

Vinson&Elkins

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PREPARING FOR AN IPO: MARKET UPDATE, PROCESS AND TIMELINE

Energy Series

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TODAY'S PANEL



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DISCUSSION TOPICS

Recent IPO Activity

IPO Timeline and Process Overview

Timeline of Typical IPO

Content of the Registration Statement

Reduced Disclosure for EGCs

Due Diligence

Testing the Waters

Roadshow

Restrictions on Communications During the IPO Process

Gun Jumping

Interaction with Research Analysts

Financial Statement Considerations

Overview of Financial Statement Requirements

Acquisition Financials

Internal Control Issues

Structuring Considerations

Primary vs. Secondary Sales

Up-C

Master Limited Partnership

Management Incentive Units

Governance Matters

Independence Requirements

Controlled Company

Corporate Governance Policies

Anti-Takeover Defences

SOX 402

Issues Specific to Upstream Issuers

RECENT IPO ACTIVITY

- Smart Sand Inc. – Closed 11/9; \$128.7 mm
- Extraction Oil & Gas, Inc. – Closed 10/17; \$633.3 mm
- Mammoth Energy Services Inc. – Closed 10/13; \$116.25 mm
- Noble Midstream Partners LP – Closed 9/20; \$281 mm
- Vantage Energy Inc. – Dual track IPO/M&A – Sold to Rice Energy for \$2.7 bn on 10/19
- Centennial Resource Development, Inc. – Dual track IPO/M&A – Sold to Silver Run Acquisition Corporation for \$1.35 bn on 10/11

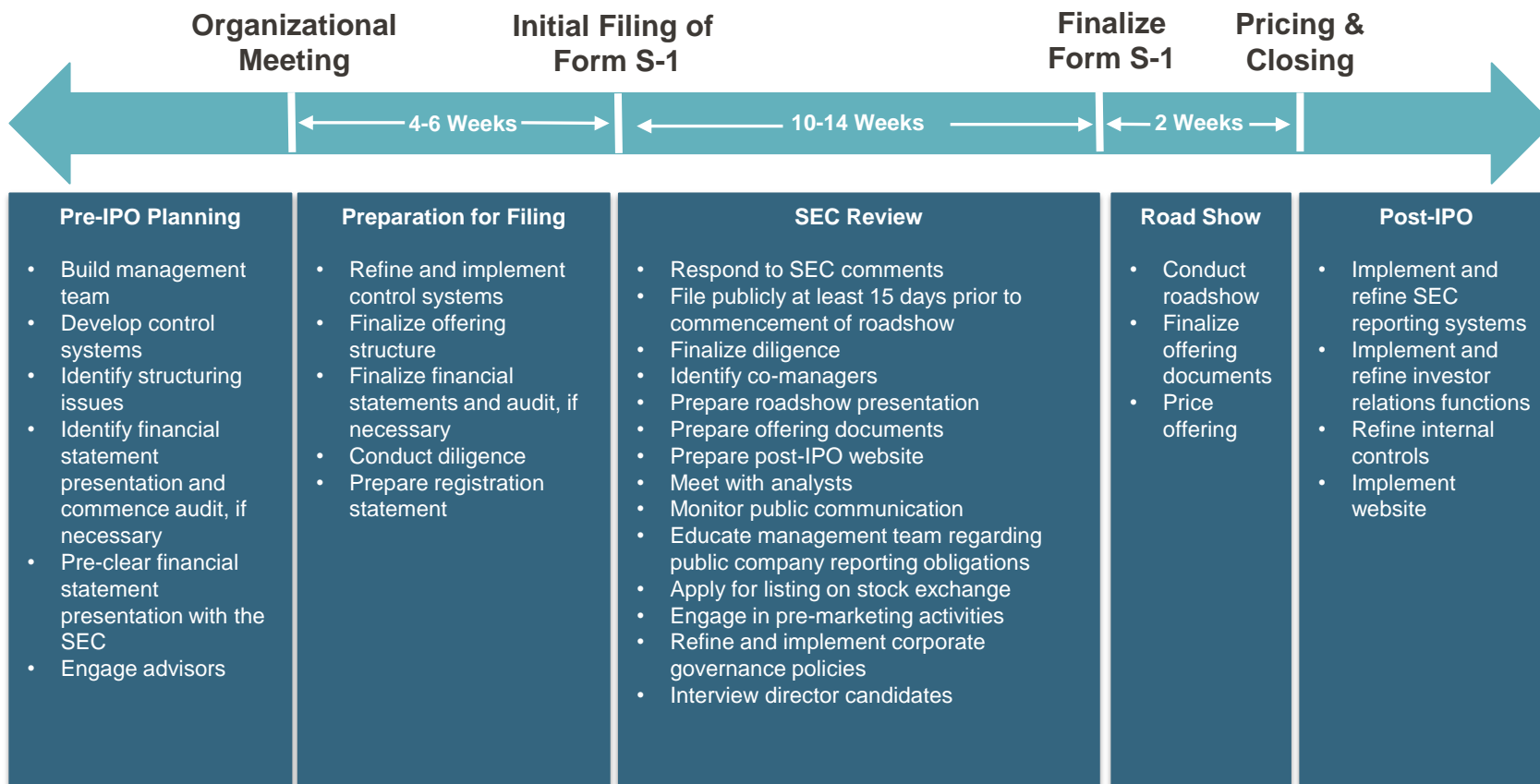




IPO TIMELINE AND PROCESS OVERVIEW

INDICATIVE IPO TIMELINE

OVERVIEW



REGISTRATION PROCESS

REGISTRATION STATEMENT

- The contents of a typical IPO prospectus are as follows:
 - Summary
 - Risk Factors
 - Use of Proceeds
 - Dividend Policy
 - Capitalization
 - Dilution
 - Forecast*
 - Selected Financial Data
 - MD&A
 - Business
 - Management
 - Executive Compensation
 - Corporate Governance
 - Related Person Transactions
 - Principal Stockholders
 - Description of Capital Stock
 - Underwriting
 - Legal Matters
 - Experts
 - Financial Statements

*MLP Only

REGISTRATION PROCESS

REDUCED DISCLOSURES FOR EGCs

- “Emerging Growth Company”:
- Less than \$1.0 billion of revenues during its most recently completed fiscal year.
- Remains an emerging growth company until the earliest of:
 - issuer has more than \$1.0 billion in revenues;
 - issuer public for at least a year and has at least a \$700 million float;
 - issuer has issued in any three year period more than \$1.0 billion in non-convertible debt securities; or
 - end of fiscal year following the fifth anniversary of the IPO

REGISTRATION PROCESS

BENEFITS OF EGC STATUS

- Confidential Submissions of Registration Statements
 - Must publicly file at least 15 days prior to launching roadshow
- Reduced Disclosure Requirements
- Increased Flexibility in Communications
 - “Testing the Waters”
- Relaxation of restriction on research analysts
- Phased-in Exemptions
 - Exemptions from Accounting Regulations
 - Exemptions from Dodd-Frank Act Corporate Governance/Disclosure Provisions

DILIGENCE

- Understand the purpose of the diligence process
 - Legal diligence
 - Registration Statement disclosure
 - Refining story for S-1 and roadshow
 - Research analyst model preparation
- Prepare staff for the time intensive diligence process
- Create virtual data room or use outside source

TESTING THE WATERS

- Emerging Growth Companies are permitted to engage in oral or written communication with qualified institutional buyers (QIBs) or institutional accredited investors (IAIs) before or after the filing of the registration statement to gauge investor interest in an offering.
- Potential Benefits
 - Ability to refine the marketing story
 - Ability to educate investors
 - Ability to address investor feedback
 - Ability to engage in price talk prior to publicly disclosing an IPO range
- Any testing the waters communications should be coordinated with underwriters
- The SEC routinely asks for copies of information used in such meetings
 - Limit content of presentation to information included or to be included in prospectus
- Testing the Waters—Rules of the Road
 - Meeting should be one-on-one
 - Written materials should not be left behind

