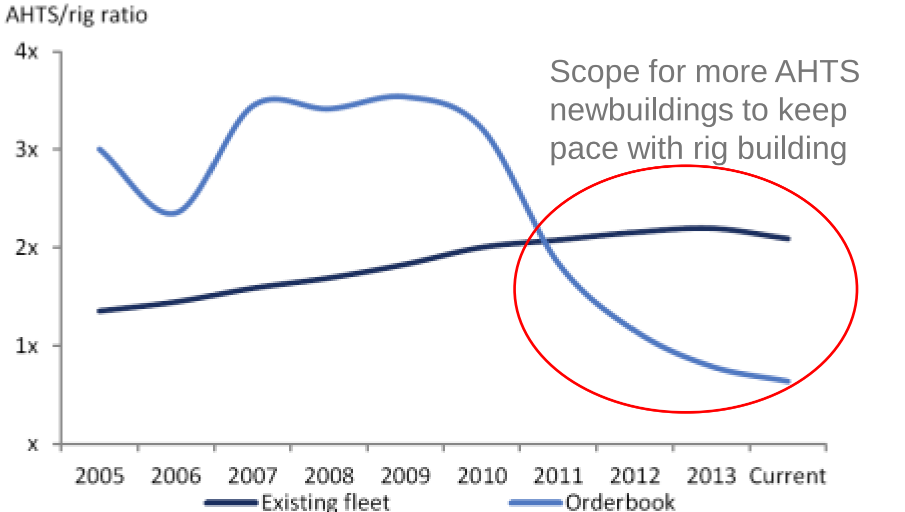
Fleet development working offshore drilling rigs



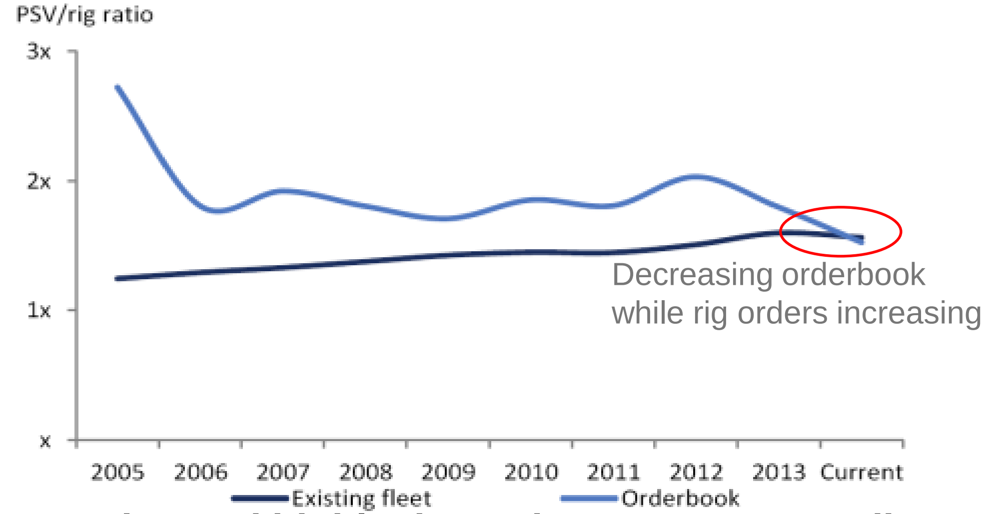
Source: Pareto Research, ODS Petrodata, rig count is net of Pareto estimate of stacking/decommissioning

OSV newbuildings – whilst "in-sync" and well-balanced – are falling behind rig construction

