

Life-Cycle Guide for Oil and Gas Companies

How to Prepare for Each Phase: From Start-up to Successful Transition



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INTRODUCTION

No matter what life cycle stage your business is in, each step comes with its own set of questions, options, decisions, and solutions.

As a business moves through each phase—from start-up to launch, growth, maturity, and finally transition—there's always excitement coupled with necessary strategic planning for the current stage and the ones to come. To help you make better decisions along the way, this guide arms you with insights and highlights the challenges you might face through your life cycle. It also addresses tax, economic, management, board, and other key considerations.

For example, an unplanned situation could arise that leads to a larger tax amount that must be paid, which surprises management. At the exit phase, it's often too late to make changes, but it's important to understand the potential outcomes to avoid being surprised. The key is to manage your business through every stage, always keeping your exit in mind as well as the subsequent tax impacts of your decisions.

We understand that each company has unique goals. This guide highlights high-level items to consider throughout your life cycle in addition to solutions—spanning accounting, consulting, investment banking, and wealth management—that can be tailored for each circumstance.



THE VALUE OF PREPLANNING

Overall, preplanning is essential rather than thinking of wealth management or investment banking as following your exit. Laying the groundwork for each transition phase and making sure your assets are positioned where they can best be of benefit are the ultimate goals.

Unfortunately, a lot of value can be diminished when an owner starts considering related topics *after* the transaction. This happens more often than not, and can leave an owner and their team playing catch-up.

| BUSINESS | | | | | |
|---|--|---|---|--|--|
| <ul style="list-style-type: none"> • Determine your goals and objectives • Carry out due diligence on your company and prepare virtual data room • Prepare pro forma adjusted financial model • Prepare and approve buyer list • Prepare preliminary market-based valuation | <ul style="list-style-type: none"> • Contact potential buyers • Distribute confidentiality agreement • Execute and distribute final confidential information memorandum • Perform preliminary buyer due diligence • Prepare management presentations • Solicit indications of interest | <ul style="list-style-type: none"> • Complete pre-deal due diligence and data room preparation • Conduct management presentations • Provide virtual data room access for due diligence • Distribute draft purchase agreement • Solicit and evaluate letter of intent proposals • Select final candidate | <ul style="list-style-type: none"> • Facilitate requests for information and further confirmatory due diligence • Negotiate and finalize transaction terms • Prepare funds flow memorandum and wire instructions • Conduct initial integration planning | <ul style="list-style-type: none"> • Complete all documentation • Execute purchase agreement and supporting transaction agreements • Perform funds flow • Initiate transaction closing | <ul style="list-style-type: none"> • Complete integration and co-strategic planning |
| 180+ DAYS PRIOR ▶ | 180-90 DAYS PRIOR ▶ | 90-60 DAYS PRIOR ▶ | 60-30 DAYS PRIOR ▶ | TRANSACTION ▶ | POST-TRANSACTION |
| PERSONAL | | | | | |
| <ul style="list-style-type: none"> • Align exit timeline with personal retirement readiness • Identify values outside of the business and prepare to exit • Begin developing financial plan and determine: <ul style="list-style-type: none"> » Financial goals, net cash needs, pre-transaction opportunities, charitable gift intentions | <ul style="list-style-type: none"> • Review personal financial plan and postsale cash flow sources and needs • Update financial plan if net proceeds have adjusted since initial offer • Review available tax-minimizing techniques | <ul style="list-style-type: none"> • Identify personal accounting items integrated with the business that need to be managed post-transaction: <ul style="list-style-type: none"> » Bill pay, personal financial reporting • Create landing accounts to receive sale proceeds • Discuss potential investment strategy based on financial goals | <ul style="list-style-type: none"> • Establish investment policy and investment implementation timelines: <ul style="list-style-type: none"> » Tax account, short-term account, long-term account • Prepare wire instructions for sale proceeds | <ul style="list-style-type: none"> • Confirm receipt is in accordance with purchase and sale agreement • Allocate proceeds as planned between established accounts • Organize and start investment implementation on funds to be held for taxes | <ul style="list-style-type: none"> • Finalize financial plans, investment policy, implementation guidelines, estimated tax payment schedule • Review insurance needs and estate plan and structure • Establish family planning needs: <ul style="list-style-type: none"> » Family governance, heir preparation, charitable planning, legacy |



LIFE-CYCLE PHASES

Through start-up, launch, growth, maturity, and transition, there are a myriad of challenges and considerations for which you can start planning. They span tax, economic, management, board, and other key strategies.