ROADSHOW

- Once the working group is ready to launch the offering, the marketing of the offering begins
- Company executives and underwriters hit the road with the preliminary prospectus and a “road show” presentation to promote the offering, meeting with institutional investors in various cities
- A typical road show for an IPO lasts up to two weeks
- Lead underwriter takes indications of interest and builds “the book”
- At this stage, no shares can be officially sold, so any orders submitted are only indications of interest and are not legally binding until offering is priced



RESTRICTIONS ON COMMUNICATIONS DURING THE IPO PROCESS

GUN JUMPING

- What is Gun Jumping?
 - Refers to prohibited actions and communications that condition the market in advance of a public offering.
 - Includes advertising, public relations and investor relations efforts that may have the effect of promoting the sale of the securities.
 - Not only covers communications about the IPO but can also include information about the Company and its business and assets.
- What are the Consequences?
 - Potential rescission right for investors in the offering
 - SEC could impose a “cooling-off” period
 - Underwriters may be unwilling to proceed with the offering

GUN JUMPING

- Communications that Involve a High Degree of Risk
 - Any communication outside the organization or working group involving the offering or a potential offering
 - Granting an interview with a reporter
 - Appearing on talk shows or at industry conferences
 - Starting a new advertising campaign
 - Posting information, particularly forward looking information, on the Company's web site
 - Broad communications to employees about the offering who are not aware of the restrictions on communications

GUN JUMPING

Safe Harbors

- **Release or dissemination of regularly released, ordinary course, factual business information intended for use by persons other than in their capacity as investors or potential investors, such as customers and suppliers**
 - does not include forward-looking statements, projections, forecasts, or predictions and cannot reference the IPO
 - issuer must have previously released or disseminated this type of information in the ordinary course of business;
 - the timing, manner, and form in which the information is released or disseminated must be consistent in material respects with similar past releases or disseminations; and
 - the information must be released or disseminated to persons, such as customers and suppliers, other than in their capacity as investors or potential investors, by the issuer's employees and agents who historically have provided this information.
- **Communications that do not reference the IPO and are made more than 30 days prior to the initial public filing the registration statement with the SEC**
 - issuer must take reasonable care to prevent further distribution or publication of such communication during the 30 days prior to the filing or else the safe harbor will not apply

INTERACTIONS BETWEEN RESEARCH ANALYSTS AND ISSUERS

- Pre-solicitation period: communications permitted if consistent with published views
- Solicitation period: one-way dialogue to facilitate vetting and analyst due diligence
 - Banking team permitted to get vetting feedback from analyst but may not share analyst's views
- Post-mandate: open communications
 - Analyst may share views on company, model and valuation

FINANCIAL STATEMENT CONSIDERATIONS



FINANCIAL STATEMENT CONSIDERATIONS

FINANCIAL STATEMENTS, PRE-CLEARANCE PROCESS AND AUDITOR INDEPENDENCE

- Evaluate financial statement requirements:
 - Emerging growth companies may limit presentation to two years of audited financial statements
 - Historical and pro forma financial statements required for certain acquired businesses (producing oil and gas properties will be treated as a “business”)
 - Issuers required to present audited financial statements of any predecessor for the required periods, with no lapse
 - An acquired business may be viewed as a predecessor if issuer has insignificant operations prior to acquisition
 - Must provide full financial statements for predecessor (not eligible for revenues over direct operating expenses)
- EGCs only required to include in any filing the financial statements that would be required at the time of the pricing of the offering
- Consider submitting a letter to the SEC to “pre-clear” your financial statement presentation, if necessary
- Confirm independence of auditor

FINANCIAL STATEMENT CONSIDERATIONS

ACQUISITION FINANCIALS

- In addition to financial statements of the issuer, registration statements generally require inclusion of audited financial statements for a significant acquisition of a “business” that has taken place 75 days or more before the offering, or, in the case of the most material acquisitions, as soon as the acquisition becomes “probable.”
- What is a “business”?
 - The SEC defines the term “business” to include an operating entity or business unit, but excludes machinery and other assets that do not generate a distinct profit or loss stream.
 - The SEC considers the acquisition of working interests in oil and gas properties the acquisition of a “business”

FINANCIAL STATEMENT CONSIDERATIONS

ACQUISITION FINANCIALS

- How is significance determined?
 - Three tests
 - issuer's investment in the acquired business compared to the issuer's total assets (investment test);
 - acquired business assets compared to the issuer's total assets (asset test); and
 - the "pre-tax income" from continuing operations of the acquired business compared to the issuer's pre-tax income from continuing operations (income test);

in each case, based on a comparison between the issuer's and the target's most recent annual audited financial statements.

Acquisitions of "related" businesses (common control or common management) are treated as a single acquisition for purposes of the significance tests.

- Level of significance determines how many years of Acquiree audited financial statements are required to be presented

FINANCIAL STATEMENT CONSIDERATIONS

ACQUISITION FINANCIALS – UPSTREAM CONSIDERATIONS

- Working interests in oil and gas properties considered to be the acquisition of a “business”.
- If the property acquired represents substantially all of the selling entity’s key operating assets, will have to provide full financial statements of the entity.
- May provide revenues over direct operating expenses if:
 - acquired assets constitute only a portion of the assets of the seller;
 - full financial statements have not previously been prepared; and
 - the seller has not maintained the distinct and separate accounts necessary to present the full financial statements or full carve-out financial statements of the property.

FINANCIAL STATEMENT CONSIDERATIONS

ACQUISITION FINANCIALS – UPSTREAM CONSIDERATIONS

- The acquisition of undeveloped acreage with no associated production is not an acquisition of a “business” for purposes of Rule 3-05.
- SEC has permitted issuers to run the significance tests based on value attributable to producing properties when the undeveloped acreage composes the vast majority of the aggregate properties acquired.
- Acquisition of royalty interests/mineral interests may or may not be considered the acquisition of a business

FINANCIAL STATEMENT CONSIDERATIONS

INTERNAL CONTROLS

- Issuers required to have internal controls over financial reporting that are part of an internal control framework to prevent and/or detect material misstatements to the financial statements.
- Increased focus on internal controls during IPO
 - Disclosure during IPO
 - Known material weaknesses
 - Status of remediation (disclosed outside of risk factors)
- Once public, CEO and CFO will need to sign quarterly and annual certifications
- Management will be required annually to assess the effectiveness of internal controls (starting with 2nd 10-K)
- Auditors will be required annually to provide a report on the effectiveness of internal controls
 - Exemption for EGCs