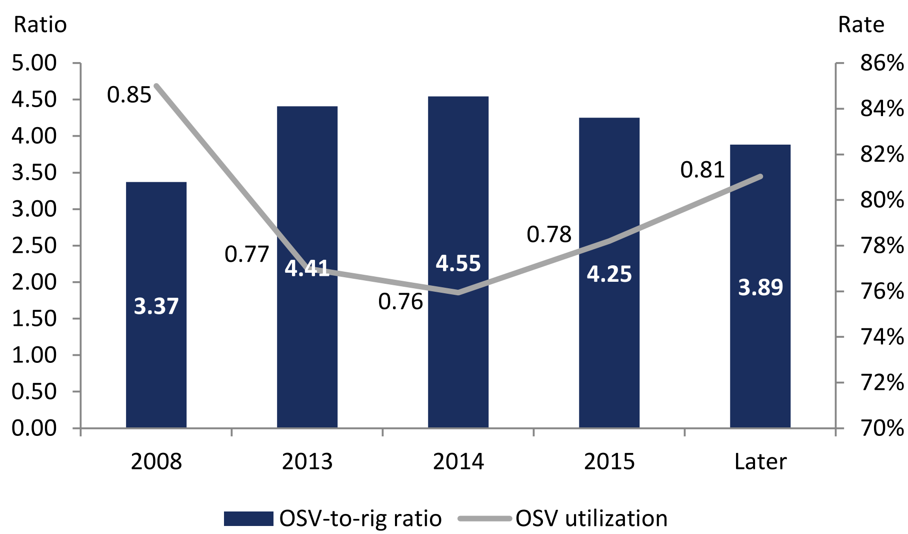
AHTS/rig ratio



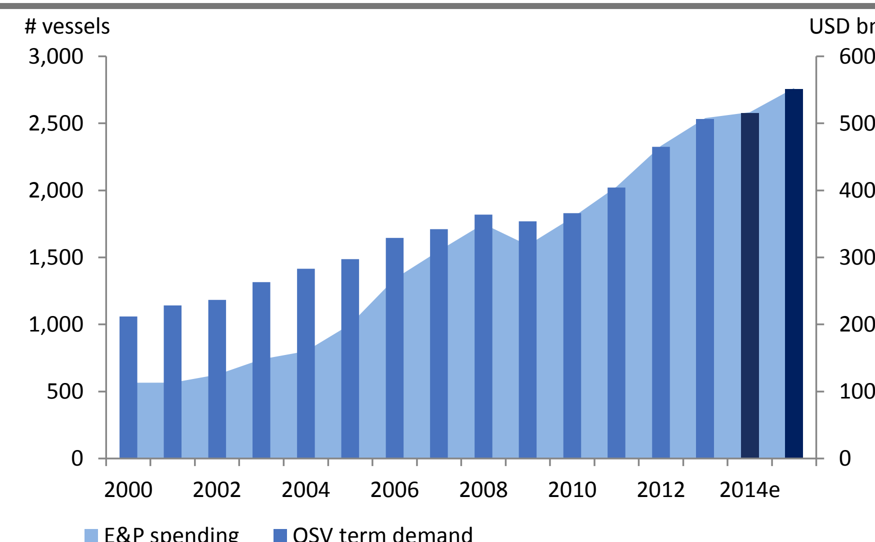
PSV/rig ratio



OSV-to-rig ratio to fall below 4.0x after 2015e



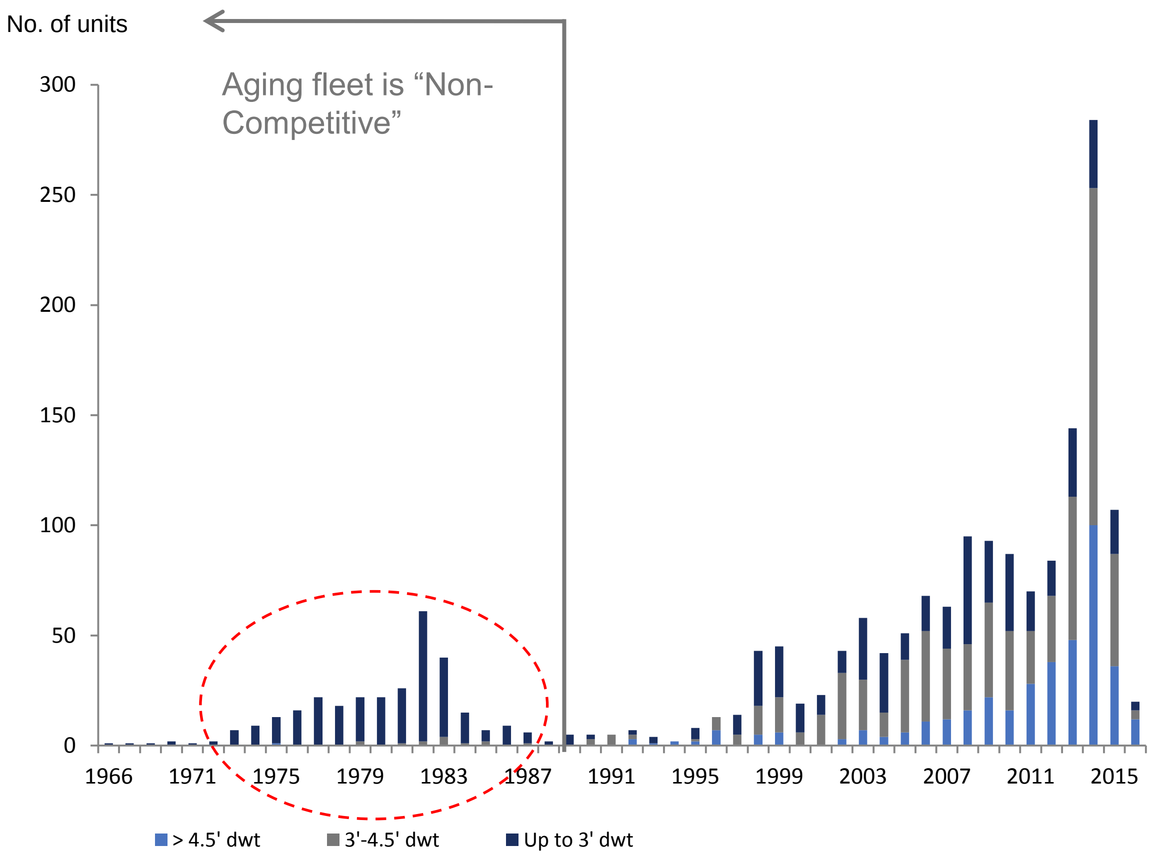
OSV demand highly dependent on E&P spending



