Going on Offense in the Oil & Gas Industry

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There is no question that the current oil and gas market environment has wreaked havoc upon the companies that provide products and services to the industry, particularly in the upstream sector. This is especially true in the middle market, where businesses tend to be more thinly capitalized and have fewer capital markets options to which they can turn for liquidity.

From 2011 through 2014, the rapid acceleration of drilling and completion activity made accurate evaluation of the enterprise values of many service and equipment companies difficult. This was especially true of many newly-founded businesses that had not demonstrated perseverance through previous cycles. These pricing inefficiencies resulted in a period of robust merger and acquisition activity during which a number of buyers clearly overpaid for targets.

Fast-forward two years and the risk of overvaluing a company is clearly much more limited. Oil prices have stabilized in a range that reflects what most management teams consider to be the new normal, at least until some catalyst emerges to change the outlook. Those that have found a way to remain profitable in this environment, however, are in many cases now positioned to consolidate market share through both organic expansion (at the expense of less-fortunate businesses) and the acquisition of companies from owners seeking to be part of a larger, more stable platform. Transaction activity related to such efforts represents a growing bright spot within the industry.

While investment groups continue to raise billions of dollars to pursue acquisitions and financings within the industry, sound actionable opportunities have thus far been relatively scarce. This confluence of interest and market timing created favorable circumstances for GulfStar Group client Gibson Applied Technology & Engineering, Inc. (GATE), a provider of consulting and engineering services to major oil and gas companies operating in the deepwater offshore segment.

GATE management had worked extensively to establish an acquisition program to grow and diversify its business. Rather than react to the market downturn by delaying these plans, the company viewed it as an opportunity to deal from a position of strength.

Several factors contributed to GATE's ability to leverage the current industry environment.

- GATE participates in all stages of development for new deepwater oil and gas fields, with the life cycle of its projects often spanning more than a decade and thus providing the company with substantial revenue visibility. Its services include everything from well site planning and materials selection at the very front end of a project to commissioning and inspection of subsea systems, process facilities and other major systems, ongoing regulatory compliance and ultimately asset decommissioning.
- Previous consolidation within the industry by global firms such as Wood Group, Worley Parsons and AMEC Foster Wheeler, left a market bifurcated between a handful of multi-billion dollar companies and a universe of smaller private specialty firms. GATE was among the larger of the remaining independents, with the scale to support an acquisition program and a balance sheet minimally encumbered by debt.
- As the commodity price environment began to deteriorate in late 2014, it became apparent that GATE would have an opportunity to potentially acquire certain target companies at increasingly attractive valuations while getting a real-time stress test of how they would perform in a difficult environment.

Management worked for more than a year to develop a consolidation strategy to take advantage of this opportunity and approached GulfStar to help arrange the necessary capital. GulfStar marketed the opportunity to a broad range of capital

provider types, including traditional banks, non-bank private lending funds, business development companies, and private equity groups. Many passed based on industry uncertainty or concern over the health of existing portfolio companies. However, those willing to more fully consider the thesis agreed that GATE represented a compelling opportunity.

The road to closing was not easy. The pace of pre-term sheet due diligence and negotiation was unusually deliberate as capital providers monitored the company's monthly performance and performed deep market research on the development plans of its major customers. Regardless, the philosophy was one that resonated: great companies finds ways to turn difficult situations and conditions to their advantage.

Private lending funds ultimately proved to be the best fit. Traditional senior lenders were under both internal portfolio management and external regulatory pressures to trim oil and gas exposure of any kind. Business development companies were likewise strongly discouraged by the equity research community to take on new energy exposure and generally faced difficulties deploying capital, as many were trading below their net asset values. A more positive consideration was that GATE's low existing leverage and the favorable terms it negotiated with potential sellers meant that the planned acquisition program could almost certainly be fully financed with debt, avoiding the need to dilute management's equity.

In April 2016, the company closed on a $45 million acquisition line with Morgan Stanley Credit Partners, a part of Morgan Stanley Investment Management. GATE initially drew funds at closing to consolidate existing debt and retire previously issued seller notes. It subsequently closed its first acquisition in August, a company that provides optimization solutions related to the maintenance, integrity and remediation of oil and gas infrastructure. This represented a new line of business for GATE.

With a supportive financial partner and lengthy roster of candidates, GATE is now poised to go on offense building a larger, better-diversified company. Since this closing, GulfStar has been approached by a number of management teams seeking to launch similar strategies. While most are generating revenue and profitability that are substantially less than were seen at the market peak, they have stopped the bleeding, accepted the reality of current market conditions and started looking for ways to aggressively position their businesses to prosper in the long-term. All that capital allocated to pursue opportunities within the battered oil and gas industry may finally find a home after all.