STRUCTURING CONSIDERATIONS



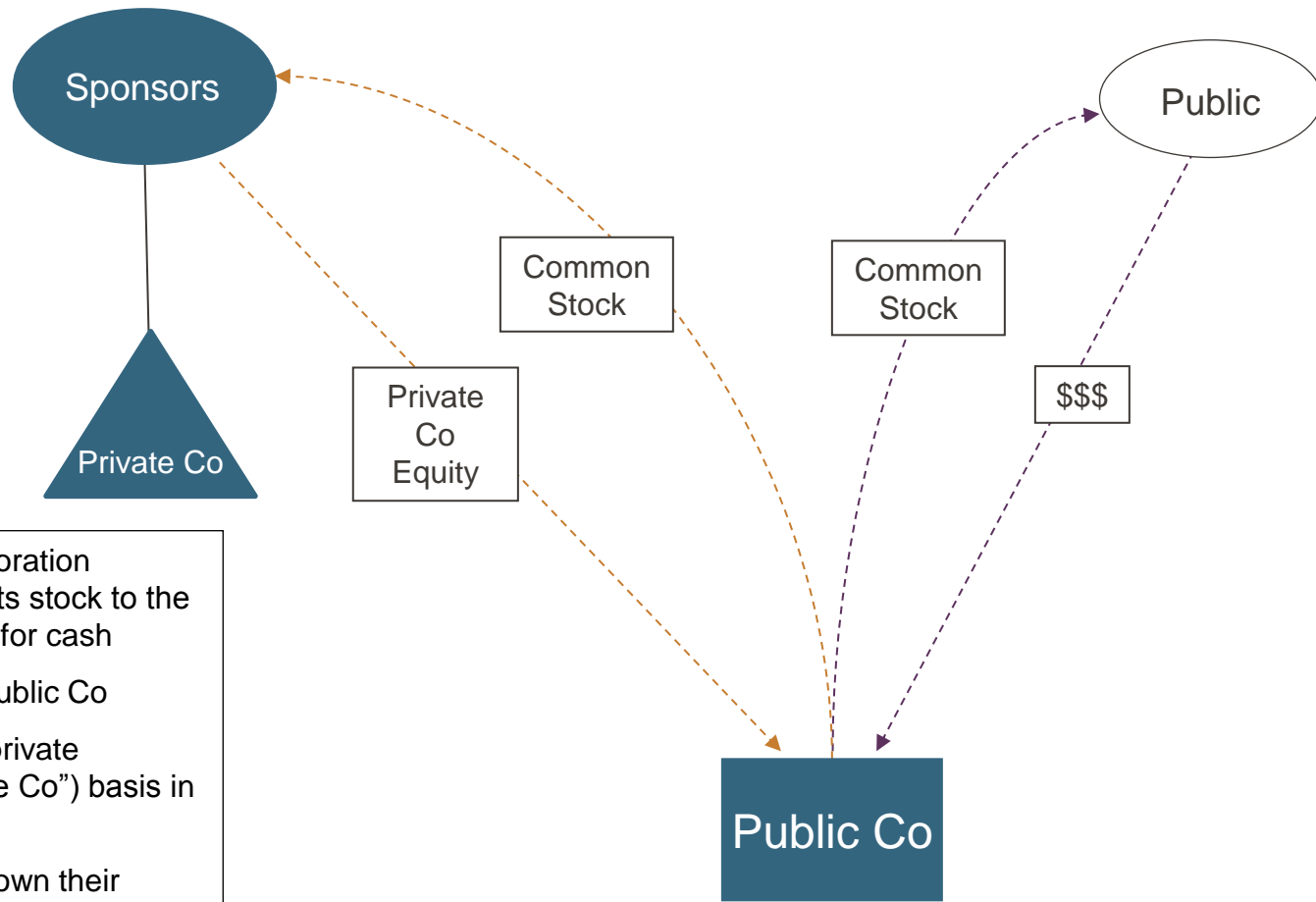
STRUCTURING CONSIDERATIONS

PRIMARY VS. SECONDARY OFFERINGS

- The allocation of primary and secondary sales should be considered in light of the issuer's capital needs and the desire for liquidity for sponsors and management
 - Investors typically prefer to see sufficient primary proceeds to allow the issuer to fund its capital budget for at least a year without returning to the equity or debt markets
 - If secondary component is over 20% of outstanding shares (post-IPO), a “synthetic” secondary may be required (sales by company used to buy in equity)
 - Sponsor and management will have restrictions on their ability to sell additional shares following the IPO
- Energy IPOs completed in 2013 and 2014 often had a significant secondary component; however, we expect the next wave of energy IPOs to have a smaller secondary component
- Section 351 Requirements – in connection with an IPO, in order for contributions of property by the sponsor to the IPO vehicle (“PubCo”) to be tax-free under Section 351 of the Internal Revenue Code, the sponsor and the primary offering stock purchasers must own at least 80% of the stock of PubCo following the transaction. This requirement will limit the amount of stock that may be sold in secondary offerings and will impose certain restrictions on sponsor arrangements to dispose of stock following the IPO

STRUCTURING CONSIDERATIONS

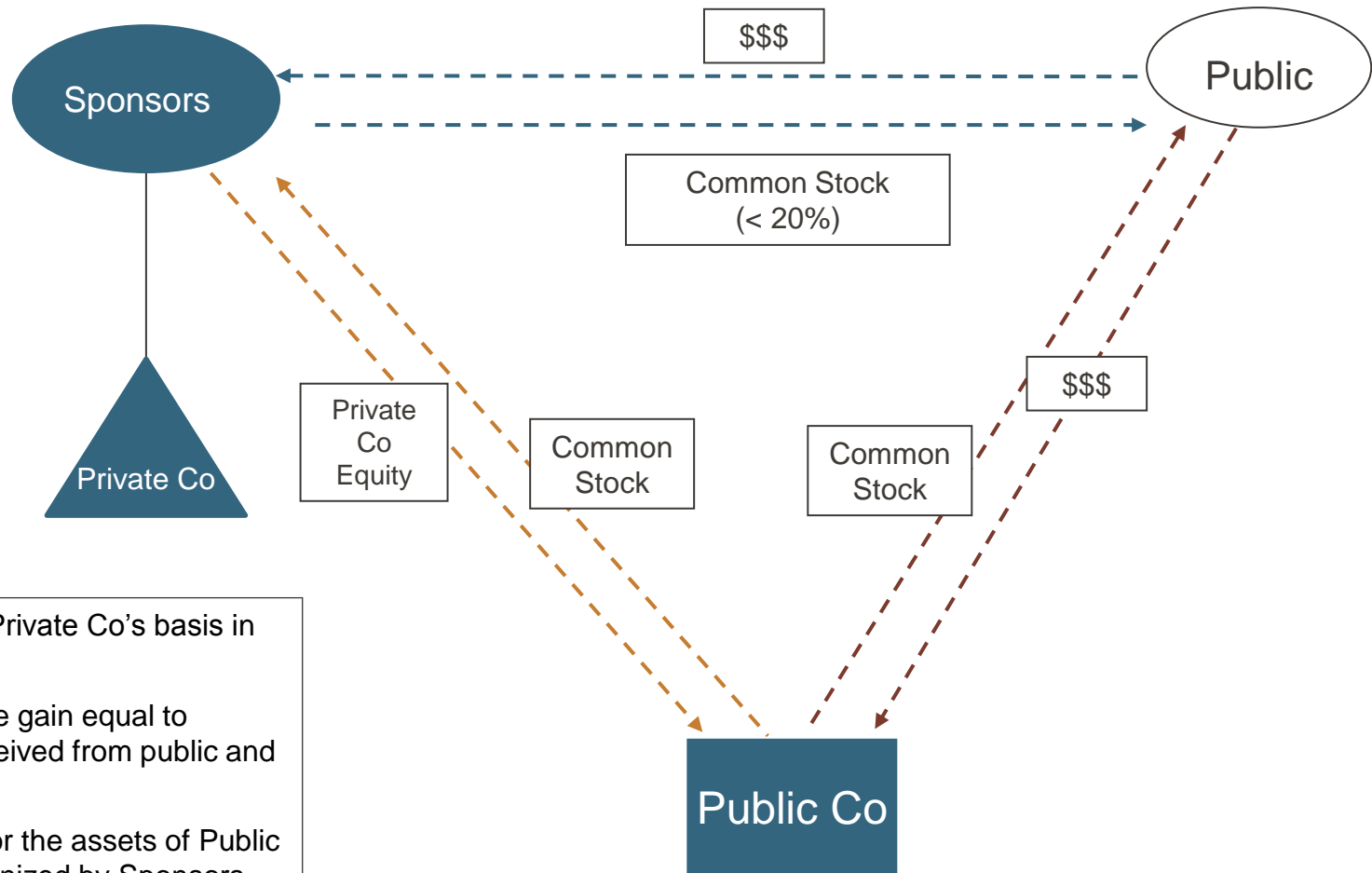
PRIMARY VS. SECONDARY OFFERINGS: PRIMARY



- Newly formed corporation (“Public Co”) sells its stock to the public in exchange for cash
- Proceeds stay in Public Co
- Public Co inherits private company’s (“Private Co”) basis in its assets
- As Sponsors sell down their positions, no basis step-up for the assets of Public Co