Source: Pareto Research, Pareto Securities, ODS Petrodata

Substantial PSVs orderbook is driven by deepwater demand – which is starting to look shaky

Global PSV fleet profile

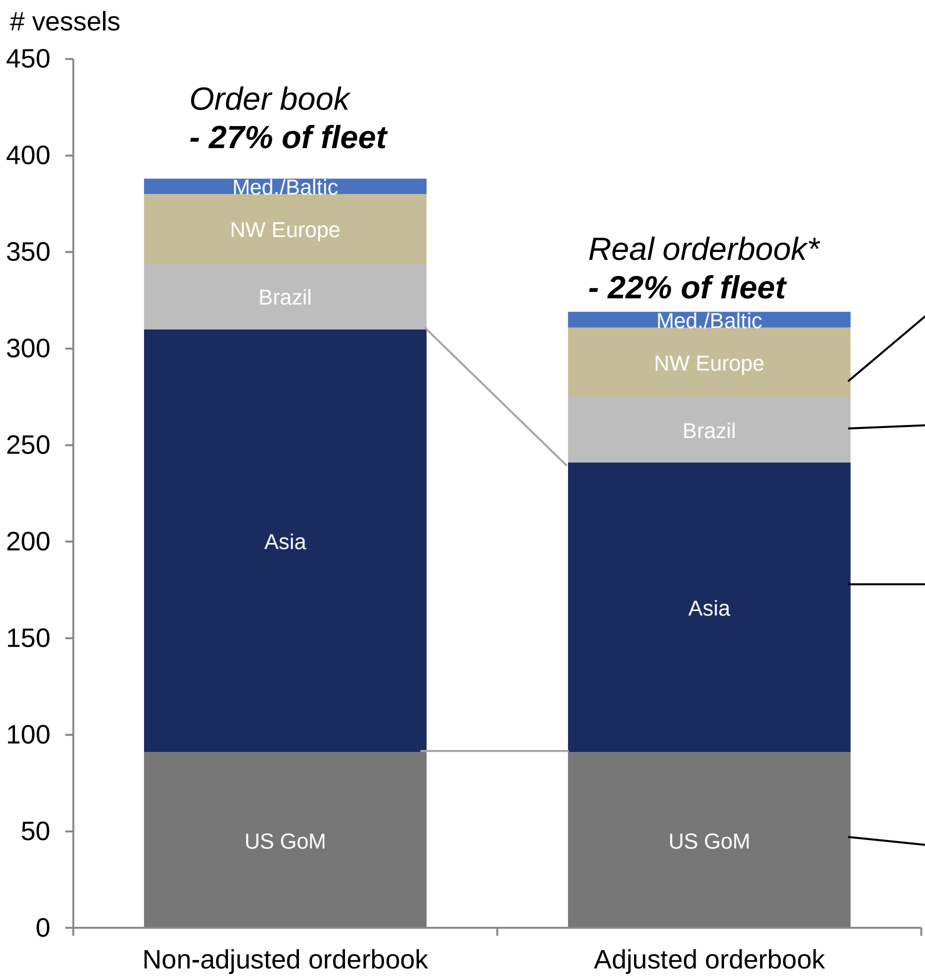


- Fleet profile: 1,417 PSVs in current fleet, with 388 (27%) on order of which 261 units are scheduled for delivery by end 2014 (likely slippage of 40% into 2015)
- Newbuildings are evenly spread between large and mid-size tonnage, with majority of new orders over past 12 months in the mid-size segment
- 307 PSVs (22% of current fleet) older than 25 years are "non-competitive"
  - Predominantly small PSVs (294) with limited demand as oil companies have upgraded their size and capability requirements
  - Lower replacement requirement for these vessels. No PSV has left the market over the past six months

Source: Pareto Securities, ODS Petrodata

High PSV orderbook, but slippage affects actual deliveries

Current orderbook



NW Europe: Limited orderbook currently close to 8 year low

Local vessels - cost and local content benefits: Vessels will operate in Brazil – delay potential

