Churchill said it best: “When you’re going through hell, keep going.” History is full of people and businesses who didn’t let a setback keep them down. The trick to getting back on track faster is not to waste valuable time thinking about the setback and instead concentrate on your next steps.

The recent plunge in crude oil prices sent oilfield service companies and manufacturers who serve the industry reeling. With falling company and asset values, along with declining revenue levels, this most recent contraction has led to a new reality for these companies. Experts are predicting that sector participants should brace for a long term correction lasting anywhere from another 12 months to two years, barring an unexpected geopolitical event resulting in a surge in demand for U.S. crude oil exports.

During periods of industry instability, companies like yours face an increased likelihood of lenders being more restrictive, financial pressures which could trigger the termination of key contracts with suppliers or master service agreements with customers, and personal financial pressures on the management team and employees. Then pile on the pressure from outside sources including vendors, lenders, investors and other existing stakeholders, and you have a real pressure-cooker. As a result, executive teams often have to quickly make high-stakes decisions regarding the future direction of their business to maximize value and protect their business. Time for a little resiliency and humility, and a lot of strategy.

**Step 1: Rightsize the Business**

Oilfield service companies need to work with their customers to identify which will continue to be active and what their future activity levels will be. They then need to be proactive in readjusting their expenses and capital structure for any projected activity decline.

With the recent surge in E&P, oilfield service companies and their manufacturers raced to purchase rigs, hydraulic fracturing units and other assets, expanded their product offering into non-core businesses and hired a large number of employees. Companies vied for talent and expanded their service offering as salaries skyrocketed and day rates increased to record levels. With a focus on top line growth instead of cost containment,

Going forward, companies must reassess their required headcount, and more importantly, their equipment needs, to meet changing customer requirements.

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efficiency to offset the effects of the lower price of crude oil, and rightsizing the equipment fleet to the overall new cash flow of the business. For most oilfield related businesses, this will mark a return to core divisions and disposing of non-core, non-performing and under-performing assets or business units through sales or liquidations. For others, the best decision may be to consolidate facilities or business lines, or exit the business or industry entirely.

Owners and managers of financially challenged business have options; but they need to act expeditiously in order to preserve their options and maintain control over their future.

Any cash-generating activities should be considered, such as the sale of equipment or inventory, or the return of unutilized equipment under lease.

Businesses with stronger balance sheets will have the greatest amount of options available to them. Owners and managers of financially challenged business also have options; but they need to act expeditiously in order to preserve their options and maintain control over their future.

Step 2: Understanding and Analyzing Available Options

There are many strategic alternatives available to those facing financial challenges. These include refinancing with their existing lender, recapitalizing their balance sheet by raising additional equity, restructuring, selling the business, or liquidating some or all of the business assets. Business leaders often combine these options to maximize results. These strategies may be used to restructure the company without the use of Chapter 11, if the hard decisions are made early enough in the process.

The current environment has led oil and gas sector lenders to restructure outstanding loans with borrowers, reduce the size of existing credit lines, require additional collateral, and tighten underwriting policies on new loans or lines of credit. Some lenders— who did not have a long history of lending to oil and gas companies— have proven unwilling or unable to ride out this cycle with borrowers. This demonstrates the importance of doing business with capital providers who understand the energy business.

Borrowers, on the other hand, are dealing with asset impairments due to lower crude prices and cash shortfalls. The result: they become out of compliance with loan covenants. With the recent growth in the industry, many of these companies had taken on additional debt to meet demand that has since declined, but the debt payments remain. Companies should manage liquidity issues proactively to ensure that they have adequate cash on hand, and implement cost reductions as well as moratoriums on all debt repayments since lenders will not cover shortfalls.

It is important for companies to maintain frequent communication with their lenders and vendors during times of industry volatility. Often lenders and other stakeholders will require borrowers to provide a 13-week cash flow forecast, granting visibility into their financial condition. Lenders want to know that management teams have a plan in place to address changing industry and business dynamics and are not just taking a wait and see approach.

Companies also need to consider divesting business units which do not have adequate management or required capital to run the business.
profitably. These units should be considered the highest priority M&A opportunities, as their sale would allow resources to flow back to the core businesses of the company.

In addition, decisions must be made regarding supplier payments. When companies are cash constrained, a common first decision is to reduce or stop payments to vendors while keeping payments current to lenders. Often this is not in the best long-term interest of the company, as trying to negotiate with hundreds of vendors becomes a daunting task. Not paying vendors is not the solution to stave off a Chapter 11; it only lengthens the process and makes the restructuring more difficult. Therefore, any restructuring plan must address all creditors, including lenders and suppliers.

There is light at the end of the tunnel. Private equity will eventually return to the sector as valuations become more aligned with targeted returns. Strategic and financial buyers will be looking for bargains; it’s imperative that business owners understand the value of their business and any assets before entering into any due diligence discussions with potential buyers.

Conclusion

Each strategic path has its own nuances. It is crucial that companies engage financial advisors and investment bankers who have a deep understanding of industry issues and dynamics, and who have relationships with industry players that allow them to effectively market client transactions. Lenders and other stakeholders typically look favorably on the hiring of these advisors. These professionals know the buyers and lenders who are active in the market, know how to assess market pricing, and have experience negotiating with constituencies who have divergent priorities. It is important to choose an advisor who has experience providing access to alternative sources of creative capital.

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