STRUCTURING CONSIDERATIONS

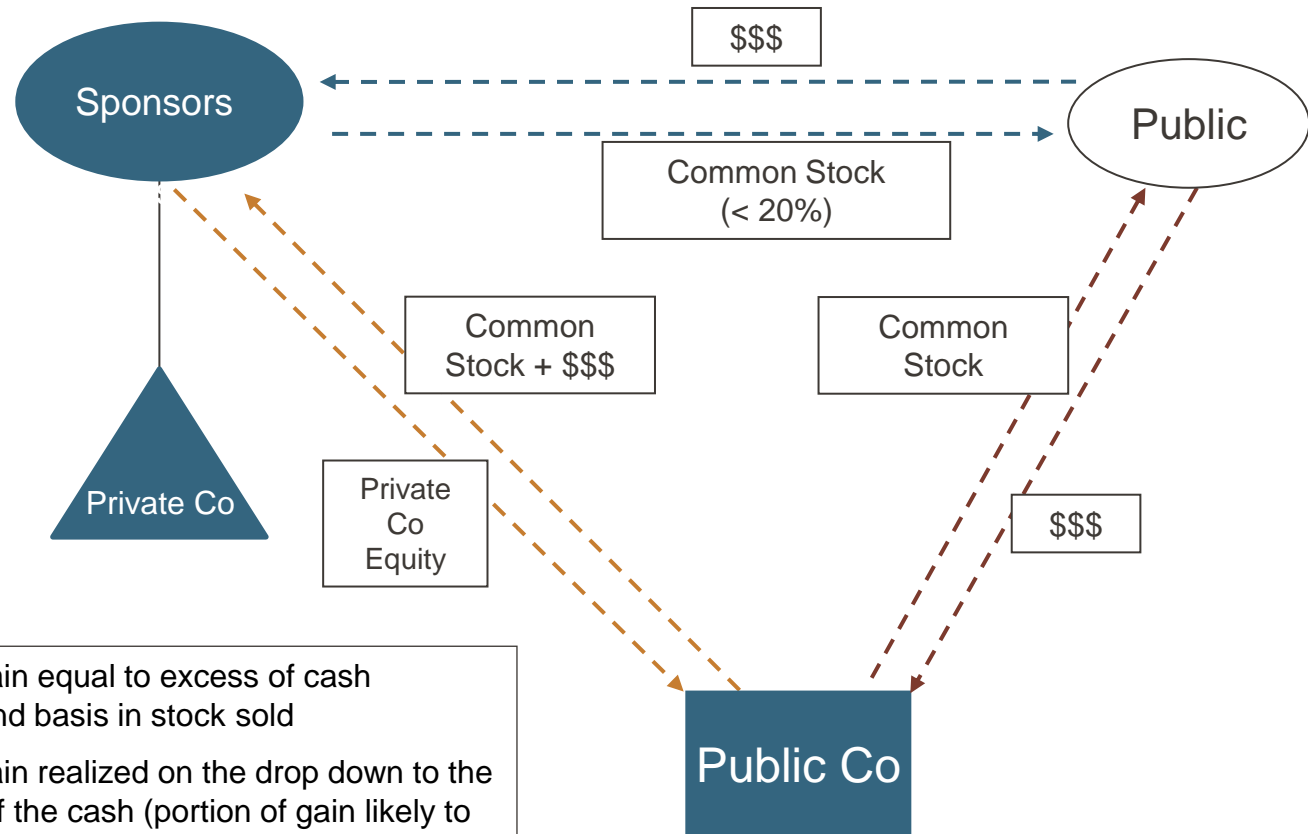
PRIMARY VS. SECONDARY OFFERINGS: SECONDARY



- Public Co inherits Private Co's basis in its assets
- Sponsors recognize gain equal to excess of cash received from public and basis in stock sold
- No basis step-up for the assets of Public Co from gain recognized by Sponsors on stock sales

STRUCTURING CONSIDERATIONS

PRIMARY VS. SECONDARY OFFERINGS: “SYNTHETIC” SECONDARY



- Sponsors recognize gain equal to excess of cash received from public and basis in stock sold
- Sponsors recognize gain realized on the drop down to the extent of the amount of the cash (portion of gain likely to be ordinary income due to recapture)
- Public Co's basis in Private Co increased by amount of gain recognized by Sponsors in drop down
- As Sponsors sell down their positions in the future, no basis step-up for the assets of Public Co

STRUCTURING CONSIDERATIONS

UP-C STRUCTURE

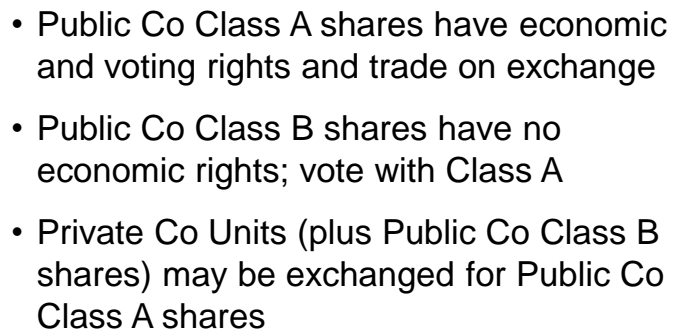
- In an Up-C structure, the public company (“Public Co”) typically owns a substantial equity interest in a subsidiary holding company (“Private Co”), which owns the operating assets. The equity interests in Private Co not held by Public Co are held by some or all of the Sponsors
- Up-C structure permits the public company to receive a step-up in basis as Sponsors sell shares
- A portion of the future tax benefit (typically 85%) is passed on to the Sponsors through a tax receivable agreement

