CAPITAL OPTIONS

FINDING THE RIGHT DEAL

CAPITAL OPTIONS 2017

A supplement to

Oil and Gas Investor

Oil and Gas Investor

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Future Financing Needs

During the fourth quarter, executives are figuring out their path for the coming year. Many factors have converged—low oil prices, OPEC, tough investor sentiment, rising service costs— and all options are on the table.

Money is among the most critical issues to be discussed and dissected. Questions include:

- What does the drilling program look like?
- Are there acquisitions to be considered, and how will these strategies be funded? And,
- Do companies need to return some money to their investors, but also fund capex?

This annual supplement provides some clues based on *Oil and Gas Investor*'s research and the profiles of some capital providers. After a grueling two years, E&Ps seem to have settled down and found their footing again in a lower-for-longer world. Returns are uppermost instead of growth for growth's sake.

S&P Global Ratings said in a September report on the energy industry's financial outlook that it expects lending markets to be broadly supportive … "based on price assumptions of $50 per barrel [bbl] for the remainder of 2017 and 2018, and $55/bbl in 2019 and beyond, as well as natural gas of $3 per MMBtu [million British thermal units] over the same period."

But the firm also said that upcoming financing needs must be handled, and multiple risk factors and variables could be game-changers putting companies in jeopardy again.

"We reviewed 120 credit facilities with maturities ranging from 2017 to 2023 for this report. A substantial number of credit facilities are maturing through 2019—a staggering $71 billion of bonds and other debt instruments are due in 2019 alone," S&P said. "And some banks might decide to pull back lending to the sector, leading to an erosion of available liquidity for many companies.

"Proactively addressing refinancing needs and maintaining adequate liquidity will be key to credit quality and ratings in the sector. As maturity crunch time draws closer, the stakes will only increase."

These are some sobering but realistic words of advice. But on the other hand, E&P companies have many options for accessing capital from multiple sources and with multiple deal structures from private equity to bank debt to second-lien debt to Drillco joint ventures, and so on.

The oil and gas industry is known for amazing creativity and technical progress in the field and its financial backers are known for creativity in deal making in the boardroom.

We don't know what 2018 will bring, but we do know it will be all hands on deck to solve any of the myriad challenges the industry could face. This supplement is a good starting place.

— **Leslie Haines**, Executive editor-at-large,
Oil and Gas Investor

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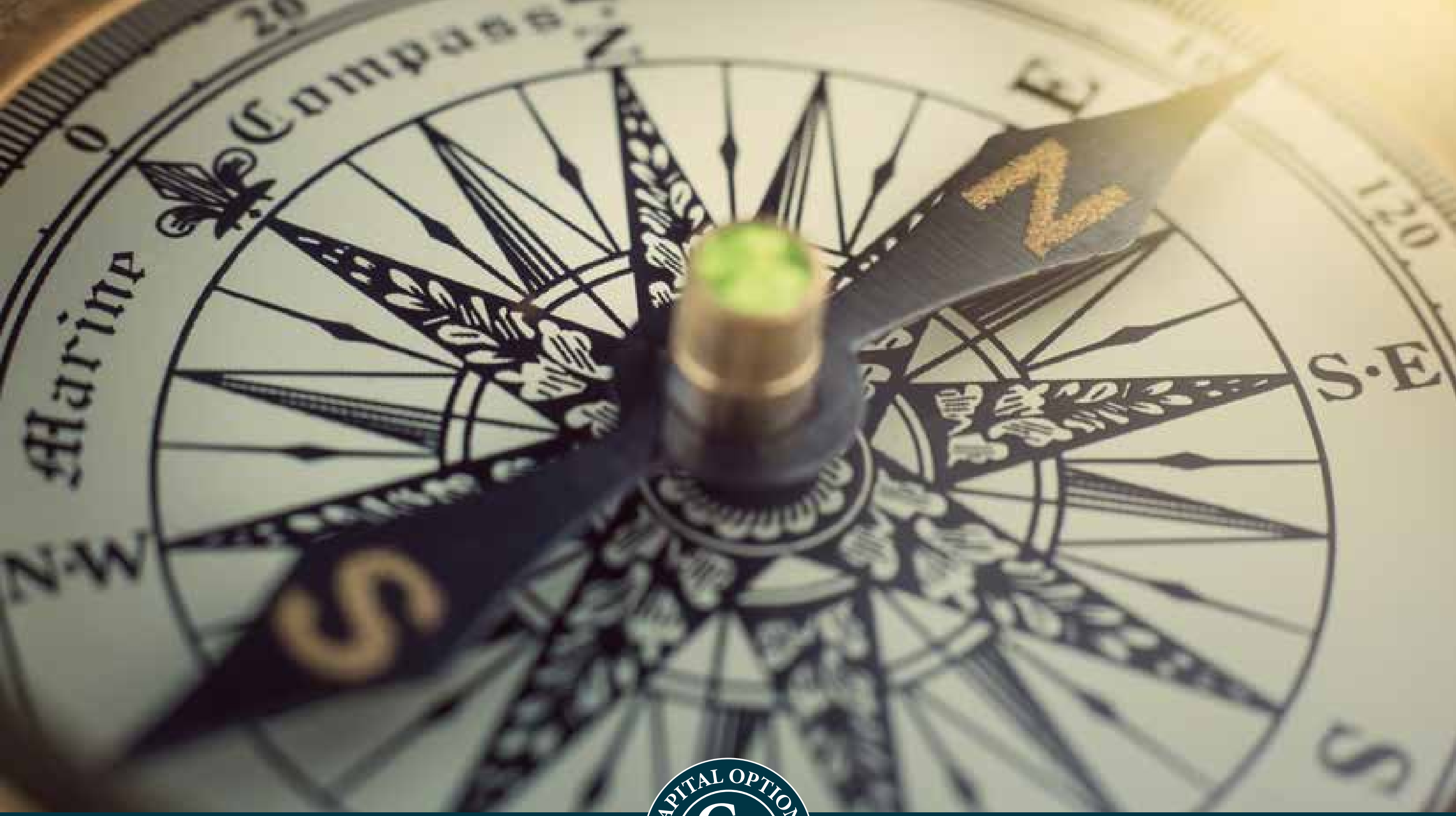


MACRO OUTLOOK

Compass Points 2017

These experts share what's on their minds regarding OPEC's next moves, U.S. oil output forecasts, the natural gas macro outlook and more.

Compiled By *Oil and Gas Investor*

For well more than a year, oil prices have struggled to remain much above $50 per barrel (bbl). This is true despite rising geopolitical tensions and continued violence throughout the Middle East, factors that in the past helped prop up oil prices. These trends have been offset by rising production from Libya and Nigeria and by declining production from Venezuela and the North Sea.

Analysts are waiting now on the outcome later this month of OPEC's formal meeting in Vienna on November 30. Most people expect that the group will extend its current production slowdown beyond the March 2018 deadline. In general, production compliance by OPEC members and their partner, Russia, has been better than expected.

But counteracting anything OPEC does, we continue to see the might and resilience of U.S. shale producers, whose technical proficiencies continue to improve like magic in every play. Producers have found a way to deliver the perfect well in an imperfect environment, one observer said, although oilfield inflation has begun to affect drilling and completion economics again and will continue into 2018.

Here, we've compiled some relevant commentary from a variety of analysts, to gauge their macro views and assumptions, investor sentiment and capital markets trends.

The IEA on global oil fundamentals

Oil fundamentals continue to improve, with second-quarter demand outstripping supply for the first time since 2014, according to the International Energy Agency (IEA).

Saxo Bank's Ole Hansen on oil macros

Based on the projected global supply/demand balance for 2018, OPEC would be required to supply 32.8 million barrels per day (MMbbl/d). On that basis, there is no room to increase production, and the only conclusion is that the group will be forced to extend the current production curbs deal beyond March 2018.

Record U.S. exports — if maintained during the coming weeks together with Libya's intent to boost production by 30% before year-end 2017 — risk putting some downward pressure on Brent relative to WTI. Brent has seen surging demand from funds and passive long-only investors after the return to an investor friendly backwardation.

Given the pull from increased refinery demand, we see Brent crude oil ending the year around $55/bbl while WTI crude oil will struggle to trade much higher than $51/bbl, given its positive impact on supply growth from U.S. producers.

Raymond James on global demand

In September, the IEA increased its forecast for expected 2017 demand growth to about 1.6 MMbbl/d year-on-year, up from 1.5 MMbbl/d previously and now closer to our model. Hurricanes Harvey and Irma are expected to slow U.S. demand growth in the third quarter, but the IEA still projects continued robust demand growth from the OECD countries heading into the fourth quarter.

We have consistently been calling for more robust demand than both agency forecasters and overall consensus—and the upward revisions continue to support our thesis that the global oil market is much tighter than many investors believe.

S&P Global Platts on U.S. production

In September, the Energy Information Administration (EIA) slashed its 2017 U.S. oil production forecast by 100,000 barrels per day (Mbbl/d) to an average of 9.25 MMbbl/d and lowered its 2018 estimate by 70 Mbbl/d, to 9.84 MMbbl/d. Despite this downward revision, U.S. crude production is still expected to climb to an all-time high next year — breaking the previous 9.6 MMbbl/d record set in 1970.

The Hill on natural gas exports

The U.S. Department of Energy (DOE) published a proposed rule in September designed to speed approvals of small-scale natural gas exports. Under the DOE plan, companies would automatically receive approval of export applications, provided they were going to ship 140 million cubic feet per day (MMcf/d) or less, and that the DOE would not have to undertake an extensive environmental review.

Raymond James on natural gas supply vs. demand

The firm thinks that respectable demand growth will simply be overwhelmed by a massive U.S. natural gas supply surge of 5-plus billion cubic feet per day (Bcf/d). The key culprits of this supply growth will be:

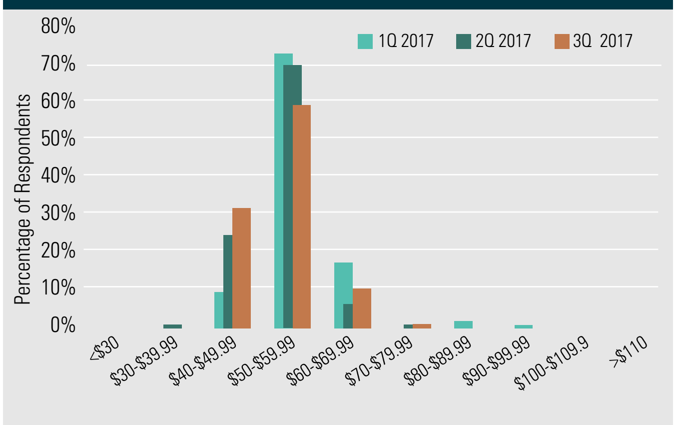
- increased pipeline takeaway from the Marcellus/Utica;
- growth in oil-driven associated gas supply (largely from the Permian); and
- a modest recovery from the resurgent Haynesville Shale.

Given our bullish crude oil deck, the associated gas component should continue to grow at an explosive and sustained pace regardless of natural gas pricing, putting further long-term pressure on Henry Hub gas prices. This relentless gas supply growth will be further compounded by growth in renewables that are increasingly becoming more cost competitive with gas.

