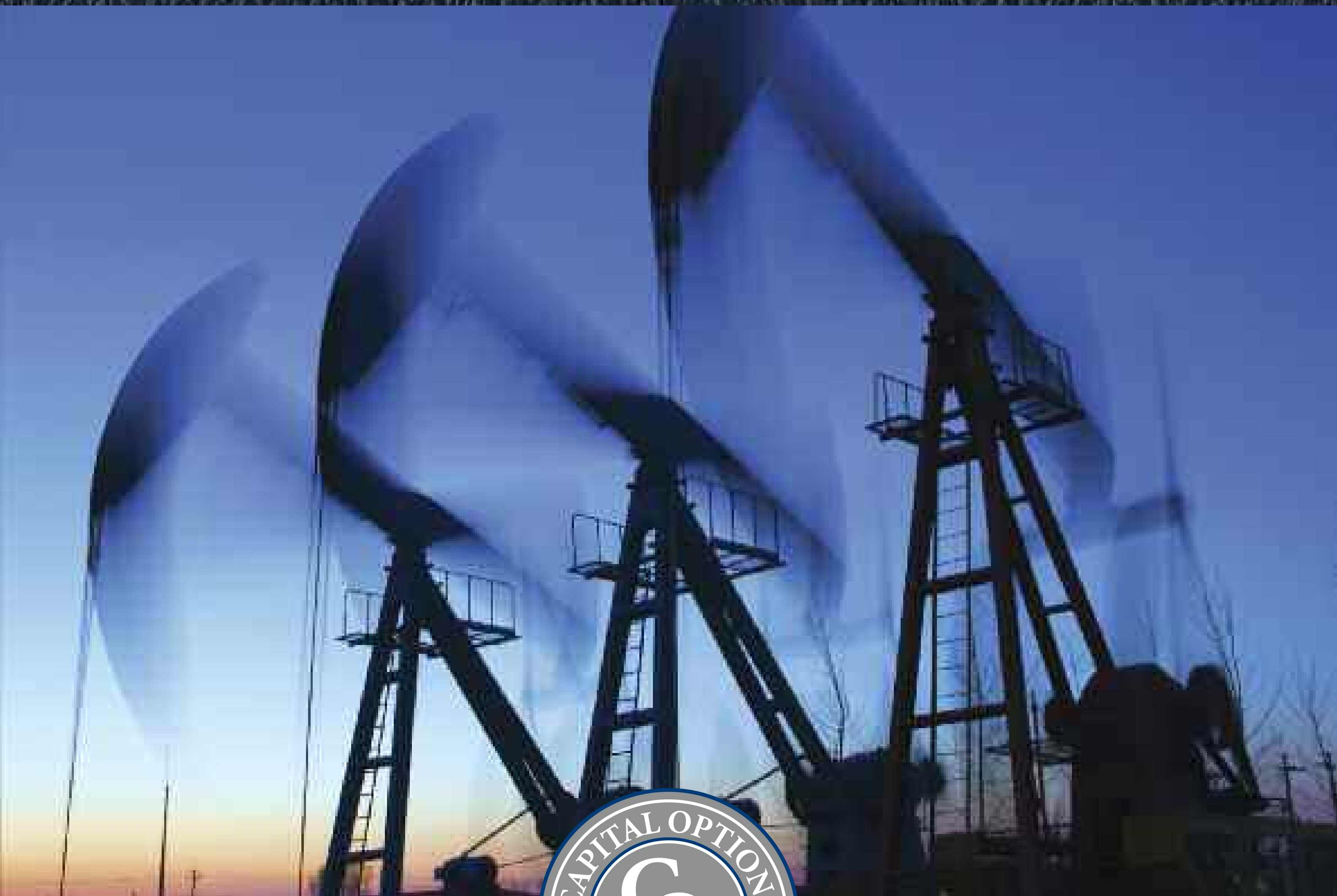
CAPITAL OPTIONS

FINDING THE RIGHT FIT



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Oil and Gas Investor

Oil and Gas Investor

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LEADERS IN PROVIDING CAPITAL

Never in the history of oil and gas drilling and production activity in the Lower 48 states has the need for capital been greater. As well service intensity grows in the resource plays, the call on capital needed per well is headed higher.

Most E&P companies are boasting of hundreds and thousands of well locations to be drilled on pads, leading to 20- and 30-year development campaigns in stacked pay zones. That's at \$6-, \$8-, \$10 million a pop. One estimate is that some \$150 billion per year must be spent in North America in the upstream alone.

And what's more, a March 2014 study for the INGAA indicated that through the year 2035, more than 340,000 miles of gas pipelines and 190,000 miles of oil lines will be needed. The picture gets even bigger.

We're not counting the capital that will be deployed for corporate mergers and acquisitions that run into the billions. Bigger still.

But let's not overlook the eager startup or the entrepreneurial company that is growing rapidly. There is demand for plenty of capital outlays there, too.

Fortunately, the banks, public markets and institutional investors stand ready to provide that capital. Energy remains one of the few growth industries in this country and a big percentage of GDP. With an eye toward crude oil exports and the sale of natural gas in the form of LNG shipments, the demands for more wells and infrastructure will only continue to increase over the next 10 years—and with that, the need for more dollars.

This special report celebrates the creativity and ambition of capital providers everywhere, and also, the enormous importance of the intellectual capital they lend to the oil and gas industry along with their dollars.

— *Leslie Haines, Editor-in-chief,*
Oil and Gas Investor

FINANCING 101

Finding The Right Fit

Financing is about more than getting the money. Decisions on the type of capital matter too.

By Scott Cockerham

The conference call was meant to be short but had turned tense, and surprisingly emotional, very quickly. As a financial advisor the investment bank for which I worked had an operator as a client. The operator had suffered a blowout the previous year and now was in dire need of capital to fund a drilling program. We'd spent months educating this client on different financing options and potential sponsors, presenting to respective suitors in data rooms and on road shows, and sorting through financing options. The call was to run through the last, best option the client had: a mezzanine facility.

Mezzanine debt varies somewhat between lenders, but the terms offered to the client were fairly straightforward. The facility came with a high discount rate to bridge the company over a multi-year period, with an equity warrant at exit, until the

drilling program was self-sustaining. But as the terms were discussed the client grew concerned when the full cost of the debt package became apparent. Then there was a long pause and the CFO, quiet until then, asked a question: what if they could pay back the loan in six months?

Mezzanine debt doesn't work that way. Lenders have a return threshold and prepayment runs counter to their interests. What the CFO illuminated with his question was his ignorance of the financing mechanisms being considered. After months of saying he understood what outside funding meant, the CFO had shown he'd really only focused on getting the money.

Knowledge of financing sources is critical to navigating a complicated landscape. The management team that fails to study up can lead its company to ruin.

A caveat

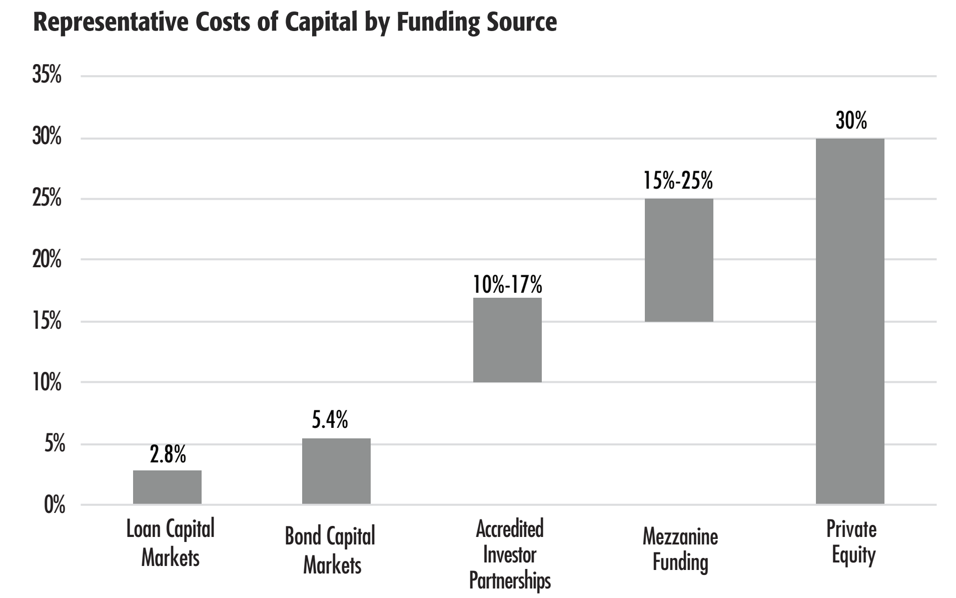
Folks who work in E&P are extremely talented at analyzing geology, engineering and operations. But, financial structures beyond a standard bank revolver can often flummox them. Regardless of what follows in this piece, if you have a need for financing beyond an RBL (reserve-based loan), hire a professional. Not a broker or a buddy who's funded a program of his own, or even an attorney, but a bona fide investment banking member of FINRA. You're not refinancing a mortgage or buying a car, so get someone in your corner with experience in this arena.

Retail syndication

Retail drilling partnerships offer accredited investors (up to 2,000 people per offering) an opportunity to participate in a drilling program. The benefit to the operator that acts as a general partner is obvious: the GP gains access to a large pool of capital and an opportunity to earn promotes for its work.

But the structure also has its drawbacks. Drilling partnerships draw retail interest because of the substantial tax benefits conferred to the investors in the form of initial intangible drilling costs (IDCs). Those IDCs and the returns for investors are maximized by spudding wells as quickly as possible, usually within a year. So, GPs must adopt a development drilling profile, similar to an MLP's, in order to provide consistent results to limited partners.

COST OF CAPITAL

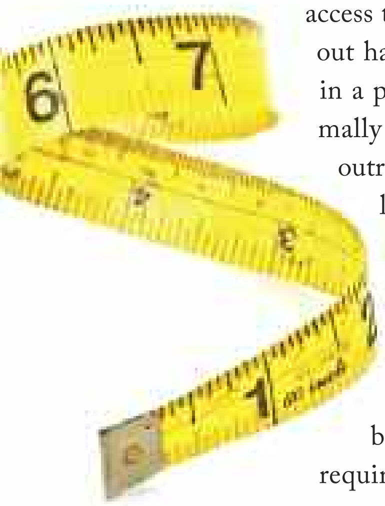


Source: Bloomberg. Bank reserve-based lending facilities and bond issuances consist of 43 offerings and $30.1B issued from August 2013 to June 2014.

Also, internal accounting, compliance and due diligence requirements mandate staffing, policy, and control additions. The cost of capital for these partnerships isn't cheap either, and can be as high as 18%. The investors bear the cost of syndication, but the GP or oil and gas company is expected to perform such that the LPs receive an attractive total return after fees.

Mezzanine lending

Mezzanine lenders offer more capital than reserve-based lenders because they don't base their investments on the value of the collateral, but on the prospect of future production. The difference in risk profile is reflected in costs of capital that can reach as high as 25%.



A mezz borrower gains the benefit of access to a large amount of capital without having to give up equity or control in a project. Additionally, there is normally no requirement to exit a project outright. The trade-offs for that access largely stem from that high cost of capital. Lenders have checkbook control and the right to foreclose on the borrower for breaking covenants, which are numerous. There is also a cost to be borne in meeting the reporting requirements of the lender. Lastly, existing lenders will either need an inter-creditor agreement with the mezzanine lender, or may have their facility bought out entirely by the mezz lender and rolled into the higher cost debt.

Private equity

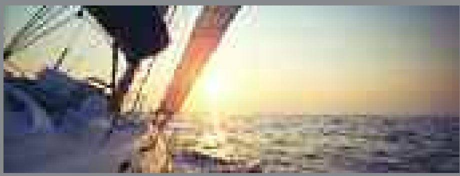
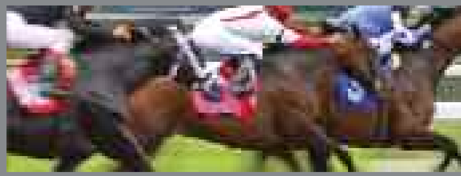
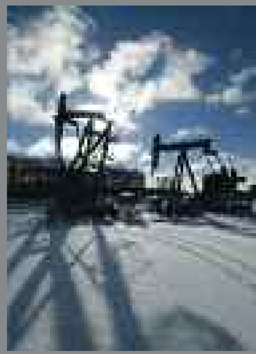
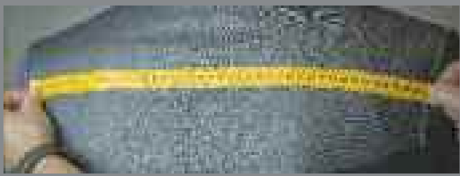
Private equity simply refers to a financial sponsor that backs an operating team or project until an exit, usually within three to five years. For the operator the ability to wholly finance a program or a company is a substantial benefit. The fact that most sponsors are hands off in their management is a plus, provided the investment recipient can deliver a return approaching 30%.

Like any other financing mechanism there are marks against a PE structure. Private equity investments are predicated on an exit (sale or IPO), and an operator has to come to terms that the timing of that decision may be made by the sponsor. There are also the same risks presented by mezzanine lending where the sponsor has checkbook control and the company will acquire robust reporting requirements. The most common complaint from PE-backed companies is the lack of equity they hold compared with truly independent peers. For most this is a hollow point: without PE backing most of these operators would have nowhere near the prospects they hold with their sponsors' support.

Conclusion

It's easy to forget that the sources of capital for operators have their own masters, their investors. Those investors expect their investment managers—the E&P companie—to look out for their interests and deliver substantial returns that mitigate the enhanced risk of direct participation in drilling programs. That access doesn't come cheap for E&P companies. Operators that know the objectives, benefits—and flaws—of the various funding sources can construct programs that will not only be successful, but will be successfully funded. ■

Scott Cockerham is the vice president of business development at U.S. Energy Development Corp. He was formerly a partner at Parkman Whaling LLC and has worked at Deutsche Bank and Goldman Sachs.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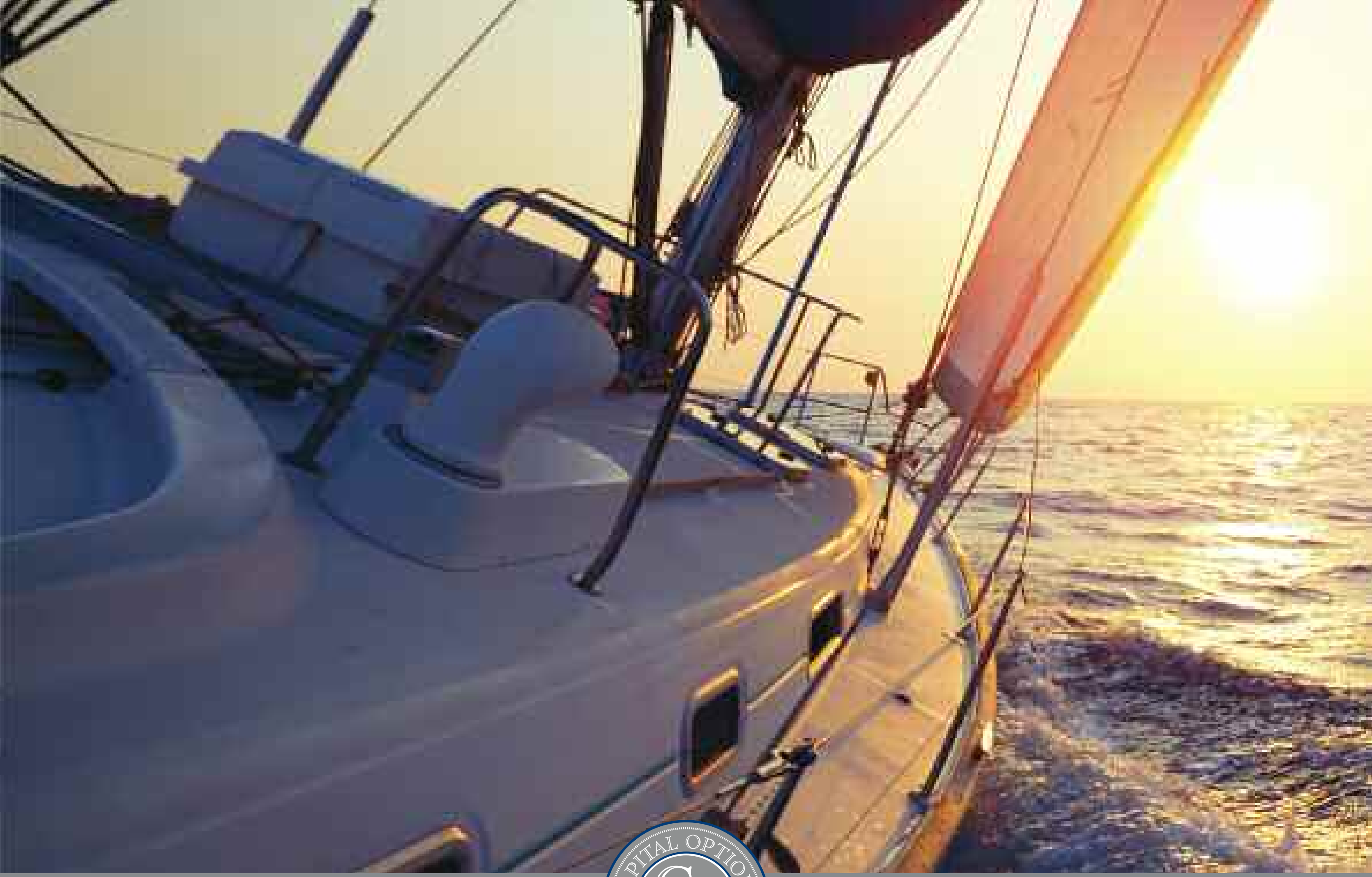


CAPITAL MARKETS

Capital Markets Show Resilience

Despite some headwinds, it could be smooth sailing for companies seeking capital.

By Chris Sheehan, CFA

The E&P sector has faced more than a few headwinds of late that were largely absent in a buoyant first half of this year. With a sequential quarterly decline of 18% in the EPX index in the third quarter, many of the E&P stocks have been battered.

Capital markets had the wind at their back earlier in the year, but the pace of activity has slowed sharply in equity issuance, although fixed income markets continue to offer yields that observers earlier suggested would no longer be available as year-end approaches.

What sort of headwinds are buffeting the sails?

Some observers are concerned that non-OPEC oil supply growth—chiefly in the U.S.—is set to overwhelm demand growth. The latter has been sub-par amidst a faltering global economy, such as in Europe, and aggravated by seasonal factors. Historical strength in demand for crude oil from China—projected to account for about 11% of global demand in 2014 by the International Energy Agency—is considered more questionable as economists trim GDP growth targets and China policy favors reforms over stimulus measures.

Stephen Straty
Jefferies & Co.

Meanwhile, as the European Central Bank (ECB) and the U.S. Federal Reserve Bank guide their policies in opposite directions, the resultant move in foreign exchange markets is strengthening the dollar and putting downward pressure on commodities, including crude oil. With the ECB easing while the Fed signals future tightening, the difference in yields between 10-year U.S. Treasuries and German Bunds reached the widest in over a decade, leading to a steady series of consecutive weekly increases in the dollar.

The tendency of an inverse relationship between a rising dollar and a decreasing price for West Texas Intermediate (WTI) oil is shown on the chart on page 10. WTI had fallen from around $106 per barrel into the low $90s in late September as the dollar marched higher during the course of the third quarter. The ICE Dollar Index was reported to have made 12 consecutive weekly gains through early October, the longest such streak for the currency in many years.

Other factors include such closely followed issues as the possible timing of the Fed's interest rate increases—generally thought to be around mid-year 2015—to a host of geopolitical issues that were hard to foresee even six months or a year ago. All these have added uncertainty to oil and gas markets.

Positive surprises

On the positive side of the ledger there have also been surprises. M&A activity has picked up, including Encana's acquisition of Permian-based Athlon Energy, at a 25% take-out premium, and the purchase by Siemens, based in Germany, of Dresser Rand Corp. Earlier, Whiting Corp. acquired Kodiak Oil & Gas.

For all the turbulence surrounding the commodity, the energy segment continues to find favor with investors in fixed income and high-yield markets, according to Stephen Straty, co-head of energy investment banking at Jefferies & Co. Although conditions are "a little choppy right now," said Straty, "we believe markets are open and very receptive to fixed income issuance, whether it's investment grade or non-investment grade. The markets remain strong."

Year-to-date issuance by Jefferies has set record levels, according to Straty, helped by "breakneck" issuance in the first half of this year that continued well into parts of the third quarter. Despite the pullback in crude, most investors take a longer-term view, he noted. What's more, they are attracted to the sector due to the underlying asset value afforded by proved reserves, as well as the large visible inventory of locations yet to drill in many of the unconventional resource plays.

Scott Van Bergh
Bank of America Merrill Lynch

"Investors have an appreciation of the paradigm shift that the shale resources have brought to the industry, and they understand that a portion of what some of the companies are doing today really is more 'manufacturing like' than 'exploration like'," he commented.

"And as a result, the market has recalibrated the risk profiles, particularly for liquids-oriented shale players. A lot of E&Ps have ample inventory which, in a normalized pricing environment, will generate very attractive returns."

One area of particular growth for Jefferies has been in the area of structured financing, where issuance has exceeded $10 billion for the last two years.

"We've seen a tremendous amount of interest on the part of private equity and institutional funds seeking to do structured financing that might involve more than just a coupon, and could include an overriding royalty or a net profits interest," said Straty. "And we continue to see that market growing."

A lot of the financing has been to back successful executives founding new companies or rapidly expanding existing operations, such as American Energy Partners and its affiliates, led by CEO Aubrey McClendon, and FourPoint Energy LLC, led by CEO George Solich. A significant portion of the funds has been raised with institutional accounts or private equity sponsors that "two or three years ago would not have been traditional buyers of debt paper," according to Straty.