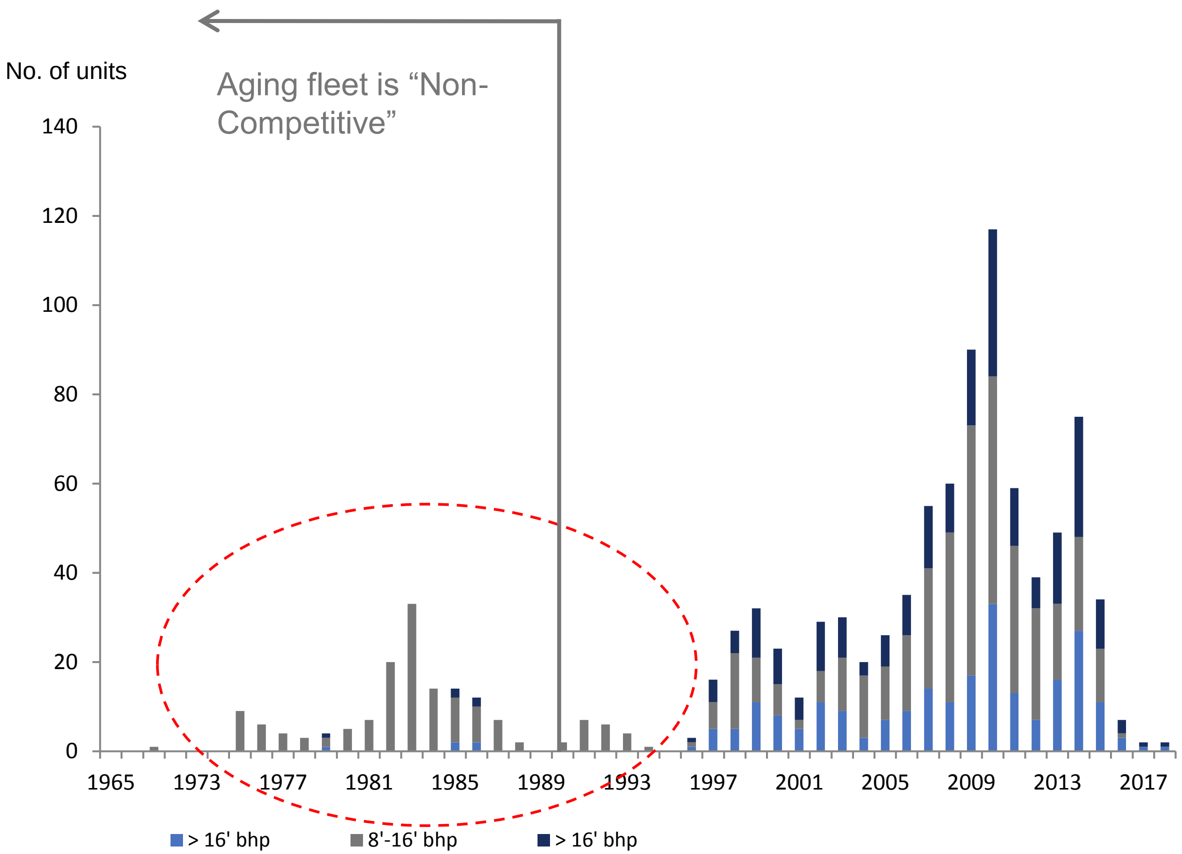
Some Asian yards unable to deliver on time, but still main source of supply

«Closed market», high relative orderbook, newbuilds replacing older tonnage

Source: Pareto Research; *Inexperienced yards, significantly delayed, financing issues

Modest AHTS orderbook merely equals replacement requirement despite strong demand – there are real opportunities in this sector