RBC Capital Markets on U.S. forecasts

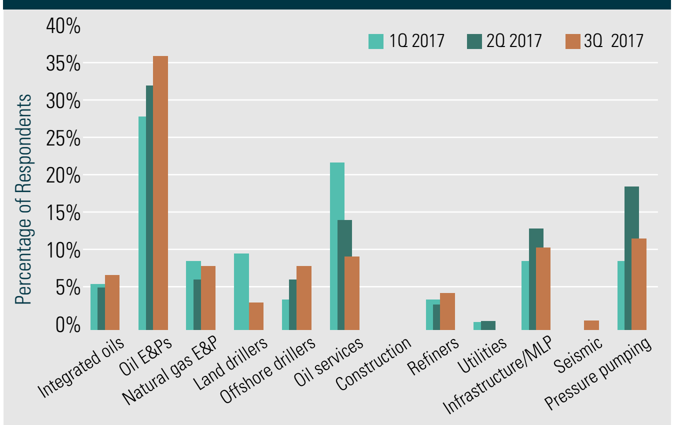
Lower 48 onshore production increased by 54 Mbbl/d to 7,038 Mbbl/d and is about 645 Mbbl/d below the 7,683 Mbbl/d March 2015 peak. We estimate U.S. oil production will grow by more than 320 Mbbl/d in 2017, then by more

EXPECTATIONS FOR WTI OIL PRICE OVER THE NEXT 12 MONTHS-THE SUB-$50 CAMP HAS GROWN

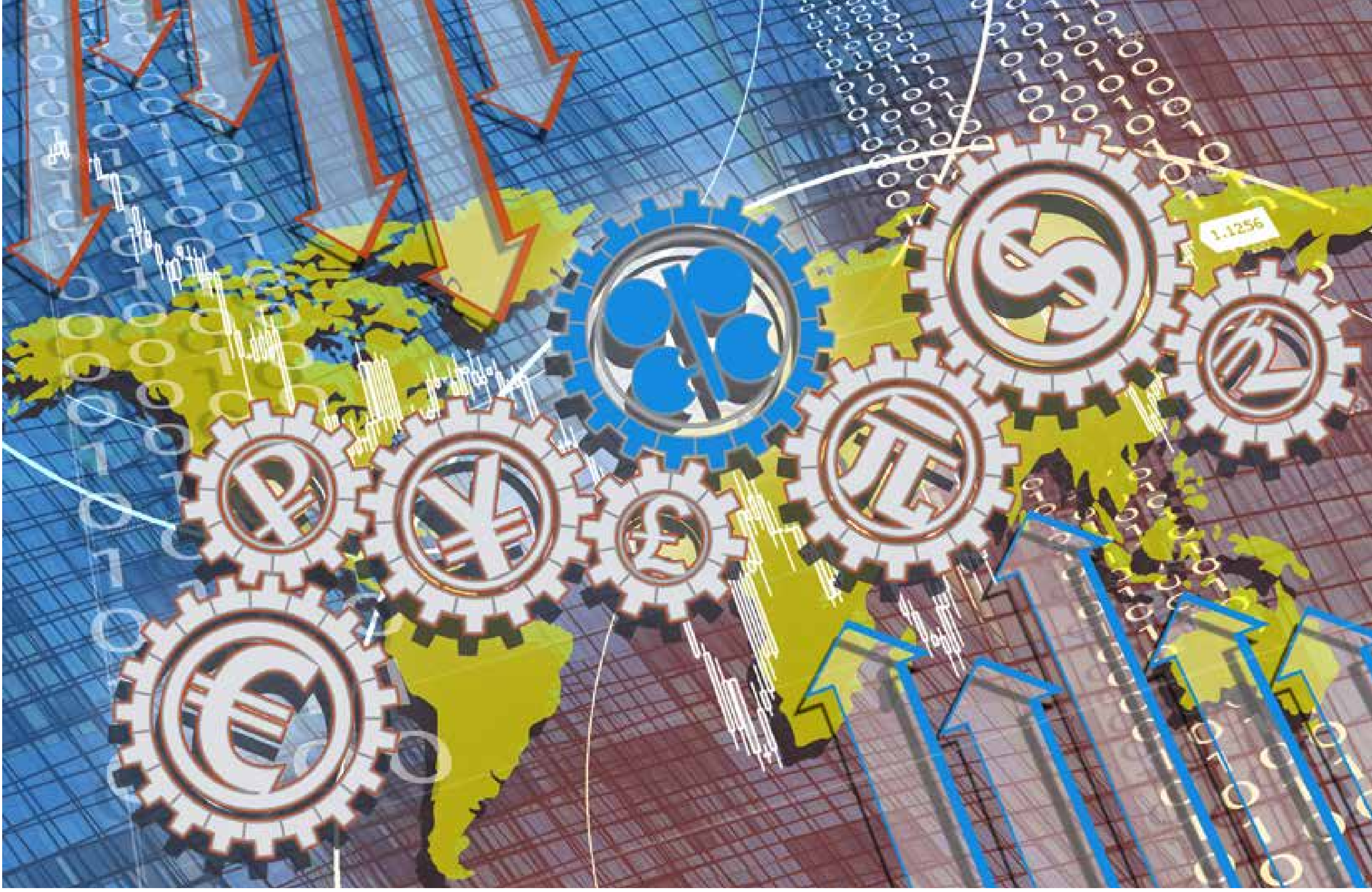


Source: Bernstein Energy Investor Sentiment Survey

WHICH ENERGY SUB-SEGMENT HAS THE MOST UPSIDE? OIL E&PS ARE FAVORED BY INVESTORS



Source: Bernstein Energy Investor Sentiment Survey



than 860 Mbbl/d in 2018, and 790 Mbbl/d in 2019, using our WTI price forecasts that range from $48.50/bbl, $50/bbl and $53.50/bbl in 2017, 2018, and 2019.

Citigroup on the latest oil price rally

Citigroup's Ed Morse still has faith the market can keep rallying. "We think it's for real," the global head of commodities research told CNBC on Oct. 2. "We're in the middle of a bit of a sell-off, maybe even testing the $50 level for WTI, but the sell-off is profit-taking more than anything else. And the momentum in the physical markets, joined by the momentum in the financial markets, really points to a higher price between now and the end of the year."

Bernstein investor survey

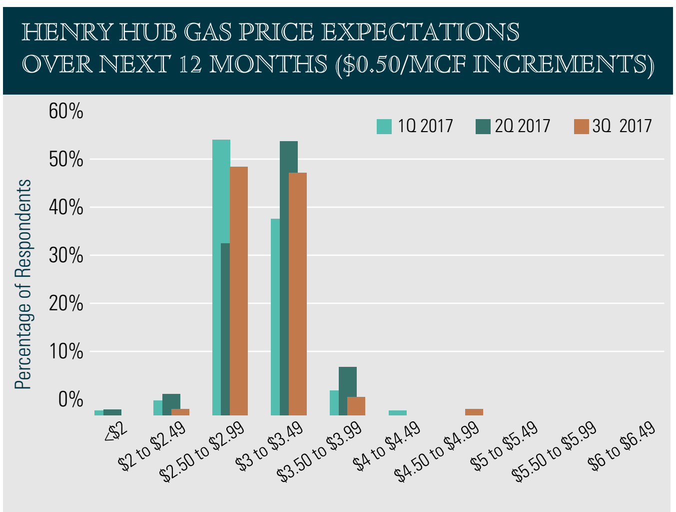
In September, Bernstein Research conducted its quarterly investor sentiment survey, which had 87 respondents.

For what's driving the stocks, investors seem to prefer valuation-based metrics against Growth, Momentum and Revisions [as driving factors] in this quarter. Ratios such as EV/EBITDA, P/CF, NAV/DCF and return on equity (ROE) all gained vote share whereas Growth, Momentum and Revisions saw a reduction in the number of votes from the second-quarter survey.

Votes for an oil price range between $50/bbl and $60/bbl for the next year remain robust. However, lower price buckets have seen an increase in vote share. The three-year outlook remains split between the $50/bbl-$60/bbl and $60/bbl-$70/bbl ranges, receiving 40% and 35% of votes, respectively. Expectations for the natural gas price were almost equally divided between the $2.50-$3/Mcf and $3-$3.50/Mcf buckets, with 48% and 47% of votes, respectively.

The Dallas Fed energy survey

For the third quarter, the Dallas Federal Reserve bank surveyed 78 E&P and 65 oilfield service company executives in September. The companies are located or headquartered in the Eleventh Federal Reserve District, which includes the Barnett, Eagle Ford, Haynesville and Permian regions.



Source: Bernstein Energy Investor Sentiment Survey

According to a summary of the Fed's survey, as reported by Cowen & Co., "Firms were asked where they believe U.S. production levels will be at the end of 2018. Responses were above the current 9.5 MMbbl/d according to the EIA, with an average survey response of 9.9 MMbbl/d. Roughly 40% of respondents expect U.S. production to be 10 MMbbl/d or 10.5MM b/d and about 20% expect production above 10.5 MMbbl/d.

One E&P executive commented, "Any production/supply reduction (or status quo, for that matter) that is experienced in the next six months is entirely synthetic. If OPEC/Russia were to take their foot off the brake, supply would increase fairly dramatically, consequently negatively impacting crude prices. Domestic production will continue to increase in the $48– $52 per barrel environment as access to capital will be sufficient to materially maintain [capex] budgets at least into the first half of 2018."

API on LNG exports

The potential global market is now estimated to be 32 trillion cubic feet (Tcf) by 2040, which is bigger than the 22 Tcf estimated in 2013.

Due primarily to the larger and more price-responsive natural gas supplies, the projected price impacts of LNG exports are about one-half of the levels expected in our 2013 report. We now estimate a price increase between 5 cents and 6 cents per million British thermal units per 1 Bcf/d of exports vs. the 2013 estimate of 11 cents to 12 cents.

Increased LNG export volumes of up to 16 Bcf/d in 2040 could support between 220,000 and 452,000 additional jobs and add $50 billion to $73 billion to the U.S. economy.

Estimates of current U.S. natural gas resources are about 3,700 Tcf, which are higher than estimates of 3,550 Tcf in our 2013 study.

Haynes & Boone on borrowing bases

Borrowing bases will likely decrease for only 26% of affected U.S. drillers this fall, compared with 41% of borrowers who were facing declines a year ago, according to a survey by Haynes and Boone. "Reading between the lines, it may be that banks remain reluctant to take any aggressive action reducing borrowing bases closer to their true value, for fear of putting too much pressure on some producers who have been financially distressed since the beginning of this downturn in prices," said Haynes and Boone partner Buddy Clark, speaking to Bloomberg.

Simmons & Co. on frack sand supply

Effective supply is likely closer to 92 million tons (80% discount), implying an approximately balanced market. In 2019 we model sand demand increasing to 125 million tons (assuming 1,100 rigs) while nameplate capacity would move to about 190 million tons if the roughly-75million of additions announced thus far came online, moving effective capacity to about 150 million tons (again using an 80% discount).

Thus, sand pricing seems poised to fall by some order of magnitude as supply and demand loosens. Several public companies dismiss this notion, yet our private sand company universe, as well as most end users, seem to agree.

RBC Capital on decline rates vs. new well count

RBC Capital's analyst, Scott Hanold, updated his assessment of nearly all the oil and gas wells drilled in the U.S. through 2016; there are about 3 million. "Our estimate of the U.S. onshore Lower 48 oil decline rate through 2016 was 34%, consistent with what we modeled a year ago. This is down from the peak level of 38% in the prior year (2015).

The 2016 decline resulted in 2.5 MMbbl/d of production replacement needed to keep production flat (onshore Lower 48 only). New wells in 2016 added 1.83 MMbbl/d of production, which was 0.63 MMbbl/d less compared to the year prior.

Overall, through 2016, onshore Lower 48 production declined 9.5%. Looking forward through 2017, RBC calculates the new base decline rate at 31%.

This implies that about 2 MMbbl/d needs to be replaced to maintain U.S. onshore Lower 48 production. Our analysis of this maintenance activity indicates this requires drilling 6,200-6,600 new wells and spending $45 billion. Although the decline rates and capitalrequirements for flat production are quite stunning, operators continue to improve well productivity, and the depth of inventory remains quite large in the core unconventional plays.

Poten & Partners on U.S. shale

Prices seem to have stabilized in the $45/bbl- $55/bbl range, well below the levels OPEC is targeting, but high enough for U.S. shale producers to stage a comeback. In August of this year, U.S. shale output reached 4.75 MMbbl/d, exceeding the March 2015 record of 4.7 MMbbl/d. The outlook for shale oil remains bright, with fields in the Permian Basin (representing 40% of current output) doing particularly well.

Bernstein on the battle

The battle between completion intensity and activity friction against efficiencies and looser purse strings will be played out in this final quarter of 2017. Note that our $50/bbl price deck for 2017 and 2018 is linked to our production forecast. So, to the extent that actuals beat our forecast positively in terms of barrels, it's negative in terms of price.

Every $10 swing in oil price translates to 600 Mbbl/d of production on an annualized basis. ■

LENDING TRENDS

Bank Borrowing Grows as Producers Control Costs

Lenders gave independents time to heal, and now loan quality has risen.