In the high-yield market, Straty indicated the sector had rebounded from some of its earlier weakness.

"The energy high-yield market is not immune from what is happening in the general market. We did have spreads widen earlier in the year," he recalled. "They've narrowed and come back. The market is still not as strong as it was in the first half of the year, but it is still in good shape."

Relative to most other industries, Straty attributed the "generally strong" performance of energy-related paper over an extended period to the sector's underlying asset value and access to developed commodity markets, including futures markets, providing liquidity. If you are a producer, "there's always a buyer for the product. Energy is a commodity that has a worldwide liquid market for it every day."

As for Federal Reserve policy, Straty believes "the Fed is going to be generally accommodating for the foreseeable future," noting that even with an eventual increase in interest rates, rates will remain at historically low levels. At the close of the third quarter, the yield on the 10-year U.S. Treasury was almost exactly 2.5%, down from around 2.7% six months earlier, even as the Fed signals measures towards a less accommodating stance.

Advises Straty: "We're a believer of 'finance when you can get it, not when you need it,' particularly when you can do it in a favorable interest rate environment."

In the world of equities, accessing capital markets has clearly become more precarious, although the window for yield instruments, such as master limited partnerships (MLPs), stands out as one key area of investor appetite. For C-Corp issuance, timing may become more important in an unsteady world.

Scott Van Bergh, vice chairman of global energy at Bank of America Merrill Lynch, said E&Ps are likely to face more volatility in the latter part of 2014 and into 2015, but that there should be periodic windows allowing E&Ps to finance. And capital markets continue to "show great receptivity for the MLP product" as retail and institutional investors seek instruments combining yield and growth.

Addressing recent market turbulence, Van Bergh said the market appeared to be "reacting to bigger fundamentals beyond those of the energy industry in particular," such as slowing growth in Europe and China, as well as caution over interest rates. "But at recent WTI prices in the low $90s, the fundamental economic story backing a lot of the shale plays here is still very, very strong."

Going forward, said Van Bergh, the backdrop of "Goldilocks" conditions in the economy (not too hot, not too cold) may no longer apply as the Federal Reserve moves away from near zero interest rates.

"I'm still very positive that we're going to get back to a financing environment that is constructive for the industry. But I do think there will be an increase in volatility as we go into 2015, and it will not be as easy to finance as it has been in the last three to four years. People will have to do their best to time things as to when markets are receptive."

A key question facing the energy sector is whether the recent selloff in public markets has impacted what has been a successful model used by many E&Ps of late, according to Van Bergh. Such a model is based on a pure-play E&P operating in a single basin that is "significantly outspending cash flow, but with the confidence that it has a friendly debt finance and equity market to finance the shortfalls. And that cash flow outspend is what has resulted in the very rapid growth trajectories that many of these companies have seen."

However, to the extent the Federal Reserve begins raising interest rates, financing spreads could "widen dramatically," Van Bergh said, emphasizing there's "a big difference between 6% and 9% in raising money in the high-yield market." And if reduced access to capital on favorable terms results in lower capex, growth rates for E&Ps will tend to slow and valuations will tend to come down.

"The question is whether that whole model that we've lived with over the last three or four years holds together," he said.

Putting it in context, Van Bergh noted energy had been one of the best performing sectors in the S&P index over the last several years and said unconventional shale plays were projected to continue on a path of double digit growth for the next five to ten years. Despite the "road bump" of recent commodity weakness, he expected markets would afford "strong market receptivity to the energy space."

One area in which E&Ps may consider a change in direction is in their preference for a single-basin strategy, according to Van Bergh. "We've been in a market where the single asset plays have been the prettiest girl at the ball for a long time," he said. "They all tend to trade at a pretty good premium to more diversified companies, and that likely continues. The question is whether some of the single basin companies—in light of having been whipsawed by basis differentials periodically, or having had oil prices weaken suddenly—begin to think having some commodity diversification in the portfolio makes sense."

Six months ago the idea would not have gained traction with most management teams, Van Bergh said.

"They would have said, 'We're committed to the single basin structure; it's what we know; it's what we're good at.' But if you roll forward to today, I think you would get a few different answers."

David Banmiller
Macquarie Capital

M&A outlook vs equity

Van Bergh observed that if raising adequate capital to maintain a certain growth rate becomes an issue, this would likely become a catalyst for a pickup in M&A activity.

"If people are not confident they can raise the financing to cover any cash flow shortfalls, and as a result have to cut capex, that could be an interesting catalyst for M&A. And when you add to that what are still ongoing activist investor programs, and you put the two together, you could see a big pickup in M&A."

At Macquarie Capital, expectations are also to see a significant pickup in M&A against a backdrop of somewhat more muted equity issuance.

"I think we are going to see a lot more corporate M&A activity over the next 12 months," said David Banmiller, managing director in Macquarie's oil and gas group in Houston. "I think the acquisition of Kodiak Oil & Gas by Whiting Corp. was the kickstarter."

Although activity is "going to be mainly M&A-driven," said Banmiller, there is likely to be continued equity issuance—somewhat more muted, but still possible—by companies seeking to access capital markets in the wake of recent market volatility.

"I don't think that issuers who are in the midst of their processes right now, or are contemplating the equity markets, are necessarily abandoning that altogether," said John Kent, managing director in Macquarie's equity capital markets group in New

York. "I think they're going to be cautious, that they're going to evaluate the landscape, and then see what valuations are and make a determination. And the only option is not the equity market. Often, there is M&A, and there is the debt market, as well."

John Kent
Macquarie Capital

In part, relying less on the equity market is made possible by what has been no lack of capital from other sources, observed Banmiller.

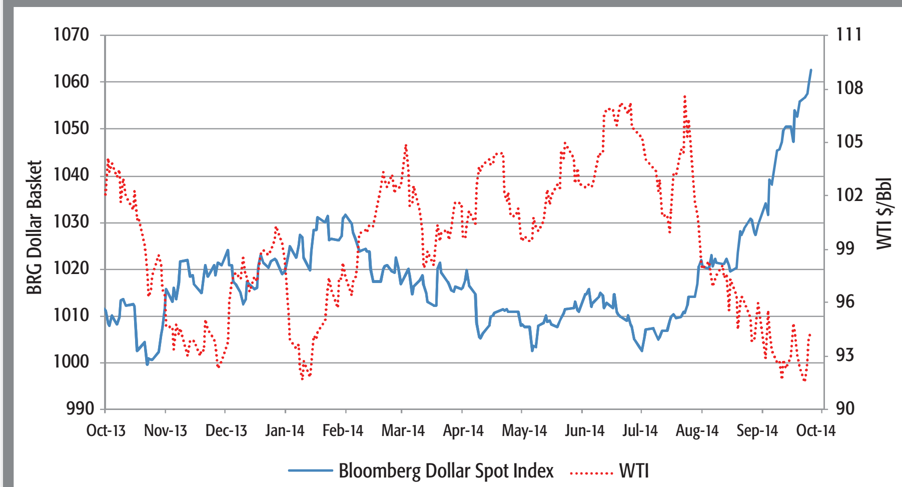
"What you see with a lot of these companies right now is that there's a lot of liquidity in the system. Given the strength of the high-yield market over the last two years, a lot of E&Ps tend to have unfunded revolvers. If E&Ps want to add additional rigs where they're operating, they often already have the debt capital available to be able to do it."

Perhaps the most important factor in determining market receptivity to an equity raise is the use of proceeds, emphasized the Macquarie team.

Assuming a positive use for funds raised, "I think we're still going to have conditions that will allow issuers to go out and raise equity, and I think investors will be receptive to it," adds Kent. "But it comes back to valuation. If we start to see a trend where valuations are really coming off significantly, I wouldn't be surprised to see issuers say they just don't need to raise equity right now."

Macquarie has also detected signs that the trend towards E&Ps favoring single-basin strategies may be receding—and, if so, possibly giving rise to acquisition opportunities.

DOLLAR VS. WTI PERFORMANCE OVER THE PAST YEAR



Source: Bloomberg as of note update on 9/25/2014

"The dialog we've had with a number of companies over the last six months has been much more focused on how they can grow outside their existing area," said Banmiller. "With the land grab largely over, the way to grow is typically either to do a corporate deal with someone in your basin, or look at other basins. I think people are going to start branching out into other basins."

Relative to 12 months ago there is now a much more serious tone to such discussions, according to Macquarie. So where could E&Ps diversify into new basins?

"The Permian and the Bakken are fairly well valued right now. Where we're beginning to see a lot of interest in is the Powder River Basin," said Banmiller. "Also, I would think where you would see more activity is definitely in the Utica and Marcellus and maybe in the Wattenberg. Over the next 12 months those are the three basins that will probably see the most activity."

The Macquarie team sees oil prices as being largely range-bound for the next several years, with a lower limit to WTI of $80 per barrel.

"I don't see a catalyst that brings us below $80 per barrel for an extended period of time," said Banmiller, noting how efficiencies gained in many basins have lowered costs. Breakeven prices in the Bakken, for example, used to be around $65-$68/bbl, but now are closer to $60-$65/bbl, he said. "I don't see any reason why activity on the oil side is going to stop."

Long term, natural gas prices are expected to benefit from the conclusion of deals to back up new liquefied natural gas (LNG) facilities, according to Banmiller.

"A lot of Asian companies have signed up for commitments, and they haven't got anywhere near to procuring the gas they need," he said. "I think we'll end up seeing some of these basins, like parts of the Haynesville, that are uneconomic at this point, returning to economic levels at some point probably in the next three years."

Macquarie is currently the fourth largest trader of physical gas in North America. At a time when some reforms are pushing a lot of commercial banks out of the commodity business, Macquarie's steady position in commodities "will put us in a competitive advantage going forward," said Banmiller. ■

PRIVATE CAPITAL

Removing Hurdles to Private Capital

The JOBS Act heralds a new era of Reg D financing and introduces crowd funding for E&P companies. How does it work?

By James C. Row and Clay Brett

In April 2012, President Obama signed the Jumpstart Our Business Startups Act ("JOBS Act") into law with the intent to encourage funding of growth capital and expand access to the capital markets to a broader community of issuers and investors.

The JOBS Act was generally intended to accomplish these dual goals by creating new exemptions to registration and reducing the regulatory burdens of issuers. While it has been heralded in public markets for its popular "IPO On-ramp" provisions, among

private issuers and industry experts, the JOBS Act is celebrated as a revolutionary innovation in private capital fundraising with its expansion of Regulation D and the introduction of "crowd funding" for capital raises of less than $1 million.

Legislators devoted an overwhelming amount of time and energy to the crowdfunding capabilities of the new law, but investors now bear down on the changes to the more commonly used "Reg D"—in particular, the emergence of a new opportunity, the 506(c) offering.

From September 1, 2013 through June 30, 2014, there were 34,173 Reg D filings submitted to the U.S. Securities and Exchange Commission (SEC), according to Offerboard.com. This represents some $581 billion—sold with an average number of investors of 9.1 per transaction across all industries. Of these, 1,563 were 506(c) offerings, or approximately 5% ($15 billion) of the Reg D offerings, with an average number of investors across all industries of 10.8. Pooled investments accounted for 346 of these offers and $8.6 billion in capital raised.

In the oil and gas sector alone, there were 1,875 Reg D offerings. The total amount offered was $94 billion and the amount sold was $11 billion. The average minimum investment was $95,852.26 and the average number of investors at the time of filing was 14.7.

Some 96 oil and gas companies used the 506(c) exemption, for a total of $1.3 billion offered and $388 million sold in the past nine months with 52% of these offerings originating from Texas. The average number of participants per transaction in the oil and gas sector was 5.1.

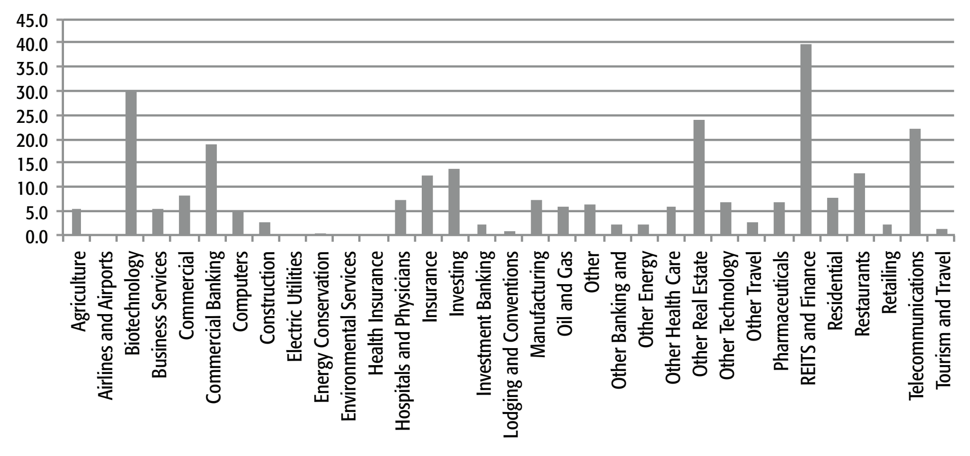
The market for private investment in the oil and gas industry has never been hotter, and Reg D has emerged as the market standard approach to raising private capital in the United States. In a capital intensive industry with investors who will chase yield while issuers still faced draconian SEC remedies, investors, issuers, operators and practitioners must understand the most powerful strategies to raise private capital to optimize capital inflows while avoiding needless liability and expense.

Introduction to SEC offering rules

The Securities Act of 1933 requires all offers and sales of securities to be registered with the SEC or qualify pursuant to an express exemption provision under the federal securities laws. One exemption applies to issuances of capital not

AVERAGE INVESTORS BY INDUSTRY

under 506(c) since 9/1/13 (excluding pooled investments)



GENERAL PROS AND CONS OF 506(C) WHEN RAISING CAPITAL

Pros	Cons
Emerging market standard approach to raising private capital; form materials are widely and freely available	Limited to only accredited investors and burden is on issuer to determine if investors satisfy
No limits on general solicitation	Market generally expects disclosure of "10-K-like" information
No limits on offering size	Involves technical legal determinations and disclosures disfavored by some non-lawyers

involving a "public offering." A transaction satisfying the requirements of Rule 506 under Reg D, in turn, satisfies certain safe harbor provisions in order to be deemed as not involving a "public offering" under Section 4(a)(2). The broad purpose of Reg D is to relax regulatory burdens on, and expand and facilitate rapid access to, capital by smaller issuers, while maintaining certain disclosure and sophistication standards to protect the investing public.

The JOBS Act removed Reg D's ban on general solicitation and advertising in offers and sales made under Rule 506(c) if the issuer meets the rule requirements. This rule change has paved the way for companies looking to raise investment through "506(c) platforms," such as Offerboard, to advertise and promote their offerings to accredited investors.

Even more, the JOBS Act allows companies on equity crowdfunding platforms to promote their offering beyond the accredited investor community on generalized social media platforms such as Facebook and LinkedIn. An implication of this will be that smaller companies will be able to reach large investors more easily and therefore have increased access to capital.

The JOBS Act changed the landscape of the private placement market. Reg D, and more specifically Rule 506(c), has many positive implications for small companies and companies involved in these types of offerings. First, there is not a size limit on Rule 506(c) offerings, which allows companies to raise an unlimited amount of capital.

Moreover, this type of offering is available to any issuer, regardless of whether they are a reporting or non-reporting company. Further, the issuer does not have to furnish information to the accredited investor, which makes the process less burdensome on the issuer—although the market may demand it. Lastly and most notably to many practitioners, Rule 506(c) allows for general solicitation and advertising, which will allow small companies to attract investors more easily and thus allow for the expansion of capital raising by small companies.

There are a few negative administrative considerations lurking within Rule 506(c). First, under Rule 506(c), issuing companies are only allowed to sell securities to accredited investors, which limits the pool of potential investors. Specifically, the issuer must have a "reasonable belief" that the investor is an accredited investor and must also take "reasonable steps" to verify accredited investor status. Thus, Rule 506(c) has the highest verification standard for accredited investors, which can be burdensome on the issuer.

The "reasonable steps" requirement, and the significant consequence of falling short of satisfying this standard, can be seen as a negative implication of the Rule 506(c) change. These issues are discussed in some detail here, but it is important to note that sales of securities conducted in violation of the private offering exemptions may be subject to rights of rescission for one year following the date of the sale of securities, regardless of whether the investor has sustained losses. Regardless, Rule 506(c) has emerged as one of the most popular methods for offering and selling securities.

Market trends and challenges for Rule 506(c)

Market trends show that Rule 506(c) offerings are quickly becoming one of the most utilized offering methods. In the last few years, there has been a general growth in private investments. This growth in the market has led to an increasing number of participating accredited investors, which in turn has led to accredited investor verification becoming more streamlined, easing the burden on issuers to verify the accredited investor status.

The JOBS Act created a new standard to verify accredited investor status for issuers. To conduct a Rule 506(c) offering, the issuer must have a reasonable belief that the investor is accredited and must also take additional, reasonable steps to verify the accredited investor status.

The belief requirement is ordinarily fulfilled by the investor filling out a questionnaire which verifies information about the investor's suitability to take part in the offering.

Guidance issued in respect of Rule 506(c) has also provided four non-exclusive methods to verify accredited investor status that will be deemed to satisfy the reasonable steps requirement: a) review of specified documentation showing that a person meets the income test in the definition of accredited investor; b) review of specified documentation showing that a person meets the net worth test; c) reliance on written confirmation from specified categories of third parties verifying the person's accredited investor status; and d) reliance on certification from an existing investor who previously invested in a Rule 506(b) offering by the issuer, prior to the effective date of the new rules.

In respect of the other Rule 506 offering methods, meeting the belief requirement is enough to satisfy SEC safe harbor

REGULATION D PROVIDES VERSATILE STRATEGIES FOR QUICK ACCESS TO NEW EQUITY CAPITAL

	Rule 504	Rule 505	Rule 506(b)	Rule 506(c)
Size of offering	$1 million per year.	$5 million per year.	No limit on size of offering.	No limit on size of offering.
Issuers permitted to rely on this exemption	Non-reporting companies and companies that are not investment companies or blank check companies.	Companies that are not investment companies. Companies ("bad actors") disqualified if any officers, directors, general partners, 10% owners or underwriters have been convicted or subject to an SEC order within the past 5-10 years.	Any issuer. Is used by both reporting and non-reporting companies. Companies ("bad actors") disqualified if any officers, directors, general partners, 20% owners or underwriters have been convicted or subject to an SEC order within the past 5-10 years.	Any issuer. Is used by both reporting and non-reporting companies. Companies ("bad actors") disqualified if any officers, directors, general partners, 20% owners or underwriters have been convicted or subject to an SEC order within the past 5-10 years.
Types of investors that can buy securities	Any investor. No limits on the number or sophistication of investors.	An unlimited number of accredited investors and up to 35 non-accredited investors.	An unlimited number of accredited investors and up to 35 sophisticated non-accredited investors.	Must be an accredited investor.
Standard of verification required of accredited investors	Not applicable.	Issuer must have reasonable belief that the investor is an accredited investor. Questionnaires often used to verify investor suitability.	Issuer must have reasonable belief that the investor is an accredited investor. Questionnaires often used to verify investor suitability.	Issuer must have reasonable belief that investor is an accredited investor. Additional, reasonable steps to verify accredited investor status.
Information requirements	No information requirement for accredited or non-accredited investors.	No information requirement for accredited investors. Disclosure requirement for non-accredited investor.	No information requirement for accredited investors. Disclosure requirements for non-accredited investor.	No information requirement for accredited investors.
General solicitation or advertisement permitted	No, subject to the exceptions provided by Rule 504(b)(1).	No.	No.	Yes, issuer may use general solicitation and advertising if all buyers of the securities are accredited investors, and reasonable steps are taken to verify accredited investor status.

Source: Pratical Law Company

rules. However, in a Rule 506(c) offering, the issuer must take the additional, reasonable step to verify the accredited investor status. This is an independent procedural requirement, and it must be met even if all purchasers are in fact accredited investors. The determination of the sufficiency of the steps taken to verify an investor's accredited status will be based on the particular facts and circumstances of the purchaser and the transaction.

Factors that the issuer may consider include: a) the nature of the purchaser and the type of accredited investor that the purchase claims to be, b) the amount and type of information that the issuer has about the purchaser and c) the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount.

The JOBS Act improved upon market capital formation by expanding the ability for the use of prevailing market tools such as Rule 506(c), while introducing new private platform-based concepts accessible to an expanded community of investors. Clearly the intent of Congress in the JOBS act was to take a modern step forward, given technology and financing practices, and lessen the rules for general solicitation and direct marketing for both crowd funding and Regulation 506(c) offerings.

The use of Rule 506(c) as a viable funding alternative will increase with exposure and knowledge of the change in law and most importantly the acceptance from the investment community. Once the issuing community and investors gain experience in dealing with the additional step of verifying accredited investor status, the use of 506(c) offerings will rise and could become the preferred capital raising tool of the future for the oil and gas industry. ■

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PUBLIC EQUITY CHOICES

Super-Charged Energy IPOs

Is a conventional IPO the way to go, or is an Up-C structure better?

By Elizabeth L. McGinley and Vivian Y. Ouyang

In the past year, more than two dozen initial public offerings (IPOs) in the oil and gas upstream and midstream sectors have raised over $10 billion in capital. In an environment of high oil prices and numerous skilled management teams seeking capital for growth, these IPOs are likely to continue.

A large portion of the privately held upstream and midstream companies are operated as partnerships, or limited liability companies treated as partnerships for federal income tax purposes. Such entities are highly tax efficient because they are not subject to federal income tax; instead, partnership income is allocated among the partners and subject to federal income tax only once, at the partner level. Similarly, partnership losses flow through to the partners and can be utilized to offset the partners' taxable income.