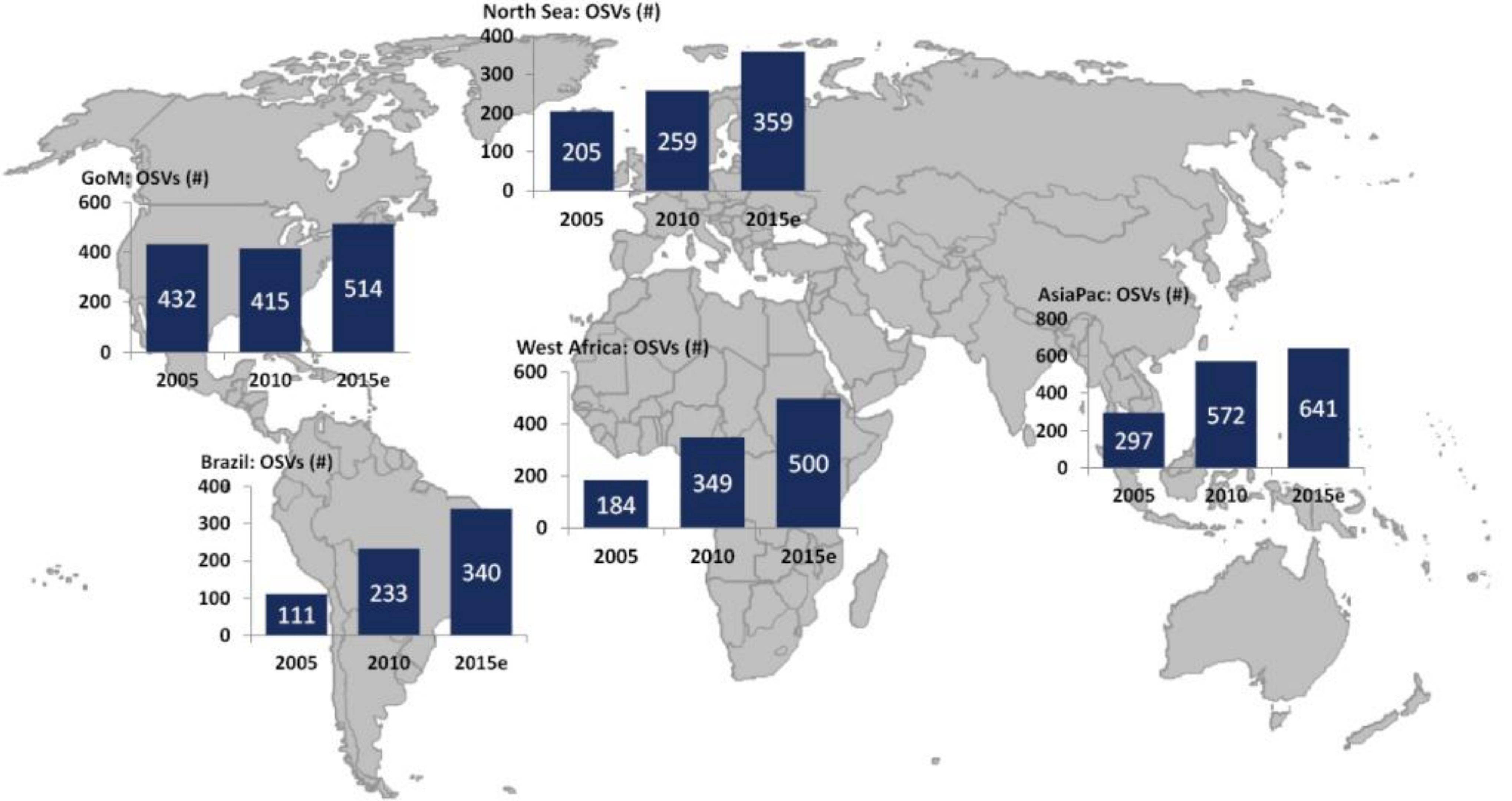
Global AHT/AHTS fleet profile



- Fleet profile: 2,022 AHT/AHTS in current fleet, with 165 (8%) on order of which 118 units are scheduled for delivery by end 2014
- 543 AHTS (28% of current fleet) older than 25 years are mainly “non-competitive”
  - Mostly 412 small AHTS (29% of small-size fleet) and 131 mid-size AHTS (24% of mid-size fleet) which still experience healthy demand for production work in shallow waters
  - The “non-competitive” fleet has decreased over the past six months – 14 vessels left the market

Source: Pareto Securities, ODS Petrodata

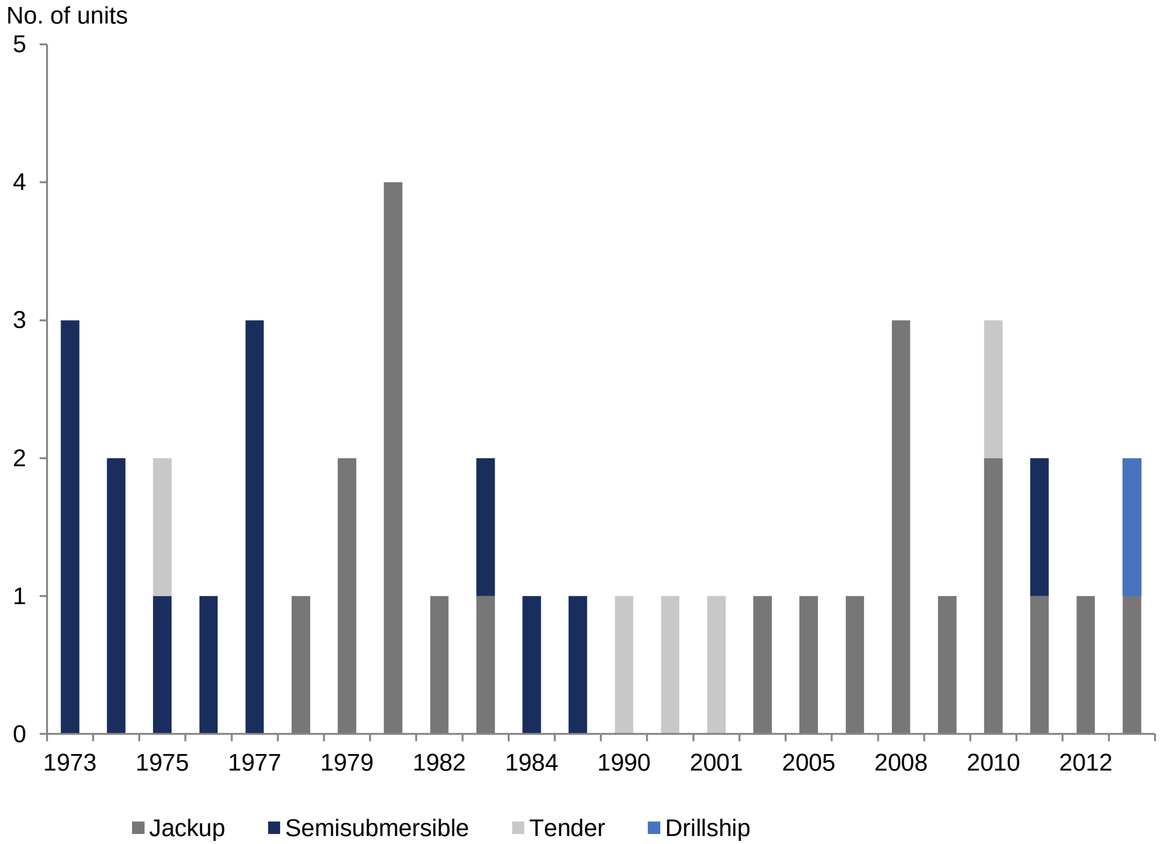
North Sea, Brazil and GoM largest OSV regions; West Africa and Mexico are emerging as key growth regions