By Gregory DL Morris

Commercial banks do appear to be coming back to upstream lending, and a few newcomers are on the scene, so it's a welcome sign that the effects of low oil prices have abated somewhat. Bank regulators have provided clear guidance on acceptable structures for upstream loans, and loans within that guidance appear to be well over-subscribed.

Stephen Hoffman, managing director of energy banking at Huntington Bank, said, "We tend to focus on syndicated transactions and in 2017 on average, due to over-subscription, we allocated about 35% below what it committed. That suggests there's certainly interest from banks in the upstream. There appear to be some newcomers as well."

Huntington's portfolio primarily consists of broadly syndicated or club deals. The structures are more predictable. Any deal with more than three banks in it is subject to semiannual review by federal regulators. "Given the guidelines, any deal that stretches wildly may be difficult to get done. However, Huntington is open to sole-bank deals and always considers a good management team in a well-capitalized structure."

With respect to the broader industry, Huntington has worked to strike a balance between regulatory guidance's stance to be a responsible steward of the environment and its associated natural resources.

Huntington's oil and gas portfolio is about $1.2 billion in commitments to more than 50 clients. The bulk of the portfolio is upstream and in reserve-based facilities, although midstream and downstream clients are included. Upstream, Huntington primarily advances on proved developed reserves with some credit given to reserves that are proved and undeveloped.

"We tend to focus on syndicated transactions and in 2017 on average, due to oversubscription, we allocated about 35% below what it committed."

—Stephen Hoffman, *managing director*

"Other than being in the U.S., we have no geographic preference," said Hoffman. "In fact, as a measure of risk diversification, the bank prefers to avoid too much geographic concentration. Additionally, we prefer clients with some scale and, if not publicly traded, that they have private-equity backing. Further, we seek to add value and so do a great deal of commodity hedging. That differentiates us as a regional bank."

On capital structure, Huntington prefers the first-lien position with a semiannual borrowing base redetermination and is pretty much a boilerplate first-lien reserve-based lender. "The more equity behind us in the capital structure, the better," said Hoffman. "Junior debt within the structure is fine as long as the leverage levels are acceptable and the cost of that debt is not excessive."

Some veteran lenders in the upstream said they never lost faith. "More than 15% of our BOK Financial loan portfolio is dedicated to energy," said Jason Reimbold, senior vice president and director of E-Spectrum Advisors, part of BOK Financial. "I don't know of any other commercial bank with that high a concentration in energy. It is mostly upstream, but we have a growing midstream presence as well." Founded by oilmen in 1910, BOK Financial has more than a century of energy lending experience.

At midyear 2017, BOK had $5.7 billion in loan commitments to energy with $2.8 billion outstanding, for a utilization rate of 51%. The outstanding portion rose from $2.5 billion at the end of the first quarter, representing an increase of 12%.

Not too high, not too low

"Energy is a primary driver for our commercial and industrial lending business," said Reimbold, which is a notable distinction from some other institutions. "Over the last few years, many wanted to reduce exposure to this sector," he noted, "but we have a deep commitment to the energy industry, so we did not pull back. We found ways to grow our energy portfolio instead."

That was not just bravado. On the contrary, it was comfort borne out of experience due to BOK Financial's long history and comfort at recent price decks, Reimbold explained. "Certainly we were not immune to market conditions, but we had a very low charge-off percentage. In fact, it was generally syndicated loans where there were a few instances of concern, but otherwise, our sole-lender loans were very strong."

BOK Financial's approach to energy lending is conservative, Reimbold stressed. "We try not to get too high in the good times or too low in the bad times. And it is at the current time of the cycle that we can be particularly helpful to the industry."

"We try not to get too high in the good times or too low in the bad times. And it is at the current time of the cycle that we can be particularly helpful to the industry."

—Jason Reimbold, *Senior Vice President and Director, E-Spectrum Advisors*

In summer 2015, the bank found that the same practicality it applies to its clients enabled it to be opportunistic and it acquired Energy Spectrum Advisors, a Dallas-based energy investment firm. "When other banks were pulling back, BOK Financial stressed its commitment to the energy industry with this acquisition and by adding investment banking to its energy capabilities." E-Spectrum Advisors is part of BOK Financial Securities, which is a full service broker dealer and affiliate of BOK Financial.

Gradual adjustments

The view of bank debt in the energy sector from the outside looking in is cautiously positive, with a heavy dose of realism. "Capital markets funding, including reserve-based lending in 2017, started optimistically," said Amol Joshi, vice president at Moody's.

"We saw plentiful debt, equity and even IPOs since mid-2016. Second-half 2016 was quite robust."

—**Amol Joshi**, *Vice President, Moody's*

"We saw plentiful debt, equity and even IPOs since mid-2016. Second-half 2016 was quite robust. Such funding is critical for spending by operators to grow production and reserves. The current challenge is that oil prices have lost momentum over the summer. That has led to equity and debt funding hitting the brakes. Lending dollars are still available because oil prices have stabilized and the risk of bank losses due to E&P bankruptcies has significantly decreased after peaking during the 2015-2016 default cycle, while E&P reserve values have since improved."

Some of that comes from industry itself, including cost and capital efficiencies. But Joshi credits banks with making gradual adjustments over the past few years.

"There was pressure for banks to move to higher quality loans and to hold more reserves against losses. The Office of the Comptroller of the Currency tightened standards. Banks proved that reserve-based lending works. They made gradual changes through a tough time. It helped that banks themselves were not under financial pressure but they did not make many major redeterminations."

In the end, "growth is dependent on spending," said Joshi. "Many companies are trying to live within their cash flow, but spending is higher in 2017 compared to 2016 and has not slowed much yet. Our outlook is for oil in a range of $40-$60 a barrel over the medium term, with possible excursions over and under. Same for gas in a range of $2-$3.50 [per thousand cubic feet]. The recent softness in prices could have some impact on 2018 spending, but it is too soon to call. We are still trying to shake off the summer doldrums."

Texas Capital Bank sounds similarly optimistic. It has about $1.6 billion in commitments to the energy sector, most of which is upstream. "I would like to grow our midstream business, but it is much more a greenfield business these days than the cash flow business it used to be," said Lester Keliher, executive vice president and head of energy banking at Texas Capital.

"We focus on active drillers, and given the downturn, that is a good place to be. Through the downturn there were several banks that sat on their hands, but we tried to be aggressive. We have long relationships with several independents, and that helps."

The bank is geographically diverse. "We are in all the usual places in the Lower 48," Keliher noted. "We don't like water, and as the price of commodities has declined some basins have gone out of favor, but there are still opportunities out there."

The focus is very much on management teams first, followed closely by the asset base. "The key is the cost to produce," said Keliher. "That is where the Permian has the advantage, but it seems that that basin has gotten a little frothy lately. There is an amazing amount of equity waiting to be put to work and that is creating some pressure on investment managers. There is something of a halo effect in the Permian that is not present in other basins."

In general, producers, investors, and bankers have bought into the philosophy of "lower for longer" for hydrocarbon prices. But it has taken some time. Indeed, it may have been banks' optimism that prices would recover that militated against any heavy redeterminations after the price collapse in late 2014.

"There have been some banks that have exited the sector, while others just sat tight. There was some meaningful damage, and there were some people humbled."

—**Lester Keliher**, *Executive Vice President, Head of Energy Banking at Texas Capital*

"Lenders, especially the larger syndications, basically kicked the can down the road based on the expectation that prices would come back more rapidly than they did," Keliher said. "Also, there were not a lot of alternatives, so many people chose just to wait and see."

It has been suggested that all's well that ends well and that lenders and their clients have muddled through without excessive pain. "There have been some banks that have exited the sector, while others just sat tight," Keliher recalled. "There was some meaningful damage, and there were some people humbled."

Over a 30-year career in energy finance, including long stretches with major national banks and some time working in distressed debt, Keliher feels the timing was propitious in March 2016 to saddle up for Texas Capital. "Some of the bank's original founders made their money knowing that prices go both up and down. We are an entrepreneurial bank, with a focus on $10 million to $200 million transactions. And we like to be partners with private equity."

Now lending is being done based on a new paradigm—one that accommodates the stricter guidance from The Office of the Comptroller of the Currency issued in early 2016. Hedging has also returned to favor.

"The majority of operators now believe in hedging again," said Keliher. "That is in part because banks have become more insistent. Operators were reluctant to hedge because they felt it limited their upside. Bankers just wanted to protect their downside, but that message never seemed to get through to borrowers. But low prices have brought clients around to reassess their model and understand that they have to lock in their revenues and control costs. So hedging does matter."

"Credit is okay these days. Everyone is healing, but only some people can make adequate risk-weighted returns at current prices."

—Mark Cranmer, *Executive Vice President, Energy Finance, Frost Bank*

Credit is not as complex

Frost Bank's book of upstream business runs about $3 billion that is all non-investment grade but ranges from $250,000 to $200 million, and up to $500 million on an arranged and syndicated basis, and from single-bank loans to family-owned operators to syndicated loans to public companies.

"Our Midland [Texas] office does a lot of smaller loans to family businesses; our core focus is the middle-market independent," said Mark Cranmer, executive vice president of energy finance at Frost Bank.

The bank's energy group operates across Texas with offices in Fort Worth, Dallas, San Antonio, Houston and Midland. The staff of 23 includes five engineers, two technicians, six bankers and two analysts. "The bankers have an average of 10 years' experience, I have 28, and our regional president in Midland has 35," noted Cranmer. That tenure gives Cranmer and his group perspective on the current lower-for-longer situation in oil and gas. And there is a focus on the resource and asset quality.

"Interest rates are not that large a factor," he explained. "Reserve-based lending is mostly production and operating cost forecasts and price sensitivity. We have already accounted for any possible increase in rates in our underwriting."

The focus is more on "good management teams, asset quality and leverage liquidity," said Cranmer. "Credit is okay these days. Everyone is healing, but only some people can make adequate risk-weighted returns at current prices. Still, we have seen some capital budgets increase among independents. We do a little internal survey every September and that is what we are seeing now."

What he is not seeing is much complex credit. "Most of the new financing these days has a lot of equity, as much as 60%-80%. Leverage is around 1.5 to 2 times EBITDA. We are not seeing a lot of second-lien or unitranche terms because there is just so much equity coming in that people are not using a lot of debt. I have not seen too many exotic structures in new financing. Also, I think that some of the bankruptcies were debt exchanges."

Through the cycles in the industry and the growth of BOK Financial, Reimbold said that the assets underlying the lending portfolio have not changed much. "I have not seen much different. There is not a preference of one play or horizon over another. That comes back to our in-house engineers' expertise. We don't have just bankers on the team. And while it is always good to get outside perspectives, I can tell you that every deal we do is engineered in-house. Every deal we do is considered on its own merits. We don't chase plays, we chase opportunities."

That said, Reimbold does have a kind word for hopefulness, noting that through the lower parts of the cycle "many banks that lent in energy were hopeful that by the end of 2015 we would see oil back to $60 a barrel. Then the hope was getting there by the middle of 2016. Then, the end of '16: By that point the industry had cleared out most of the challenged credits. Lots of other credits were strained, but not beyond repair, and they have managed to survive."

At the same time, "there has been a reluctance among most to accept losses," Reimbold added. "Banks are in no hurry to bring finality. In some cases that has led to a sort of limbo, but absent outside drivers to take action, no action had to be taken."

Many observers anticipated that outside pressure, which was from regulators pushing banks to increase reserves against loan losses and to increase the overall quality of their loan portfolios, and also from the necessities of banks' own balance sheets. Reimbold acknowledged those expectations were widely held, but he noted that along the way there was robust deal flow in the divestiture and acquisition of acreage. "Both banks and their customers found ways to maintain the status quo without harsh redeterminations." ■

PRIVATE EQUITY TRENDS

Private Equity Adapts

Action between private equity funds, their portfolio companies and asset sales still moves mountains, but hold times and strategies may have changed.

By Gregory DL Morris

In the ebb and flow of capital options for upstream producers, private equity (PE) is proving to be adaptable. The appetite of public markets for offerings, and of public companies for making acquisitions, has ebbed, but PE continues to invest upstream while modifying its exit strategies and time lines.