If, however, a partnership is publicly traded, the partnership and the partners both are subject to federal

income tax on the income generated by the business, unless the partnership qualifies as a master limited partnership (MLP).

Income of public corporations, in contrast to private partnerships, is subject to tax twice, once when earned by the corporation and again at the shareholder level, when dividends are received or taxable gain is recognized on the sale of the corporate stock. In a conventional IPO of a business operated as a partnership (unless the existing partnership can qualify as an MLP), prior to the IPO, the partnership business is contributed to a corporation and the corporation issues shares to the public.

As a result, all of the historic partners lose the advantage of a single level of federal income tax on their business income and flow through of tax losses from the date of the IPO.

In the Up-C structure, however, the historic partners continue to hold all or a portion of their interests in the historic partnership and the public invests through a corporate partner in the partnership.

The Up-C structure generally is created by forming a new corporate member of the existing upstream or midstream partnership. This corporation then issues shares to the public, and the cash proceeds are applied to acquire additional interests in the partnership—either from the historic partners or in exchange for a contribution to the partnership. Accordingly, the historic partners can continue to enjoy a single level of federal income tax on the partnership earnings and flow through of tax losses.

While the historic partners retain a direct interest in the existing partnership, such interest is not liquid and cannot be readily traded like shares of the public corporate partner. However, in the Up-C structure, the historic partners typically have the right to exchange their partnership interests for shares of the public corporation. Such an exchange is taxable, so historic partners typically delay the exchange until they seek to exit all or part of their investment in the business.

Because frequent exchanges and other transfers of the partnership interests could cause the partnership to be treated as publicly traded, the exchange agreements should include limitations on exchanges to avoid such result.

In addition, in the Up-C structure, the corporate partner manages the historic partnership. However, the historic partners who managed the partnership's business prior to the IPO typically continue to manage the business indirectly by acquiring non-economic high vote shares in the public corporation when it is formed, and cause the corporation to issue only low vote shares to the public. The high vote shares allow the historic partners to vote for the board of directors and may provide approval rights for significant corporate actions.

Super-charged benefits

The "super-charged" effect of the Up-C structure to historic partners results from an agreement, referred to as a tax receivable agreement (TRA), between the public corporation and the historic partners providing for periodic payments from the public corporation to the historic partners for certain cash tax savings of the corporation.

The tax receivable agreement provides that the corporation periodically will pay, generally, 85 percent of its cash tax savings associated with the additional depreciation or amortization and other tax deductions derived by the corporation and attributable to the Up-C structure.

These additional cash payments to the historic partners can increase their return from the IPO by 30 or 40 percent.

> The Up-C structure can present more complexity, but it results in greater tax efficiency than the conventional IPO.

The increased tax deductions to the corporation are derived from the transactions occurring at the time of the IPO and thereafter. First, at the time of the IPO, when the public corporation buys partnership interests from the historic partners, and the historic partners recognize taxable gain on the sale, an election can be made to provide the corporation with a "stepped up" basis equal to the purchase price of the interests, in its share of the assets of the partnership.

As a result, the corporation receives greater depreciation and amortization deductions than if no such election were made, reducing the taxable income and cash taxes of the corporation.

Also, if at the time of the IPO, the public corporation acquires interests from the partnership in exchange for a contribution of cash, the historic partners can agree to provide additional depreciation deductions to the corporation, as if it received a purchase price tax basis in its share of the partnership assets, and increase the allocation of income to the historic partners.

Following the IPO, as payments related to the purchase of partnership interests are made under the tax receivable agreement, such amounts are bifurcated into deferred purchase price for the partnership interests and an interest payment. The additional purchase price produces additional step up, and, consequently, additional deductions to the public corporation.

Further, a portion of each payment treated as interest paid to the historic partners is deductible to the public corporation. Finally, when the historic partners subsequently exchange their partnership interests for corporate stock, the corporation can obtain yet another step up in its basis of the partnership assets associated with the exchanged interests, yielding even greater deductions for the corporation.

When the historic partners recognize gain on the sale of their partnership interests to the public corporation for cash, or upon an exchange of their partnership interests for corporate stock, or recognize income resulting from an increased allocation of deductions to the corporate partner or interest associated with the TRA payments, they often can shelter such income with existing losses, resulting in no current cash tax cost.

In addition, they receive the periodic cash payments under the TRA from the corporate partner, effectively monetizing their tax losses.

The TRA must be negotiated by the parties and address a number of important issues. A primary issue is how the relevant tax benefit to the corporation is computed. Frequently, the cash payments to the historic partners under the TRA are computed on a "with and without" basis. That is, the payments are equal to a percentage of the difference between the corporation's actual cash tax liability and its tax liability had it not received the benefit of the additional deductions described here.

The specified deductions for which TRA payments are made are treated as used last by the corporation.

The parties also must agree on the percentage of the cash tax savings paid to the historic partners. While 85 percent is common, the percentage does vary among TRAs, but it is advisable that the corporation retain some of the tax benefit so it is incentivized to maximize the value of the tax deductions. The TRA also should address the historic partners' obligation to return payments attributable to deductions successfully challenged in an audit, as well as the parties' rights and obligations, including the possible acceleration of payments, if the agreement is breached or terminated or if there is a change of control of the corporation.

Additional advantages of the Up-C structure include an increased ability to effect tax-deferred acquisitions, either through using corporate stock in non-taxable exchanges for target stock or mergers, or through contributions of property to the partnership in exchange for partnership interests. Further, public company stock and stock options can be used to compensate employees.

The Up-C structure also is widely understood and accepted in the public market. It has been successfully employed for well over a decade. Because public company equity generally is valued based on the corporation's EBITDA (earnings before interest, taxes and depreciation), which does not include the value of tax attributes, the existence of the TRA generally has not resulted in the market imposing a discount on the shares of the public corporation.

Accordingly, the Up-C structure, including a TRA, has been accepted by the energy industry and successfully employed in recent energy IPOs including Jones Energy, Athlon Energy and Parsley Energy.

The Up-C structure can present more complexity, but it results in greater tax efficiency than the conventional IPO without limitation on the nature of the assets or income generated from the business. The structure can dramatically enhance the returns to the historic partners, as well as reduce the cash tax liability of the public corporation, making the Up-C structure an attractive alternative to conventional energy IPOs. ■

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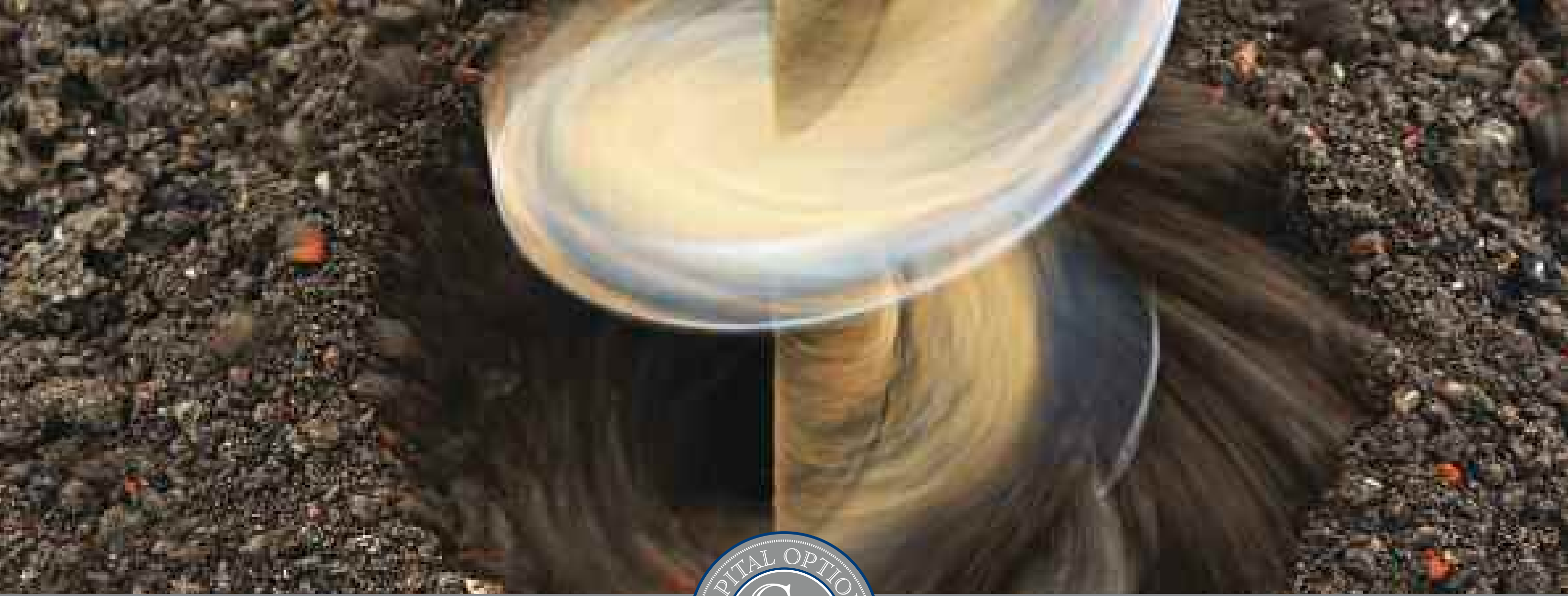


HIGH YIELD

Bond Market Opens Wider

Investor appetite for yield and energy stories offers increasingly favorable terms to junk-bond issuances.

By Nissa Darbonne

High-yield-debt buyers' interest in E&P issuances has tipped the scale to favoring the issuer, with 93% of such offerings into the third quarter of this year being under 50% call-protected.

"Five years ago, you would see eight-year-plus maturities with, maybe, five years of call protection," Steve Jones, managing director and high-yield desk strategist for KeyBanc Capital Markets Inc., told energy-industry attendees recently in a KeyBanc-hosted program in Houston.

"Now, the market has shifted inside of that. In 2011, we saw 97% was over 50% call-protected; now, 93% of it is under 50%. So, if you do an eight-year piece of paper, it is common now to see three-year call protection. We like that because…it gives optionality (to the issuer): If rates rise, you wouldn't touch this paper. If rates fall, you'll be able to refinance it quicker and you're going to be able to get rid of higher-cost debt.

"That's a huge shift in our market."

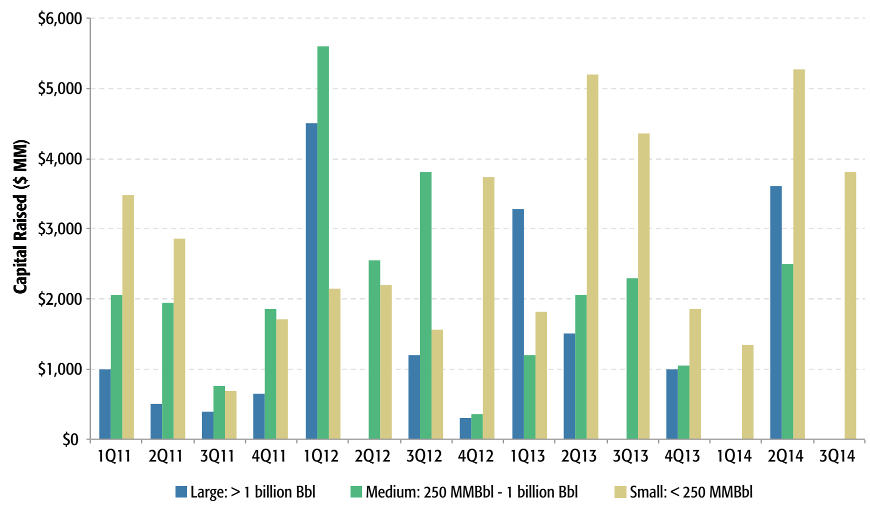
The appetite for new-issue E&P bonds is also resulting in lower interest rates than the issuer's credit rating would suggest, he said.

"When you go out to meet investors and you're (doing) a secondary or a new deal, explain to them what you're going to do and execute on it. Don't worry about the ratings. The ratings…don't always completely correlate at initial pricing.

"You'll get triple-C or Caa1 bonds that will trade inside of a B3 bond or you'll have a B3 that will price inside of a B1. So the rating is not the key. The object is having the right operating model and to explain it clearly to investors."

And, operating in a hot basin helps. Permian Basin-leveraged Cimarex Energy Co. tapped into the "crossover buyer" market in its $750-million, senior, unsecured issuance in May, for example, Jones noted. The offering was sold at par and upsized from $600 million.

E&P NEW ISSUE BY SIZE AND DATE



Recently more high-yield issues have come to market for smaller companies.
Sources: Bloomberg, Company filings, KeyBanc Capital Markets

"It's highly rated—BB+ and Ba1—so it's on the cusp of investment grade. The offering was priced at 4.375%, which is not, technically, what I'm used to calling high-yield; however, what they discovered is the crossover-buyer market.

"You're seeing investment-grade buyers step down into the market to get yield, so (E&P companies) now have a bigger field of capital."

In two more hot plays—the Bakken Shale and a new oil play in Oklahoma, the SCOOP—Continental Resources Inc. sold $1 billion of senior, unsecured notes at 3.8% due 2024, and $700 million at 4.9% due 2044 in May at 99.644% and 99.717% of par. It used proceeds to pay off its bank debt and it redeemed its $300 million of 8.25% notes due 2019.

Meanwhile, issuers that operate in more-established basins, such as in Canada and the Gulf of Mexico, have to differentiate themselves, Jones said. "It becomes a relative-value game with (debt) buyers...So you can offer larger coupon, looser covenants, longer call protection. What are you going to do? You have to explain your value model to the buyers."

Of the $17.6 billion of E&P issuances year to date, 40% funded M&A transactions, compared with 21% by this time in 2013, he added.

SELECTED OFFERINGS (Through early October 2014)

- **CABOT OIL & GAS CORP.** privately placed $925 million of senior unsecured notes with institutional investors in late September amidst a $210-million, 30,000-net-acre expansion acquisition in the Eagle Ford Shale play. In the series, $100 million was placed at 3.24% due 2021, $575 million at 3.67% due 2024 and $250 million at 3.77% due 2026.

- **PERMIAN-FOCUSED AND NEWLY PUBLIC RSP PERMIAN INC.** priced $500 million at 6.625% due 2022 at par, up from an expected $450 million, and paid off its bank facility.

- **SANCHEZ ENERGY CORP.** privately priced $300 million at 6.125% due 2023 at 100.75%, up from an anticipated $250 million, for working capital and other purposes.

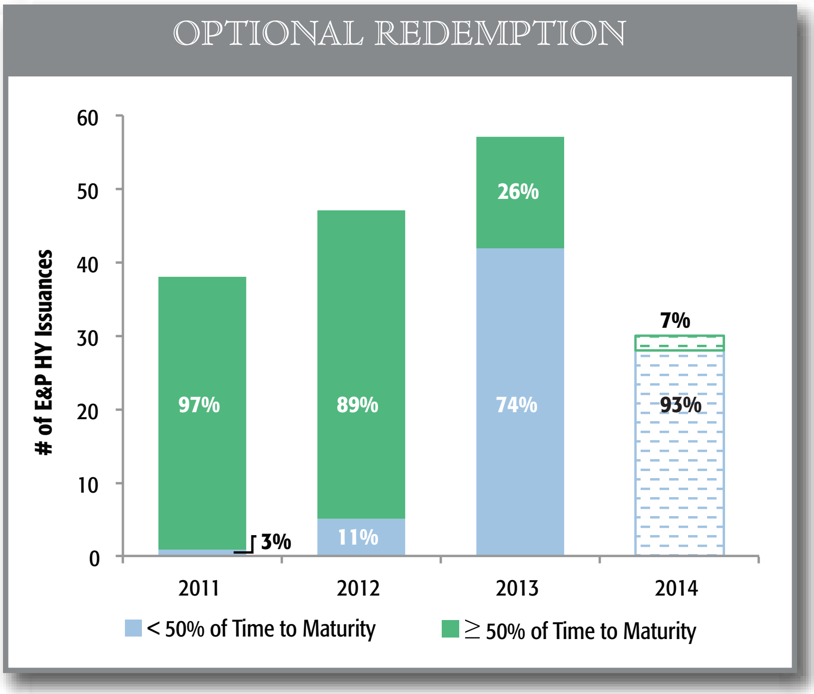
- **LINN ENERGY LLC** sold $450 million at 6.5% due 2019 at 102% of par and $650 million at 6.5% due 2021 at 98.619% of par for a total of $1.1 billion, up from an anticipated $1 billion, to pay bank and other debt.

- **MARCELLUS- AND UTICA-FOCUSED ANTERO RESOURCES CORP.** privately placed $500 million at 5.125% due 2022 at 100.5%, following on from a similarly priced placement in May in a $600-million raise. It paid some of its bank debt with the more recent raise. In the May raise, which was up from an anticipated $500 million, proceeds were used to redeem $277.5 million of outstanding 7.25% notes due 2019 and reduce its bank debt.

- **WPX ENERGY INC.** issued $500 million of 5.25% senior unsecured notes due 2024 at par to pay bank debt.

- **ULTRA PETROLEUM CORP.** privately sold $850 million at 6.125% due 2024 at par to fund part of its $925-million, Pinedale Field acquisition from Royal Dutch Shell Plc. The offering was upsized from an anticipated $700 million. (In addition to the cash portion of the acquisition cost, Ultra traded 155,000 net Marcellus acres in Tioga and Potter counties, Pennsylvania, to Shell.)

- **AUBREY MCCLENDON'S AMERICAN ENERGY-WOODFORD LLC** planned in September to privately offer $325 million of senior unsecured notes due in 2022 to fund lease acquisitions, pay all of its bank debt, make a distribution and for other purposes. In August, his **American Energy-Permian Basin LLC** closed a private placement of $1.6 billion of notes, consisting of $350 million of floating-rate senior unsecured due 2019, $650 million at 7.125% due 2020 and $600 million at 7.375% due 2021. The raise was to fund its $2.5-billion, 63,000-net-acre acquisition in the Permian Basin from Enduring Resources II LLC. The placement was upsized from an anticipated $1.4 billion.



Investors are demanding shorter maturity bonds, particularly for 8-year final maturities. *Source: KeyBanc Capital Markets, Bloomberg*

Overall, issuances by companies in the broader energy sector—E&P, midstream, downstream, coal, oilfield services and alternative energy—this year, to date, have been 19% of the high-yield offerings, totaling $45.5 billion. The total raise is 14% or $34.2 billion of all issuances by this time in 2013.

"(Bond buyers) often say, 'We see too much E&P paper.' The answer, according to the numbers and according to the markets, is there is still capacity for E&P issuance," Jones said.

He added that raising that $17.6 billion from high-yield debt offerings this year has been largely—some 60% of the dollar volume—by small E&Ps, which Jones categorizes as those with fewer than 250 million barrels of proved reserves.

"When you look at the early part of the (current) credit cycle, beginning in 2011, what we saw were issuances by the mid- and large-cap names—the serial issuers. The market was just getting on its feet. Into 2012, midcap names were most aggressive in raising capital. Since then, it has been small-cap names."

By Jones' tally, all raises in the first quarter and so far in the second quarter have been by small issuers. "So we've really turned into a small-cap market…The market is open for first-time issuers as well as for smaller-cap and lower-rated companies."

The market appears to remain fairly disciplined, however, he noted. Plugging the data into an X-versus-Y-axis graphic, operators with the lowest debt as a percent of their proved reserves and greatest amount of hedged production are trading—on a "spread to worst" basis—better than those with more debt and less hedged. ■

SMALL-CAP STRATEGIES

Opportunity Knocks for Small-Cap Operators

Banks are lending, mezzanine lenders proliferate, and even private equity is interested in stretching to meet small-caps' needs.

By Gregory DL Morris

As even small-cap oil and gas companies face growing demands for capital to acquire acres and put development plans into action, they are finding the doors open for just about any type of equity or debt that fits their needs and assets. Despite temporarily softening commodity prices, banks are eager to lend on proved reserves, and interest rates remain modest.

Beyond the banks, investors of all stripes are still interested in oil and gas. Many new firms specialize in mezzanine debt, and private equity is showing increasing interest, especially via joint ventures for specific plays. For companies with sufficient balance sheets, secondary offerings to the public market and high-yield debt are attractive options.

"Without doubt, the lowest cost of capital for small-cap oil and gas companies is reserved-based lending," said Sylvia Barnes, managing director and group head of oil and gas investment and corporate banking at KeyBanc Capital Markets in Houston.

"Providing your banks with a senior secured position, which generally translates to a bankruptcy-remote, real-property interest, means you are only going to pay Libor plus a few percentage points. Certainly, a first lien position is most economical, but in the case of rapidly growing smaller upstream companies, a senior second lien from your banks can make a lot of sense."

Barnes explained that first and second liens have distinct differences. "For your first lien facility, non-producing reserves can only be used for about 25%

of the present value calculation of the borrowing base. So if you have significant PUDs [proved undeveloped locations] or even PDNPs [proved developed nonproducing locations] in the jar but not producing, that can be a problem."

Resource plays can seem to create something of a Catch 22. "Small producers can need a lot of capital up front before achieving production," Barnes observed, "and that lumpiness can be too much for a first lien. That is where a second lien can be very helpful. Not all banks do it, but we lead syndicates where the first lien does not take care of everything, and we provide a second-lien bank facility which can increase the amount of nonproducing reserves used in the present calculation to around 40%."


Sylvia Barnes
KeyBanc


Keith Behrens
Stephens Inc.

Barnes said that "second-lien bank facilities can provide stretch financing with some flexible off-ramps, slightly longer term and more accommodating covenants, but higher pricing, e.g. in the order of Libor plus 7%."

Two noteworthy institutional second-lien transactions have taken place recently, one for $175 million by American Eagle Energy Corp., which closed in August. It was a privately placed second lien priced at 11% with 99.059% original issue discount. A similar transaction is currently in the market for Callon Petroleum Co.