Source: Pareto Securities, ODS Petrodata

Drilling activity in Malaysia focus on shallow and mid water markets

Rigs existing fleet profile in Malaysia

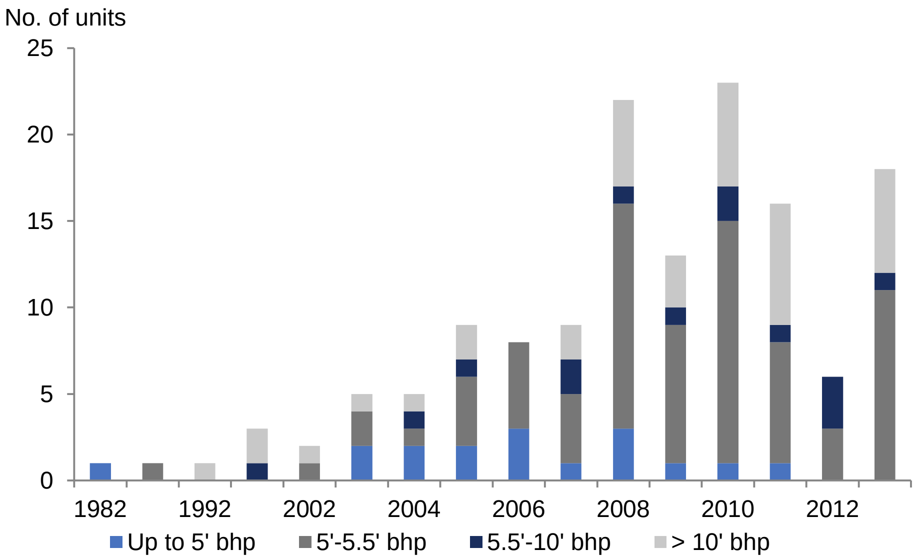


- There are currently 41 rigs in Malaysia, of which 21 units (51%) are Jackups (shallow-water market) and 14 units (34%) are Semis (mid-water market)
- The Jackups are primarily old units, probably MOPUs supporting marginal fields
- An additional 7 firm newbuilds (5 Jackups and 2 Tenders) are ear-marked for the Malaysian market over the next three years

Source: Pareto Securities, ODS Petrodata

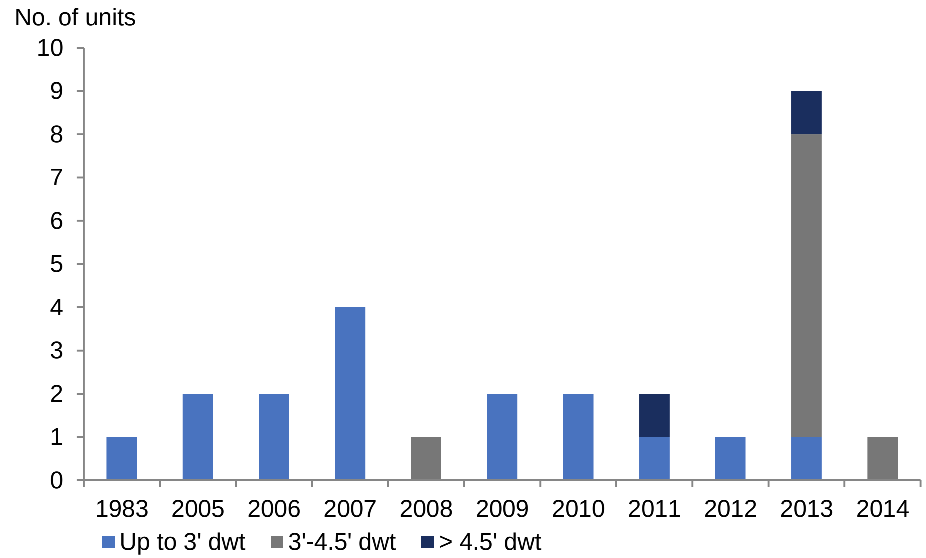
A closer look at OSVs in Malaysia

Malaysia AHT/AHTS existing fleet profile



- 142 existing AHT/AHTS with a young fleet profile – only 2 (1%) are old and above 25 years old
- The fleet is dominated by 74 small standard AHTS between 5,000 to 5,500bhp (52%)
- This represent a AHT/AHTS-to-Rig ratio of 3.5x, higher than the global average of 2.6x
- AHTS utilisation in Malaysia is 80%, 6% above the global average