START-UP

The start-up stage begins with an idea that comes to fruition through careful research and planning.

Tax Considerations

When selecting an entity type—C corporation, LLC, or partnership—it's important for the founders to explore the potential international, federal, and state and local tax impacts of each option. These decisions can help you minimize the tax impacts of growing, running, and eventually transitioning the business.

Economic Considerations

As the management team considers how to run the business, be profitable, and provide returns on investment, there's an increased need for tools and insight to assist with making these decisions.

If your company is looking to grow quickly through acquisition, then conducting due diligence on those targets prior to the deal can help provide a risk assessment as

well as insight on the past, present, and future financial performance of a potential acquisition.

Management Considerations

Owners and management teams strive to have the right people involved and keep them motivated. It's important that the potential financial incentives of those employees are aligned with desired behaviors and outcomes as well as company goals.

This can be achieved through equity-based or incentive compensation scenarios for key employees. Considering the various international, federal, state, and local tax implications of these awards can help you make the best decisions for the benefit of the recipients.

It's also a good time to contemplate how to structure internal control over financial reporting and related impacts as you move forward. While discussing the implications of those scenarios, we may be able to help identify candidates thanks to our industry insight and networks.

Board Considerations

When founding a company, you might not have all of your board positions appointed. When you consider the weight and authority of a board and the corporate governance structure, these appointments will affect the future of the company and should be made thoughtfully.

Personal Considerations

There's a great deal of risk when starting a business enterprise. Take time to assess how to mitigate personal risks through proper entity structuring as well as establishing personal insurance. In this phase, the focus is on protection planning.

Other Key Considerations

When you consider the type of funding that was used to create your company, understand how it might impact the next stages of growth to avoid any surprises down the road.

HOW WE CAN SUPPORT YOU

Business Concept Development

- Federal, state, and local tax planning and consulting
- Financial modeling
- Industry and market research
- Management and board team identification
- Tax consulting

Target Evolution

- Due diligence
- Financial modeling
- Structure selection and consulting



LAUNCH

Bringing products or services to market as a new entity sets a critical foundation for ongoing business processes, practices, and decisions. In this phase, you've received your cash and any assets from the owners and have started to execute your business strategies.

Tax Considerations

During this phase, your entity implements its planned tax structure and begins to capture income and costs. It's imperative to meet income tax compliance requirements while managing your planning and reporting strategies.

Economic Considerations

It's important to continue tracking and managing costs while evaluating the impacts of costs and investments through financial modeling. Be sure to allocate the necessary resources to help drive the company's future growth.

Management Considerations

This is the time to select and implement an accounting system or outsourcing opportunities. When making these choices, design and implementation of internal control practices are necessary. The system you select should support the type of reporting that management needs to make informed decisions.

Board Considerations

The board should actively monitor the implementation of internal controls and work closely with management to define the reporting that's necessary to help evaluate the company's performance and make informed investment decisions. Selecting the proper IT system is one way to help facilitate clear communication and track your company's performance.

Personal Considerations

Through launch, you'll continue to focus on protection planning to help balance the risk that's inherent in starting a business enterprise. In addition to addressing your entity structure and establishing personal insurance, which was hopefully put in motion in the start-up phase, you can also begin considering your retirement and savings plans.

Other Key Considerations

Make sure that your policies, procedures, and internal infrastructure are set up so your accounting follows generally accepted accounting principles (GAAP) and possibly SEC reporting if a public offering or sale to a public company is part of your strategy.

Technology is also an integral part of a well-run organization—it behooves you to manage its use and integration, particularly when it comes to mitigating cybersecurity risks. Another item to consider as you move forward: Establish a system to compile data to comply with various disclosure requirements.