Beyond the second-lien market lies a pot of gold at the end of the rainbow in the high-yield market, but it tends to be accessible only for producers with more than 6,000 barrels of oil equivalent per day production and issues of at least $250 million and larger.

"The real end-game for smaller upstream companies is to optimize their cost of capital and access the high-yield debt market along with senior bank financing," said Barnes. "High yield is basically covenant-free, eight-year money, making it almost disguised equity, and that is what lets CFOs sleep at night. But for companies with smaller capital needs—almost the "tweeners"—high-yield is not viable. The best option for growth-oriented debt capital to supplement first-lien bank debt is a second lien."

Bigger reserves for bigger borrowing

"Bank debt is generally the lowest cost of capital for small-cap producers," said Keith Behrens, managing director and head of the energy investment banking group at Stephens Inc. "If bank debt provides enough capital to meet a company's needs, then that should be the best option from a cost-of-capital point of view. If the reserve base grows, then the borrowing basis should grow with it. It is all predictable, and a lot of banks provide this type of financing."

Bank reserve-based lending is based on proved reserves, Behrens stressed. "To have success growing the borrowing base, producers need to have success converting PUDs into PDPs [proved developed producing reserves]. You need to have production online typically for six months to get borrowing base credit."

Two other points bear on the bank-based reserve lending, Behrens noted. Despite the recent softness in oil prices, "commodity price decks for lending tend to be a little sticky. It takes a more prolonged change in commodity prices for banks to revise their price decks, so changes week-to-week or even month-to-month do not usually mean major changes in the borrowing bases. Also, hedges are factored in," which is another advantage to well-established production.

As a next step, if the amount of debt a bank will advance is insufficient, Behrens suggested mezzanine structures and second liens.

"We have seen a lot more groups enter this area and assist the producers if they need more capital than what a bank will provide for an acquisition or a drilling program. There is plenty of mezzanine capital available these days, and plenty of groups providing this type of financing."

The mezzanine finance market seems to be moving into a more aggressive phase, according to Behrens. "As I said, plenty of capital is available, and it's definitely a healthy environment for borrowers. They definitely have access to the money they need. We are seeing a lot of groups making loans at high levels of leverage."

Equity markets are another option, Behrens suggested. "Recently, the equity markets have been strong, but for any individual company, the attractiveness of a follow-on offering varies very much with where the company's stock is trading in terms of multiples of cash flow, etc."

Stephens has been active in arranging mezzanine and equity capital for upstream companies, said Behrens. "There is a huge need for capital driven by aggressive drilling programs. The companies that have been successful want to expand or accelerate their programs."

Viability for visibility

Liquidity remains a key issue for all small-cap firms, especially oil and gas companies, because drilling wells and developing large acreage positions are so capital intensive, said Jason Stevens, director of energy equity research at Morningstar.

"Both of those—wells and acreage—are important if a small company wants to demonstrate that it is viable, either as a stand-alone operation or as a take-out candidate."

Secondary offerings to boost liquidity "are not out of the question," said Stevens. "That is especially true if the producer is in one of the darling plays—the Eagle Ford, Permian, Marcellus and Utica." That does not close out other regions; it's just that producers in other basins generally have to make a strong case.

While equity is preferable, analysts tend to be agnostic about types of leverage, as long as it is not excessive. "Bankers are pretty generous these days," said Stevens. "It is not hard to borrow vs. reserves with cheap money. Private equity has also been active in making loans, especially mezzanine structures."

In the world of equity, Barnes sees public markets being clearly the cheapest form of capital. "That is why they go public in the first place. However, being a public company is not a light mantle to bear; the governance and regulatory burden takes time and energy. But once you are in the market, it is by far your best equity option. Only in rare instances does it make sense for private equity to invest in a public company, and in those cases, often under particular circumstances and arrangements."

One such arrangement was the recent investment by Apollo Global Management in the Tuscaloosa Marine Shale development of Halcón Resources Corp. Apollo's initial investment was $150 million, but it could be expanded over time to $400 million. Halcón is one of the three top players in the TMS along with Goodrich Petroleum Corp. and Encana Corp.

In public statements, Halcón management said it did not want to sell down any of its position nor surrender control of wells or acreage. Financial sources also note that while Halcón has strong and experienced management, its balance sheet and stock price at the time of the transaction were not strong, so creativity in arranging the deal was essential.

The structure is a financial joint venture under which Apollo provided capital to a subsidiary of Halcón that holds the TMS acreage. Apollo gets a return through a coupon as well as an override on some wells.

A secondary offering is one obvious solution, especially against good assets, said several sources. The snag for some potential investors, they note, is that while a company can promote its offering as a way of funding development for a specific drilling program or acquisition, once the transaction is completed the funds can go for general corporate uses.

"You can say you are going to use the funds for this or that, but there is no obligation," said one source. This is in contrast to other types of investment where the funds are dedicated to a specific purpose.

"Historically, small-cap firms have turned to private sources of capital mostly when they do not have available capacity on their revolver to complete a major development project or acquisition."

—Frost Cochran, Post Oak Energy Partners

Nonop options

"Historically, small-cap firms have turned to private sources of capital mostly when they do not have available capacity on their revolver to complete a major development project or acquisition," said Frost Cochran, managing director of Post Oak Energy Partners in Houston.

"Those types of public-private ventures can take the form of traditional nonoperated or mezzanine structures, convertible vehicles or JVs [joint ventures]. There are also private drilling partnerships. We see all of those. Small companies often need partners, especially in the more capital-intensive operations."

Lately, Cochran said where he has seen more joint ventures with the investors taking nonoperated positions or arrangements where the development is done by a joint venture of the public and private firm.

"Some small caps have exciting early-stage development projects, or even just acreage positions, but no available capital. Even if they have no debt, they need to be creative to manage risk."

Cochran is less sanguine about high-yield debt. "I would use it as I could for appropriate assets, but not in every case.

As producers are moving from exploration to delineation to rapid development, high yield can be appropriate for the later stages of that progression. It is not for early exploration or delineation because you don't have the production to support it. You don't even have the de-risked type curve yet.

"When used too early, high yield can be hazardous for everyone involved."

Small-cap oil and gas producers have options these days, said Todd Overbergen, partner and head of energy at Stellus Capital Management, Houston.

"Even some private equity will look at opportunities with public companies, whether that is preferred offerings or direct equity, as long as the public company has a nice reserve play, and especially if it is willing to drop assets into a subsidiary or special purpose vehicle."

Those types of transactions tend to fit for companies just getting started on a project with a large amount of undeveloped acreage. For small caps that are more mature and have more production and PDP reserves, however, mezzanine lenders will be more apt to structure financing against production and be more aggressive with PUDs.

"Mezz shops can work with stretch debt vehicles that could include a slug of warrants," Overbergen said. "Creativity is important, but if you have good assets and good management, then there will be capital. We are even seeing some influx from the Wall Street banks, from hedge funds, and from family offices."

One challenge for both sides in any deal is making the connection. There are producers seeking participation, and investors looking for solid projects to back. In an earlier era when the industry was smaller, friends of friends were often sufficient to bring parties together. That is still true, but Overbergen suggested that many prospective partners in small-caps are identified today through investment banks.

"Making the connection can be difficult these days," he said. "We usually identify small-cap opportunities through an investment bank, especially a regional one. From time to time we do find investments by word of mouth, but in recent years it has usually been through a banker."

Where small producers tend to run into trouble, Overbergen cautioned, is when they are illiquid.

"They tend to have a very small float. Investors in general, and especially private equity, want liquidity. They are going to want their money back in three to five years and it makes a single investor uneasy to become a big part of the float. That is another area where small-cap firms need to show creativity. The first choice for a public company is a secondary offering. But if for some reason you don't think you can do that, then you can go to your bank or to private equity." ■

Jason Stevens
Morningstar

Frost Cochran
Post Oak Capital

Todd Overbergen
Macquarie Capital

PAUL BECK
Executive Director
Macquarie Energy Capital

ON STRUCTURING DEALS

We really try to tailor the structure to the opportunity—whether that might be coupon-only debt, project/mezzanine debt, public or private equity investments or some combination of these—based on the needs of our client.

WAYNE PENELLO
CEO
Risked Revenue Energy Associates

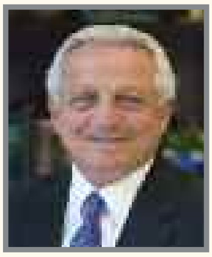
ON HEDGING ADVISORY

As an independent entity that surveys counterparties, we are incentivized to get the right hedges at the best prices for our clients. Our clients' hedge programs have not only reduced risk to their cash flows but have added to their bottom lines.

MITCHELL L. SOLICH
Sr. Managing Director
SFC Energy Partners

ON OUR APPROACH

Our goal has been to diversify geologically, and we don't take a view that we'll look only at specific plays or formations. We spend less time thinking about long-term trends and more time thinking about the quality of the team in front of us and the compelling nature of the opportunity they've identified.



ROBERT L. GAUDIN
Founder and CEO
Holland Services

ON A&D TRENDS

Because of the progression toward more A&D work that we are seeing in the industry, Holland has been uniquely positioned to help clients identify potential bolt-on opportunities and assist them with monetizing their assets by qualifying their ownership to ensure a smooth transaction.

ROB LINDERMANIS
Managing Director
Energy Investment Banking
MLV Energy Partners LLC

ON CAPITAL STRATEGY

We see great opportunities to provide capital for companies that have an acquisition, development, exploitation and enhancement strategy.

W. BRYAN CHAPMAN
Executive Vice President
Energy lending Group Manager
IBERIABANK

ON ECONOMICS

Over the past couple of years, many of our clients have been adjusting their commodity mix through acquisitions and shifting their drilling programs away from natural gas to unconventional oil plays to capture better economics.

ON MULTIPLE PLATFORMS

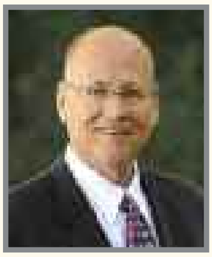
Having a banking relationship with an organization that has both lending and capital markets capabilities helps companies access the different types of capital they need over time.

TONY WEBER
Managing Partner
NGP Energy Capital Management

ON TEAMS

Sometimes the teams are supplemented, sometimes they are combined, and other times they are started from scratch—but it's always nice to have recycled teams you can go back to with more and more capital.

The one thing NGP does as well as anybody is to give a young entrepreneur, engineer or CEO a chance to prove himself or herself.



GREGORY DONELSON
Energy, Renewables & Resources Initiatives
International Mergers & Acquisitions

ON FUNDING

Our services are not a venture capital model and we aren't an incubator platform. We provide access to capital from our own and management partner team members as well as family offices and individual accredited investors.

The Capital Providers

In the pages that follow, we are pleased to provide a forum in which a variety of capital providers are spotlighted, whether they be private equity players, purveyors of mezzanine debt structures, and capital for smaller and midrange companies. Each provider shares a story, if you will: their strategies and investing philosophy, and most important, how they can help oil and gas companies to get more capital for starting up, for growth through acquisitions, and to pursue more development drilling.

We believe that these profiles will enable the reader to better understand the nuances between different types of capital and the capital providers themselves. In the end, however, it is the creation of personal relationships, trust and compatibility that matter just as much as the deal structures and the ultimate cost of capital. With the right type of capital applied to the right type of assets, and partners who understand and rely on one another, who have aligned their goals and interests, much progress can be achieved.

In these days of drilling to expand the production from resource plays, capital is needed more than ever before. We continue to hear about horizontal wells with more than 30 fracture stages, for example, zipper fracs, and much longer laterals. The service intensity has ratcheted up significantly—and so has the call on capital. We therefore hear of all kinds of creative partnerships being formed, sometimes between public and private entities.

As the range of opportunities expands, capital providers are stepping up to the plate.

BRIAN THOMAS
Managing Director, Oil & Gas Group
Prudential Capital Group

ON THE MIDDLE MARKET

The middle market energy industry has evolved considerably in the last decade, both in terms of the nature of the resources being pursued and developed, as well as the experience and quality of the management teams pursuing new ventures and projects.

JONATHAN FARBER
Managing Director
LIme Rock Partners

ON THE REVOLUTION

There's been a fundamental revolution in the U.S. that has made it a very exciting place to invest in the last couple of years for both E&P and oilfield service investments. But as the price of drilling wells has changed, so has the firm's investment size. Today the smallest E&P commitment Lime Rock will consider is $50 million.

STEPHEN STRATY
Co-Head, Energy Banking
Jefferies & Co.

ON THE SHALES

Investors have an appreciation of the paradigm shift…and they understand that a portion of what some of the companies are doing today really is more 'manufacturing like' than 'exploration like.' The market has recalibrated the risk profile…

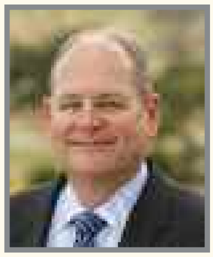
ON FINANCING

We've seen a tremendous amount of interest on the part of private equity and institutional funds seeking to do structured financing that might involve more than just a coupon, and could include an overriding royalty or a net profits interest.

STUART REXRODE
CEO
Bluerock Energy Partners

ON CAPITAL ADVANCES

Our growth capital has provided clients with a lower-cost alternative to selling equity. We will actually advance up to 10 years of the undiscounted PDP cash flow, when coupled with an attractive upside development plan. We will fund development drilling. We like projects supported by at least three producing wells, with multiple upside opportunities included in the work plan.



BILL WALDRIP
Managing Director
EnCap Flatrock Midstream

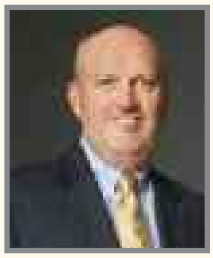
ON RELATIONSHIPS

We look at the relationship as a true partnership. We provide our teams with much more than capital…It's a group effort.

CHUCK YATES
Managing Director
Kayne Anderson Energy Funds

ON RELATIONSHIPS

Because we provide financial depth as well as our own internal engineering expertise, we like our management teams to talk to us like a working interest partner and think of us as a value-added resource, collaborating in tandem with our companies to come up with the best approach to "crack the code." Kayne's most successful teams tend to have similar risk tolerance and technical aptitudes to our own…



JAY MITCHELL
Managing Partner
CLG Energy Finance LLC

ON CUSTOMIZED DEAL STRUCTURE

We operate in a select market that lies between reserve-based lending and private equity, providing customized senior secured stretch and mezzanine financings across the entire oil and gas value chain. We structure our transactions to ensure a cost-effective financing in which management retains maximum control. CLG has the ability to advance more capital than a traditional conforming borrowing base lender…against all proved reserve categories.

JORDAN MAYRE
Partner
Denham Capital

ON ENTREPRENEURS

We are looking for management teams with an edge. If you can't write your edge in one sentence on the back of your business card, you don't have one. The oil and gas industry has herd tendencies, and we are looking to partner with teams that can break from the herd. We are not looking for market timers or quick results.

BlueRock Energy Partners

BlueRock Energy Partners calls itself "the unique capital providers for small producers." For more than 20 years, BlueRock Energy Partners has been providing growth capital to small independent E&P companies, often providing funds for projects that are deemed too small to obtain traditional bank financing. In total, BlueRock has provided more than $375 million in small transactions.

Typically it provides capital ranging from $1 million to $20 million to producers for reserve-based acquisitions and monetizations with associated production enhancement and/or development. Most of the deals have been under $10 million.

To potential borrowers it asks: Do you need growth capital, have current production, and want to retain your project's potential upside without having to personally guarantee a loan?

"Our growth capital has provided clients with a lower cost alternative to selling equity," said Stuart Rexrode, CEO of BlueRock. "Our ideal client has an established track record, regional expertise and an executable development plan."

"BlueRock provides the growth capital you need, and you provide us with a term overriding royalty interest until we achieve a contractual rate of return. Once the rate of return is met, the overriding royalty interest is conveyed back to you, and BlueRock may retain a small permanent override in the project," Rexrode said.

"There are some significant differences in both how we calculate our advance rate and how we structure our transaction. Banks typically lend between 45% and 60% of the existing PDP reserves at a PV-10," Rexrode said.

> "Our goal is to give the property back to you along with the upside."
>
> —*Stuart Rexrode*

"They [banks] will also give some minimal value for PDNP and PUD reserves. We, on the other hand, will actually advance up to 10 years of the undiscounted PDP cash flow, when coupled with an attractive upside development plan," Rexrode said. "The results of a sound development plan should be sufficient to pay the transaction off within three to six years, including BlueRock's contractual rate of return. It helps to think of our capital as a better alternative to permanently selling off your equity in the project. Our goal is to give the property back to you along with the upside."

Most transactions are priced between 15% and 18%. Upon achieving the rate of return, BlueRock will retain a small permanent override in the project, typically between 1% and 3%.

"It is nonrecourse, no personal guarantees 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," Rexrode said.

"We take the production, reserves, and price risk right alongside the producer. And, price hedging is not required. We do not look to additional assets within your company for collateral coverage, like a bank would," Rexrode said.

"We will fund development drilling. However, we do not fund pure exploration plays. We like projects supported by at least three producing wells with multiple upside opportunities included in the work plan."

BlueRock's partners originated and managed the producer finance business at Tenneco Ventures in 1993, which subsequently became Domain Energy and later Range Energy Finance Corp. BlueRock's

Summary of Advantages

- Client retains upside and control of project
- Provides more capital than a bank
- No personal or corporate guarantees
- Investment team: engineers, geologists and financial professionals
- Simple deal structure and reporting requirements
- No third-party engineering reports required
- Repeatable and expandable
- Cost of capital may be tax deductible
- Favorable accounting treatment may apply

How It Works

- Investment Size: $1 million to $20 million
- Deal Structure: A nonrecourse financial production payment via limited term overriding royalty and small permanent overriding royalty after payout
- Use of Proceeds: Acquisitions, development plans, and monetizations
- Timing: Simple deal structure results in minimal documentation and the ability to close in less than 30 days
- Closing Costs: Closing costs are nominal with no hidden fees
- Hedging: Hedging is not required
- Area: Lower 48 (USA)

Source: BlueRock Energy Partners

organization includes engineers, geologists and finance professionals, all having industry experience prior to entering the project-finance business. "We understand our clients' obstacles because we have lived them ourselves," he added.

BlueRock client Brett Owens, vice president, Paterfamilias LP, an E&P company, offered this testimonial:

"BlueRock offered us an opportunity to break a cycle of limited capital with a traditional bank financing and to finance some key projects that allowed us to take our family-owned company to another level. We had assets we believed in, and our financing with BlueRock afforded us the capital we needed without having to sell a portion of that upside we were working for and anticipating.

"Working with BlueRock we were able to close our transaction on time and get to putting the capital to work. When parts of our projects changed, BueRock worked with us to adapt and expand our financing. Managing our relationship was simpler than with a bank. Even after the conclusion of our most recent financing with BlueRock, our relationship persists and we speak with the team regularly on new possible ideas and projects." ■

BLUEROCK ENERGY PARTNERS

www.bluerockep.com

CLG Energy Finance

Financial Strength. Industry Expertise. Agility.
CLG Energy Finance is your resource for efficient and creative financing solutions.

From left to right: Jay Mitchell, Mark Tharp, Alicia Summers

Where we operate

Founded in 2009, CLG Energy Finance LLC (CLG Energy) operates primarily in a select market that lies between reserve-based lending and private equity, providing customized senior secured stretch and mezzanine financings across the entire oil and gas value chain.

To date, CLG Energy's investments have generally been in the upstream space. However, we are also interested in, and evaluate, midstream, downstream and oilfield service opportunities, investing opportunistically when it makes sense for all parties involved.

When evaluating potential lending opportunities, we are oil and gas agnostic: We believe that compelling debt investments are worth evaluating, regardless of asset mix or geographical location. While we are generally focused on North America, we will also consider select international opportunities.

How we work

Our long-term "buy and hold" strategy means we are not motivated by trading and syndication issues. We are backed by Beal Bank and Beal Bank USA, both multibillion-dollar, privately held financial institutions, providing us an exceptional ability to deliver creative solutions others simply cannot match.

We structure our transactions to ensure a cost-effective financing in which management retains maximum control. CLG Energy has the ability to advance more capital than a traditional conforming borrowing base lender and we have the flexibility to advance capital against all proved reserve categories.

STRUCTURES

- Conventional Term Loans
- "Stretch" or Drilling Tranche Loans
- Mezzanine Debt
- Uni-Tranche Facility (Senior/Mezzanine)
- Delayed Draw Term Loans

USES

- Refinancing/Buy-Outs/Recapitalization
- Acquisition Financing
- Project Development
- Terming Out a Revolver
- DIP/Exit Facilities/Stressed Financings

> "Compared to private-equity firms, we have the flexibility to creatively structure a deal, which generally protects against equity dilution and allows management teams more control and flexibility in how they run their business."
>
> —*Mark Tharp*

Further, we have the ability to lend against new production at a quicker pace than most financial institutions, allowing borrowers to accelerate growth in value to their shareholders without trading away their economic upside.

Our goal is to grow with the success of our borrowers. As the value of the collateral increases, the size of the loan can grow with it.

When considering an investment, CLG Energy is laser-focused on asset evaluation. We evaluate the overall quality of the collateral as well as asset risk, management team experience, market conditions, and the opportunity to grow with the success of the borrower to find value that other firms may not fully recognize.

Our approach is flexible and can accommodate almost any senior secured structure. We will work with you to create a financing solution that meets your needs.

Since its inception, CLG Energy has closed more than $1 billion in debt financings. We are open to secured transactions at the project or corporate level and will consider deals ranging from $20 million to more than $500 million.

We are interested in high-quality assets controlled by quality management teams. Oil and gas management teams should be able to demonstrate a track record of creating value in basins/formations consistent with those of the transaction being financed.