Malaysia PSV existing fleet profile

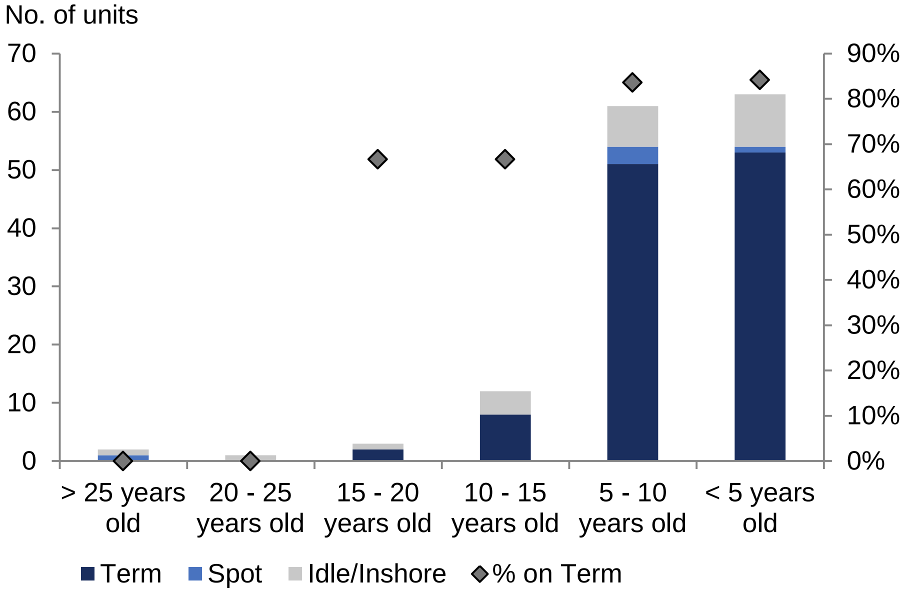


- 27 existing PSV with an evenly spread fleet profile; only 1 (4%) is old and above 25 years old
- The fleet is dominated by 16 small PSV (59%)
- This represent a PSV-to-Rig ratio of 0.7x, lower than the global average of 1.8x, reflective of the shallow waters' drilling activity
- PSV utilisation in Malaysia is 85%, 5% above the global average

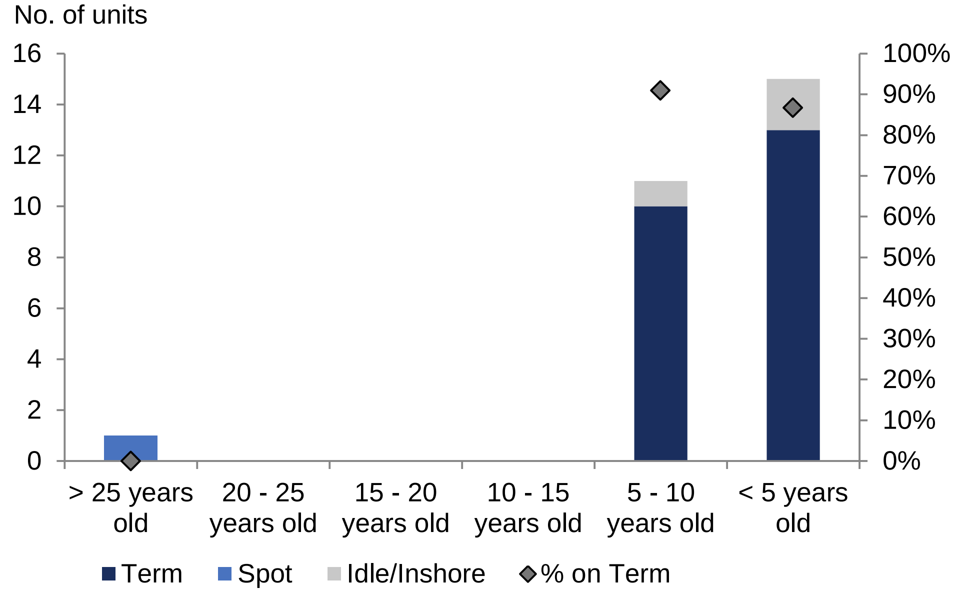
Source: Pareto Securities, ODS Petrodata