A&D activity has slowed in recent months, but Dheeraj (D) Verma, president of Quantum Energy Partners, cautions against reading too much into that.

"It is difficult to draw broad conclusions. The important takeaway is that since November 2014 when the price of oil fell by half, there has been a flight to quality. This behavior is consistent with what you can observe in other industries also, whenever there are significant structural dislocations."

What that means for private-equity funds is a divergence. "For high-quality assets there is plenty of buyer interest and capital," he said. "For assets of lesser quality there is limited liquidity, and in some cases no liquidity. In those cases you may see longer hold times or even write-downs. And in those situations, leverage is also often a big culprit, as we saw with the upstream MLP write-downs in the last few years."

Just because a particular asset does not fit in a given portfolio today does not mean it never did or never will.

"It is true that there have been periods of irrational exuberance," said Verma, echoing the notorious Wall Street term. "But mostly the challenge is volatility. The longer the commodity prices remain volatile, the more people get skittish. For deals to get done, people need a commodity price deck from which to do business."

Stressing the "psychology of stability," Verma noted that oil prices seemed to have stabilized around $50 per barrel (bbl). Then the price slid to about $44/bbl, and is now back to $50/bbl or higher. "It will take a few months before people can start to feel comfortable again. Whenever stability is challenged, it takes time for the psychology of stability to return," he said.

> **"…we've had a fairly consistent liquidity pattern, because we accumulate assets with the buyer universe in mind."**
>
> — **Mark Welsh**, *EnCap Investments LP*

Recently, a significant amount of press has pointed to the influx of capital into energy private-equity funds over the past few years, noted Chuck Yates, managing partner at Kayne Anderson Energy Funds. "Despite that, we are seeing many attractive investment opportunities in the current market and have been successful deploying capital. We closed our seventh fund in October 2016 and we have already invested almost 70% of the fund's capital."

"We have noticed a trend whereby exit windows are rapidly opening and closing," said Chuck Yates, managing partner, Kayne Anderson Energy Funds.

Technology advancements continue to expand the opportunity set for the industry as new drilling targets, previously thought to be uneconomic, are unlocked and the economic boundaries of existing plays are expanded. "Who knew that we'd be using over 20 million pounds of sand and 50 stages when completing horizontal wells in many plays across the country?"

The view on early-stage assets

Kayne Anderson's portfolio companies target early-stage opportunities across North America. In the current market environment, larger E&Ps are divesting early-stage assets that they don't expect to drill in the near-term, and/or where they have drilling obligations or upcoming lease expirations.

"Those types of assets are frequently sold with little to no existing production or cash flow," Yates noted, "so they don't provide much credit support. They are often acquired at reasonable entry costs and can include significant undeveloped acreage with attractive growth potential. Large companies view early-stage assets with near-term capex requirements more as a liability [than an asset]. And the longer the current oil price environment persists, we believe capital-constrained companies will continue to sell these assets to generate additional liquidity."

In terms of exits, Yates added, "I wouldn't say that there is a logjam in the A&D market, it's just that certain assets are much easier to sell than others at the moment. In the current market, management teams are learning to live within cash flow, reining in spending and focusing on shareholder returns. As a result, large public operators are less eager to venture out of their most proven, economic plays and into out-of-favor basins or less-proven areas in the 'hot basins,' which may still be highly economic.

"That change in mindset has actually reduced competition for early-stage assets."

Mark A. Welsh IV, managing director of EnCap Investments LP, said the firm has been an active seller. "Over the last several years we have had a fairly consistent liquidity pattern because we accumulate assets with the buyer universe in mind. That said, the A&D market has slowed, together with overall slowness in public markets. There has been limited transaction volume on the sell-side today vs. six months ago."

With commodity prices staying lower for longer, but being relatively volatile within a trading range, larger operators with multiple assets in multiple basins are making decisions on where to direct their limited development capital. "As a result, we have been able to make some opportunistic acquisitions."

E&Ps often buy assets with eventual buyers in mind, but Welsh explains that "the decision by a specific operator to divest a specific asset is just that: specific to the company, time and place. They have one balance sheet and multiple assets." There is nothing to say the same asset would not be a good fit for another operator, or even the same operator at another time.

"It could also be a staffing question," Welsh added. "We had one transaction where the operator had one set of assets in the Midcontinent and another in South Texas and they preferred not to divide their operational and technical staff

"Those positions that are not shales have an exit story already attached," said Jonathan Farber, managing director, Lime Rock Partners.

between the two. There are considerations beyond just the balance sheet that lead to a divestiture. In those cases we can bring management, not just capital."

Ebb and flow creates opportunity

About half of the teams that EnCap backs are repeats. "Others are new to us, but certainly not new to the industry," Welsh said. "Our teams bring us the opportunities because they are the basin experts; they are out in the market actively evaluating deals. We continue to maintain the posture of active investment when the right opportunities present themselves."

The typical cycle for EnCap runs three to four years. "We have been pretty consistent through the years," Welsh said. "It is difficult to predict cycle time exactly, so the key is to be agile and adaptable."

Ryan J. Smith, an EnCap associate, added, "The ebb and flow of the market creates inherent opportunity. We own assets that we like and continue to develop. We are flexible and patient, and if the market does not offer a premium for a given asset at a certain time, we will continue to hold and de-risk the value drivers such as drilling additional benches, tighter well spacing, and enhanced completion techniques. Not only will this allow us to grow production and cash flow from the asset while we own it, but it will also create the potential for an even greater return once the market comes around."

"...if the market does not offer a premium for a given asset ... we will continue to hold and de-risk the value drivers..."

—**Ryan J. Smith,**
EnCap Investments LP

Whether the holding period is long or short, EnCap sticks to a simple capital structure. "The common equity is from us, and typically the only other form of capital is a conforming reserve-based loan," Welsh explained. "We usually take a very conservative approach to leverage. It averages just about 10% across our portfolio companies. Over the years it has ranged as high as 20% at some times, but that is still quite low relative to industry standards. We try to avoid mezzanine and other more complex structures."

Exiting conventional investments can be a huge challenge, said Jonathan Farber, co-founder and managing director of Lime Rock Partners. "If you have lunch these days with investment bankers in Houston, their main question is how can they help other private equity firms exit legacy or conventional positions at reasonable values. There are no easy answers. That is one reason we have focused on shale almost exclusively for the past few years."

About 80% of Lime Rock's activities are in shale. "Those positions that are not shales have an exit story already attached," Farber said. "For example, we have a conventional position in a shallow-water Gulf of Mexico play. It was structured in a way to self-liquidate over time, so there is no need for us to find a buyer."

Part of the reason public equities are not as involved in taking in PE-backed portfolio operators as they used to be is that the public firms are hampered by their languid stock prices, Farber suggested. "In the past year or so we have seen a slight increase in the price of oil, but equity prices are down because of a meaningful decline in market confidence."

In effect, it has been good that operators have embraced the lower-for-longer mentality, because it puts more of a focus on costs. But once non-specialized institutional and retail investors came to accept lower-for-longer oil prices, that idea seems to have put oil out of favor for the broader market.

Quality, technology and security

Quality will win out, Farber said. "If you have quality shale assets, you have options. That can be with a strategic buyer [a large, publicly traded or national oil company] or through joint ventures or non-operator arrangements. Superior assets lend themselves to a variety of capital sources."

Another characteristic that will enhance assets' attractiveness is improvement in the ratio of technology to costs. "We currently expect some escalation in service costs, but we also anticipate those will be offset by advances in technology and operational efficiency," Farber said.

A central capital markets tool is hedging, Farber added. "From a risk perspective the options for shale are far superior to conventional development. For a dollar committed to shale today, you can hedge away some of exogenous conditions within a few weeks or months. For larger operators with liquid positions, they can probably hedge those risks instantly."

Adding his own perspective to the psychology of stability, Verma emphasized that "people like to gravitate to this factor or that, but there is nothing substantive now that we have not seen or managed through in past cycles. It is the same three or four factors. The only thing that is new is that there is more macro-economic noise around oil demand, geopolitical risks, global slowing of gross domestic product, and climate change. While relevant, many of these factors are exaggerated and oversimplified by the popular press."

Directly to the point of exit capital availability, Verma said, "We have had several recent examples of meaningful exits across our portfolio. We have sold Permian assets, but so have others. What is interesting is, we have also been successful in monetizing some large gas assets we have developed over the past five-plus years in the Marcellus and in the Scoop. At the moment the sharp divide is between exit capital for oily assets and the lack of interest in most gas assets. To sell gas assets today, they have to be in the top quartile, maybe even the top decile."

PRIVATE EQUITY SUPPORT

Arrange, evaluate and negotiate credit agreements and other financial arrangements.

Share relevant capital markets knowledge.

Provide technical support through in-house engineers.

Share real-time technical information, including drilling and completion designs from other portfolio companies.

Use various models to determine cash flow, hedging risk, holding periods.

Provide A&D expertise on deal structure, buyer contacts, exit timing.

Additionally, Verma said that while some exits may have had to be delayed a few months to a year, others have been accelerated. "We have sold some Permian assets sooner than anticipated. We were well on the way to proving them up when we found multiple buyers interested in owning them. Start to finish was three years, rather than four or five."

While many managers focus on the financial aspects of their capital flow, Verma noted that the business is still about exceptional people focused on cost-centered execution. "In the past few years, a lot of the public companies have bulked up on inventory. So while private companies remain a source of acquisition-led growth for these public companies, there is a high bar to displace their existing inventory. This will result in more patience, longer hold times, more drilling and even more creativity on exits."

"Assets of lower quality may require longer hold times," said D Verma, president, Quantum Energy Partners.

Prudence and patience

Ultimately, any asset acquisition will have to compete with public companies' existing inventories. Yates suggested that the best way to combat exit friction is to be selling highly economic and repeatable inventory. "If public operators aren't there for an asset sale, the influx of capital has led to an increase in the number of private operators that can be aggressive buyers. In some cases, the most prudent course may be to be patient and to continue development until the market strengthens. However, we believe a highly competitive market still exists for well-delineated assets in the right zip codes."

Another new wrinkle is tight timing. "We have noticed a trend whereby exit windows are rapidly opening and closing," Yates said. "As a result, we've taken steps to ensure we are positioned to capitalize on a potential exit opportunity within a short time frame.