Who we are

Our experienced investment team of Jay Mitchell, Mark Tharp and Alicia Summers has more than 50 years of experience in oil and gas.

We have evaluated hundreds of oil and gas properties and financed a variety of transactions in the upstream, midstream and oilfield services sectors.

Give us a call or send us an email to discuss your lending needs. Let us help you unlock your company's potential. ■

For more information, contact Mark Tharp at mtharp@clgenergyfinance.com.

Denham Capital

Denham Capital attributes its success over the past 10 years to partnering with management teams with an "edge," according to Jordan Marye, a partner with the energy and resources-focused private-equity firm.

Described as a "truly differentiated business strategy," Marye advises members of a management team to do an honest self-evaluation before seeking capital. Teams need to think long and hard when forming a coherent business strategy, and then they need to refine it until they have a clear foundation for the venture's ultimate success.

> "There is a big difference between knowing how to produce hydrocarbons and knowing how to make money."
>
> —*Jordan Marye*

When developing that strategy, companies should keep in mind the background and expertise of the team. "A succinct strategy that fits your team's strengths and skill set is the key to unlocking your competitive edge," he said.

"Team members should ask themselves questions like 'where are we great' and 'how can we maximize our advantage to make money?'

"Entrepreneurs should focus their time and effort on what they do best," added Marye. "All entrepreneurs have a vision, but successful entrepreneurs have and know how their edge will make that vision a reality. If you can't write your edge in one sentence on the back of your business card, you don't have one."

Just as Denham urges partners to focus on their competitive advantages, the firm says it continues to focus on partnering with quality teams with differentiated strategies, not individuals, no matter how experienced and talented. Success is directly proportional to the quality and performance of the team.

Denham looks for teams that possess both technical and leadership capabilities and know how to allocate capital to its best use. "There is a big difference between knowing how to produce hydrocarbons and knowing how to make money."

Strategy, execution and leadership are the cornerstones of a successful partnership. In oil and gas, business plans are guaranteed to change over time; it is leadership and vision that will carry the day and drive effective execution. "The oil and gas industry has herd tendencies, and we are looking to partner with teams that can break from the herd."

Denham's edge

Denham's edge can be defined by two main characteristics: financial expertise and operational know-how. The company's professionals have worked in both operational roles, as well as having been principal investors in the oil and gas space, making them uniquely situated to help entrepreneurs and existing companies build valuable, successful enterprises.

Denham is known as a "value-added" capital partner; one with both deep operational and commercial expertise that can work with a partner to assess appropriate risk management and capital discipline initiatives.

"Our firm is comprised of not only an investment staff that possesses extensive energy knowledge but also technical professionals that are engineers or have been operators and business owners. Combined, our industry insight goes beyond the bottom line," Marye explained.

Combining its edge with that of its partner to create something greater than the sum of the parts is what makes Denham's investments successful. It is all about aligning interests and building partnerships, Marye said.

"We view each of our partnerships as a unique opportunity. We're flexible and creative in structuring the best transaction for everyone involved. By working closely to ensure a common definition of success from the onset of the relationship, we create investment strategies that align with the goals of each management team."

Collaboration and teamwork are vital to success in the oil field, so Denham looks for like-minded management teams who value the power of partnership and trust. Its portfolio companies share Denham's vision of growth and value creation. Working in lock step with each of its management teams, Denham makes sure the firm's financial resources complement a team's hustle and competitive edge, yielding a successful venture for all.

Denham works with a long-term investment horizon. "We are not looking for market timers or quick results. Instead, we focus on building fair partnerships centered on lasting success. Our management teams' successes are our successes, so from the start of a relationship, we develop exit strategies that make sense for everyone involved," Marye said.

"We are looking for the best investments, with the best risk and reward profile. Usually our funded companies have what we call, 'dislocated value,' meaning that the value we perceive is not yet fully recognized in the market."

Denham Capital's Carl Tricoli and Jordan Marye discuss the shifting interplay between public and private capitalization from the firm's Houston office.

10 years of success

Denham has more than $7.9 billion in invested and committed capital dedicated to three energy subsectors: oil and gas, mining and power. In recent years, the firm has allocated as much as two-thirds of its capital to the oil and gas space, with the remainder committed to power and mining investments.

Denham concentrates its oil and gas investing efforts on upstream exploration and production. As a natural complement to the portfolio, Denham has also invested in midstream infrastructure. "Our team's experience and historical success centers around E&P. As such, there's an operator bias to anything we do."

Since its founding a decade ago by Stuart Porter and Carl Tricoli, who heads the oil and gas team, Denham has partnered with 26 oil and gas companies. Half of those investments have been realized and Denham has exited those companies. Currently, the firm has 13 active oil and gas partnerships.

Marye says other companies can boast of more deals, but Denham prefers to focus on building platforms and limiting strategy or geographic overlap in the portfolio. The capital commitment per company varies from about $50 million to more than $300 million, but the sweet spot for the firm is $100 million to $250 million.

The funds come from a variety of institutional investors globally, representing leading foundations, endowments, public and private pension funds, and high-net-worth individuals and families, who share Denham's positive outlook on energy investment. ■

DENHAM CAPITAL

www.denhamcapital.com

PHILLIPS energy partners

FELIX ENERGY

Silver Oak Energy

PALOMA RESOURCES

PIEDRA OPERATING

BOLD

CAIMAN ENERGY

PetroQuest

ENDURING RESOURCES

oakvalley

Protégé Energy III LLC

RENAISSANCE

MANTI

MARLIN

GULFTEX

QStar

ESCONDIDO RESOURCES II

NCX

Cornerstone Natural Resources LLC

SIERRA

Common Resources

DORADO

PLANTATION PETROLEUM COMPANY

FIREWHEEL

GRENADIER

GFI

matrix OIL & GAS INC.

RESOURCE DEVELOPMENT TRACKER

EMPRESA ENERGY

UNCONVENTIONAL GAS RESOURCES

Limestone

EnCap's Investment Approach

EnCap Investments closed its eighteenth fund in May, and it is no accident this company is still going strong after over twenty-five years. Caution breeds consistency at EnCap. The firm continues to thrive because it has a lengthy track record of delivering top quartile returns while limiting risk for its institutional partners. In addition to its $5-billion upstream fund, the ninth of its type, EnCap is working out of a $3-billion midstream fund managed by its affiliate, EnCap Flatrock Midstream.

The operating model for both funds is virtually identical, according to co-founder and principal, David Miller. "We focus on start-up or early-stage companies with management teams that have extensive industry experience and a proven record of value creation. It's also important that we are on the same page relative to risk management. In the upstream area, the growth strategy can be about lower-risk drilling or reserve acquisitions or a combination of the two. Most of our midstream companies are pursuing 'greenfield' infrastructure projects in the most active resource plays."

When EnCap makes a determination about an investment, Miller says the criteria are "first and foremost, people; second, projected economics in the context of our view of hydrocarbon prices; third, our assessment of the underlying risk; and fourth, do we believe the asset base the company is planning to assemble will be attractive to the buying universe."

EnCap generally has 20 to 25 separate investments in each fund. The recent average commitment per portfolio company is $250 million. "Our capital is usually advanced incrementally over a two- to four-year period as the management team brings compelling opportunities to the table," says Miller.

David B. Miller D. Martin Phillips

Half of the management teams EnCap backed in its last three upstream funds were teams the firm backed successfully in earlier funds.

"We back them, they sell, and we turn around and back them again. Repeat management teams are a significant part of the EnCap franchise," says Miller enthusiastically. "In one case, we backed the same management team five times; we have multiple teams we've supported three or four times. It's not unusual for a repeat team to move to a new basin, because the competitive dynamics have changed in the area where they were active previously."

While EnCap backs many teams repeatedly, there is a strong interest in fresh talent as long as a prospective team's thoroughness and efficiency meets EnCap's gold standard.

Over the last decade, EnCap has moved from one economically advantaged resource play to the next, says Miller. The firm realized before most competitors that the market had changed. Competitive dynamics had made buying reserves more challenging, and the risk profile in most of the shales and unconventional plays represented a good fit for private equity. The fundamental question was no longer, "Are we going to find hydrocarbons?" Rather, the most important considerations became: "Can the portfolio company capture opportunity?" and, "Are they capable of developing oil and gas reserves on an economically attractive basis?"

EnCap therefore seeks out proven talent as a means of ensuring risk meets reward on every deal. EnCap attracts complete teams of prudent and experienced operators, who demonstrate efficient exploitation plans, established entrepreneurial connections, and successful track records.

However, EnCap is very particular about the timing of its portfolio companies' entry into a specific project. "The right time to enter is when we have enough downhole data to get comfortable with the reserve risk, but before the play has become over-heated with acreage prices bid up to exorbitant levels. There have been situations where we really like the prospective management team, but the entry price was too steep."

Adaptability is Profitability: The Perfect Exit Strategy

In the end, oil and gas company founders and the private-equity providers that back them want to take their chips off the table and book a meaningful return. But as private-equity investors back some management teams on a repeating basis, and as they develop track records in certain basins and segments of the market, there is less emphasis on a fixed schedule for liquidating positions.

Another huge factor is that the buyer appetite is changing. The big acreage buyers of previous years already have plenty on their plate; some say they have too much to digest. This makes selling a position being closed out a more complex affair than just hanging out a for-sale sign. Generally, when oil and gas assets are sold today, the acreage has to be more full developed than it was just a few years ago, indicating a longer hold time for the PE firm.

For any given asset or group of assets, there are several different ways to exit an investment: an initial public offering (IPO), or a sale in the acquisition and divestiture (A&D) market, whether to a C-Corp, a master limited partnership or another PE-backed firm.

"Historically, the holding period for investments has been around three years," says co-founder and principal, Marty Phillips, "but we've had a number of deals extend out over five years before we exit. The timing of the sale of a portfolio company is principally about maximizing value, and our interests are very well aligned with management in that regard."

The holding period is also influenced by the overall level of M&A activity in the industry, and what types of assets or properties buyers have an appetite for.

"Market dynamics have changed dramatically over the past few years and will continue to evolve," says Phillips. "Billions of dollars were spent by the majors and foreign national oil companies as they bought their way into North American resource plays and now these buyers are less active in the acquisition market and seem to be concentrating resources on developing existing positions," he observes.

"While the M&A markets fell in 2013, 2014 is emerging as a strong M&A market with private equity and MLPs driving the demand."

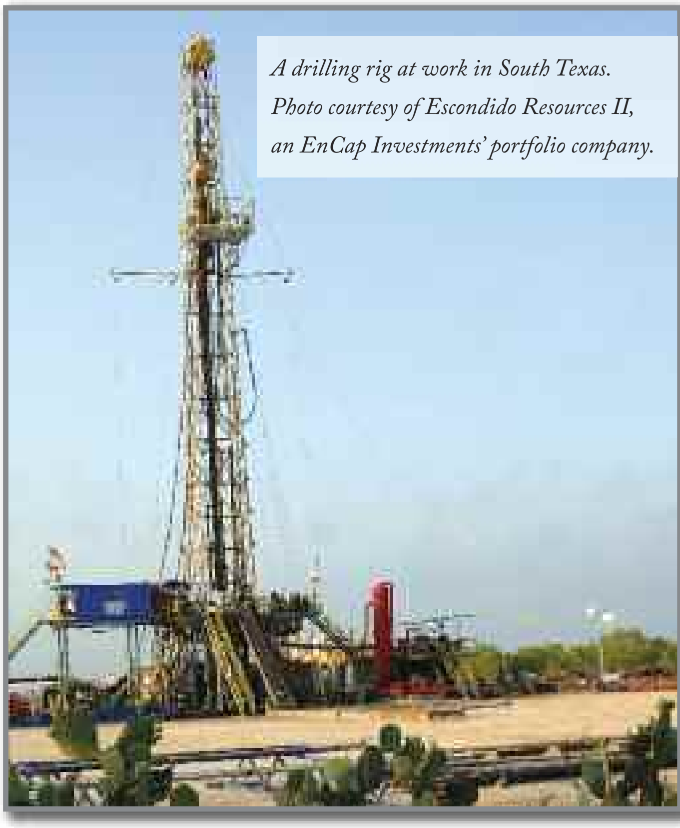
Today's buyers are frequently demanding that the assets are delineated, with a larger component of proved, developed reserves," says Phillips. "The recently announced sales of Enduring, Piedra and OGX are good examples of more defined assets generating strong demand from the current universe of buyers."

The recent valuation arbitrage between the M&A and IPO markets has created opportunities to take companies public to realize the high value, as evidenced by the recent significant increase in energy E&P IPOs during 2014, including Eclipse Resources which went public in June 2014.

Phillips says, "The opportunity set is always evolving and the picture today and what it will be in three to four years are likely very different. For that reason, it's essential that both we and our portfolio company management teams can adapt." ■

EnCap Investments L.P.

www.encapinvestments.com



A drilling rig at work in South Texas. Photo courtesy of Escondido Resources II, an EnCap Investments' portfolio company.

EnCap Flatrock Midstream

The Midstream Opportunity and the Midstream Entrepreneur

Opportunity

It's an exciting time to be in the midstream business. The opportunity set has never been more compelling and the future is bright for the midstream entrepreneur. Equity-backed midstream companies are playing an increasingly important role in meeting strong niche demand to rapidly develop local and regional midstream infrastructure and provide producers with a high level of customer service.

"Midstream activity follows the drillbit by definition," said Bill Waldrip, founder of EnCap Flatrock Midstream and one of its three managing partners. "There is an organic link between the two, with the drillbit creating the need for midstream infrastructure. That's why we spend a lot of time evaluating upstream economics. Our analysis shows that for every dollar spent on the upstream side of our business, another 15 cents to 35 cents is required on the midstream side. It's a metric we've used for a long time and it's held up extremely well. Annual upstream capital expenditures in North America are at a run rate of approximately $150 billion, putting midstream capex in the $20 billion to $50 billion per year range."

From left to right: EnCap Flatrock's three managing partners, Dennis Jaggi, Bill Waldrip and Billy Lemmons have more than 100 years of combined experience in the energy industry. The firm's team of 17 professionals includes seven engineers and three MBAs.

EnCap Flatrock's estimates put the number at $40 billion, or $400 billion over the coming decade. Waldrip points out that the price-driven shift from dry gas to liquids-rich natural gas and crude oil has increased the need for more capital intensive midstream infrastructure including gathering, processing, fractionation, pipeline transportation, rail terminals and related storage, along with crude oil and NGL facilities. A recent INGAA study (March 2014) examined midstream requirements through 2035 and determined that more than 500,00 miles of pipeline will be required, including 340,000 miles of natural gas pipeline and 190,000 miles of oil pipeline.

Waldrip and his partners agree that the need for midstream development is long-term in nature. "The initial chapter in the development of the shale plays is over," said Dennis Jaggi, also a managing partner at EnCap Flatrock. "Many shale plays have moved out of the delineation phase. We're seeing rig counts climb, pad drilling is expanding in areas like the Bakken, and producers are making 20- to 30-year development plans to exploit multi-stacked pay zones in areas like the Permian and the Mid-Continent. That translates into a very large and recurring midstream opportunity set that will last a long time."

Unique perspective

While they are focused on midstream, developing and maintaining a thorough understanding of the upstream landscape is critical to EnCap Flatrock's success. "Our relationship with EnCap Investments provides us with significant insight into what's working on the supply side of the equation and status of development in every major shale play," said EnCap Flatrock's third managing partner, Billy Lemmons. "It's a unique perspective that gives our portfolio companies a meaningful edge."

Capital

EnCap Flatrock is the most active private equity firm entirely focused on the midstream sector. Since it was founded in 2008, the firm has raised more than $5.5 billion over three funds. Substantially oversubscribed, the most recent fund, EnCap Flatrock Midstream Fund III (EFM III) closed in May 2014, reaching its $3 billion hard cap. The fundraise lasted less than four months, evidence of investor enthusiasm for both the firm and the midstream sector.

The right people

It's a confidence that flows from EnCap Flatrock's successful track record and its highly experienced team. In 2012, four of the firm's portfolio companies had realizations, generating more than $3.7 billion and strong returns for investors and management teams alike. Waldrip, Jaggi and Lemmons are confident in the trajectory of the current group of companies. They credit the quality of their portfolio company management teams and their ability to execute along with the strong relationships EnCap Flatrock forms with its portfolio companies.

"We look at the relationship as a true partnership," said Waldrip. "We provide our teams with much more than capital. We come to work every day thinking about what we can do to help our portfolio companies succeed. Whether it's commercial expertise and the industry contacts we've developed over our 30 years in the business, or evaluating risk, our teams know they aren't alone when it comes to making things happen. It's a group effort and we're in it together from start to finish."

Putting it all together

Private equity is playing an increasingly important role in the midstream sector. The emergence of the equity-backed midstream operator has tracked the emergence of shale plays. EnCap Flatrock estimates that more than $30 billion in midstream-directed equity capital has been raised since 2007. The ability to attract top-tier teams and help them execute their business plans is the key to EnCap Flatrock's success in an arena that has become more competitive. "We've developed a strong presence in the midstream marketplace. Producers like working with our teams because they know they are well-capitalized, flexible, agile, and focused on one opportunity at a time," said Lemmons. "The result is that producers are bringing deals to us, and that's exciting.

"We like the role our companies play in the value chain. Historically we have focused close to the wellhead, where the relationship between producers and midstream companies is most organic and where we can generate attractive risk-adjusted returns by backing early-stage companies. Recent developments in condensate and crude oil production are also generating opportunities more closely aligned with the refining and downstream market sectors. Once our companies mature and develop strong growth platforms they become either valuable to the larger public players in the space and attractive acquisition targets or ready for a possible IPO."

"It's a great time in midstream and the formula for success isn't complicated," adds Waldrip. "When opportunity and capital meet experience, dedication, and the right people, extraordinary things can happen. We are always looking for the very best midstream executives who are ready to run their own company and realize the financial and personal rewards of their efforts." ■

MIDSTREAM FOCUS

HISTORY

Founded in 2008 by EnCap Investments L.P. and the former Flatrock Energy Advisors

Offices in San Antonio, Texas, and Edmond, Oklahoma

Over $5.5 billion raised across three funds

16 midstream entities funded, including three teams backed for a second time

Four realizations in 2012, generating ~$3.7 billion

DEEP EXPERIENCE

MANAGEMENT

- Senior level experience
- Strategic development and execution
- Investment management
- Personnel identification and management

COMMERCIAL

- Contracts
- Capital investment economics
- Decision analytics
- Risk management
- Energy finance
- Vast industry contact base

TECHNICAL

- Reservoir engineering
- Upstream economics
- Pipeline and plant design
- Cost estimates and analytics

OPERATIONAL

- Facilities management and optimization
- Regulatory compliance
- Construction management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Holland Services

While Holland Services started as a land services company 35 years ago, it has grown to become a trusted partner working to maximize the private equity investments of many companies through a host of additional services.

“Our professional advisors provide our clients with day-to-day attention and personal, hands-on service,” says Robert L. Gaudin, Founder and Chief Executive Officer of Fort Worth, Texas-based Holland Services. “We help our clients turn investment opportunities into asset realities.”

> “We help our clients turn investment opportunities into asset realities.”
>
> *—Robert L. Gaudin*

Holland’s asset management team works with groups of all sizes, including private equity-backed exploration teams, independent oil and gas companies, family offices and individual investors, to get the most out of their assets. If the assets are already owned, Holland’s experience with everything from joint ventures and non-operating interests to royalty and mineral interests maximizes those investments. If a client is looking to acquire assets, Holland’s industry relationships built over three decades of experience can help identify strategic oil and gas investment opportunities. The company’s diverse customer base also allows it to bring interested buyers and sellers together to conduct mutually beneficial deals.

“We work with a lot of mid-to-large-sized E&P companies, as well as private equity-sponsored companies, so we know what the sponsored companies’ assets are,” Gaudin says. “We also work for large international companies that are the most likely buyers of those assets. We know who is looking to add to or divest of particular assets.”

The company’s vast network of relationships helps connect its clients to investment capital infusion opportunities which is a major benefit no matter where the assets are located.

“Because of the progression toward more A&D work that we are seeing in the industry, Holland has been uniquely positioned to help our clients identify potential bolt-on opportunities and assist them with monetizing their assets by qualifying their ownership to ensure a smooth transaction,” Gaudin says.

The benefits to Holland’s asset management clients mean these services essentially pay for themselves. While Holland’s clients are focusing on growing their asset base, Holland is behind the scenes, handling the critical work that goes along with asset ownership. The company also keeps its clients informed on oil and gas market developments and helps them to understand the financial effects of choices such as leasing out properties.

“What differentiates us is a turnkey set of services tailored to each client’s needs. Our talented professionals draw upon deep industry experience and market knowledge, state-of-the-art technologies, a wide array of service offerings and a broad geographic presence to offer the most sophisticated and efficient solutions possible.”

“We continue to redefine the value a land services company brings to the E&P industry in the 21st century,” Gaudin says. “Simply put, we are here to ensure our clients are able to monetize their assets, and we can help them every step of the way.” ■

Holland SERVICES
LAND SERVICES REDEFINED!
www.hollandservices.com

IBERIABANK

Having one company that can fund your growing business can be critical to your success.

Lafayette, Louisiana-based IBERIABANK created the Energy Lending Group in 2009 and a year later launched IBERIA Capital Partners (ICP).

The Energy Lending Group's loan commitments have grown to more than $1 billion, with approximately 80% to upstream and 20% to midstream companies.

"Our clients utilize various forms of equity capitalization including approximately 40% that are publicly-traded companies, about 35% that are private-equity backed and some 25% that are private," said W. Bryan Chapman, executive vice president and Energy Lending Group manager.