HOW WE CAN SUPPORT YOU

Initial Funding

- Audit, review, and compilation
- Tax planning
- Federal, state, and local tax compliance
- Equity instrument valuation services
- Tax compensation planning
- Specialized tax consulting
- Structure selection and consulting
- Transaction services

Policies, Procedures, and Infrastructure

- Accounting for policy and procedure development
- ERP system selection and implementation consulting
- GAAP and SEC reporting, guidance, and compliance
- International tax consulting
- IT project management
- Specialized tax consulting
- Technology management

Asset and Business Acquisitions

- Financial and operational diligence
- Tax diligence and structuring
- Valuation services





GROWTH

This phase focuses on ways to expand or innovate your business while anticipating and managing any related changes. Now is the time to develop existing assets or target and acquire new assets.

Tax Considerations

Keeping track of changes to federal, state, and local tax laws can feel daunting—not only because there are many different areas to juggle but also because the laws can frequently change without much notice. Nevertheless, it’s essential to understand if or how these changes could impact your business.

Economic Considerations

In the growth stage, you’re spending money as time goes on, which makes managing cash flow and monitoring the amount of leverage imperative.

The cost of developing operating properties is significant, but production-related activities produce the bulk of collected revenue. The production value chain is generally completed with gathering and other operating field services, such as water hauling, trucking liquid products, and treating oil and gas to the point when produced oil and gas may be marketed.

Below is a diagram depicting the economic value chain for oil and natural gas production.

A producer’s total production value is burdened by a variety of obligations to government. It must also provide sufficient margin to support the costs of development and operations as well as pay royalty owners or other private interest owners.

Management Considerations

If you’ve grown to a size that you’re able to offer equity or benefit plans to your employees, consider how to offer and distribute these.

Also, consider how you’re growing. Whether it’s through the management of the company, asset or business acquisitions, or divestitures, there are unique considerations and impacts for each.

Board Considerations

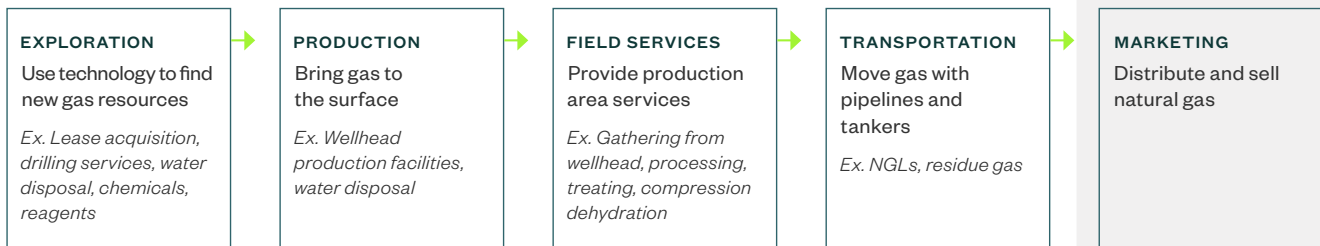
The board is more active in business decisions that involve any acquisition or divestiture during the growth phase. It pays attention to monitoring internal controls, which means more involvement and interaction with the management team.

Continue to keep a watchful eye and adapt how the board and management interact to facilitate effective communication.

OIL PRODUCTION ECONOMIC VALUE CHAIN



NATURAL GAS PRODUCTION ECONOMIC VALUE CHAIN





Personal Considerations

Your company has grown along with your personal net worth, making personal financial planning key during the growth phase.

Many owners wait too long to consider estate planning, even though it can help you save taxes in later years. Think of estate planning as a process, not a project. Take the time to assess your tax exposure to state or federal taxes and consider to whom you'd like to pass your assets.

Diversification also plays a part. You're growing a business and have concentrated risk in a great asset. You may want to consider ways to diversify your holdings as you spin off cash from the business in a way that's strategic and aligned with your personal financial goals.

Other Key Considerations

If your company's growth expands, domestically or internationally, there are additional considerations that should be on your radar—transfer pricing and withholding taxes, for example.

It's also time to begin solidifying a potential exit strategy. While you might have discussed this and made some decisions during the start-up phase, it's important to revisit and adapt your plan while considering an IPO, a private equity infusion, or a company sale, which all have different implications.