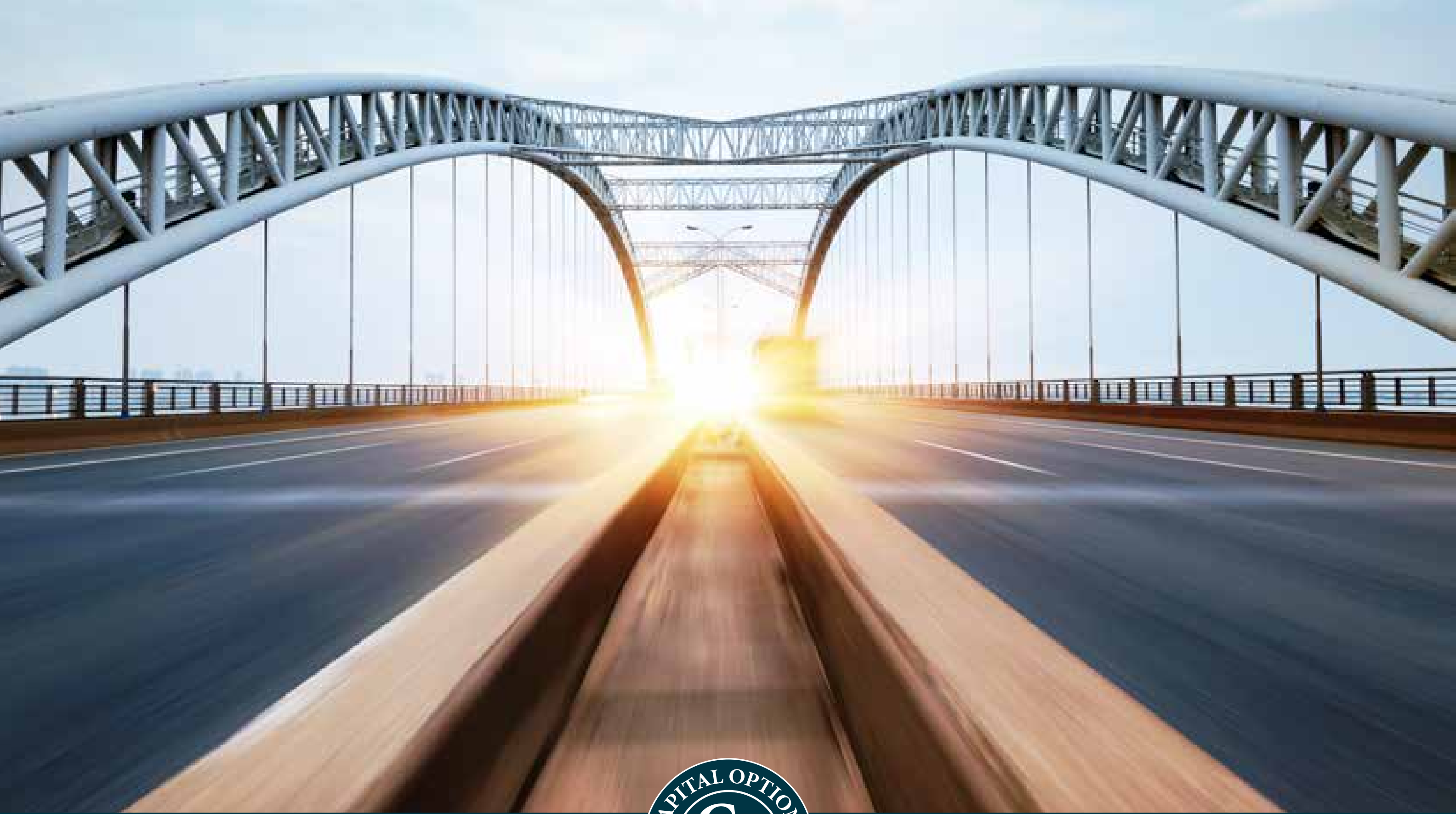
A few notable exits that we closed in the past year were Silver Hill Energy Partners I & II, Panther Energy II and HRM II. Silver Hill and Panther were both successful Delaware Basin exits to large public companies and HRM II sold D-J Basin and other assets. Silver Hill was the largest exit of the three at $2.4 billion and, given how large the deal was, the buyer needed to use a significant amount of stock to finance the transaction."

There are also buy-and-hold scenarios. "When we evaluated a Bakken acquisition from a large public operator in the third quarter of 2016," Yates recalled, "we really liked the asset from a technical standpoint but at the time, the Bakken was out of favor and we needed to be prepared for the possibility of holding it for several years until that market improved. We ran multiple modeling sensitivities to see what returns would look like if we held and developed the asset for an extended period." ■

PRIVATE EQUITY FIRM	PORTFOLIO COMPANY	FOCUS	AMOUNT ($MM)	DATE
Quantum Energy Partners	Rockcliff Energy*	ArkLaTex	$525	Aug. '17
Quantum Energy Partners	Vitruvian Expl. IV	Eagle Ford	$450	Aug. '17
EnCap Investments LP	Silverback Expl. II	Delaware Basin	$500	July '17
Quantum Energy Partners	Impact E&P	Rockies	$300	July '17
Kayne Anderson Energy Funds	Native Exploration	Scoop/Stack	$150	July '17
EnCap Investments LP	Staghorn Petroleum II	Midcontinent	N/A	May '17
Quantum Energy Partners	Middle Fork Energy	Rockies	$200	May '17
Lime Rock	Reveal Energy Services	Frac Mapping	N/A	Apr. '17
EnCap Partners	Fortis Minerals II	Various	N/A	Mar. '17
EnCap Partners	Ameredev II	Permian	$400	Mar. '17
EnCap Partners	Mongoose Energy	Texas, Rockies	N/A	Apr. '17
EnCap Partners	QStar II	Permian gas	N/A	Mar. '17
EnCap Partners	Olifant Energy	Permian, Anadarko	N/A	June '17
EnCap Partners	Royal Holly Energy	Cotton Valley	N/A	Jan. '17
Kayne Anderson Energy Funds	Fund VII	-	$2,000	Oct. '16
EnCap Partners	Novo Oil & Gas	Various	N/A	Aug. '16
Quantum Energy Partners	Sentinel Peak Energy	California heavy	$300	Apr. '16
Kayne Anderson Energy Funds	Invictus Energy	Various	$150	Jan. '16
EnCap Partners	Fortis Minerals	Interests & royalties	N/A	June '16
EnCap Partners	Grayson Mill Energy	Rockies	N/A	Oct. '16
EnCap Partners	Payrock Energy II	Various	N/A	Sept. '16
EnCap Partners	PetroLegacy Energy	Permian	N/A	Sept. '16
EnCap Partners	Raisa Energy	Non-op WI, minerals	N/A	Apr. '16
EnCap Partners	Felix Energy II	Permian Basin	$500	Sep. '15
Kayne Anderson Energy Funds	Monadnock Resources	Various	$100	Aug. '15
Kayne Anderson Energy Funds	Triumph Energy	Midcontinent	$100	July '15

* Purchase of assets from Samson Resources II.

Source: Company reports.



ALTERNATIVE FINANCING

Non-traditional Capital Bridges the Gap

Producers seek a simpler capital structure between debt and private equity.

By Gregory DL Morris

In recent years, as independents have worked to recover from the Great Recession and live within the lower-for-longer reality, the overall trend has been to simplify the capital stack. This is especially true of operators with some combination of prime acreage and low leverage. Given their druthers, many operators want nothing more on their balance sheets than straight equity – public or private – and reserve-based bank borrowing.

Nice work if you can get it, but not all operators can. Given the dearth of public market appetite for either new offerings or corporate-level acquisitions, there remains alternative financing, from high-yield and mezzanine debt to more hybrid structures. That has largely been driven by borrowers' assets, said Jason Reimbold, senior vice president and director of E-Spectrum Advisors, part of BOK Financial.

"In a general sense high-yield has been and remains an option, and other forms of capital may also be appropriate. At the same time, there may have been some disappointment by borrowers in these alternative forms of capital."

Private equity is at a crossroads, according to Reimbold. That is most evident in his backyard with

Oklahoma's Stack play. "We see multiple development teams backed by private equity (PE), all with 50,000 net acres, more or less, and a dozen wells down. All of them were anticipating an exit around the end of 2017. That time is at hand, but we have seen a retreat; buyers have started to evaporate.

"That puts the question back on the PE backers of these developments: how much money do they continue to risk drilling wells?"

That anxiety is reflected in pricing. Reimbold highlights that for the 12 months ending August 2017, the price for West Texas Intermediate is higher by a modest 6%. In the same period, the E&P composite index for stock prices is down a sobering 26%. That varies by geography: operators primarily in the Permian have seen their equities go down only 12%, while those primarily in the Niobrara are off a vertiginous 36%.

"That gap could, and indeed should, be filled with alternative forms of developmental capital, all types of structures, but mostly with a credit focus," said Reimbold. "However, there is some apprehension about moving down the road with all those structures in place. It makes the true cost of capital very difficult to know."

Several of the operators that are clients of Huntington Bank came close to issuing high-yield debt earlier this year and yet, most were pulled.

> "Highly levered companies don't necessarily want to go back to banks that are going to be tight in their advance rates and covenants."
>
> **—Amol Joshi**, *Vice President, Moody's*

Gauging the Space

"It seems pretty quiet in that space right now," said Stephen Hoffman, managing director of energy banking at Huntington. Unsecured term-loan debt was fairly popular in 2016 with investment-grade upstream companies. Many of those were refinanced quickly with investment-grade bonds or asset-sale proceeds.

In the leveraged upstream segment where Huntington's focus has been, he adds that he has not seen "much new unsecured debt at all. I see some second-lien and a lot of private equity. Private equity is what kept the M&A market going in my view. Huntington completed about 15 new upstream deals in 2017, and I think every single one of them has had a private-equity commitment. A couple had a second-lien as well."

Companies that survived the most recent downturn with balance sheets in need of repair appear to be the ones looking at alternative debt. "It's not a new idea," said Hoffman, "but many of these structures have equity and debt-like characteristics. Depending on the interpretation, it can allow the company to get full or partial equity credit for it while providing the investor with a better position than pure equity. Second-lien debt seems to be available, but I have not seen much mezzanine debt. Recently I've seen few syndicated bank revolvers refinanced entirely by institutional first-lien term loans."

Private equity's role

Far from sucking all the oxygen out of the room, private equity is filling a gap in the upstream, he said. "For bank lenders, private equity has been a great partner. Most of the new deals Huntington is entering are capitalized 50-50 with bank debt and private equity. When the high-yield market returns – and it always does – it'll likely reduce the bank debt in the structure, not the equity. I've previously mentioned regulatory guidance. I don't think you can underestimate its impact on loan structure in upstream lending over the last few years. Within the industry there's room for debt in the upstream, but if some of it is bank debt, then it's essential that it fit within regulatory guidance."

In contrast to some lenders who say that alternative financing is making the market more complex, Lester Keliher, executive vice president and head of energy banking at Texas Capital, said that he is seeing the trend toward simplicity.

"Commercial banks are limited to total debt of 3.5 times EBITDAX so that puts a lower limit on debt. As such, we are seeing more simple transactions of bank debt and equity, vs. mezzanine, high-yield, second-lien, and structures like those."

At the same time that bank debt seems to be holding steady but with tighter advance rates and covenants, high-yield debt and equity softened over the summer, noted Amol Joshi, vice president at Moody's. "High-yield made significant gains in 2016 but has not made much money for investors in 2017. And while there has been good private-equity deal flow, I don't know if lately there is much new money investing in energy public equity. It seems mostly to be recycling dollars, with funds selling and recirculating capital."

The net result is that "the cost of capital is creeping higher," Joshi cautioned. "The non-traditional capital that is bridging the gap for some producers is replacing less-expensive, traditional sources of funding. It is true that the non-traditional lenders do have some bank-like structures, but those providers mostly make their money on stretch and mezzanine deals."

When Moody's makes its ratings, they generally favor simpler capital structures. That said, Joshi maintains that more complex capital has a place, particularly in "Drillco" developments. "In those cases the investors typically put in capital while the company contributes its acreage. If there is a reversion after the Drillco hits its payout plus return, that can be a good way to raise capital without traditional leverage. There is complexity, and that always raises issues."

While the general preference is for simpler forms of capital, including debt, Joshi noted that some smaller operators tend to stay with non-traditional capital. "Highly levered companies don't necessarily want to go back to banks that are going to be tight in their advance rates and covenants." ■

PRIVATE EQUITY FUNDING

Energy Funds Target Subscription-Based Facilities

Alternative debt financing, secured by a fund's limited partners, is another arrow in the quiver.

By Taylor M. Smith

The worst oil and gas price slump in decades has made it more difficult for E&P companies to obtain conventional reserve-based debt financing on favorable terms. However, many do rely on energy-focused private-equity funds. In turn, these private-equity funds, interested in using debt to finance their investments and related expenses, may find a welcome alternative in subscription-based credit facilities. This is a financing tool becoming increasingly popular in the real estate and private-equity buyout industries, but it could apply to energy as well.

Beyond providing an alternative to conventional reserve-based debt financing, subscription-based credit facilities also offer logistical and process-oriented benefits for energy funds and their portfolio investments.

A subscription-based credit facility (sometimes called a "capital call facility" or a "subscription line") is a senior secured revolving credit facility borrowed by a fund or by its non-operating affiliate, and it's secured by the fund's capital commitments from investors and by the fund's contractual rights relating thereto.

The availability of borrowings under this type of credit facility is usually subject to a borrowing base limitation determined by reference to the credit quality of the fund's investors.

An often-cited logistical advantage of subscription facilities is that they allow funds to make new investments, contribute additional capital to existing investments, and pay operating and other expenses, in each case without first needing to call capital and wait for investor contributions to be funded. Instead, subscription facility borrowers can access loan funds upon minimal advanced notice, using investor contributions to repay those borrowings when convenient and practical.