"Our clients are involved in both conventional and unconventional plays and pursue various strategies including lease/drill or acquire/exploit tactics. They create value by focusing on low-risk re-completion programs, reducing unit operating or drilling/completion costs and taking on little or no exploration risk," Chapman said.

"Having a banking relationship with an organization that has both lending and capital markets capabilities helps companies access the different types of capital they need over time. Initially, E&P companies may need a borrowing base revolver to cover working capital needs and to fund capital expenditures that exceed internally generated cash flow. Down the road, as a company makes acquisitions or executes a successful drilling program, the borrowing base will eventually increase, so clients often decide it is prudent to access the high yield market to repay their borrowing base revolver to replenish liquidity, or access the equity markets to maintain an appropriate leverage profile," Chapman said.

W. Bryan Chapman Jefferson G. Parker

This is where clients can turn to ICP.

ICP, a wholly owned subsidiary of IBERIABANK Corp., is a capital markets brokerage business. It offers equity research, institutional sales, trading and investment banking. Jefferson G. Parker is the president.

"ICP's sole concentration on energy, along with being physically located in the traditional heart of the energy belt, allows us to be more effective than many of our peers. This focus, combined with our tag-team approach to banking the industry, gives us a competitive advantage," Parker said.

IBERIA Capital Partners provides investment banking services through capital raises, including initial and follow-on public equity and debt offerings, along with valuation and financial advisory services. ICP has completed more than 50 energy investment banking transactions, helping raise $15 billion in equity and debt capital. The firm has nearly 100 companies under research coverage.

"Energy sector research is the core of our business. Beyond providing facts and figures, our research team approaches sector analysis with an eye beyond the prototypical Wall Street reports and recommendations," Parker says.

"Our sales and trading professionals have a firm understanding of the energy markets learned from years of experience. Our relationship-based team serves institutional clients and energy companies across the country and internationally, communicating innovative and detailed investment ideas."

Publicly traded IBERIABANK (NASDAQ: IBKC), with assets over $15 billion, is committed—through the growth of its energy groups—to continue providing clients with capital, expertise and resources. ■

IBERIABANK

www.iberiabank.com

International Mergers and Acquisitions

International Mergers & Acquisitions (IMA) was established in 1969. IMA is an association of consultants providing capital formation and strategic and operations consulting services to public and private companies through a multi-disciplinary team. Gregory Donelson leads the Energy, Renewables and Resources initiatives for the firm.

Q What segment of the energy market do you serve? What is your philosophy?

The IMA Resources Team bridges the funding gap between start-up and proof of concept to commercialization, production and early growth. Our niche is helping oil and gas exploration, production and service companies which are poised for or recently attained commercialization or the beginning revenue phase of operations. We support conventional production that can benefit from exploitation and the application of new technologies by reaching into untapped zones and applying efficiencies. The IMA Resources Team looks to unlock value with above-average returns and an overall risk profile that appeals to our investor groups. Of particular interest are companies with technologies or processes creating efficiencies with economic advantage and situations where waste streams become feedstocks for other products or can be utilized in a sustainable manner.

> "We prepare young, growing companies to attract the next rounds of capital from larger PE groups and investors."
> *—Gregory Donelson*

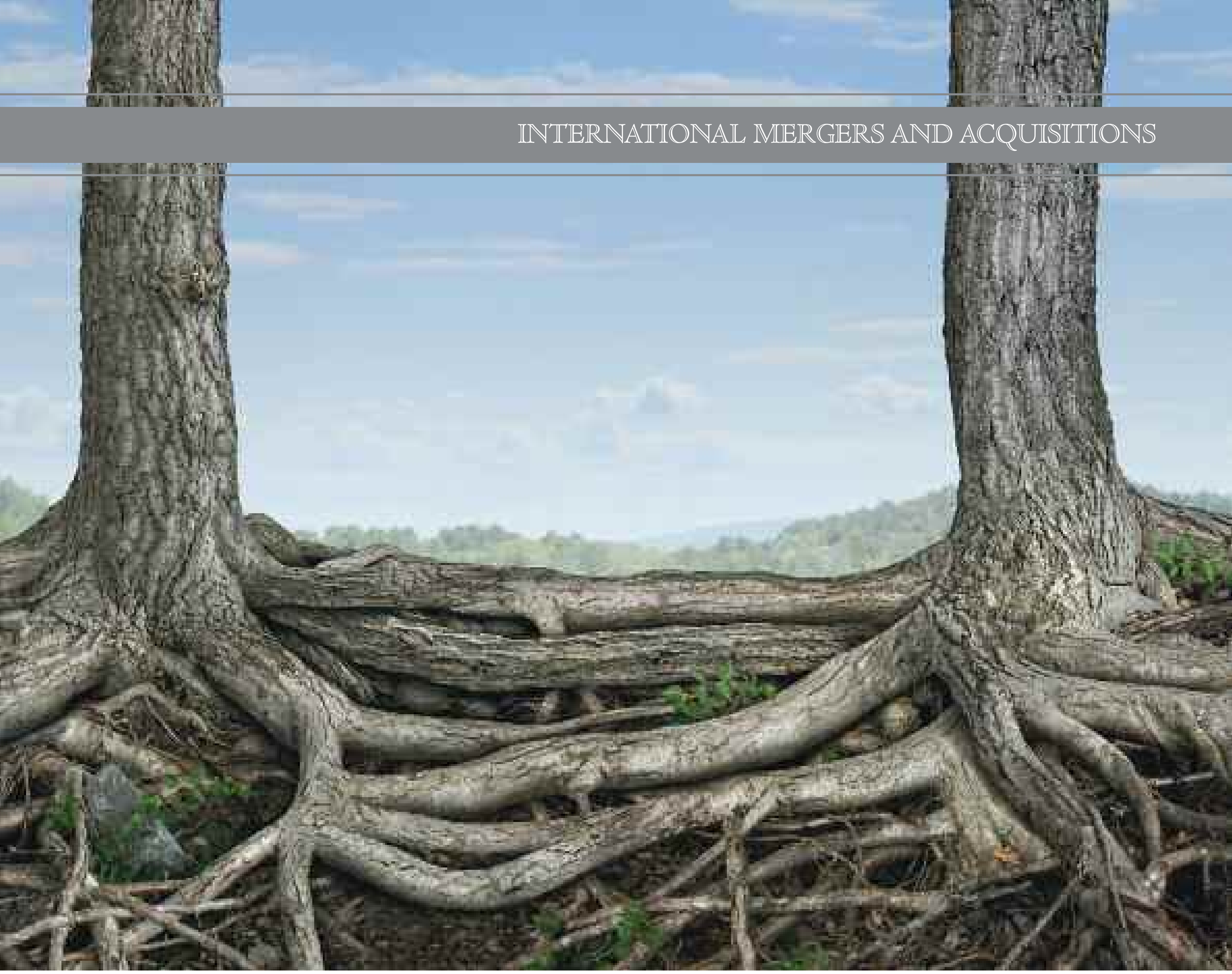
Our philosophy is one of shepherding. Our clients usually know quite clearly the endpoints of their visions and dreams. Many require some direction and guidance. Our mission is to provide the access to the missing components for their success, be they financial, managerial or marketing.

The partners in our IMA Energy Renewables and Resources initiative team are Logi Energy LLC, the Integrated Group Companies and The Better Image Co. Logi Energy is the general partner of the Peak Oil Value Fund (www.logipeakoil.com) and provides management and operations support as well as financial oversight and dynamic hedging capabilities. The Integrated Group Companies provides transaction structuring and capital access. The Better Image Co. (www.thebetterimagecompany.com) provides marketing and branding.

Q How does IMA and your team work with clients?

Where the IMA Resources Team provides the most value for entrepreneurs and investors, is by championing emerging companies into commercialization of products, services and production operations during the early growth phase. This philosophy recognizes that financial engineering by itself can no longer deliver acceptable returns. The IMA Resources Team brings genuine operational and commercial insight to our clients to develop and execute winning strategies. Our services are not a venture capital model and we aren't an incubator platform. We provide access to capital from our own and management partner team members as well as family offices and individual accredited investors.

The IMA Resources Team actively supports our clients by providing management support in strategic planning, a staged-in capitalization plan, market positioning, branding and company infrastructure development that includes, personnel, IT, training and accounting/financial systems. Our



advisory services are fee based upon performance, including equity participation for bringing our clients successfully through the next level of funding—attracting a more institutional or traditional lender or investor.

Q What is your typical transaction size?

The typical transaction for us is $500,000 to $10 million. Most of this capital is in the form of equity or convertible preferred debt. Often the IMA Resources Team is able to leverage a client's customer base and or sales prospects into nontraditional financing that benefits both the client and their current and future customers.

Q Do you work with other financial service providers?

Absolutely. The benefits of collaboration are exponential. We prepare young, growing companies to attract the next rounds of capital from larger private-equity groups and investors. To use a baseball analogy, we act as the farm team developing prospects for the debut into the big leagues. We see a great variety of companies that have the potential to develop into businesses with size and scale.

Q What are some of the more interesting projects you are working on now?

The IMA Resources Team is supporting a new, environmentally friendly chemical enhanced oil recovery process, an oilfield water processing and purifying company with game-changing technology, methane to liquids/olefins in a non-Fischer Tropsch process, and a company developing Tesla fluid pumps. We also established a strong relationship with a very unique social funding platform, www.RedRockAssets.com. Red Rock is focused on providing project debt funding of $5 million to $25 million for junior mining and energy companies worldwide. ■

IMA Since 1969 ®
www.ima-world.com

Jefferies

While Jefferies LLC initially began as an institutional stock brokerage firm more than 50 years ago, it only started in the investment banking business 20 years ago, with a big push in the past 12 years. Jefferies has become the largest independent investment bank in the U.S., with $45 billion in assets. As Jefferies began to expand its investment banking efforts, the firm focused on building out its capabilities on an industry-by-industry basis. In 2005, the firm expanded into the energy industry through the acquisition of Randall & Dewey, one of the largest and most experienced advisory groups in the energy sector.

Standing, left to right, Ajay Khurana (Americas Co-Head of Energy Investment Banking) and Steve Straty (Americas Co-Head of Energy Investment Banking); sitting, left to right, Peter Bowden (Global Head of Midstream Energy Investment Banking) and Ralph Eads (Global Head of Energy Investment Banking).

Today, Jefferies' energy practice includes 80 professionals located in Houston, London and Hong Kong who have completed 145 bookrun financings and advisory transactions since the beginning of 2012 valued at approximately $133 billion.

Q Why do companies hire Jefferies?

Ralph Eads, global head, Energy Investment Banking: Companies hire Jefferies for three reasons. No. 1: the quality of our execution is exceptional. We have greater technical expertise and we have more experience. On the sell-side, we're one of the leading advisors in the world. We get better answers and results for our clients.

The second reason is the continuity of our team. A number of our competitors have had high turnover and that hasn't been the case here. Our clients know what they're getting, and they don't have to worry that we're going to quit and go somewhere else.

The third reason is that we give unbiased advice and we have a client-driven focus. We are not a balance sheet-driven bank and our clients don't have to worry that we have a conflicted agenda. We view ourselves as the leading seller of oil and gas assets in the world and we're focused on that activity.

Another factor that differentiates us is the depth of our technical capability. We have 34 people focused on the technical side, and 13 of them have been with us for more than a decade. It's the core of what we do. Our technical insight is superior; we have a virtual oil company here. It's been at the core of our team for decades, and our sole objective has been and continues to be advising companies on buying and selling oil and gas assets. We're oil industry first and investment bankers second. It's a different mindset. We have 1,000 man-years of oil and gas industry experience. For us, it starts with the rocks.

Q What is the key driver of Jefferies' success?

Eads Definitely the quality of the people. We have a fantastic team. Our lack of turnover has a lot to do with why we've been so successful. If you're interested in being in oil and gas M&A, this is a good place to work. The people who leave do so to do something different, but if you want to do oil and gas M&A, this is the ideal place to be. While many of our competitors have had a lot of turmoil, our firm has been stable.

Pete Bowden, managing director and global head, Midstream Energy Investment Banking: We think like our clients, we make their problems our problems, and we drive hard to achieve an outstanding result for our clients.

Q Jefferies has a large and very experienced technical team. What sets them apart?

Eads Our team is a lot bigger, it's a lot more experienced and it's much broader in terms of our capabilities. We do grassroots basin analysis for our own use, not as a part of any project. We have an R&D function here on the technical side that does early work on promising basins and new completion technologies. It's a skunkworks. It allows us to be the first mover. We use our technical analysis to bring insight to our clients, and then we help them understand the data. So far in 2014, we have grown our technical and project management team 15%, adding talent with prior tenures at Nexen, Marathon, Noble, BHP and BP, to name a few.

Bowden Most of our technical personnel were in the oil and gas business for 15 to 20 years before switching to banking, and have now been in banking for more than 10 years, so that's real experience, not smoke and mirrors. We are a technically driven A&D business. Under Ralph, we've expanded that to a global investment banking business that draws off that deep expertise. The business was built on the concept that other Wall Street bankers could give you M&A tactical advice, financing advice and capital, but they couldn't talk well locations and hydrocarbon supply. We can do it all.

> "When a client is making a big investment decision, our ability to translate our data into financial analysis really differentiates us."
>
> *—Ralph Eads*

Q Jefferies has been successful in private capital raising. Why?

Eads Our deeper technical understanding. When a client is making a big investment decision, our ability to translate our data into financial analysis really differentiates us. Our translation work is the best in the world, it allows us to look at what the technical data says and turn it into the financial consequence. For private equity, that's critical. It helps investors understand the issues that are involved.

Q Who are some of your most active clients?

Eads American Energy, Chevron, Four Point Energy, EnCap, Anadarko, EnerVest, Blackstone and KKR are some of our most active. We helped sell privately owned GeoSouthern to Devon. It was partly owned by Blackstone. The key issue in that sale was to understand the well performance. It wasn't all the same, so we had to bring the buyer and seller together. Initially, they could agree on the parameters of the sale, but they couldn't agree on the reserves. We had the ability to bring them together to develop a view on the reserves so they could do a deal.

Bowden In the midstream sector, we work a lot with Chevron, Buckeye, Williams, MarkWest, and Crestwood, although we spend time with all of the gathering and processing MLPs, as well as the crude oil and refined products and long-haul pipeline partnerships and the midstream-focused private-equity firms like EnCap Flatrock, Energy Capital Partners and Energy Spectrum.

Q Can you elaborate on how you've grown such a successful international reputation?

Eads We're among the leaders in the North Sea. That's the core of our international business, and it has grown concentrically from there. We've done transactions all over the world. Our international success is a result of the same kind of technology and commercial rigor that makes us different in our U.S. business. It all comes down to the quality of the work.

Q How has the M&A&D market been for Jefferies this year?

Eads This will probably be our record year. We built a midstream business and we've grown it to become the leading midstream business. We've also had high levels of activity from some of our core customers. We have a lot of repeat customers because we can demonstrate that we provide good answers and results for our clients.

We are expecting more of the same next year. The industry continues to see high levels of activity, and we're constantly looking for opportunities for investors and natural sellers of assets.

Q Jefferies has built out a strong midstream practice.

Eads We started our midstream practice because it was a logical extension of what we do. It's critical to understand the wells attached to the midstream and how we leverage our capabilities in that area. We found Pete Bowden and it took me two years to recruit him, but it was a no-brainer. We use the same model for our midstream

> "The business was built on the concept that other Wall Street bankers could give you M&A tactical advice, financing advice and capital, but they couldn't talk well locations and hydrocarbon supply."
>
> *—Peter Bowden*

practice as we've used for our upstream practice—we focus on a deep technical understanding, excellent execution skills and good client service. It's just blocking and tackling. There's no magic, it's just hard work.

Bowden I ran the midstream business at Morgan Stanley and I came over to Jefferies to marry my midstream M&A expertise with Jefferies' technical capabilities. We built a team of midstream bankers that are deal-oriented and not concierge coverage officers. Eighty percent of our business is sell-side, in what has been a great sell-side market for midstream. Our business is M&A, and M&A is a sleeves rolled-up undertaking. We're deal guys and we want to help clients solve their most pressing strategic objectives. If you look at the volume of deals we've done over the past couple of years that takes an intensity on the part of our bankers that's not easy to find.

We've also been successful because we fundamentally understand the midstream sector. We understand the drivers of midstream businesses, but we also understand the subsurface and the long-term oil and gas potential of the various conventional and unconventional operating areas. Since the founding of the midstream group two-and-a-half years ago, we've completed 29 midstream transactions for $100 billion of total consideration, and that includes four public midstream transactions of $5 billion or larger. Also, this year we advised Kinder Morgan Energy Partners and Kinder Morgan Management in the amalgamation of all of the Kinder Morgan entities into a single $140 billion company, which was the largest M&A deal of the year and the second-largest energy M&A deal of all time behind the merger of Exxon and Mobil.

Q What is one thing most people don't realize about your group's practice?

Eads Most people don't realize how differentiated our technical team is as compared to our competitors. Most banks have a technical team, but ours is different. It's a lot bigger and it's a lot better, given our technical expertise.

Bowden We're more energy guys than bankers. We're deep on the technical but we're also incredibly facile with energy finance.

Q What is your philosophy or strategy on deal-making?

Eads We typically focus on deals that are $100 million or larger. We want to be in business with good companies. We like to build long-term relationships, and we have people we've been doing business with for decades. That characterizes our business. We're also responsive to the market; the world changes all the time.

Q What type of projects do you look for?

Eads We have a high tolerance for complicated, hard projects. If the other guys are dermatologists, we're brain surgeons. We do long, complex projects with a lot of technical content. The big guys are factories, while we're much more custom-crafted. We're doing what the clients want. All of our work is client-driven. ■

Jefferies

www.jefferies.com

Kayne Anderson Energy Funds

Q How did Kayne Anderson become involved in energy private equity?

Kayne Anderson started investing in energy in 1992 when now-CEO Bob Sinnott joined the firm. Early on, our energy investments were typically structured as private-equity investments in public companies through the firm's hedge funds. As a result of the success we experienced, energy investments became a larger part of the funds and, in 1998, we raised our first dedicated energy private-equity fund. We closed our first fund in August of 1998 for $112 million.

Since the launch of Kayne Anderson Energy Fund I, our energy private-equity team has expanded to 16 investment professionals solely focused on high-growth, middle-market oil and gas companies. We have raised more than $4 billion in capital, made over 90 investments in both first-time and repeat management teams and sold over 50 oil and gas companies that have delivered exceptional returns to our investors.

In addition to our private-equity activities, Kayne Anderson has become the preeminent institutional investor in the midstream sector, where we now manage more than $23 billion in investments. All told, Kayne Anderson has approximately $27 billion in assets under management in the energy sector with a team of over 40 professionals focused on the space.

Mike Heinz, Managing Partner

Chuck Yates, Managing Partner

Q What is your strategy?

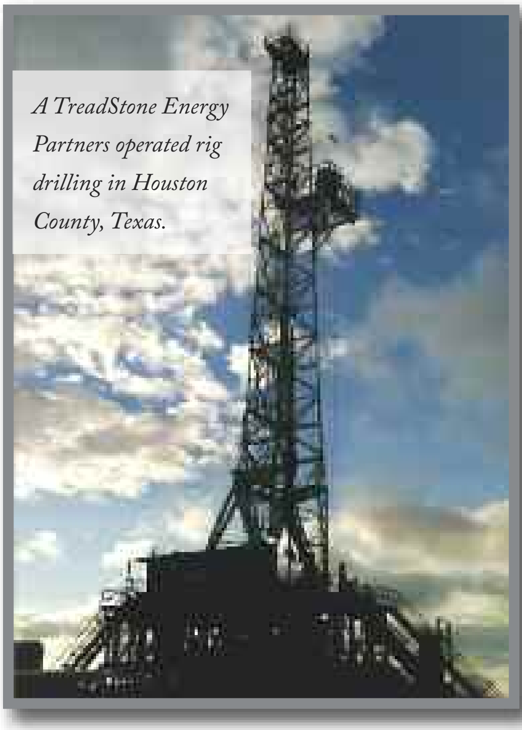
We have maintained a consistent strategy throughout our history, which is to partner with talented private oil and gas companies seeking to pursue underexploited opportunities with significant growth potential. Backing quality, like-minded management teams is crucial to our business model, and we seek to partner with strong teams possessing an established track record and basin-specific expertise. Our portfolio companies frequently consist of oil and gas professionals from majors and/or large independents who have served in leadership roles, often as divisional heads or top executives. Another subset of our management teams are career-long oil and gas entrepreneurs with deep networks in their operating areas.

Our typical commitment size is about $100 million, although we have done, and will do, larger deals. Within our current portfolio we have companies operating in nearly every basin in the U.S., along with a presence in Canada, and we focus entirely on opportunities in onshore North America. Our approach is return-driven, which allows us to remain agnostic towards both commodities and asset classes (conventional and unconventional); we look for profitable transactions that can deliver superior risk-adjusted results for our partners.

Q What is it that allows you to work well with management teams?

Because we provide financial depth as well as our own internal engineering expertise, we like our management teams to talk to us like a working interest partner and think of us as a value-added resource, collaborating in tandem with our companies to come up with the best approach to "crack the code." Kayne's most successful teams tend to have similar risk tolerance and technical aptitudes to our own internal deal teams and are able to understand not only the opportunities but also the challenges in evaluating a particular set of properties.

During the testing and eventual development of a project, our current portfolio of 40-plus investments across every major basin provides a unique frame of reference that, when combined with our deep fundamental technical understanding, allows for "knowledge



A TreadStone Energy Partners operated rig drilling in Houston County, Texas.

integration" among our investment professionals. This may come in the application of certain technology or an innovative approach to developing an asset, but our "knowledge integration" ultimately leads to knowledge transfer to our management teams as we work together to establish the project's commercial success. Though there is no doubt our portfolio companies are capable of unlocking and optimizing a play on their own, the added resource of Kayne's diverse knowledge base aids in bringing everyone up the curve in a quicker and more cost-effective manner.