HOW WE CAN SUPPORT YOU

Funding Growth

- Accounting for uncertainty in income taxes
- Asset impairment analysis
- Audit, review, and compilation
- Credits and incentives studies
- Domestic production activities credit
- Equity instrument valuation services
- Federal and state income tax compliance
- Financial reporting
- Internal control over financial reporting (SOX 404)
- Severance tax compliance
- Tax planning
- Tax provision computation and review
- Transaction taxes
- Derivative valuation
- GAAP and SEC guidance and compliance
- Hedge designation
- IPO readiness
- Net operating loss tax considerations (IRC Section 382 studies)
- Private placements
- SEC reporting
- Standardized measure of oil and gas reserves (SMOG) consulting

Personal Planning

- Financial planning
- Tax planning
- Investment management and consulting
- Initial estate planning assessment

Development & Maintenance of Systems

- Internal audit co-outsourcing
- IT project management
- IT risk assessment
- Software selection
- Technology management consulting
- Cybersecurity

Attracting and Retaining Talent

- Accounting for share-based compensation and other instruments
- Employee benefit plan audits
- Stock compensation valuation
- Tax compensation planning

Geographic Expansion

- Domestic production activities
- International tax consulting
- Office of Natural Resources Revenue (ONRR) royalty payments
- Severance tax consulting and compliance
- State and local tax consulting

Private Equity Placement

- Detailed financial model to assess historic and projected financial performance
- Capital needs assessment
- Positioning and growth strategy
- Potential private equity groups (PEGs) screening for strong fit
- Private Placement Memorandum preparation and distribution to approved PEGs
- Management presentation preparation for meetings with PEGs

- Buyer's letter of intent analysis
- Enterprise valuation and investment structure negotiation with shareholders
- Investment transaction completion with shareholders, accounting, and legal advisors

Joint Ventures and Partnerships

- Joint interest and royalty audits

Asset and Business Acquisitions

- Carve out financial statements
- Due diligence
- Foreign Instrument in Real Property Tax Act (FIRPTA) consulting
- Income tax compliance and consulting
- Investment banking, buy-side advisory
- Valuation services
- Percentage depletion
- Post-closing settlement statement consulting
- Sales tax consulting

Divestitures

- Carve out financial statements
- Earnings and profits studies
- Financial and tax structuring (federal and state)
- Investment banking, sell-side advisory
- Seller preparation and due diligence
- Transition and separation preparation

Other

- Forensic accounting
- Litigation support



MATURITY

The focus here is on remaining competitive and sustainable as your business matures with continuous improvement to productivity, efficiencies, and best practices. While maintenance and growth are a priority, start evaluating what your exit strategy will be and its impact if you haven't already.

Tax Considerations

With an exit strategy in your scope, you can begin to review the implications of transaction taxes, also known as sales and severance tax.

Economic Considerations

Continue to monitor and manage cash flow in this phase, but be aware of coming financial reporting requirements. The strength of any company's financial reporting comes, in large part, from the strength of its internal controls, which is why they're of critical importance to all companies—whether private or planning to go public.

Management Considerations

Continuous improvement that adds to the profitability of the company is the goal of any management team. Look at using integrated systems and processes to be as efficient and effective as possible.

HOW WE CAN SUPPORT YOU

Funding Growth

- Accounting for uncertainty in income taxes
- Audit, review, and compilation
- Credits and incentives studies
- Domestic production activities credit
- Equity instrument valuation services
- Federal and state income tax compliance
- Financing reporting
- Internal control over financial reporting (SOX 404)
- Investment banking, private equity placement
- Investment banking, sell-side advisory
 - » Detailed financial model to assess historic and projected financial performance
 - » Positioning and growth strategy
 - » Potential buyer screening, including corporate or private equity group buyers
 - » Confidential Information Memorandum preparation and distribution to approved buyers
 - » Management presentation preparation for meetings with private equity group buyers
 - » Buyer's letter of intent analysis
 - » Enterprise valuation and investment structure negotiation with shareholders
 - » Investment transaction completion in with shareholders and accounting and legal advisors
- Severance tax compliance
- Statement on standards for attestations (SSAE No. 18)
- Tax planning

- Transaction taxes review (sales tax and severance tax)
- Derivative valuation
- GAAP and SEC guidance and compliance
- Hedge designation
- IPO readiness
- Net operating loss tax considerations (IRC Section 382 studies)
- Public offerings
- SEC reporting
- Standardized measure of oil and gas reserves (SMOG) consulting

Personal Planning

- Financial planning
- Tax planning
- Investment management and consulting
- Estate and gift plan
- Charitable giving plan
- Insurance management and consulting