STRUCTURING CONSIDERATIONS

UP-C STRUCTURE: KEY ATTRIBUTES

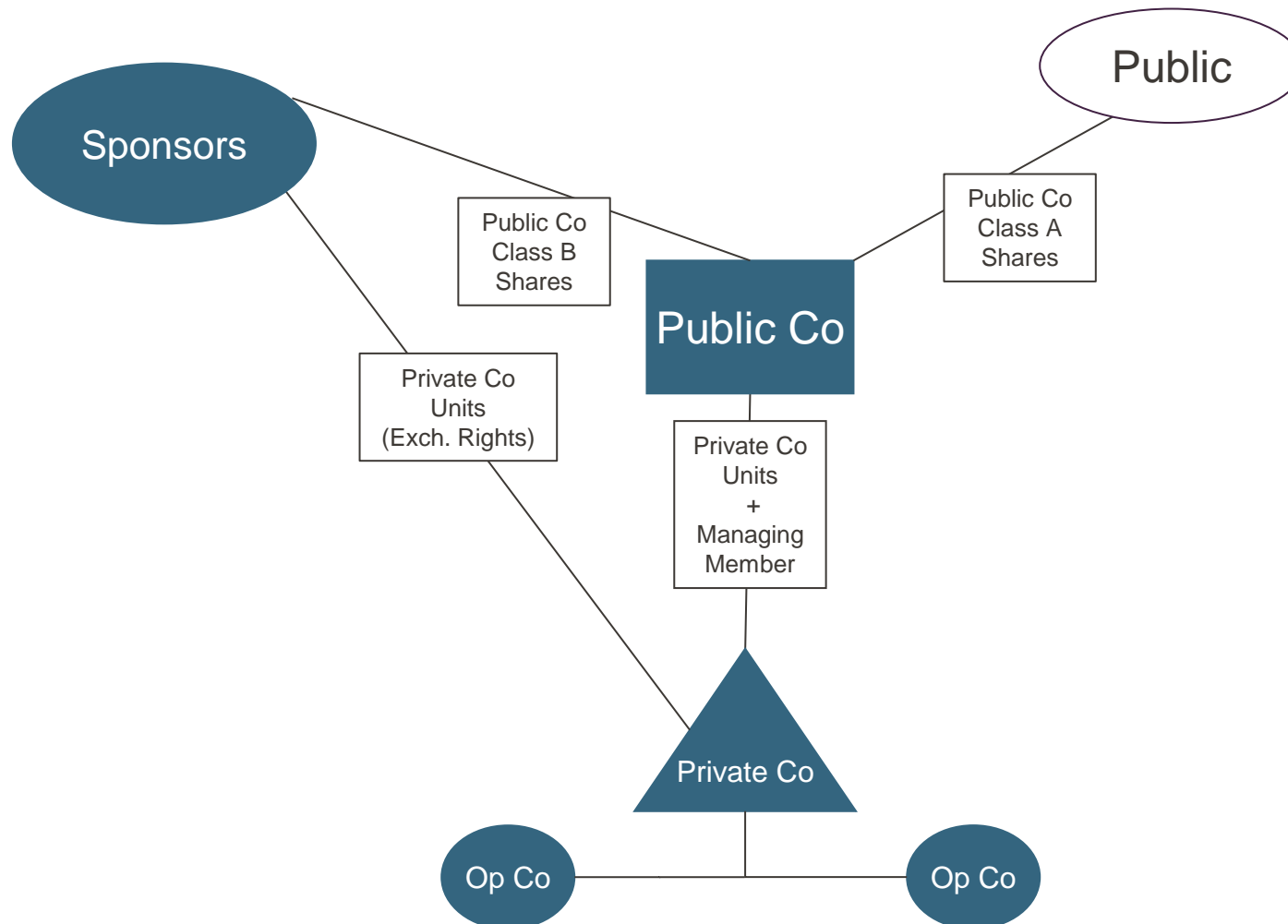
- Public Co is formed to issue Class A common stock to the public for cash in an IPO; Class A common stock has economic and voting rights
- Public Co uses proceeds from the IPO to make a capital contribution to Private Co in exchange for equity interests in Private Co and is designated managing member of Private Co
- Public Co (and in turn Private Co) is managed by the board of directors of Public Co, which is elected by Public Co's stockholders
- Some or all of the Sponsors retain their interests in Private Co, which interests will not have voting rights
- In addition, the Sponsors will receive Class B common stock in Public Co, which entitles the Sponsors to vote on matters requiring the approval of Public Co common stockholders but does not include any economic rights; the Sponsor's voting rights match their percentage economic interest in Private Co
- Sponsors' interests in Private Co (together with the Class B common stock) is exchangeable for Class A common stock at the election of the applicable Sponsor