Like our portfolio companies, we prefer to dig deeply into the geology as well as the operational and production history of a given asset to understand what could generate success, and to use that data to dictate the best path towards value creation. Our like-minded management teams appreciate the time and effort offered to help achieve the common goal: to profitably develop their projects in order to eventually maximize shareholder returns.

Two recently realized investments in portfolio companies operating in the Mississippian play in Oklahoma, Calyx Energy and Plymouth Exploration, benefitted from Kayne's investment approach firsthand. By working directly with each company's technical staff in analyzing and interpreting the geologic and well data, we were instrumental in assisting both management teams' understanding of each project's key attributes. Once we were comfortable that these projects were working, we encouraged both teams to accelerate the development of their assets, ultimately resulting in two successful realizations in what was previously considered a challenged, "out of favor" play.

Q How has the A&D market been for Kayne this year and what are you forecasting for next year?

Kayne has witnessed an unprecedented run of significant realizations over the past 12 months. Beginning in earnest with the sale of Axia Energy's Uinta Basin assets in December 2013, Kayne has now generated $1.2 billion in distributions to our limited partners over the last 10 months. Included in these distributions are proceeds from sales by Adventure Exploration Partners II, Calyx Energy, Corlena Oil Co. II, Plymouth Exploration and TreadStone Energy Partners. We expect to announce additional substantial realizations over the course of the next year as our portfolio companies continue to develop assets in preparation for eventual monetization events. It is certainly a very busy—and very exciting—time at Kayne Anderson! Thankfully, our portfolio companies also like working with us, and we have enjoyed a very high retention rate of repeat management teams.

Q What are the key drivers of Kayne's success?

From inception, our strategy has been consistent in terms of our focus on middle-market upstream opportunities. We've historically applied a bottom-up, asset-level evaluation using our in-house engineering capabilities combined with sound financial assumptions to assess individual opportunities, seeking projects with asymmetric risk/return profiles. From that point, we apply a disciplined approach to testing the concept without exposing too much capital unnecessarily, and if we determine the project to be a success, then we continue to "feed the beast" by aggressively deploying capital to accelerate development. This methodology has allowed us to minimize the magnitude of our losses while delivering significant profits on our successes.

An example of this strategy is TreadStone Energy Partners' acquisition of Fort Trinidad Field. As a small asset package (less than $20 million), Fort Trinidad was overlooked by many companies seeking larger opportunities, yet fit nicely into our middle-market focus area. TreadStone and Kayne were able to understand and appreciate the downside potential of this acquisition, but also recognized the possibility that a successful testing program would prove up hundreds of highly economic drilling locations, allowing for a more aggressive bid on the package. Over the course of two and a half years, TreadStone built the production rate substantially through the implementation of modern fracture stimulations, and the company sold this asset in July of this year for $715 million, resulting in an outstanding return to Kayne and Treadstone management.

But the real reason behind Kayne's success is the strength of our management teams. Throughout our history we have partnered with top-tier management teams who have demonstrated the ability to identify, cost-effectively capture and successfully exploit oil and gas assets across a variety of commodity price and broader macroeconomic cycles. We expect our latest fund, Kayne Anderson Energy Fund VI, to consist of nearly two-thirds repeat management teams who have generated superior returns in prior funds, and Kayne is excited to continue our partnerships with these companies in future funds.

Q Do you plan to be in the market raising capital over the course of the next 12 months?

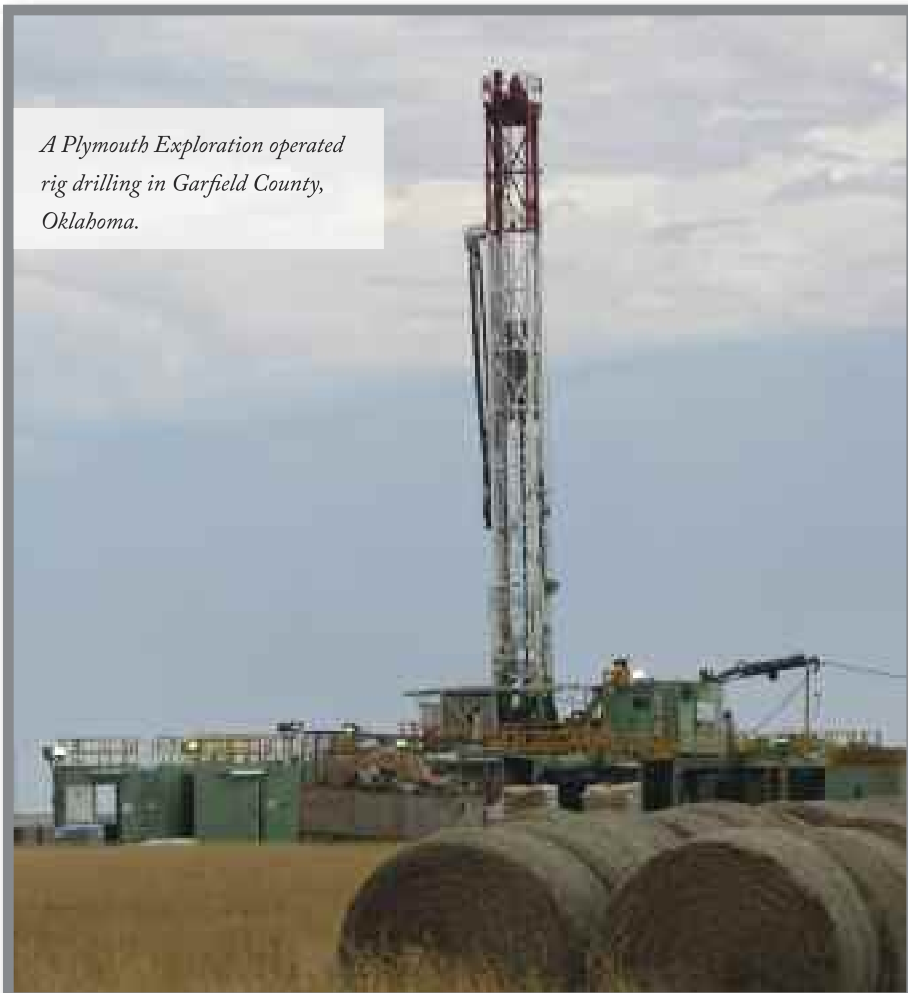
We plan to officially launch Kayne Anderson Energy Fund VII during the first half of 2015. Given the capital-intensive nature of the domestic resource plays, the oil and gas industry has witnessed the emergence of an attractive investment landscape within the middle market. We believe opportunities will continue to arise to allow our portfolio companies to capitalize on this shift in industry focus through two strategies: capturing resource play positions with compelling economics and acquiring under-exploited assets sold by larger operators in order to fund resource play drilling.

As our existing portfolio companies continue to generate successful exit events, we intend to re-up with a number of these exceptional teams to find and develop new projects that demonstrate these characteristics. In order to properly capitalize these repeat teams—along with the emerging generation of new quality management teams—to pursue the current opportunity set, we believe the time is right to raise our next energy private-equity fund.

Q What industry trends are you monitoring that may affect your approach to providing capital?

We keep a close eye on the public markets and have clearly taken note of the value uplift that can be captured through the public markets as opposed to the A&D market. Though we never mind cash offers at the right price, we have experience in tapping the equity markets via public offerings and a Kayne portfolio company or two may seek to exit through the public markets in the foreseeable future.

Additionally, we are encouraging our portfolio companies to capture incremental value from their resource play positions once the concept is deemed to be successful. Some examples of this may include negotiating an equity interest in associated midstream projects or acquiring mineral interests, the thought being, "we took the initial E&P risk on the asset, why should we give away any of the potential upside?" ■



A Plymouth Exploration operated rig drilling in Garfield County, Oklahoma.

Lime Rock Partners

In 1998, Jonathan Farber and John Reynolds were equity research analysts at Goldman Sachs covering E&P and oilfield service companies, when they saw an opportunity.

"Through the use of technology, small companies were able to deliver growth for their shareholders," Farber said. "We felt like we could carry that theme into the private-equity context."

With that, Lime Rock Partners was formed, with an initial strategy that remains the same today: invest in global E&P and oilfield services, with a focus on backing quality management teams with differentiated growth strategies. The firm's Fund I was fully capitalized in 1998 at $100 million. Lime Rock Partners is currently investing Fund VI, which capped out at $825 million. Total funds raised are $5.5 billion.

Unlike many private-equity firms, Lime Rock has had a global focus from the beginning, although it has slowly evolved to include more investments in North America. Its initial fund included investments in U.S. and Canadian producers, as well as a North Sea oil and gas company. Today, Lime Rock still looks to invest internationally, but there is a "higher bar" for those investments—now that so many exciting opportunities exist in the firm's own backyard, Farber said.

"With the advent of technology that can be used to overcome limited permeability, we feel like huge areas of the U.S. have been opened up to exploitation, which wasn't the case even five years ago," he said. "There's been a fundamental revolution in the U.S. that has made it a very exciting place to invest in the last couple of years for both E&P and oilfield service investments."

As the price of drilling wells has changed, so has the firm's investment size. Today, the smallest E&P commitment Lime Rock will consider is $50 million. The firm is less inclined to do exploration deals, which is a result of its experience and developments in the industry.

Another aspect of Lime Rock's strategy is that it doesn't employ in-house technical teams because it doesn't want to impede its management teams' decision-making, Farber said. Instead, the firm focuses on assisting portfolio companies with long-term strategic decision-making, exit-planning, and capital formation. The firm believes that its exposure to specialist and technology-oriented oilfield service companies also helps it bring unique strategic insight to its E&P investments.

Lime Rock also maintains a long investment period, which typically runs three to five years but has been as long as 10 years.

When Lime Rock is investing a fund, it focuses on management teams that bring a strong knowledge of a play. This was exemplified with the firm's 2013 investment in Endurance Resources, which is focused on the Bone Spring oil play in New Mexico. With Lime Rock's $100-million commitment, Endurance has already drilled several successful Bone Spring wells and expanded its leasehold position.

"If we have a company addressing a play in New Mexico, that will be the only portfolio company we will back involved in that play."
—*Jonathan Farber*

Another recent investment is a $300 million commitment to Imaginea Energy, its second equity backing for a company led by Suzanne West. Like Black Shire Energy, which Lime Rock successfully exited in 2013, Imaginea is focused on an acquisition and exploitation strategy of producing oilfields in Western Canada. ■

LIME ROCK PARTNERS
www.lrpartners.com

Macquarie Energy Capital

In 2002, Macquarie executives recognized the similarities between the "food chain" of metals and mining companies in their native Australia and independent oil and gas producers in North America. Macquarie had already built an industry-leading merchant banking business lending to and investing in small and medium-sized base and precious metal mining companies by funding their growth via acquisitions and development, and then sharing in the upside as those companies went public or were acquired by larger mining companies.

Fast forward to 2014, and Macquarie Energy Capital (MEC), part of the firm's Metals and Energy Capital team, has grown to 40 professionals in five offices worldwide, with the largest group located in Houston. The team has funded more than $4.5 billion of debt and equity in over 150 transactions in almost 12 years.

"We've had quite a ride since opening the office in 2001," said Paul Beck, executive director and co-head of MEC globally. "In my 30 years in the oil and gas business, the roller-coaster ride over the past 12 has had the wildest swings. We've seen crude oil prices cycle from $25/bbl to almost $150/bbl, then drop to around $35/bbl only to recover again to north of $90/bbl. Natural gas prices have oscillated from around $2/Mcf up to over $10/Mcf, back down to around $2/Mcf, and then struggled back up to around $4/Mcf.

"LIBOR fluctuated from 2% to over 5% and then back down to less than 0.50%. A couple of large hurricanes and a big oil spill have made the Gulf of Mexico an expensive and difficult proposition for all but the largest of independents. And, now we are in the midst of a capital-intensive, North American 'shale storm' that is projected to make the U.S. energy-independent.

"We really try to tailor the structure to the opportunity—whether that might be coupon-only term debt, project/mezzanine debt, public- or private-equity investments or some combination of these."

—Paul Beck

"Given this historical perspective and our demonstrated ability to execute transactions from one extreme to the other, we are excited to see what the future holds."

Part of MEC's ability to navigate these changes can be attributed to the technical approach that the team takes on each transaction. With a staff of 14 engineering and geological professionals, the team evaluates each transaction with the goal of understanding not only the asset, but also the operator, so risks and operational hazards are fully understood upfront. In addition, Macquarie's A-rated balance sheet is the source of the Energy Capital team's funds, so there are no concerns about fund availability due to running out of funding or crossing over fund boundaries.

"We really try to tailor the structure to the opportunity—whether that might be coupon-only term debt, project/mezzanine debt, public- or private-equity investments or some combination of these—based on the needs of our client.

As the capital severity of exploiting reserves in the resource plays has increased, we continue to be excited about the opportunity to put more capital to work. We're agnostic as to geographic location or natural gas- versus crude oil-weighted assets, as long as the numbers work. We're actively seeking debt transactions between $20- to $150 million of upfront committed capital, and equity investment opportunities ranging from $5- to $25 million," Beck said. ■

MACQUARIE

www.macquarie.com

MLV & Co.

MLV & Co. is a full service investment bank focused on efficient capital raising and providing simple and creative solutions to its clients. Since its inception in 2010, MLV & Co. has completed more than 300 transactions and raised more than $20 billion on behalf of its clients.

In 2014, MLV added Ron Ormand as Head of Energy Investment Banking and Rob Lindermanis as Managing Director to expand the firm's product focus into financial advisory, private placements and principal investments. MLV now has a highly experienced team and broad range of products in its energy banking group, and the energy team is complemented by experienced resources throughout the firm. Since this expansion, the firm has completed more than 20 energy transactions comprising more than $2 billion. Both Mr. Ormand and Mr. Lindermanis have more than 30 years of experience in the energy finance industry. MLV also recently announced the retention of James McBride as Senior Advisor to the Energy Group. Mr. McBride is also a 30+ year veteran of the industry, and most recently served as CEO of Capital One Securities' Energy Banking Division.

"We focus on maximizing the efficiency and cost at which companies are able to gain access to the capital markets," Mr. Ormand said. "We offer companies creative solutions designed to maximize proceeds to the company while minimizing costs. We also provide financial and strategic advice to growth companies seeking to preserve and grow shareholder value."

"We focus on maximizing the efficiency and cost at which companies are able to gain access to the capital markets."

—Ron Ormand

MLV TRANSACTION HIGHLIGHTS

- 75 traditional equity offerings, raising more than $13 billion
- 120 preferred and unsecured note offerings, book runner on 50+, raising more than $6.5 billion
- 160 ATM offerings, the most of any investment bank, raising more than $1.6 billion

ENERGY TRANSACTION HIGHLIGHTS

- 90 energy deals
- $6 billion of public equity financings
- $2 billion of preferred equity transactions
- $2.7 billion of ATM transactions

MLV'S INVESTMENT BANKING SERVICES INCLUDE:

- Equity Offerings
- IPOs
- ATMs
- Preferred Stock Issuance
- "Baby Bonds" and High Yield Debt
- PIPEs
- Debt and Equity Private Placements
- Mergers and Acquisitions
- Fairness Opinions
- Recapitalizations
- Restructuring Advisory
- Pre-IPO financial advice

MLV Energy Partners LLC

As part of the firm's expansion of product offerings in the energy sector, MLV & Co. formed Houston-based MLV Energy Partners LLC to provide capital to the energy industry. Specializing in oil and gas financing, MLV Energy Partners focuses primarily on investments in growing energy companies. Ron Ormand and Rob Lindermanis serve as MLV Energy Partners' Managing Principals supported by a team of experienced financial and technical professionals. The firm works closely with its clients to structure flexible investment products specifically tailored to their capital needs.

"We see great opportunities to provide capital for companies that have an acquisition, development, exploitation and enhancement strategy."
—*Rob Lindermanis*

"We see great opportunities to provide capital for companies that have an acquisition, development, exploitation and enhancement strategy," Mr. Lindermanis said. "MLV Energy Partners is uniquely situated to partner with these companies and fund their ongoing growth and expansion."

MLV Energy Partners commits to E&P companies that transactions will be evaluated, approved and closed in a timely manner. MLV recently completed a $103.75 million debt, bridge and equity financing of Ram Energy LLC, a privately held, Tulsa-based E&P company focused on conventional oil and gas properties. ■

MLV ENERGY PARTNERS PROVIDES CAPITAL FOR:

- Acquisition of Producing Properties
- Development Drilling
- Enhancement/Exploitation
- Recapitalization Needs
- Monetization of Existing Assets

MLV ENERGY PARTNERS' CUSTOMIZED FINANCIAL PRODUCTS INCLUDE:

- Mezzanine Debt
- Subordinated Debt
- Stretch Senior Debt
- Convertible Debt
- Bridge Financing
- Project Financing

MLV & Co

www.mlvco.com

Vanguard Natural Resources
$750,000,000
Preferred Series A & Common Units
At-the-Market Issuance
Joint Agent

Legacy Reserves
$175,000,000
Series "B" Preferred
Joint Bookrunner

RAM Energy LLC
$103,750,000
Debt & Equity
Principal & Sole Advisor

Gastar Exploration
$106,250,000
Common Stock
Follow-On Offering
Co-Manager

Callon Petroleum
$112,500,000
Common Stock
Follow-On Offering
Co-Manager

NGP Energy Capital Management

After more than 25 years, NGP Energy Capital Management remains the preferred private-equity firm for both investors and management teams in the energy and natural resources sectors. The firm just completed a closing of NGP's 11th fund—the largest in NGP's history and solidifying the firm's status as one of the most important, and effective, private-equity franchises focused on energy.

Maximizing shareholder wealth

Shortly after its founding in 1988, NGP realized its strategy should focus less on making bets on commodity prices and instead concentrate on putting capital behind management teams who were great at building businesses. The goal was to partner with industry veterans who "were high-character individuals whom we would trust with our kids," and who knew how to generate returns regardless of commodity prices.

"That was the light-bulb moment for NGP," acknowledged Tony Weber, managing partner at NGP Energy Capital Management. "We should partner with people by giving them capital up front and have them use our money, as well as their own, to shop for deals and build their business."

The strategy works. After more than 25 years, NGP has built a premier investment franchise in the natural resources sector, closing more than 265 transactions with more than $45 billion of total equity value. What's more impressive is NGP's ability to maximize shareholder wealth.

Attracting the right people to drive returns

NGP determined early on that it would generate returns by backing effective management teams, so the firm worked hard to differentiate itself from competitors. Weber believes one of NGP's most important differentiators is the fact that the firm does not discriminate on the size of its equity commitments.

"Most of our contemporaries are no longer interested in the $30 million to $40 million equity commitments," said Weber. "Even though we currently have $14.4 billion under management, we're still a place where two or three men or women can get backed to build a business. The one thing NGP does as well as anybody is to give a young entrepreneur, engineer or CEO a chance to prove himself or herself. Over the past five years, we have made finding the next generation of energy leaders our priority."

Building long-term relationships is part of NGP's recipe for success. Once a team proves itself, NGP is eager to back them again in a new venture. About two-thirds of NGP capital is reinvested with teams that have been successful in the past, meaning an initial investment usually indicates the start of a relationship that may last for decades.

First-time management sponsorship, in most cases, equates to smaller equity commitments. However, a hallmark at NGP has become "feed the winners."

> "Even though we currently have $14.4 billion under management, we're still a place where two or three men or women can get backed to build a business."
>
> —*Tony Weber*

"You can take a lot of risk out of your business by going back to men and women who have made you money before," explained Weber. "Sometimes the teams are supplemented, sometimes they are combined, and other times they are started from scratch—but it's always nice to have recycled teams you can go back to with more and more capital."

For example, in 2003, NGP was the private-equity sponsor for Ray Davis and Kelcy Warren when they started Energy Transfer Partners.

"Ray and Kelcy had $50 million of assets in the company. We, along with our co-investors, put in additional capital and purchased a large Texas gathering system from Aquila in 2005. Through a series of mergers, capital markets transactions, acquisitions and good fortune, it all worked. In the end, our $37.5 million investment was returned more than 38 times in less than five years."

several of these portfolio company CEOs were women."

Over the past five years, NGP implemented a "Leaders under 40 Program" to specifically target executives earlier in their career who can take senior-most roles in new oil and gas companies.

"Think about the genius of someone like Mark Zuckerberg in the tech space, and other whiz kids at that age," said Weber. "Why wouldn't we have young genius entrepreneurs in the oil and gas sector?" In fact, said Weber, "we do, and we are making it our priority to find them."

Out of the seven upstream energy initial public offerings (IPOs) during 2014 year-to-date, NGP has sponsored five and has two more in the pipeline slated for 2014.

Even though 80% to 85% of NGP's business is upstream related, every investment decision at NGP is focused on people—not assets. Weber said an A+ asset in the hands of an under-qualified management team is a great way to lose money. Ray and Kelcy are A+ people who just happened to also own, operate and build A+ assets.

The next generation of oil and gas leaders

Weber and the team believe the next wave of value creation will come from resource play development driven by younger entrepreneurs. As a result, NGP has implemented new strategies to target geologists and engineers younger than 40 years old, and developed the resources to support those that want an opportunity to prove themselves earlier in their careers.

"We are willing to target oil and gas executive teams at an earlier age than most of our competitors," said Weber. "In fact, NGP has backed more than a dozen CEOs under 35 years old, and

But NGP provides more than just first-time equity commitments to young executives—it also provides access to a seasoned strategic advisory board and offers to connect young leaders with one of the firm's "Operating Partners," a group of industry veterans, many of which have run more than one company backed by NGP, to mentor and guide teams when they need it.