Additional benefits for borrowers include the opportunity to increase yield at the fund level—without over-levering portfolio companies—as well as the potential for more attractive pricing than portfolio-level debt. Lenders are attracted to the low historical default rate associated with these facilities and to a structure that allows for lending on the basis of the relatively strong credit quality of fund investors, rather than on the basis of unproven or underperforming assets at the portfolio company level.

Subscription facility details

Borrowing base. The amount available to be drawn by the borrower under a subscription-based credit facility is typically determined by multiplying the dollar amount of the borrower's unfunded capital commitments from qualifying investors by an advance rate.

In this sense, subscription-based lending functions much like typical asset-based lending—but instead of inventory, receivables or proven oil reserves, the asset being lent against is investor commitments.

Investors that qualify for inclusion in the borrowing base are usually pension plans, endowments, insurance funds, and other similar investment-grade or large, institutional investors.

Untethering the timing of a fund's investments and expenditures from the timing of the fund's receipt of capital contributions is likely to appeal to energy funds desiring to deploy capital more quickly or more frequently than can be done through the regular capital call process.

Some subscription-based credit facilities have permitted investors with lower credit ratings to be included in the borrowing base subject to a lower advance rate and certain additional conditions, such as limits on the concentration of such investors. Others have used financial maintenance tests in lieu of a borrowing base concept.

As the subscription facility market continues to evolve and draw in lenders with a wider range of risk tolerance profiles, it is likely that funds without investment-grade or institutional investors can expect to see increased access to subscription-based borrowing opportunities.

Collateral. The borrower's obligations under a subscription-based credit facility will be secured by a pledge of the borrower's right to call capital from its investors pursuant to fund organizational documents, and by a pledge of the bank account into which investor contributions must be funded.

Thus, upon default under the facility documentation, the lender or collateral agent will have the right to step in and take control of the capital call process, enforce borrower's rights in respect of unfunded commitments, and take over the pledged bank account and any funds deposited therein.

Security instruments will likely include, among others, an account control agreement in favor of the lender and a pledge agreement made by the fund's general partner or controlling member in favor of the lender. To support the pledge of unfunded commitments, the lender may require letters of acknowledgement from investors, especially if not adequately addressed in the fund's organizational documents.

Lenders. Many subscription-based credit facilities are bilateral arrangements between one borrower and one bank, while others are syndicated to a wider group of lenders represented by an administrative agent.

Issues relating to fund organization. Most, if not all, subscription facility lenders will require the borrower fund's organizational documents to explicitly permit the fund to incur debt and grant liens on the fund's assets (including its unfunded capital commitments).

In addition, the fund's organizational documents will likely need to include an irrevocable obligation of investors to fund capital calls as well as an acknowledgement of the lender's right to call capital pursuant to a power of attorney.

While it may be possible to add these permissions through amendments to the fund's organizational documents or address them via consent letters from investors, the ideal time for a fund to start planning a subscription-based credit facility is prior to the fund's inception, while structuring the fund's organizational documents--and before raising commitments from investors. This ensures that the fund documentation and investor expectations relating thereto do not inhibit the planned financing.

Key covenants. Some key covenants on subscription facility borrowers may cause heartburn for the fund's investors. These include financial reporting requirements that could extend beyond what the fund's organizational documents would otherwise require (thereby obligating investors to spend more time and money on reporting, or to disclose more information that they view as private or proprietary).

Another cause for concern may be restrictions on the transfer of partnership or equivalent equity interests (thereby inhibiting investors' exit options), and restrictions on modifi-

cations to organizational documents (thereby making it more difficult for the fund to adapt to changing conditions in ways that best serve investors).

While these foregoing concerns are valid, they may also be mitigated by provisions that shift the burden and consequences of transfer restrictions onto the fund borrower instead of the investors themselves, or, by the decreased frequency of capital calls once the fund borrower has access to an alternative source of liquidity, and by the possibility of obtaining better pricing on borrowings.

Investors may even appreciate the additional discipline imposed by debt covenants on fund borrowers.

Investors are likely to be more comfortable with the use of subscription facilities as a logistical tool to expedite closing on transactions than as a form of permanent leverage. They may argue that prolonged use of subscription facility debt is a means of situating the risk of lost equity at the investor level while retaining the extra yield derived from leverage at the fund level.

In the ordinary course, the risk to investors of losing contributed capital is balanced by an expectation of a preferred return on such contributed amount. In a subscription facility context, however, a fund can monetize the credit quality of the fund's investor base, incur debt that puts investors at risk (via lender enforcement of capital commitments during an event of default), and side-step the fund's obligation to pay a preferred return to investors on contributed capital (because with a revolving line of credit at hand, investor capital need not actually be received in order to make investments).

These concerns may be mitigated by provisions in fund organizational documents that better align risk with compensation, for example by entitling investors to a designated return on committed (rather than contributed) capital during periods when subscription facility borrowings are outstanding. A durational limit on subscription facility borrowings may also be helpful to prevent a fund from relying too heavily on debt at the expense of investor returns.

Structural variations. Variations on the basic structure outlined here have evolved in the subscription facility market to address alternative investment vehicles, feeder funds, side letters, investor tax consequences, investor governmental immunity, and a range of other issues facing private-equity funds and their investors.

Benefits for energy funds

While funds focused on real estate and corporate buyouts have traditionally been the most common borrowers of subscription-based credit facilities, the market is growing in a variety of industry sectors. The process-oriented value proposition of this financing tool--untethering the timing of a fund's investments and expenditures from the timing of the fund's receipt of capital contributions--is likely to appeal to energy funds with a desire to deploy capital more quickly or more frequently than can be done through the regular capital call process.

Fund borrowers may assess that routine drilling and maintenance expenses can be paid for more efficiently through a revolving line of credit, which requires notice to and receipt of funds from one lender with institutional expertise in supplying cash quickly, than through the capital call process, which requires notice to and receipt of funds from a disparate group of investors.

For energy funds that have high credit quality investors but are nevertheless experiencing the difficulties associated with obtaining favorably-priced debt in the current commodity price environment, subscription-based borrowing can facilitate a meeting of the minds between lenders and fund borrowers that may not otherwise be possible between lenders and oil and gas E&P companies.

Many of the banks engaged in reserve-based lending to energy companies also have subscription finance departments that may be able to offer better pricing for a subscription facility at the fund level than for a conventional reserve-based credit facility at the portfolio investment level.

Subscription facility lenders may view the established financial position of a fund's investors, and the diversification inherent in the pooling together of commitments from separate investors into one borrowing base, as a more defensible basis for extending credit than a portfolio-level asset that is unproven or otherwise suffering directly from depressed commodity prices.

Conclusion

Private-equity funds focused on the real estate and corporate buyout industries have increasingly turned to subscription-based credit facilities for the liquidity and process-oriented benefits that such facilities offer—but these benefits appear to be equally attractive in the energy industry.

In addition, subscription facilities may be an avenue for energy funds to mitigate the challenges associated with reserve-based borrowing during an extended oil and gas price slump.

Energy funds interested in subscription-based borrowing opportunities can contact the subscription finance departments of most major banks to obtain more information about the lending criteria associated with these facilities.

As with any significant debt agreement, borrowers should be represented by counsel experienced in negotiating debt covenants, collateral documents and related deliverables; subscription facility borrowers will also need counsel experienced in fund formation and mechanics.

Counsel should be engaged in connection with lender negotiations (no later than the term-sheet stage, where most of the material business terms will be decided). Also, counsel can help in connection with hardwiring the required debt-accommodating terms into the fund's organizational documents, and negotiating those terms with prospective or existing investors. ■

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Capital Steps Up to the Plate

In the following profiles, *Oil and Gas Investor* is pleased to present further detailed information on some of the most active capital providers to the E&P space.

A fundamental revolution in American oil and gas production has taken place that continues to astonish the world despite the volatility of commodity prices and geopolitics. It affects OPEC and U.S. government decisions, not to mention Nymex prices and U.S. export volumes.

The companies in this report have played a large part in capitalizing—and coaching—the E&P firms that have led that revolution. Whether they provide private equity, second-lien debt, mezzanine structures or joint-venture capital, the menu of choices and the amount of dollars available are large. Hold times may have changed, and which strategy each provider is willing to fund varies.

However, a consistent theme is that returns can be had up and down the spectrum if the right partnerships with aligned interests coalesce around the right deal structure. And that kind of firepower attacks opportunities in the right play. In this case, one plus one equals more than two.

Undeveloped acreage in resource plays has become a currency with which to create value, whether that is for growing production or proving up a play concept and readying it for sale to a different E&P.

We believe these profiles enable readers to learn more about these capital providers' philosophy. They range from full-service investment banks offering a wide range of services to any size company, to boutique private-equity providers specializing in funding smaller entities poised for success.

As the range of opportunities expands into new plays and overlooked basins, these players will continue stepping up to the plate, looking to coach savvy management teams who are pursuing growth and returns for their investors.

—Leslie Haines

Blue Rock Energy Partners

For 25 years, regardless of commodity price cycle, BlueRock Energy Partners has been providing growth capital to independent E&P companies, and is now looking to take its business to the next level.

BlueRock has historically provided capital to producers for reserve-based acquisitions and monetizations, coupled with associated production enhancement and/or development drilling.

> "The level of cash flow and value you ultimately receive is far greater than if you sold down your working interest to a typical industry partner,"
>
> —**Stuart Rexrode**, *Managing Partner*

"While we require a PDP [proved developed producing] component in our transactions, we are differentiated from a typical RBL [reserve-based lending] facility in that success in the non-PDP upside work plan is required for BlueRock to achieve its target rate of return, and for the client to achieve its goals," said Stuart Rexrode, managing partner. "We are willing to take the risk and advance additional capital on a well-developed upside work plan given the rates of return we are seeking."

BlueRock is focused on transactions in the $5 million-$25 million range.

BlueRock Energy Partners calls itself "the unique capital provider for small producers." However, given the pullback in traditional lending, BlueRock has seen a significant uptick in opportunities on the higher end of its investment range.

"As an alternative finance company, our structure provides much greater flexibility than a traditional RBL banking facility," said Rexrode. "There are significant differences in both how we calculate our advance rate and how we structure our transaction. Whether we are financing an acquisition, refinancing bank debt, or simply providing drilling funds, our clients maximize the funding capacity in the project while avoiding the high cost of equity. We certainly see ourselves accessing additional capital sources and growing our investment portfolio significantly."

From a deal structuring standpoint, BlueRock provides the growth capital for clients in return for a financial production payment, structured as a temporary overriding royalty interest [ORRI], until a contractual rate of return is achieved. Once the rate of return is met, the temporary ORRI is conveyed back to the client, and BlueRock may retain a small permanent override in the project.

The results of a sound upside development plan should be sufficient to pay the transaction off within 4-6 years, including Blue Rock's contractual rate of return.

"It is non-recourse, non-covenant. No personal guarantees or board seats are required, and you maintain your interests, upside, and control in the project. The level of cash flow and value you ultimately receive is far greater than if you sold down your working interest to a typical industry partner," said Rexrode. "To achieve our return, we take production, reserve, and price risk right alongside the producer."

BlueRock's partners include reservoir engineers and finance professionals, all with extensive industry experience. "The last three years have definitely been a challenge for our clients and target market. However, the one constant has been our commitment to provide growth capital to independents," said Rexrode. "That hasn't wavered for 25 years, and we plan to put significantly more capital in this marketplace in the years to come." ■

www.bluerockenergycapital.com

EIV Capital LLC

EIV Capital, based in Houston, is an energy private investment firm that provides growth equity capital to small and mid-cap North American energy companies. EIV invests primarily in the midstream sector, and also considers investments across the rest of the energy value chain. Founded in 2009, EIV has raised three funds employing similar strategies, closing its most recent $450 million fund in early 2017.

Experienced, entrepreneurial team

In the current environment with numerous funding options available, EIV's diversity of energy industry experience allows it to differentiate itself as a potential partner for entrepreneurs.

“We believe our experience starting, operating, growing and exiting our own companies helps EIV be an attractive partner to entrepreneurial management teams. We work collaboratively with our partners, supporting them as they successfully grow their companies.”