UP-C STRUCTURE: FORMATION TRANSACTIONS



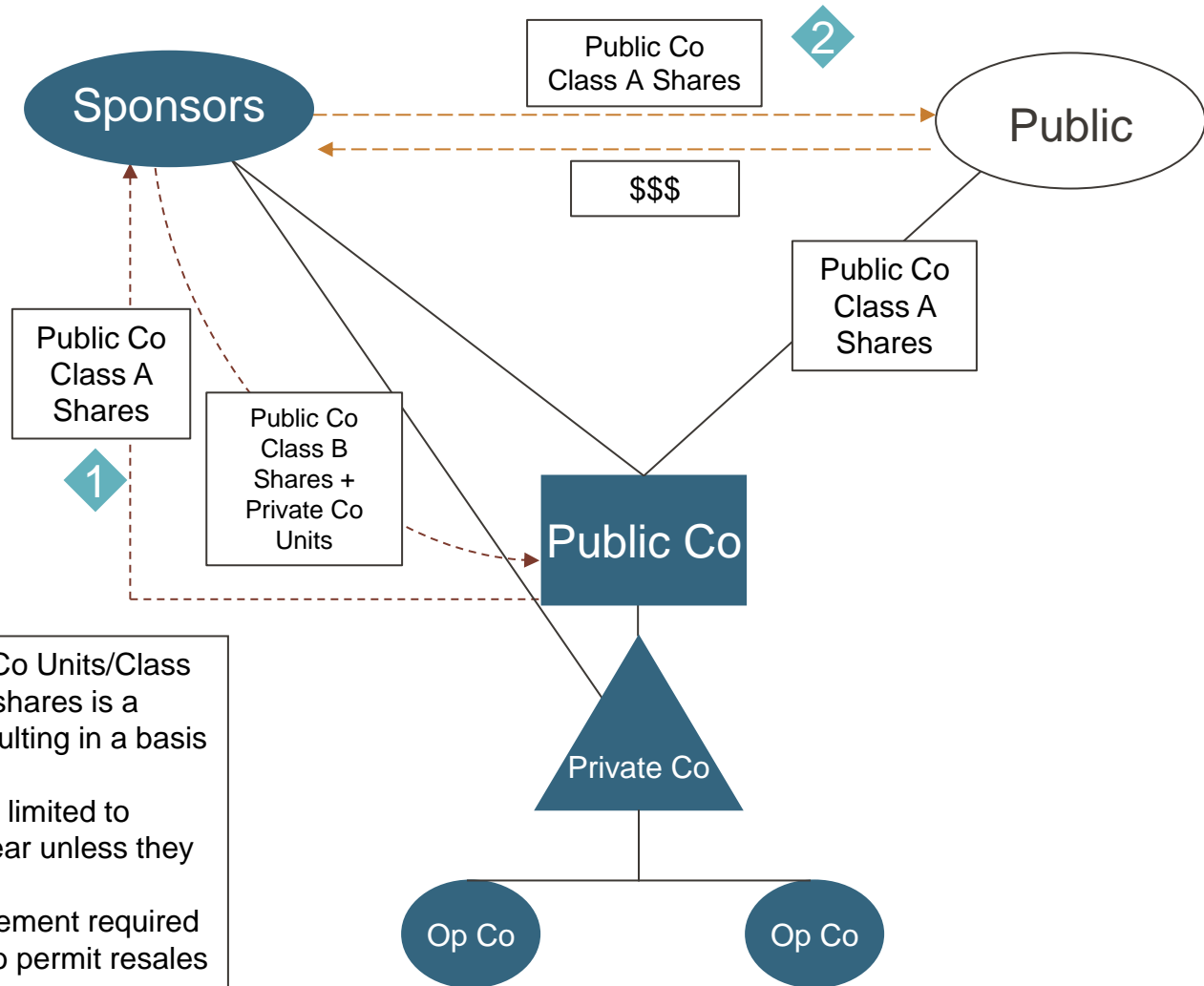
STRUCTURING CONSIDERATIONS

UP-C STRUCTURE: FINAL STRUCTURE



STRUCTURING CONSIDERATIONS

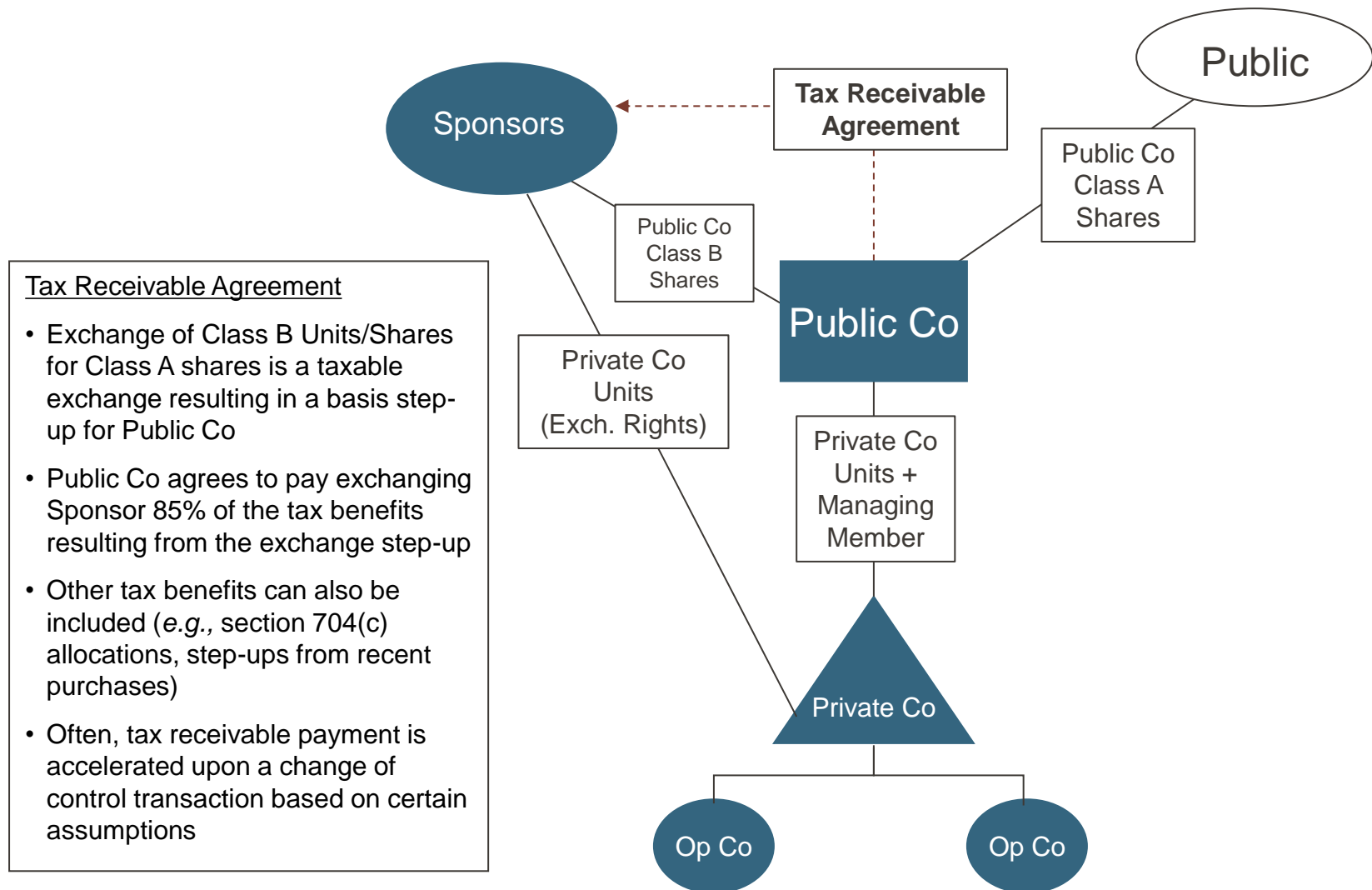
UP-C STRUCTURE: EXCHANGES



- Exchange of Private Co Units/Class B shares for Class A shares is a taxable exchange resulting in a basis step-up for Public Co
- Often, exchanges are limited to certain number per year unless they exceed a certain size
- Shelf registration statement required to be filed with SEC to permit resales of shares to public

STRUCTURING CONSIDERATIONS

UP-C STRUCTURE: TAX RECEIVABLE AGREEMENT



STRUCTURING CONSIDERATIONS

UP-C STRUCTURE: ADVANTAGES

- Sponsors remain in pass-through structure
- Future sell downs by Sponsors generate basis step-up for Public Co of which Public Co retains 15%
- Value of tax receivable payment to Sponsors can be substantial
- Change of control may result in acceleration of tax receivable payment to Sponsors
- Future acquisition of Public Co could be structured to provide a basis step-up to purchaser to the extent of the remaining interest of the Sponsors
- Future acquisition of Public Co for equity consideration could be structured as corporate reorganization (but there are limits—see disadvantages; probably only available for transactions between comparably sized counterparties)
- Public Co can be used as an acquisition vehicle to effect taxable or tax-free corporate acquisitions
- Private Co can be used as the acquisition vehicle for future acquisitions of pass-through entities

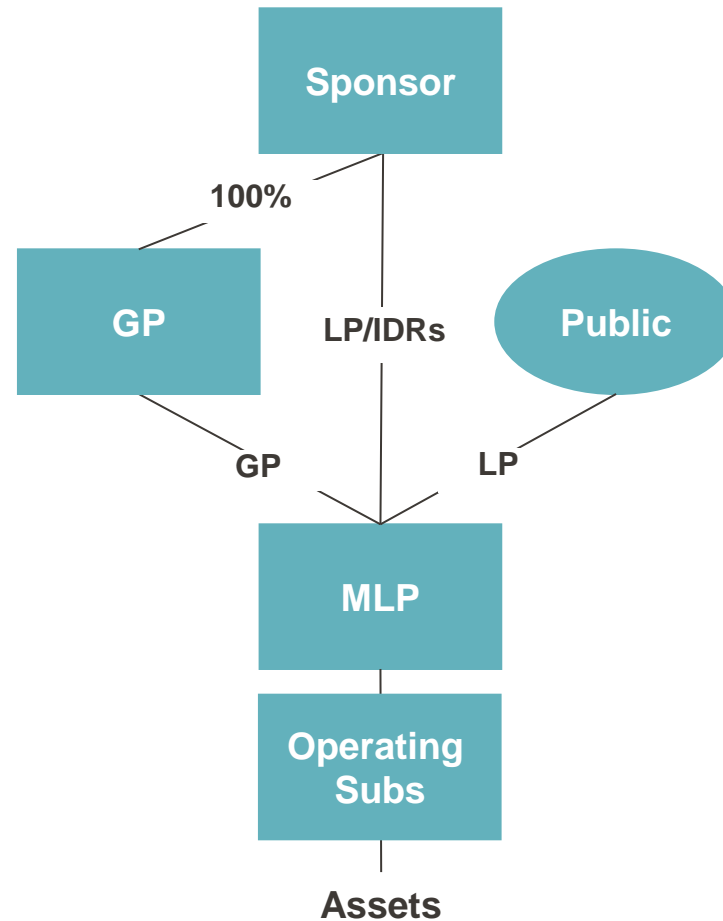
STRUCTURING CONSIDERATIONS

UP-C STRUCTURE: DISADVANTAGES

- Payments under tax receivable agreement may take many years to realize and value of payments difficult to determine
- Up-C structure and tax receivable agreement may become impediment/cost to change of control transaction
 - Tax receivable payment may be accelerated and will be based on certain assumptions that may prove incorrect, including that tax benefits from exchange will be realized in the future by Public Co
 - Acquirer may be unwilling to complete an acquisition unless Up-C structure is unwound which may require consent of Sponsors
 - Up-C structure may interfere with stock for stock tax free reorganizations particularly with regard to buyers who are unwilling to form new holding company to own both companies in a “double dummy” transaction
- Structure creates additional complexity
 - Financial reporting
 - Cash management, including managing tax distributions and cash trapped at Public Co
 - Tax reporting
- Rule 144 may not be available for secondary sales; as a result, Public Co may be required to keep a shelf registration statement available for future secondary sales by owners of Private Co interests who exchange
- Issuance of high yield notes at Private Co level may result in dual SEC reporting companies