Development & Maintenance of Systems

- Internal audit co-outsourcing
- IT general controls (ITGC)
- IT project management
- IT risk assessment
- Severance tax process development
- Software selection
- Technology management consulting
- Cybersecurity

Attracting and Retaining Talent

- Accounting for share-based compensation and other instruments
- Employee benefit plan audits

- Stock compensation valuation
- Tax compensation planning

Geographic Expansion

- Domestic production activities
- International tax consulting
- Office of Natural Resources Revenue (ONRR) royalty payments
- Severance tax consulting and compliance
- State and local tax consulting

Joint Ventures and Partnerships

- Joint interest and royalty audits

Asset and Business Acquisitions

- Carve out financial statements
- Due diligence
- Foreign Instrument in Real Property Tax Act (FIRPTA) consulting
- Income tax compliance and consulting
- Percentage depletion
- Post-closing settlement statement consulting
- Valuation services

Divestitures

- Carve out financial statements
- Earnings and profits studies
- Financial and tax structuring (federal and state)
- Seller due diligence
- Transition and separation preparation

Other

- Forensic accounting
- Litigation support



Board Considerations

During this phase, the board is responsible for evaluating assets and divestitures and assessing how they'll impact the exit strategy in the transition phase.

Personal Considerations

Your net worth has grown and its structure has changed.

Now it's time to assess and align your financial plan to your potential exit scenarios. This is also a great time to revisit your estate plan because there are a variety of tax-efficient strategies to make sure your wealth creates a legacy for whatever purpose you desire.

In addition, there's an opportunity to assess the charitable intentions you have and plan for those prior to a transition.

Other Key Considerations

It's important to communicate assigned roles and responsibilities related to the exit strategy. Begin carving out your financial statements and conducting earnings and profit studies while assessing how each will impact your transition.

The goal is to set you up for the best possible outcome. If you haven't prepared in each of the preceding phases, you could tackle a modified, last-minute checklist, but time is of the essence.

TRANSITION

All of your hard work culminates in the transition phase. Whether you're selling or closing your business, or taking a different step in your company's evolution, each of these options requires a transition plan and financial considerations. The roles of employees, the management team, and the board can be different or nonexistent, depending on your chosen exit strategy.

Tax Considerations

You've already outlined an exit strategy approach and the related tax structuring. Now it's time to implement that plan.

Economic Considerations

Prepare to pay the owners and all participants in any of the company's incentive programs.

HOW WE CAN SUPPORT YOU

Exit Strategies

- Determination of value for GAAP, tax reporting purposes, and estate gift planning
- Financial and tax structuring (federal and state)
- Valuation services
- Accounting for uncertainty in income taxes
- Credits and incentives studies
- Federal and state income tax compliance
- Outsourced accounting services
- Tax compensation planning
- Tax planning

Personal Planning

- Financial planning
- Tax planning
- Investment management and consulting
- Estate and gift plan
- Charitable plan
- Insurance management and consulting
- Family office solutions

Investment Banking, Sell-side Advisory

- Detailed financial model to assess historic and projected financial performance
- Positioning and growth strategy
- Potential buyer screening, including corporate or private equity group buyers
- Confidential Information Memorandum preparation and distribution to approved buyers
- Management presentation preparation for meetings with buyers
- Buyer's letter of intent analysis
- Enterprise valuation and investment structure negotiation with shareholders
- Investment transaction completion in with shareholders and accounting and legal advisors

Public Exit

- Audit, review, and compilation
- Earnings and profits studies
- GAAP and SEC guidance and compliance
- Federal and state tax exit consulting
- International tax consulting
- Net operating loss tax considerations (IRC Section 382 studies)

- SEC reporting
- Tax provision computation and review

Asset and Business Divestitures

- Carve out financial statements
- Post-closing settlement statement consulting
- Purchase price allocation
- Seller preparation and due diligence
- Federal and state tax planning
- Transition and separation preparation
- Valuation services

Other

- Cybersecurity
- Derivative valuation
- Domestic production activities review
- Hedge designation
- Litigation support
- Office of National Resources Revenue (ONRR) royalty payments
- Severance tax consulting and compliance
- Standardized measure of oil and gas reserves (SMOG) consulting



Keep in mind that post-closing settlements can often be contentious. A third-party can often help mitigate emotions during this time, working to align the settlement with the terms of the purchase and sales agreement.