NGP has aligned itself with industry veterans such as Ray Davis (Energy Transfer Partners), Kelcy Warren (Energy Transfer Partners), Steve Gray (RSP Permian), and John Redmond (BlueStone Natural Resources) that have successfully started, built, and sold companies alongside NGP for decades.

"These guys know what life in private equity is like, and they know NGP," said Weber. "They are a great touchstone for these young management teams to have on their boards or to act as a liaison with NGP and the markets."

NGP leads the oil and gas IPO market

The capital markets are open, and investor appetite for great energy companies is strong. NGP's success at backing and building successful management teams has overflowed into the public markets. Out of the seven upstream energy initial public offerings (IPOs) during 2014 year-to-date, NGP has sponsored five and has two more in the pipeline slated for 2014. And, believe it or not, most of the management teams are under 40.

Weber recalls a recent example, WildHorse Resources, which was a first-time team of young engineers, Jay Graham and Anthony Bahr, who just recently made their IPO debut as part of Memorial Resource Development (NYSE: MRD).

"They were a first-time team for us, so they started out with $35 million in equity, which they used to acquire and exploit primarily gas assets in north-central Louisiana. They did a terrific job—drilled, acquired, and took on additional capital. As I mentioned, we like to feed the winners."

As a result, NGP has supported the WildHorse management team with capital in excess of $300 million. In 2011, NGP combined several companies, including WildHorse, into Memorial Resource Development with the vision of eventually creating two publicly traded vehicles: a C- Corp for growth assets and an MLP for mature long-lived assets that would trade on a yield basis.

Eventually, in June 2014, Memorial Resource Development Corp., the growth development company comprised of WildHorse and three other companies, sold 49.2 million shares at $19 during its IPO, receiving net proceeds of $382.1 million. Prior to that, in December of 2012, Memorial Production Partners, the MLP focused on long-lived, low-decline natural gas assets, went public.

Other companies such as Rice Energy, Parsley Energy and RSP Permian, all with young management teams, continue to capture the attention of large institutional growth investors.

"We made our first commitment to the Rice family at Rice Energy when they were in their twenties, and to Bryan Sheffield, at Parsley Energy, when he was in his early thirties," said Weber. "This shows you that we find young teams early."

But IPOs may seem like a double-edged sword. When an NGP-sponsored company goes public, they lose the management team. Weber acknowledged as much, but emphasized that NGP's philosophy of backing effective management teams remains the same, private or public.

"It's true that we are sacrificing some of these management teams to the capital markets," admitted Weber. "But in the past two years, we've been much more active making private investments in public equity [PIPEs]. If we liked the team enough to back them, and they performed well enough to go public, then why wouldn't we support them as managers of a public company?"

The future

The oil and gas industry has spurred a step-change in the amount of capital required to develop resources in North America. Vertical well programs that used to require $20 million to $30 million per year in capital expenditures now require $100 million to $120 million to drill and develop the same asset horizontally.

The industry will continue to evolve and need outside capital, and NGP has proven it can adapt with the times. Weber and the team are satisfied that NGP Energy Capital Management can play a meaningful role in an industry that continues to need more and more capital. ■

NGP ENERGY CAPITAL MANAGEMENT

www.ngpenergycapital.com

The Source Rock For Energy Capital

Prudential Capital Group, the private investment arm of Prudential Financial Inc. (NYSE:PRU), is not a new participant in the energy risk investment sector. Making investments across energy industry opportunities and projects has been one of the firm's strategies for more than 50 years.

"Because of its substantial portfolio and reputation for long-term capital across the energy value chain from upstream oil and gas drilling, production and midstream infrastructure to power generation and transmission, many may not realize the increasing role that Prudential Capital Group has played in risk investing," said Randall Kob, managing director of Prudential Capital Group and head of the firm's Energy Finance Group. The Energy Finance Group is comprised of the Oil & Gas Group led by managing director Brian Thomas, and the Power Group led by managing director Ric Abel.

Kob further stated, "Across both our Oil & Gas and Power Groups, our strategy is to provide the appropriate type of capital for the financing need. We have a strong appetite for both debt and equity, which allows us to provide more options and flexibility in customizing capital based on the investment opportunity rather than the availability of capital. Our investment success in the broader energy sector has followed a straightforward approach that involves forming close working relationships with management teams and then collaborating with them to tailor the most appropriate form of capital for their business."

"We operate as a knowledgeable financial partner with management teams across all stages of growth, often providing both debt and non-control equity in the same transaction; so we defy a narrow characterization," added Brian Thomas. "We are not exclusively limited to a single form of capital, and that's an important distinction in a sector that has historically relied on single purpose capital providers for debt or equity funding."

Thomas goes on to explain that Prudential Capital Group has a middle market orientation such that it often works with management teams early in an enterprise's lifecycle by providing risk capital or non-control equity. As the business grows, Prudential Capital can continue to partner with the management team by providing additional forms of debt financing. The ability to focus on providing for the changing needs of the client is one of the reasons Prudential Capital has worked with the same management teams across multiple platforms over many years.

While Prudential Capital has the ability to accommodate shorter-term capital needs, it often works with management teams seeking a buy-and-hold approach that isn't necessarily driven by a specific time frame or exit strategy. "We have an investment strategy to partner with companies that often have a longer-term investment horizon than might otherwise be accommodated by classic fund sourced capital," says Thomas. "Examples of this would include oil and gas operators seeking to retain current producing assets as part of a longer term development strategy or midstream

Prudential Capital's Energy Finance Group provides capital to companies and management teams across the energy value chain including oil and gas exploration and production, midstream, energy services, energy infrastructure projects and utilities.

Scale and Commitment

- A team of 14 experienced investment professionals
- Average tenure of investment staff is 15 years
- $6.9 billion investment portfolio as of 6/30/14
- Committed capital through all market cycles
- Debt and equity appetite in excess of $1 billion annually

Typical Investment Size

Senior Debt	$10 - $250 million
Mezzanine Debt	$10 - $50 million
Equity	$10 - $50 million

asset owners seeking alternative liquidity and or growth capital options that don't require a material change in ownership or operational control.

"The middle market energy industry has evolved considerably in the last decade, both in terms of the nature of the resources being pursued and developed, as well as the experience and quality of the management teams pursuing new ventures and projects." These trends have lined up well for institutional investors, such as Prudential Capital, to expand its investment activity within the sector as an alternative financial partner for many companies.

"Beyond offering a variety of financing options, Prudential Capital Group has the ability to fund entire transactions and serve as a single source capital provider delivering a quicker closing, post-closing continuity and a certainty of execution. With a team of fourteen investment professionals averaging over a decade and a half of transaction experience, Prudential Capital's Oil & Gas Group has both the scale and experience to work directly with management teams locally to efficiently structure, close and manage its investments. In fact," Thomas adds, "our group has committed to over 13 transactions in 2014 and typically invests in excess of $1 billion annually in senior debt, mezzanine and private equity in companies and projects."

Prudential Capital Group's Oil & Gas portfolio currently totals more than $6.9 billion (as of 6/30/2014) in private debt and equity investments, primarily invested in the upstream and midstream sectors. While Prudential Capital's mezzanine and equity investment sweet spot lies somewhere between $20 million and $50 million, the firm can also accommodate senior debt investments of more than $200 million. Prudential Capital also regularly partners with similar institutional investors to assemble the necessary capital to accommodate much larger transactions, while it focuses on energy investments within onshore U.S. and Canada.

When considering new investments, Prudential Capital Group targets proven management teams with strong technical expertise, a solid development plan and quality assets. Often, these are teams who have achieved previous success, but are looking for options to diversify their access to both debt and equity capital from a single relationship. Thomas summarizes, "It's not our investment criteria that sets us apart in the industry, rather it is our reputation for investing in relationships and our consistency as a capital provider that have been our most competitive assets." ■

Prudential

www.prudentialcapitalgroup.com/energy

From left to right: Brian Thomas, Randall Kob, Ric Abel

For more information contact:

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managing director
(214) 720-6216
brian.thomas@prudential.com

Risked Revenue

Q Why should an oil and gas firm hedge its production?

Most firms that hedge do so to ensure their future cash flows. With a well-designed hedge program, a company can be confident that it will achieve budgetary success regardless of swings in commodity prices.

Q What is the hallmark of a successful hedge program?

Successful hedge programs are powered by robust analytics. All too often, managing commodity risk with derivatives is an opaque and confusing endeavor because firms have inaccurate or incomplete information. R^2 has invested heavily in analytical talent and data systems, including SunGard's Kiodex Risk Workbench. Through us, clients have a world-class commodities risk management solution, supported by a team of experts. Due to our uncompromising emphasis on systems and personnel, our clients have all of the necessary data and risk analytics at their fingertips when making hedge decisions.

Q How does R^2 ensure that its interests are properly aligned with those of its clients?

Conflicts of interest abound in financial consulting arrangements unless preventing them is made a priority. As an independent entity that surveys counterparties, we are incentivized to get the right hedges at the best prices for our clients. We contractually align our interests with our clients' interests. Many clients subscribe to R^2 services under a retainer agreement. This "fee for services" model allows R^2 to eliminate many potential conflicts of interest embedded in "fee for transactions" models employed by many of our competitors. Our clients have confidence that R^2 is focused on providing the highest level of independent and objective consulting services possible.

Q Why does R^2 call itself a full service risk consultancy?

We offer a la carte services in each of the following areas: (1) risk advisory; (2) transactional support; (3) deal capture; (4) valuation and reporting; and (5) research and analysis. The majority of our clients engage with us in all five under a retainer agreement.

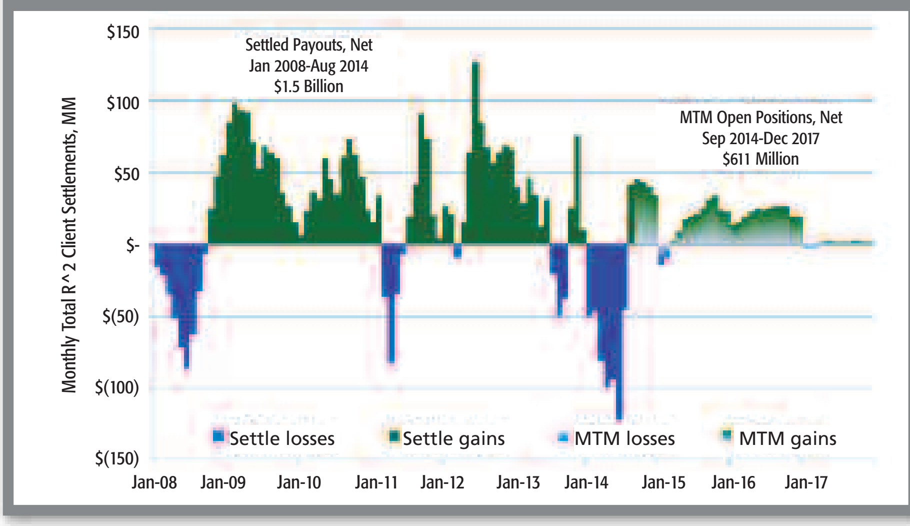
Q Tell me about the typical R^2 clientele that you help.

We are proud to service producers, midstream companies, MLPs, private equity firms, utilities, government agencies, and end users with their hedging needs. We enjoy a client retention rate of nearly 100%, with many new clients being referred to us by existing ones. The confidence that our clients place in us to help them with the critical challenges related to their hedging activities is our most important achievement.

Q Tell me about R^2's track record in the performance of its clients' hedge portfolios.

Our clientele has been paid for hedging. Our clients' hedge programs have not only reduced risk to their cash flows but have added to their bottom lines. Hedges held by R^2 clients have generated over $1.5 billion in receipts since 2008. Open positions are valued at more than $600 million. The graph below depicts the historical monthly performance of R^2 client hedges in aggregate. ■

HISTORICAL MONTHLY PERFORMANCE



SFC Energy Partners

For the founders of SFC Energy Partners, the term "partner" is more than just a part of the firm's name; it's the very cornerstone on which the private-equity firm is built.

"We spent our careers learning how to be good partners, having come from the operations side of the business, so we understand what to worry about and what not to worry about, and for our portfolio companies that means we can communicate at a very grassroots level," said Mitch Solich, senior managing partner. "Our motto is, 'We've been in your shoes.' We'd be proud to be your partner."

In 2005, Mitch Solich and his team found themselves at the end of another successful private-equity-backed start-up after the sale of Medicine Bow Energy and decided they wanted to create a platform to leverage off of more talent.

"There are a lot of very smart people in this business with a lot of great ideas," Solich says. "We know we don't know all the answers, and we probably don't even know what all the questions are. We also wanted to gain more geologic diversification, and the way to accomplish these two goals was to form our own private-equity energy fund."

SFC initiated fundraising for its first fund in 2006, which closed in March 2007 at $415 million. That initial fund is now fully committed, and the firm is in the process of committing its second fund, which closed at $596.7 million, giving the firm more than $1 billion under management. SFC currently has 14 portfolio companies, and the partners expect fundraising for their third fund to begin in 2015.

SFC developed an oil bias in 2009, and all of its deals since then have been oil deals ranging from $50 million to $100 million, though the partners say they look at deals on either side of that sweet spot. The initial goal of geologic diversification has taken the firm's investments all over onshore North America, including Alberta, and has kept them from focusing on specific areas.

> "We would be proud to be your partner."
>
> —*Mitch Solich*

"Our goal has been to diversify geologically, and we don't take a view that we'll look only at specific plays or formations," Solich says. "The result of our deal screening has allowed us to accomplish both goals. We've been able to leverage off talent and we're now invested in basins across North America—the Rockies, the Midcontinent, the Permian Basin, the Gulf Coast and Alberta."

Technical acumen

SFC's history as operators gives them a different way of evaluating deals, and they tend to focus quite a bit on the technical side of the deal, allowing them to understand the deal as well as the management team and act as better partners.

Solich says the firm doesn't focus on a specific type of management team. Instead, SFC prefers to focus on the merits of the project, the skill sets of the team, the dedication and maturity of the team and the ability of the team to execute a project and get across the finish line.

"This is how the deal works: We give you money, you give us a lot more back," he says. "We're focused on management teams that will allow us to achieve that mission, and they'll make a lot of money doing that."

While the founders of SFC can find a lot to worry about in the future of oil and gas, Solich says finding the right management teams can take care of a lot of the unknowns.

"The future is unknown, and we're world-class worriers," he says. "But the right management team can get on top of all of it. They can identify the risk and execute their way through it. Those are the teams we want.

"We spend less time thinking about long-term trends and more time thinking about the quality of the team in front of us and the compelling nature of the opportunity they've identified." ■

Stellus Capital Management

Stellus Capital Management LLC has a philosophy of flexibility when it comes to meeting the capital needs of its clients. The firm believes by providing flexible capital on a strategic, risk/reward basis, it will be able to match the risk/reward of each individual opportunity.

The group behind Stellus was spun out of D.E. Shaw in early 2012, investing under the Stellus brand ever since.

The need for flexibility recently presented itself, said Todd Overbergen, partner and head of energy for Stellus Capital Management LLC.

"When we started, we had an ideal investment size of $10- to $50 million, and now our ideal investment size is $30 –to $100 million."

—Todd Overbergen

"When we started, we had an ideal investment size of $10- to $50 million, and now our ideal investment size is $30 –to $100 million," he said. "We are seeing some creep in deal sizes as the cost of drilling wells goes up and the amount of wells that need to be drilled to prepare a project to market has increased. We think getting a project to the 15% to 50% range of development is more important today than it was a few years ago."

Over the past eight years, the Stellus team has invested more than $1.5 billion in energy. The firm's energy group focuses on providing equity and equity-linked debt capital to small and middle market energy companies. It maintains a niche in the sub-$100-million, or middle market, where there is a great need for capital that cannot easily be accessed from private-equity firms.

"We've been in this niche for quite a while, since 2001," Overbergen said. "The thing I find interesting about our end of the market is, we really are not building companies per se, we are about projects. We work with experienced people who've put together projects with some equity risk, because they are in the early drilling stage."

Stellus finds management teams with drill-ready projects who need to build the team and need a capital infusion.

"By the time they come to us, they have the project drill-ready, they have some of their own capital in it, but they need more development capital—that's where we come in," Overbergen said. "We help them develop the project and then sell it."

Stellus is a project-oriented partner, rather than strictly providing capital.

"We rarely do a blank-check deal," Overbergen said. "We're much more project-oriented and we build a structure around that. We can take $30- to $50 million and hopefully turn that into $200- or $250 million of enterprise value. We do find there's a ready market out there to sell that size asset."

While Stellus maintains a focus on upstream deals, its investment team has broad experience across the energy industry. It invests the majority of its capital upstream, particularly in resource plays and lower risk, conventional development projects, but it is also looking to invest a portion in oilfield services and midstream. In any deal, it focuses heavily on understanding the technical aspects.

"We do our technical due diligence on the front end, and then we put our dollars in," Overbergen said. "We prefer a two- to four-year life cycle for our projects, then we sell them to a buyer who has a cheaper cost of capital."

Since the firm's spinout in 2012, Stellus has closed four investments totaling $163 million in capital commitments. It is currently closing a fifth investment, with a repeat management team. ■

STELLUS
CAPITAL MANAGEMENT
www.stelluscapital.com

1980s

1983	■ Crude oil futures begin trading on Nymex ■ First Reserve is formed to invest private equity in energy
1984	■ Chevron formed via merger of Standard Oil of California and Gulf Oil ■ Texaco vs. Pennzoil legal battle for Getty Oil begins
1987	■ Black Monday NYSE crash
1988	■ EnCap Investments formed ■ Natural Gas Partners (NGP) formed
1989	■ Exxon Valdez runs aground in Prince William Sound, Alaska

1990s

1990	■ Henry Hub gas futures start trading on Nymex ■ Apollo Global Management formed ■ Through this decade, capital providers move down the balance sheet and new providers such as Enron, Shell Capital and Duke Energy provide financing to producers
1996	■ Chase Manhattan merges with Chemical Bank, keeping the Chase name
1997	■ Qatar opens world's first major LNG export terminal
1998	■ NationsBank acquires Bank of America, keeping the BofA name ■ Oil plunges below $11/bbl ■ Kayne Anderson raises its first standalone energy fund ■ Lime Rock Partners formed ■ Quantum Energy Partners formed ■ Exxon buys Mobil for $75.4 billion; BP buys Amoco for $48.2 billion
1999	■ BP buys Arco for $26.8 billion

2000s

2000	■ JPMorgan merges with Chase Bank; Chevron buys Texaco for $36 billion
2001	■ Enron goes bankrupt and dissolves
2002	■ Conoco and Phillips merge
2003	■ Oil falls below $25/bbl ■ Fed chairman Alan Greenspan warns of natural gas shortages
2004	■ U.S. oil imports at a record 11.3 MMbbl/d ■ JPM Chase acquires Bank One
2005	■ Chevron acquires Unocal for $16.4 billion after federal government blocks bid by Chinese state oil company ■ Hurricanes Katrina and Rita devastate the Gulf Coast ■ Natural gas hits record high of $15.65/MMBtu ■ ConocoPhilips acquires Burlington Resources for $35.6 billion
2006	■ Anadarko pays $21 billion for Kerr McGee and Western Gas Resources ■ LNG imports to U.S highest ever at 3.1 Bcf/d in May
2008	■ World recession officially begins; mortgage crisis accelerates ■ Lehman Brothers goes bust ■ Oil hits $147/bbl on Nymex; Natural gas peaks at $13/Mcf ■ Bernard Madoff arrested as head of $65-billion ponzi scheme ■ JPM Chase acquires troubled brokerage Bear Stearns, and bank Washington Mutual ■ BofA acquires brokerage Merrill Lynch and mortgage firm Countrywide ■ U.S. government takes over Fannie Mae and Freddie Mac mortgage lenders
2009	■ Crude plunges to $34/bbl after financial crisis hits ■ Wells Fargo merges with Wachovia; natural gas falls to $3/Mcf

2010s

2010

- Dodd-Frank financial reforms signed into law
- Exxon-Mobil buys XTO for $30 billion
- Apache acquires 51% of Kitimat LNG project in B.C., Canada
- Deepwater Horizon explosion and fire at BP's Macondo well kills 11
- Apache buys BP's Permian Basin, Canadian and Egyptian assets for $7 billion
- Statoil and Talisman spend $1.8 billion to acquire Eagle Ford interests
- U.S. government ends post-Macondo ban on deepwater drilling in Gulf
- Chevron buys Atlas Energy for $4.3 billion to enter Marcellus

2011

- S&P downgrades U.S. sovereign debt from AAA to AA+.
- Kinder Morgan buys El Paso Corp. for $21 billion to create largest pipeline holdings in N.A.
- Marathon splits upstream and downstream operations
- U.S. gas production in December at record high of 66.2 Bcf/d

2012

- ConocoPhillips splits upstream and downstream operations
- N.A. natural gas prices drop to lowest level since 2002
- Departing Citigroup chairman Richard Parsons tells the annual meeting, "The 2007-2008 crash was the result of throwing off Glass-Steagall." On CNBC Sandy Weill admits financial conglomerates should be dismantled; he had championed overturning Depression-era rules allowing megabanks to be created.

2013

- This is the best year for IPOs since 2000, with energy LPs raising the most money.

CAPITAL PROVIDER VOICES

DAVID B. MILLER
Co-founder and Principal
EnCap Investment LLC

ON FUNDAMENTAL QUESTIONS

In the upstream area, the growth strategy can be about lower-risk drilling or reserves acquisition or a combination of the two. Most of our midstream companies are pursuing greenfield infrastructure projects in the most active resource plays. The fundamental question is no longer "Are we going to find hydrocarbons?" Rather, the most important question has become: "Can the portfolio company capture opportunity, and are they capable of developing oil and gas reserves on an economically attractive basis?"

TODD OVERBERGEN
Partner
Stellus Capital Management

ON DEAL STRUCTURES

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