STRUCTURING CONSIDERATIONS

TYPICAL MLP ORGANIZATIONAL STRUCTURE



— = Ownership

GP = General Partner

LP = Limited Partner

IDR = Incentive Distribution Rights

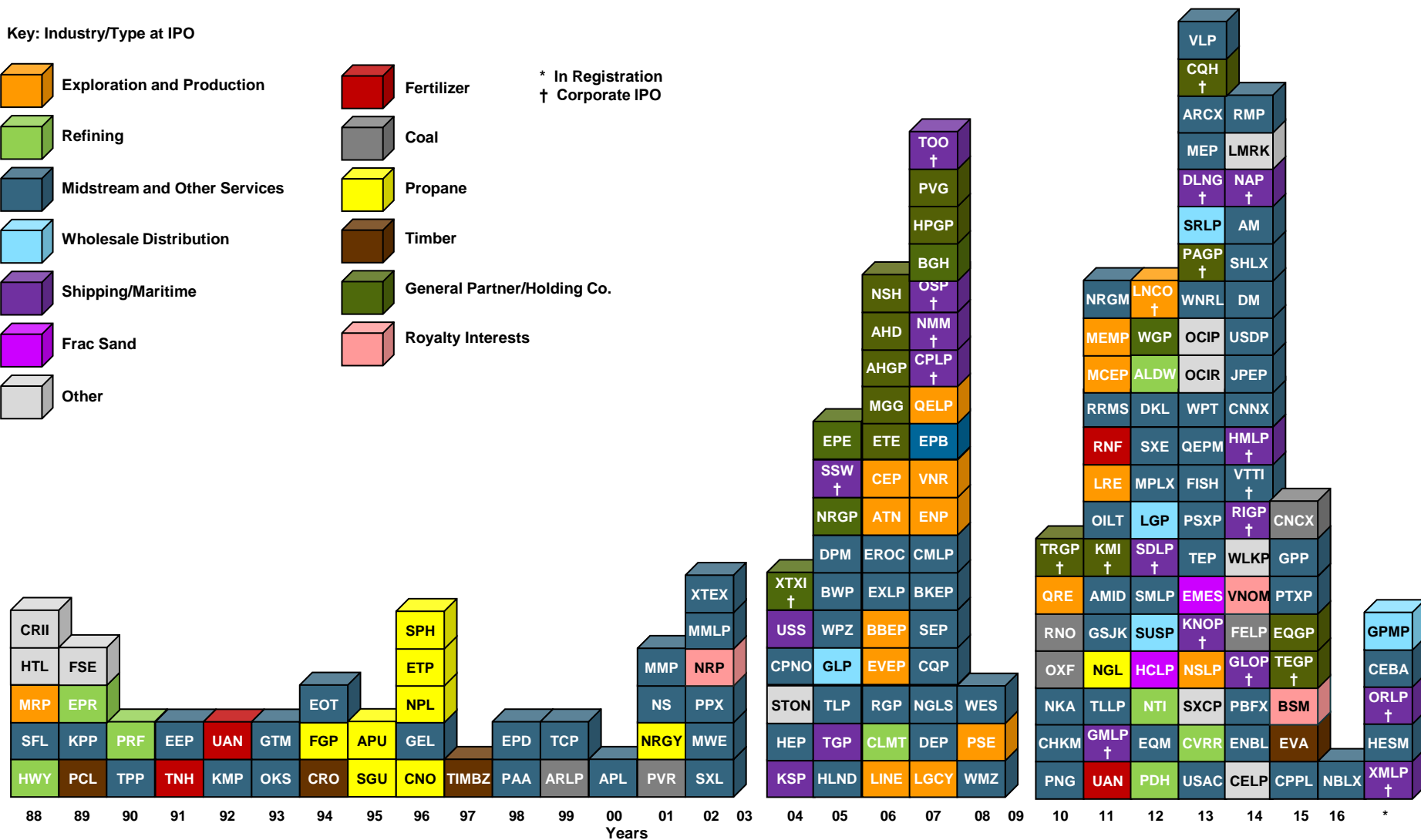
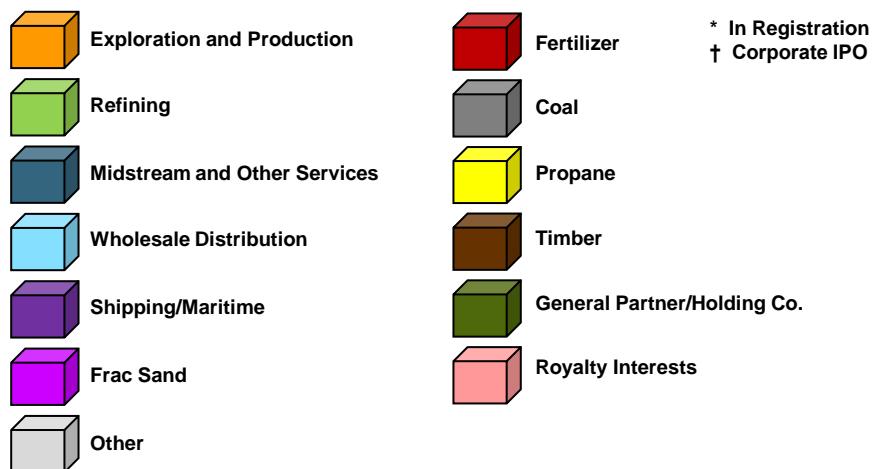
STRUCTURING CONSIDERATIONS

MLP OVERVIEW – KEY CONSIDERATIONS

- Distribution Policy
 - Generate stable (and increasing) cash distributions to unitholders
 - Expectation of distributions (yield) is a marketing requirement
 - Since 2010, traditional MLPs have had yields at IPO ranging from 2.7% to 13.7% (average of 7.0%)
- Minimum Quarterly Distribution (“MQD”)
 - In prospectus, the MLP makes a statement as to its intention to distribute a specified MQD per unit basis
 - Basis for yield at which the MLP is marketed
- Subordinated Units – Form of Distribution Support
 - Sponsor retains Subordinated Units
 - Often 50% of total units
 - Form of cash distribution support - subordinated to Common Units in payment of the MQD
 - Common Units entitled to arrearages in MQD if not paid
- Incentive Distribution Rights
 - Provides incentive for the Sponsor to grow distributions and compensation for subordination

MLP INITIAL PUBLIC OFFERINGS 1988-2016

Key: Industry/Type at IPO



STRUCTURING CONSIDERATIONS

TREATMENT OF WATERFALL

- How are Management Incentive Units Treated at IPO?
 - Crystalize the waterfall at IPO based on the price to the public and distribute shares of the public entity to equity holders and incentive unit holders or
 - Preserve the waterfall for some period of time
 - Can either be a date certain (i.e. 18 month anniversary of IPO) or proceeds distributed as Sponsors sell down
 - Waterfall may be split between multiple sponsors and preserved in separate holdcos
 - Preservation of waterfall provides additional incentive for management to grow the company for the benefit of Sponsors
- Common Considerations
 - How long have the Sponsors had capital committed to the investment?
 - Where are the Sponsors in their fund life cycle?
 - Are all of the assets of the portfolio company going into Public Co?
 - How far is the portfolio company in its development/growth plan at the time of IPO?
 - Ongoing alignment of Sponsors
 - Existing commodity prices and expectation regarding future commodity prices

GOVERNANCE MATTERS



GOVERNANCE MATTERS

BOARD OF DIRECTORS: INDEPENDENCE REQUIREMENTS

- Independence / Committee Requirements
 - A majority of the board must be independent; and
 - The board must have audit, compensation and nominating/corporate governance committees, each comprised entirely of independent directors
 - Enhanced independence standards for audit committee members
 - IPO transition rules:
 - Each committee must have one independent director upon initial listing;
 - A majority of each committee must be independent within 90 days of initial listing;
 - Each committee must be comprised entirely of independent directors within one year of initial listing; and
 - A majority of the board must be independent within one year of initial listing
 - Private equity designees may be considered independent except in many circumstances for audit committee

GOVERNANCE MATTERS

BOARD OF DIRECTORS: CONTROLLED COMPANY STATUS

- A “Controlled Company” is defined as a “company of which more than 50% of the voting power for the election of directors is held by an individual, a group or another company”
 - Requirement can be satisfied by a single owner or a group of owners who agree to vote in concert in connection with the election of director
 - Examples include:
 - Voting agreement that gives each of the Sponsors the right to designate a certain number of directors
 - Voting agreement whereby one Sponsor agrees to vote as directed by another Sponsor
- A Controlled Company is exempt from the following requirements:
 - Majority Independent Board;
 - Independent Compensation Committee; and
 - Independent Nominating & Governance Committee
- A Controlled Company is still required to have an independent Audit Committee
- A Controlled Company relying upon these exemptions must disclose in its annual meeting proxy statement that it is a Controlled Company and the basis for that determination