Chartering dynamics of OSVs in Malaysia

Malaysia AHT/AHTS utilisation by age group



Malaysia PSV utilisation by age group

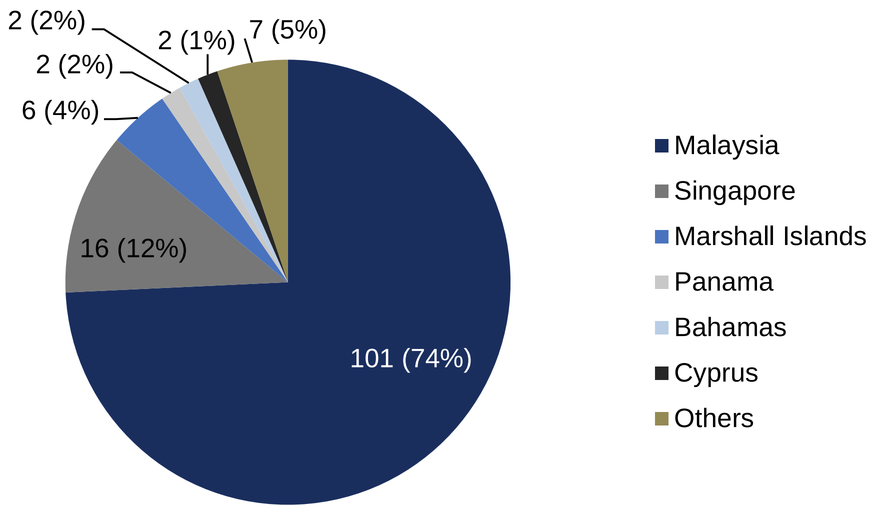


- Younger vessels have significantly higher term utilisation than the older vessels
- Vessels above 25 years old are mainly on spot, and are expected to leave the market in the near future
- Worryingly, a significant portion of the idle tonnage are young vessels – an indication that owners may have over-built in recent years
- Major term charterers include Petronas Carigali (which account for approximately half of all term charters), Shell, Hess, Murphy, Talisman and ExxonMobil
- Major operators in Malaysia include Alam Maritim, Jasa Merin, Icon Offshore, Ezra and Bumi Armada

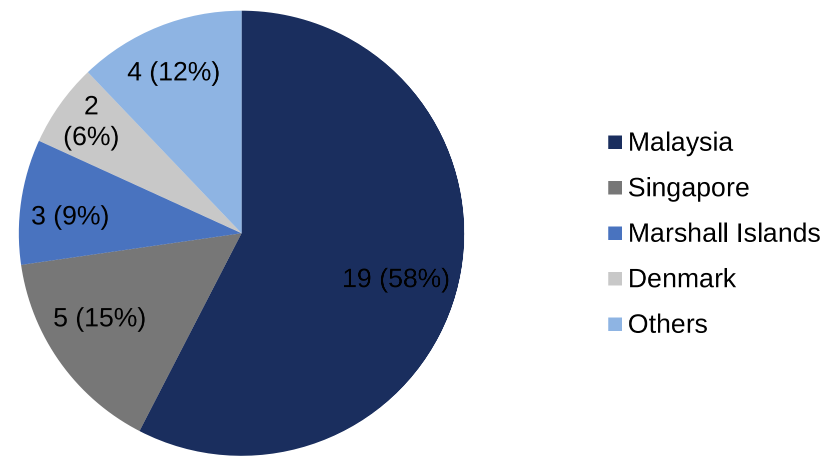
Source: Pareto Securities, ODS Petrodata

How “effective” has cabotage been in Malaysia?

Flags of vessels operating term in Malaysia



Flags of vessels operating spot in Malaysia



- Of the 169 existing OSVs located in Malaysia, 120 vessels (71%) currently fly the Malaysian flag
- Other popular flags include Singapore with 16 vessels (12%) and Marshall Island with 9 vessels (5%)
- As an evidence of cabotage, 74% (101 vessels) of vessels operating on term contracts are Malaysian-flagged as compared to vessels operating spot where only 58% (19 vessels) are Malaysian-flagged
- Cabotage is practiced stronger in the AHTS market, where 74% of the AHTS (105 vessels) are Malaysian-flagged while 56% of the PSV (15 vessels) are Malaysian-flagged
- 46 Malaysian-flagged OSVs are not operating in Malaysia – these are mainly owned by Malaysian owners such as Bumi Armada, Petra Petroleum, Nam Cheong and Yinson Holdings

Source: Pareto Securities, ODS Petrodata

The Oil Services market will be resilient in the short term, but the macro story is starting to become challenging

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	Yard capacity increasing & more efficient	–	While blue water yards have been securing new offshore orders subsidised by the Chinese government; the newbuilding supply situation have not been as bad as feared – the orderbook has not changed materially and orders are muted.
	Secondhand market pressure	–	Newbuilding prices have put pressure on secondhand values and transactions.
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	Cabotage advantages	+	Cabotage regulations in certain markets allows owners to enjoy premium rates – but all markets go to excess, we already see this in Malaysia.
	Opex inflationary pressures easing	+	Costs are stabilising after doubling over the past five years (caused by shortage in qualified DP mariners). Some owners are benefiting from the stronger USD.
	Financing challenges remain	+	Alternative financing (bonds / SNL) increasingly popular; and we expect companies to be more discerning in the deploy of most capital.
	Active shallow water activity	+	80% of offshore oilfields to be developed are in shallow waters; a shortage of near-term oil leads to increased focus on production from marginal fields.
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	Subsea & IMR activity	+	OSV demand for pipe laying, decommissioning, subsea, seabed mining activity all at an all-time high. New frontier activity requires more advanced vessels.
	Demand from offshore gas projects	+	Healthy demand for small to mid-sized AHTS and PSV, for extraction, processing and transportation of offshore gas projects.
	Technical obsolescence	+	Aging vessels: 28% of AHTSs and 22% of PSVs above 25 years but are all small sizes. The difference in utilisation between new and old vessels remains at 35%.

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