You've worked hard to build your company, making it all the more important to realize the profit you want when exiting the business. Make sure you don't leave money on the table.

Personal Considerations

Linking your exit plan to your personal financial goals is especially important during the transition phase. You should take the time to strategically organize liquidity into buckets for retirement and living, taxes, and new ventures.

Depending on your personal financial needs, you could require an outsourced family office solution that acts as a personal CFO if you relied on those accounting and project management resources through the business.

Management Considerations

It can be challenging to keep employees motivated and engaged when their roles and future with your organization may be uncertain. Review potential financial incentives you outlined during the start-up phase and assess how they align with the exit strategy.

Board Considerations

The board should continue to actively work with management on decisions related to the exit.



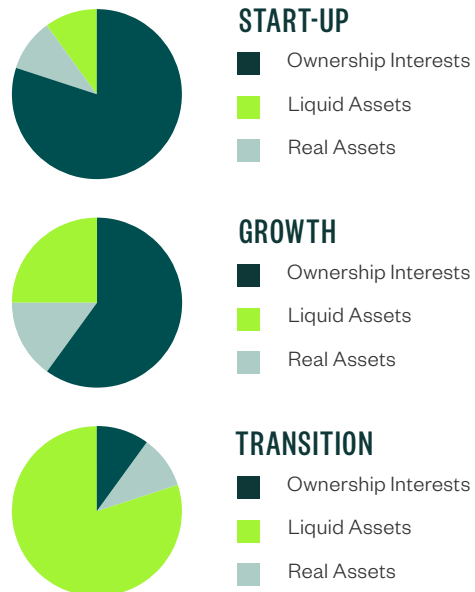
AFTER YOUR TRANSITION

Start-up. Launch. Growth. Maturity. Transition. These aren't just the different phases of your company. When you're an owner, they're also the moments in your life when you must evaluate where you've allocated your financial resources.

Owners should consider how to redeploy their newfound liquidity after an exit, not only from an investment perspective, but also a tax and estate planning standpoint.

For example, at the start-up stage, most of your assets likely take the form of your ownership interests in the company, with a smaller percentage devoted to personal liquid and real assets, such as real estate—personal as well as business—or business equipment.

But as your business grows, you may need more real assets to accommodate expansion. And as your business matures and you prepare your exit strategy or transition, you might find yourself with a greater proportion of liquid assets.



The above charts depict a general breakdown for how to deploy your assets during the three phases.

For more information about how to plan for each of the phases of your business's life cycle, contact your Moss Adams professional. To stay up-to-date on issues that affect your industry, you can subscribe at mossadams.com/subscribe to receive Alerts and Articles.

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About Our Oil & Gas Practice

Embracing a culture of possibility is essential to success in the oil and gas industry. You frequently navigate price fluctuations, cost containment issues, supply-chain management, and changes in the regulatory environment. While keeping pace with the changes can be daunting, it can also provide an opportunity for innovation. As you pursue new possibilities and evaluate alternatives, engaging a team that understands the specific challenges you face will allow you to concentrate on what really matters: growing your business.

WHO WE SERVE

Oil and gas is at the center of an expanding global marketplace. New technology and an evolving regulatory environment is rapidly changing the industry. We speak the language, and we know the specialized accounting rules.

Tackling complex issues drives us, whether it's navigating price fluctuations, cost containment, supply chain management, technological improvements, enhanced production demands, deregulation, or the need for capital. We know the importance of being able to adapt while safely delivering services, and our team of experienced professionals have worked in the supply chain—so they understand the challenges you face.

- Upstream exploration and production
- Oilfield services
- Midstream
- Downstream

HOW WE HELP

In addition to audit and tax services, we provide the following services, we provide the following to the oil and gas industry:

- Valuations
- Due Diligence
- Private Placements and Joint Venture Formations
- Litigation Support
- Accounting for Derivatives and Hedging
- Severance Tax
- Ad Valorem Taxes
- Sales and Use Taxes
- Accounting for Income Taxes (ASC 740)
- SOX 404 Compliance
- Section 382 Studies
- Domestic Production Activities (Section 199)
- Joint Interest Audits

As you explore your next opportunity, discover how Moss Adams can help your business thrive.

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