GOVERNANCE MATTERS

GOVERNANCE POLICIES AND PROCEDURES

- Newly public companies will be required to implement a number of corporate governance policies and procedures, including:
 - Regulation FD Policy
 - Insider Trading Policy
 - Short-Swing Trading and Reporting Policy
 - Code of Conduct
 - Financial Code of Ethics
 - Audit Committee Pre-Approval Policy
 - Whistleblower Policy
 - Related Persons Transactions Policy
 - Stock Ownership & Retention Guidelines

GOVERNANCE MATTERS

ANTI-TAKEOVER DEFENSES

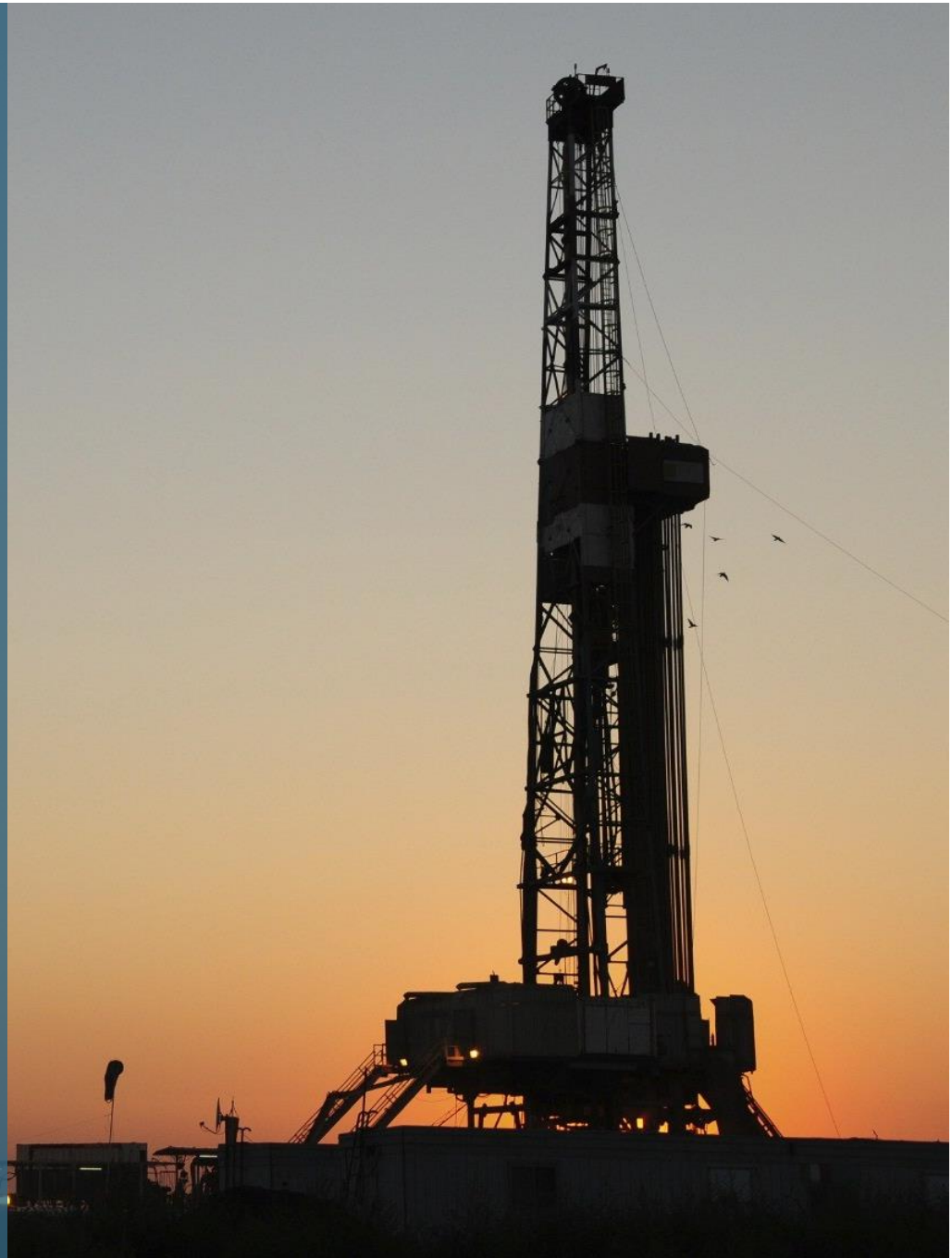
- Consider anti-takeover defenses
 - Staggered board
 - Removal of the right of stockholders to act by written consent
 - Removal of right of stockholders to call special meetings
 - Delaware Section 203 business combination provisions
 - Rights plan (“poison pill”)
 - Ability to issue preferred stock
 - Supermajority vote for significant corporate actions or to amend the bylaws
 - Removal of directors only for “cause”
 - Advance notice requirements for stockholder proposals
 - Delaware exclusive forum provisions
 - Loser pay provisions
- For Sponsor-backed public companies, often certain of these protections spring into effect after the Sponsor’s ownership falls below a specified level

GOVERNANCE MATTERS

SOX 402

- Under Section 402 of the Sarbanes-Oxley Act of 2002, Issuers are prohibited from, directly or indirectly, through a subsidiary or otherwise, extending, modifying, maintaining or arranging extensions of credit, in the form of a personal loan, to or for their directors or executive officers.
- “Issuers” is defined to include not only those public companies that either have securities registered under the Exchange Act or are required to make periodic filings under the Exchange Act, but also companies that file or have filed registration statements under the Securities Act.

ISSUES SPECIFIC TO UPSTREAM ISSUERS



ISSUES SPECIFIC TO UPSTREAM ISSUERS

NAV DISCONNECT BETWEEN RESOURCE POTENTIAL AND PROVED RESERVES

- Drilling Locations
 - In recent years, the SEC has not objected to the presentation of drilling locations beyond PUD locations
 - Methodology varies significantly from issuer to issuer:
 - Total acreage/spacing
 - 3P locations
 - Specifically identified based on geologic analysis
 - Risking
- Type Curves
 - Basis for type curves
 - 3rd party reserve engineers
 - Adjusted 3rd party type curves
 - Offset operators
 - Management type curves
 - Multiple type curves vs. average type curves

ISSUES SPECIFIC TO UPSTREAM ISSUERS

RESERVE REPORTING: 2-STREAM VS. 3-STREAM

- Prior to the recent commodity price decline, as liquids prices rose, issuers began breaking out proved reserves and production on a 3-stream basis
 - SEC raised questions as to whether processing contracts allowed for accurate reporting of proved reserves on a 3-stream basis
- The SEC has recently focused on issuers that report volumes on a 2-stream basis even though NGLs are “significant”
 - The SEC’s disclosure rules require disclosure of volumes by final product sold
 - ASC 932-235-50-4(a) requires separate disclosure of NGLs if “significant”
- Inconsistency between reserve reports and financial statements is a red flag for the SEC

ISSUES SPECIFIC TO UPSTREAM ISSUERS

RESERVE REPORTING

- Reserve Reports
 - Underwriters generally will require 3rd Party reserve reports
 - Audited vs. Fully-Engineered
 - SEC Price Deck
 - Changes in methodology in reserve reports for periods where an audit opinion has been issued can result in restatements to the financial statements for that period
 - SEC may focus on assumptions behind 5 year development plan used to book PUDs and the impact of lease expirations on booked reserves

ISSUES SPECIFIC TO UPSTREAM ISSUERS

IMPACT OF COMMODITY PRICE VOLATILITY

- Recent SEC Comments driven by Commodity Price Volatility
 - Disclosure of potential future impairments
 - Quantification of the impact of current commodity prices on proved reserve volumes based on potential scenarios deemed reasonably likely to occur by management
 - Ability to hedge commodity prices at similar pricing levels to that reflected in historical financial statements

THANK YOU

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