— **Patti Melcher**, *Managing Partner*

Collectively, the EIV investment team has 200-plus years of experience investing in and operating energy companies with a diverse array of backgrounds, including operational, entrepreneurial, commercial and financial. Due to this broad assortment of experience, EIV can quickly understand the business, capital and leadership requirements necessary for a potential partner to achieve long-term growth and profitability as well as identify and avoid possible challenges.

EIV enjoys working with executives to build their business and commits time and capital to help management position the company for success. In many of its recent investments, EIV spent considerable time alongside its potential partner refining the business plan or providing strategic guidance prior to making an initial capital investment. EIV provides valuable, practical solutions and advice to its partners using firsthand personal experience, both at the outset of a partnership and during growth.

EIV's differentiating experience is best illustrated by one of its initial investments. In early 2011, Brent and WTI oil prices diverged sharply, which many attributed to geopolitical tensions. However, EIV attributed it to insufficient infrastructure available to move rising U.S. crude production to market. Within four months, EIV partnered with a midstream company to piece together the infrastructure to purchase oil in Oklahoma, transport it to Louisiana and sell it directly to refineries, capturing the arbitrage. EIV also implemented a hedging program to protect its investment. This project demonstrates why EIV is not solely a source of capital, but also a partner that brings experience and helps its partners execute their business plans.

Focused investment strategy

EIV invests the majority of its capital in traditional midstream businesses, such as transportation, logistics and processing. The firm also pursues opportunities throughout the energy value chain, including post-completion oilfield services, downstream, petrochemical, power and renewables.

EIV's thorough understanding of the energy industry allows it to partner with entrepreneurs focused on providing high-quality service to producers, midstream companies or other customers regardless of investment size. While EIV's typical equity investment ranges from $20 million to $80 million, EIV is willing to invest larger or smaller amounts if the opportunity has an appropriate risk-adjusted return. EIV's focus on return vs. capital deployment allows it to pursue niche opportunities and support its partners as their businesses grow into stable, profitable enterprises with steady cash flows that are attractive to potential acquirers.

Three recent partnerships help demonstrate EIV's capabilities. In June 2017, EIV worked with existing

> "As unconventional plays continue to mature and consolidate, more niche opportunities arise for entrepreneurs to provide great service to their customers and grow first-class businesses."
>
> —**David Finan**, *Partner*

investors at AMP Americas to commit $47 million to allow AMP to pursue growth opportunities across its businesses, which include both renewable natural gas production and CNG fueling infrastructure.

In April 2016, EIV partnered with H2O Midstream to pursue midstream opportunities focused exclusively on oilfield water. Well before oilfield water logistics was a hot topic, EIV identified the sector as primed for growth, professionalization and cost savings. Upon introduction to H2O Midstream, EIV knew it had found a like-minded partner and brought an initial $100 million commitment to the team, with incremental capital available if needed for the strategy. In June 2017, H2O Midstream closed the acquisition of Encana's produced water infrastructure in Howard County, Texas, and executed a long-term agreement for midstream water services.

In February 2016, EIV partnered with CAM Integrated Solutions to form a new engineering, procurement and construction management company. CAM is focused on supporting producers with the "first mile" midstream tie-in from the wellhead to the main header/gathering system in top-tier producing basins within the Lower 48. EIV and CAM felt this market was underserved as most engineering companies focus on larger projects. Due to CAM's experience and relationships, it has built a well-regarded engineering firm serving top producers within its first 18 months of operation.

Personal support and relationships

EIV's experience allows it to provide commercial, financial, accounting and/or operational support to its partners that may not have a full suite of upper-level management in an effort to control costs. By concentrating its investment focus and limiting the number of investments per fund, typically eight to 12, EIV ensures its operationally-focused team can be a resource for its entrepreneurial partners throughout the investment lifecycle. This ongoing support allows the executive teams to focus on what they do best.

While the executive teams might be small, EIV firmly believes that partnering with the right people is key to delivering successful results. For that reason, EIV seeks to partner with motivated, ethical and experienced partners and enjoys getting to know its partners on a personal and professional level both prior to and during the company's growth cycle. Establishing these personal relationships early creates a culture encouraging open dialogue and regular communication allowing EIV and its partners to collaborate to avoid potential pitfalls, quickly act on growth opportunities, or solve the unforeseen issues that occur in a growing business.

Current opportunity set

Throughout its existence, EIV has not changed its fundamental strategy: to partner with high-quality management teams to pursue business plans based on solid operating fundamentals and strong customer relationships requiring long-term service. These opportunities exist and can be profitable regardless of size, market cycle or geography. The current environment presents opportunities for both first-time and serial entrepreneurs to identify inefficient or underutilized assets and work with capital providers, such as EIV, to enhance midstream operations, improve customer service and drive returns.

Even in mature or out-of-favor basins, producers still need high-quality service and appreciate midstream providers that bring solutions to improve margins. Innovative teams can generate attractive returns as in-fill midstream opportunities are developing in maturing unconventional basins. This is particularly true for smaller capital projects that have been overlooked purely due to size.

Most of EIV's investments are sourced through the team's personal and professional relationships, and EIV continues to evaluate a substantial number of high-quality opportunities. EIV is excited to partner with knowledgeable executive teams to develop profitable, customer-driven assets in the current environment. ■

Lime Rock Partners

In 1998, Lime Rock Partners was founded by John Reynolds and Jonathan Farber while they were in their late twenties. Nineteen years later, Reynolds and Farber still lead the investment efforts alongside young leaders who have risen through the ranks of the firm. In Lime Rock's Houston office, managing directors Will Franklin, Greg Highberger, J. McLane, and Jeffrey Scofield lead efforts for deal sourcing and partnerships for U.S. E&P and oilfield services companies. All began at the firm as associates. Townes Pressler leads the effort to help portfolio company teams accelerate their growth.

> "… if you're not looking forward to talking to your investment partner weekly—and daily during some periods—you've probably chosen the wrong source of capital."
>
> —Jeffrey Scofield

What differentiates Lime Rock from other veteran North American E&P capital providers is its selectivity, creativity and partnership. "As we invest in both E&P and oilfield service, and also opportunistically outside North America, we are not seeking to back five new U.S. E&P teams every year," McLane explained. "We usually back about one new team a year."

What is Lime Rock looking for? "There are already hundreds of private E&P teams chasing deals, most of them in a handful of counties," McLane said. "We want to back teams that have a high chance of success. To us, that means three things: differentiated access to assets, a technical edge in developing them, and the appropriate strategy to remain more nimble than operators trying to put too much capital to work."

This selectivity is enhanced by Lime Rock's strategy to avoid putting teams in direct competition with each other—chasing the same type of asset in the same area at the same time.

Lime Rock's current roster of E&P partners includes: CrownQuest Operating, which has partnered with Lime Rock for nearly 11 years in developing assets in the Midland Basin through the CrownRock and CrownRock Minerals vehicles; Prime Rock Resources in the Delaware Basin; San Jacinto Minerals I and II in the Marcellus and other basins; Arena Energy in the Gulf of Mexico Shelf; Capstone Natural Resources II, active on the Central Basin Platform; and Augustus Energy Partners II in the Rockies.

Lime Rock also stresses its creativity in putting deals together. "We are looking to help our investors and entrepreneurs achieve their goals," Scofield said. "That means not stamping out deals from a template. Our last four E&P deals have been notable for their variety: a carve-out team of young entrepreneurs from a bigger E&P company; an overriding royalty interest purchase—alongside Lime Rock Resources—from a team we've worked with in the past; a new entity put together with existing partners that had developed and sold two assets in the same basin; and a second strategy developed by an existing team for which we raised a very large co-investment pool."

McLane added, "With so many of the best acreage positions identified and already locked up by well-capitalized companies, we suspect that multiple strategies or assets led by creative teams will likely be a large part of E&P investing going forward."

Total capital commitments raised by Lime Rock have exceeded $7.5 billion, and the team has made 95 investments over the past two decades.

The team seeks to be an exceptional partner to its portfolio companies. "That begins with us and our companies," Highberger said, "and with understanding where we can contribute—in financing, deal sourcing, exits, industry relationships, and helping our companies better understand the macro trends affecting the business. It also means trusting our teams in drilling and completion decisions.

"But the partnership isn't just a two-way street. One of our great joys is to bring all of our E&P teams together to discuss their challenges and opportunities, and one of the most interesting parts of the job is to introduce our E&P teams to oilfield service companies in our portfolio and broader network with interesting technologies and perspectives."

Scofield added, "And we try to always have fun with the entrepreneurs we work with, because if you're not looking forward to talking to your investment partner weekly—and daily during some periods—you've probably chosen the wrong source of capital." ■

LIME ROCK PARTNERS

www.lrpartners.com

Opportune LLP
Adding Value to Private Capital

Since Opportune's formation in 2005, the energy-focused firm has assisted private capital organizations in growth, oversight and monetization of their investments. Opportune's professionals include C-level industry executives and board members of public companies, as well as former partners with Big 4 accounting firms — all with careers dedicated to the energy industry.

How does Opportune add value to private capital organizations?

Growth: Private capital brings together multiple disciplines in order to grow their investments. To fulfill this need, Opportune has purposefully created service lines that work together to successfully evaluate and close acquisitions. These services include: acquisition due diligence (including land), valuation, engineering services and tax structuring and advisory.

Oversight: While private capital organizations provide board oversight of their investees, they may not have bandwidth to delve into specific operational concerns. Opportune provides capital entities, creditors and management teams with assessments of financial performance and the quality of available information. Representative Opportune services include: financial planning and analysis, business process and technology assessments, back-office outsourcing (including land), derivative valuations, engineering services and tax compliance.

Monetization: The monetization of investments is more than an event, it is a process. Opportune is a market leader in managing the IPO process for its clients, as management teams often lack either the time or experience required to smoothly navigate the following demands of a registration statement: document preparation and coordination, management of audits and the SEC process, and turnkey project management post-IPO.

Across energy segments, Opportune's practice areas include: chemical engineering, complex financial reporting, dispute resolution, enterprise risk, outsourcing, process and technology, reserve engineering, restructuring, strategy and organization, tax, transactional due diligence and valuation. These practice areas offer a variety of professional services throughout the growth, oversight and monetization of private capital investments.

Reach out to one of Opportune's private capital experts today to maximize your next transaction.

Private Capital Experts

David Baggett
Managing Partner

Josh Sherman
Partner

John Vanderhider
Partner

Outfitter Energy Capital

Outfitter Energy Capital LLC may be a relatively new name on the scene, but in reality, its activity in the energy private-equity space began in 2008. Outfitter is the continuation of an established and successful middle-market private-equity team, led by managing partners George McCormick and Curt Schaefer. They have been partners for nearly a decade, only now they own the business directly. Previously, they were founders of TPH Partners, the private-equity business within Tudor, Pickering, Holt & Co. (TPH) in Houston.

Cycle-tested

The Outfitter leadership team spun out from TPH at the end of 2016. It was of the utmost importance to both Outfitter and TPH that this transition be accomplished as seamlessly as reasonably possible for the benefit of both its limited partners and its portfolio companies. As a result, Outfitter continues to manage TPH Partners LP and TPH Partners II LP.

From a standing start in 2008, Outfitter's principals have successfully raised and deployed approximately $400 million in 12 platform companies. Based on capital commitments to these companies, Outfitter's sector allocation has been about 80% upstream, 10% midstream and 10% oilfield services.

"Our goal from the beginning was to focus on less competitive, off-market transactions to find access to high-quality resources at attractive entry prices," McCormick said. "We believe that this approach is a material mitigant to some of the risks inherent to investments in the oil and gas business."

Another equally important tenet of Outfitter's approach is the desire to partner with high-quality entrepreneurs that are experts in their own space, whether that space is defined in geographic, geologic or relationship terms.

"We look to partner with teams that know their backyard really well. Those are the folks who will have the knowledge and relationships that will allow them to capture and exploit the types of assets that George is referring to," Schaefer said.

"And that partnership aspect really is the key for us. A successful relationship with a management team is forged through being true partners in the creation, growth and ultimate sale of their business. We work very hard to be much more than just a checkbook to our partners, and I think our management teams would tell you we've generally succeeded," McCormick said.

