

## **The Rising Deepwater Opportunity**

### **Why are you optimistic about the deepwater investment opportunity?**

**Deborah Byers, EY:**

I am optimistic about deepwater and offshore in general for two reasons. One is just a technical reason that we need to open up new horizons, because even if demand is flat, we have to continue to make investments to meet demand on a global basis. Secondly, cost curves have come down tremendously in the deepwater operations.

Some of this is transferring technologies and methodologies that the companies have learned from offshore operations, but some of it is just being leaner and meaner. So, one of the things that happens when you have low oil prices [is that] suddenly you realize you need to be more efficient. So, you're looking at taking cost out of both your operations and how you finance things, as well as your supply chain. All of that discipline is finally coming to fruition and is going to be moving into the deepwater operations.

### **What led to the current overcapacity in the deepwater sector?**

**Byers:** People rushed in, they saw that there was a new generation of rigs that were needed, a new entrance came in, and what was unusual was they built rigs on spec. And suddenly you had massive, million-dollar shipbuilding programs, which created this overcapacity that we see today.

### **How have private equity investors regarded deepwater in recent years?**

**Byers:** The Darling, as everybody knows, has been the unconventional. So, with deepwater, the traditional wisdom is [that] you need 80-dollar-plus oil to make deepwater work. You have these next-generation rigs, which are not cheap—half-a-billion dollars is an entry point. So, it is a huge barrier both for the capital intensity, the debt on the balance sheet and, again, there was better investment that's been realized certainly in the Permian, for example, that's been where everyone is rushed. So, it has not been a focus.

### **Do you disagree with the conventional wisdom on deepwater breakeven economics?**

**Byers:** Absolutely. This is why we're looking at deepwater as a potential area for investment. Both because there will be a rationalization in space and, secondly, because costs have come down. I think several of the big operators are touting that deepwater—they can operate competitively, potentially targeting that \$30 to \$40 sweet spot. That's the cost, so everyone is looking at cost takeout and transferring some of the efficiency gains they've seen onshore to offshore. And that starts to change the game. So, if you're focused on being able to operate in deepwater—whether it's Brazil or the U.S. Gulf of Mexico—it starts to become very attractive.

### **Why do you expect consolidation in the space?**

**Byers:** If you look at the natural cycles of M&A, when you have overcapacity, and they start to fix their balance sheet because they need to be more cost competitive, the natural next step is consolidation. That allows excess capacity to come out of the market. Frankly, you've seen some bankruptcies happening now with the large deepwater players with recent filings. That, in itself, will take capacity out of the market. But, I think we've got probably another year before that occurs.

Then, that sets up the stage for strategic consolidation. Following that is where I think there'll be two areas where private equity can find a niche to play and potentially look at pretty good returns starting in 2018, 2020.

### **Do you expect corporate divestments to lead to private equity deal opportunities?**

**Byers:** All the service is cutting back on some of their research groups, certain areas of their service arms that they have cut back on. Those are the areas that I think—whether it's logistics, supply and research, and development areas—are going to get cut, along with some asset divestitures, that will give private equity an opportunity to position for when the deepwater does come back. Eventually, it will have to come back.

### **Beyond the Gulf of Mexico, how is offshore Brazil looking as a deepwater play?**

**Byers:** I'm going to say something surprising, which is that I think they're equivalent at this point. Other than the fiscal regime, as well as the potential geopolitical uncertainties surrounding Brazil—if you set that aside, in terms of the economics and attractiveness of those basins, I think they could be equivalent to the right operator.