Outfitter is in the early stages of building this new, standalone business, so its success is very personal and important to the team, according to Schaefer. "Our team has worked together for almost a decade, so we know each other very well. Our resolve, judgment and discipline have certainly been tested by the worst commodity cycle since the '80s, but that experience has only reconfirmed our investment tenets—as well as provided some lessons learned," Schaefer said.

Middle-market specialists

Outfitter Energy Capital seeks majority equity positions between $25 million and $100 million of initial equity capital need in the upstream and midstream spaces. The partners believe this sweet spot allows for less competition for the initial resource acquisition and also provides the potential to benefit from ultimately selling into a larger and more liquid market after the assets are more fully developed. However, these companies often need more capital to achieve their goals as success unfolds.

"Like the outfitters on a pack trip, we are guides to success for our portfolio companies."

—**George McCormick**, *Founder And Managing Partner*

"By starting with a more modest amount of equity capital than some of our larger competitors, we are able to take advantage, for management and our investors, of adding additional capital later at better terms. I think this is a benefit of our approach that management teams can sometimes underappreciate," Schaefer said.

"We need to leverage local knowledge and relationships to capture the resource wherever we invest," McCormick pointed out. "Our management teams know the area; they've worked it before. They—and we—may have access to deals not as widely known or otherwise unavailable, something that may be off the market but is quite intriguing nevertheless."

To that end—and to date—Outfitter's portfolio companies have not purchased a single asset in a bank-run auction process. "We love to sell in a very competitive auction, but buying in one can be a recipe for over-paying, and we are pretty allergic to that outcome," McCormick said.

"Our E&P companies typically start with a targeted, core acreage position to minimize upfront risk dollars on land until our own or neighboring drilling activity confirms the prospectivity of adjoining areas. We don't believe in making a large land grab just for size's sake and then hoping enough of it works out. That's not our style," Schaefer said. "We all learn and improve as we go. We have to remember, notwithstanding the often-used 'manufacturing process' argument, rock quality in any play can change fairly dramatically over a given area.

Curt Schaefer
Managing Partner

Respecting these nuances can make a big difference in value creation."

The end goal is to prudently grow volumetrically, meaning more reserves and more production, while maintaining a conservative and solid balance sheet and then, ultimately, selling the company into a larger and more competitive market. Importantly, in the current oil and gas price environment, the reservoirs involved must allow the asset to deliver at the low end of the cost curve. The acreage should be sufficiently undeveloped in order for the portfolio company to achieve target returns through exploitation drilling, which requires the right team with the right expertise to execute on the opportunity.

"We think of our job as helping our company partners access the necessary tools, and sometimes the path, for their own success. In this sense, we really are a guide of sorts. Hence, the genesis of the Outfitter name," McCormick said.

"We may not be providing them with horses, supplies and equipment, but we do provide essential growth capital, seasoned advice, and access to the many contacts and relationships we've developed through the years. We are in this to facilitate a successful business outcome for each and every one of our partners. Other than the sheer fun and excitement of this business, isn't that what we are all looking for in the end?" ■

OUTFITTER
ENERGY CAPITAL

www.outfitterenergy.com

Pearl Energy Investments

Chris Aulds, *Partner*

Billy Quinn, *Managing Partner*

At Pearl, we believe building strong partnerships is the key to success—and our portfolio companies can attest to that.

Founded in 2015 and based in Dallas, Pearl is focused on an investment strategy that leverages the team's deep-rooted relationships in the energy industry to partner with best-in-class management teams pursuing attractive risk-reward opportunities in the upstream, midstream, and service sectors. The firm has $1.1B of committed capital under management and closed its most recent fund at its hard cap of $600MM in July 2017.

Pearl was founded by industry veterans Billy Quinn, former co-managing partner of Natural Gas Partners, and Chris Aulds, former co-founder of TEAK Midstream and Crosstex Energy Services. Together, Quinn and Aulds have more than 50 years of experience in the energy business.

This unique combination of energy investment and operational expertise sets Pearl apart and gives us the perspective to understand the challenges and opportunities in today's energy industry.

Investment strategy

"First and foremost, we are in the business of partnering with entrepreneurial management teams that have complementary backgrounds and share a capitalistic mindset," said Quinn. "We look for teams with clearly demonstrated technical and deal flow competitive advantages stemming from proprietary relationships and local market knowledge."

Pearl targets small to middle-market investment opportunities with equity capital requirements between $25MM and $75MM, and has led investments requiring in excess of $125MM.

Stewart Coleman, managing director, said, "We believe our targeted investment universe has an outsized number of opportunities with asymmetric risk-return profiles."

Additionally, Pearl does not believe in "stacking" teams geographically and prefers to back one team in a basin. "Our goal is to be a real partner, not just an equity capital provider," Coleman continued.

"We have the luxury of being selective with our teams, and purposefully sized our funds and equity commitment amount to allow us to exclusively pursue the highest-conviction investments in each basin," said Aulds. "This helps us avoid competition among our portfolio companies, reduce conflicts, and improve alignment while also generating top-tier returns."

Adding value

Pearl prides itself on its partnership approach and a differentiated ability to execute quickly, both during the initial process of backing a team and in working with portfolio companies to grow and create value.

"The Pearl leadership team has a unique history of not only investing in, but founding and building, successful companies across the oil and gas value chain," said Aulds. That diversity of experience extends across Pearl's investment staff. For example, Vice President Steven Cobb started his career at Pioneer Natural Resources in various engineering and financial roles before joining Pearl in 2015.

"The team's complimentary areas of experience, perspectives, and networks allow Pearl to truly understand the workings of a growing portfolio company, adding value at all stages of development from inception to successful exit," Aulds continued.

Pearl believes in a customized approach to private equity that results in a company achieving its goals and reaching its full potential.

"Chris and I work directly with every company in the Pearl portfolio. We believe in a collaborative approach; listening to our portfolio companies, understanding what is important to management teams, providing open lines of communication, and maintaining transparency," said Quinn.

"Our ultimate goals are to provide resources and motivation to our teams, align interests, and add value for everyone." ■

PEARL
ENERGY INVESTMENTS
www.pearl-energy.com

Seaport Global

Seaport Global is a full-service mid-sized independent investment bank, offering capital markets advisory, sales, trading and research services led by senior professionals with decades of experience.

The firm's bankers work with capital markets and sales and trading professionals in a highly integrated approach which combines boutique-quality knowledge and service with bulge-bracket distribution capability. This type of corporate culture demands intuitive insights from Seaport's most senior professionals every step of the way.

> "We combine the industry knowledge of our bankers and research analysts with the capital markets knowledge and relationships of our sales people and traders to provide seamless execution for our issuers."
>
> —Daniel O. Conwill IV, *Co-CEO*

Seaport Global's team of industry veterans is known as a group of business-savvy strategists who anticipate challenges and provide intuitive insights in their respective fields. These senior advisers lead Seaport Global's professionals to uncover true value for its clients. With guidance of experienced leadership, the firm brings passion, work ethic and integrity that make Seaport Global a trustworthy, reliable partner.

Today, Seaport Global operates with over 350 professionals in offices across the U.S. and Europe and has become a leader in investment banking for the energy value chain. This versatility and expansiveness is what allows Seaport Global to achieve clients' goals efficiently and effectively.

Q What are some of Seaport Global's strengths and corporate capabilities?

Seaport Global's core strength involves being a very flat organization where owners and deal teams sit side by side. Given our size, breadth and client relationships, we always have the A-team on every transaction. Generally, we offer financial services, including debt, equity and all advisory services to the full gamut of energy companies—which we define as any company whose business dissects the energy value change, even beyond traditional E&P and OFS models.

Q What types and sizes of deals does Seaport Global do for oil and gas companies?

We work with companies of all sizes, but we typically do equity deals over $50 million, debt deals over $100 million, and asset sales of at least $50 million. We have been incredibly successful financing small-and-medium-sized companies that need careful explanation and deeper technical analysis. We have also strengthened our A&D practice by building out a group that not only focuses on business development, but also engineering and geologic detail. We think this is a big differentiator.

Q What are some of Seaport Global's recent deals?

We pride ourselves on executing difficult deals that require creativity and drive, and we have built a solid reputation on this front. With an emphasis on sub-$2 billion market cap companies, our equity business is strong. We have led more transactions of this size, particularly in E&P, than anyone else on the Street.

Left to right:
Michael Bodino, *Partner, Managing Director*
Andy Taurins, *Managing Director (A&D)*
Michael Schmidt, *Partner, Managing Director*
Tom Schaefer, *Managing Director (A&D)*

In terms of debt, we have had a number of marquee deals in the power and E&P space this year—most notably, Gastar Exploration, for whom we raised a total of $425 million in a three-part deal. We also completed a $500 million Argentinian project financing for new power generation capacity.

Q What is Seaport Global's view of the oil and gas market, commodities price outlook now and in 2018?

The commodity markets will be unstable and likely volatile over the next 18 months. The bulls in all of us say that last year's fourth-quarter strength and this year's early fall rally is a sign of an "up-and-to-the-right" rally, but there are certainly near-term supply concerns that could prevent a fundamental recovery until sometime in 2019. Fortunately for Seaport Global, our clients depend on us throughout the good times and the challenging ones as well. We have to be flexible enough to serve them whenever they need us, and we have built our entire firm around that very idea. ■

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www.seaportglobal.com

Tailwater Capital LLC

Jason Downie, *Managing Partner*

Edward Herring, *Managing Partner*

Tailwater Capital LLC is a highly specialized middle-market private-equity firm focused exclusively on the energy sector. Edward Herring and Jason Downie, the firm's two managing partners, co-founded Tailwater Capital in 2013 to be the preferred source of private-equity capital for oil and gas entrepreneurs. Today, Tailwater manages $2.1 billion in committed capital deployed across five funds targeting midstream and non-operated working interest upstream opportunities.

With a well-established track record consisting of more than 65 transactions in the upstream and midstream sectors worth $16.6 billion, Tailwater believes that alignment of interests and a long-term partnership approach are two essential ingredients for creating value.

"Edward and I co-founded Tailwater in January 2013 after focusing on energy investing at a large generalist private-equity firm together, and have been working together for over 19 years. We learned that a 'one-size-fits-all' approach to private equity often risks falling short of achieving goals, particularly in the dynamic energy sector. As a result, we take the time to understand what is important to the management team, and structure our investments to address their needs while providing our investors exceptional returns. Aligning interests from the start eliminates friction, makes for a more motivated team and builds value for everyone. That makes Tailwater Capital a preferred source of private-equity capital for leading energy entrepreneurs," said Downie.

Tailwater is actively funding both midstream and upstream opportunities. The firm's midstream strategy is straightforward, concentrated on teams with projects for de-bottlenecking areas where production growth is outpacing the existing infrastructure. If operators are expected to continue drilling in an area at prevailing commodity prices, then the chances are high there will be a long-term need for midstream solutions.

On the upstream side, Tailwater prefers to invest in non-operated working interests. The firm can manage risk by building a diversified portfolio of interests while maintaining investment selectivity and flexibility along the way.

"This two-pronged strategy—midstream and upstream—provides our investors with complementary strategies and provides us a strong and sustainable competitive advantage," explained Downie.

Edward Herring described Tailwater's strategy this way: "Some of our best investments have come to us at a very early stage, and we don't want to say 'no' to a good idea just because it doesn't fit a certain template. If a team is in the right basin and their project can generate good economic returns with an interesting value proposition, then we want to look at it. Oftentimes, we find that if one producer has a problem that's not being met by a large MLP or a service provider, then other producers are probably having the same problem. As a result, what originally looked like a small midstream project can become a large business if you are creative."

By design, Tailwater has a higher concentration limit, meaning it can invest in multiple projects with the same team. Instead of funding six teams with six projects, Tailwater has the ability to cultivate multiple projects behind the same team and feels that flexibility can lead to better returns for investors and management teams.

"With this approach, our teams can be collaborative and not feel like they are competing with Tailwater's other portfolio companies. That's different than other shops, and it improves our ability to establish alignment from the beginning," explained Herring. "We view trust, transparency and partnership as core to all of our deals. You put all that together, and it's a win-win for Tailwater, our management partners and our investors." ■

TAILWATER CAPITAL

www.tailwatercapital.com


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MANIFOLD PRESSURE
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UPPER PIPE RAMS