CAPITAL FORMATION 2018

Energy Market Players

JUNE 2018

A Supplement To

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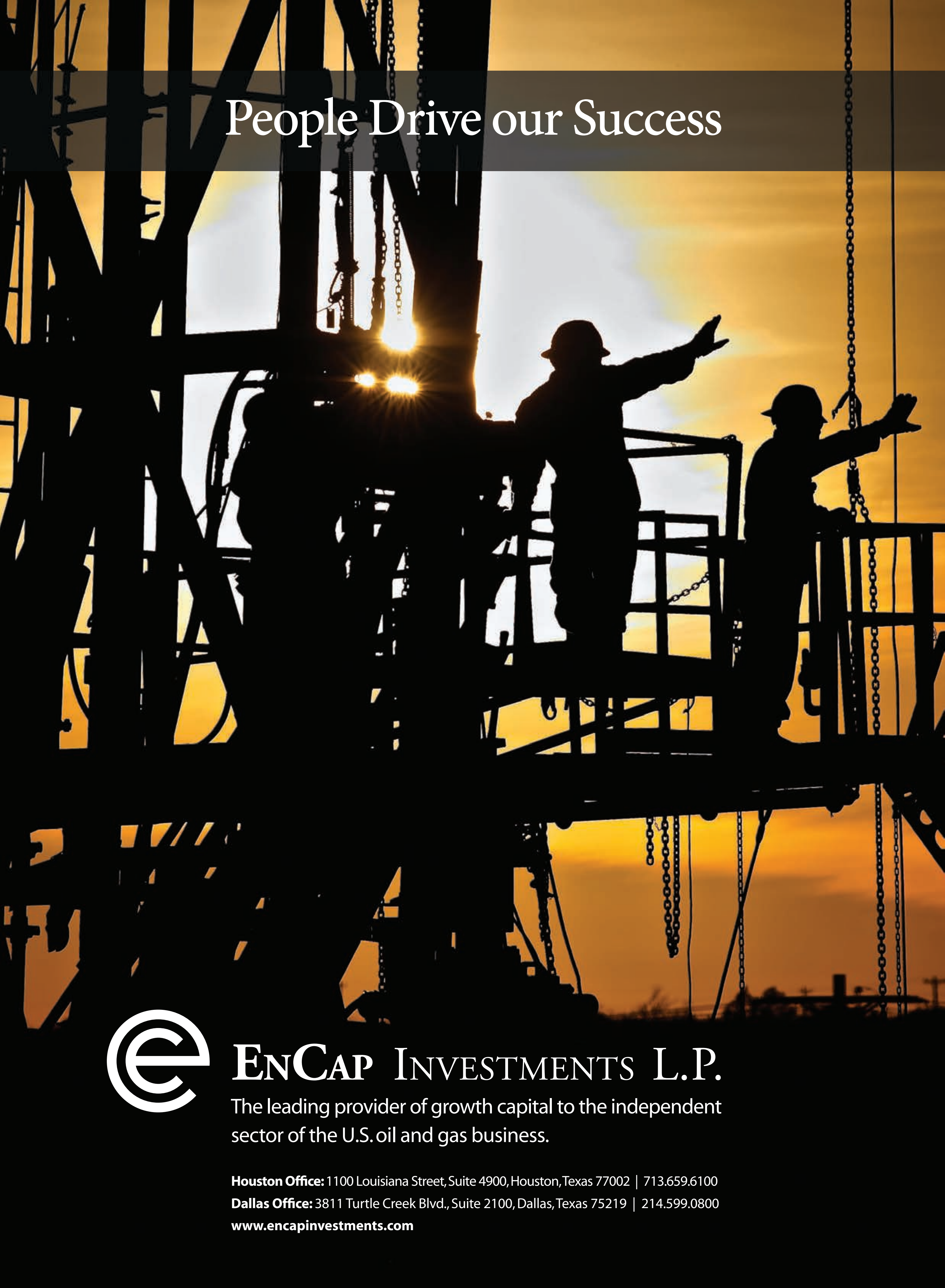
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www.encapinvestments.com

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Oil and Gas Investor

1616 S. Voss, Suite 1000
Houston, Texas 77057-2627
713-260-6400
Fax: 713-840-8585
oilandgasinvestor.com

Executive Editor-at-Large
LESLIE HAINES
lhaines@hartenergy.com

Editor-in-Chief
STEVE TOON
stoon@hartenergy.com

Associate Managing Editor
ERIN PEDIGO
epedigo@hartenergy.com

Senior Financial Analyst
CHRIS SHEEHAN, CFA
csheehan@hartenergy.com

Contributing Editor
GREGORY DL MORRIS

Corporate Art Director
ALEXA SANDERS

Senior Graphic Designer
MAX GUILLORY

Senior Marketing Manager
TAMARA MURPHY
tmurphy@hartenergy.com

Production Manager
SHARON COCHRAN
scochran@hartenergy.com

Ad Material Coordinator
CAROL NUNEZ
cnunez@hartenergy.com

For additional copies of this publication,
contact customer service at 713-260-6442.
custserv@hartenergy.com

Vice President, Sales
DARRIN WEST
dwest@hartenergy.com

Senior Director, Business Development
NELLA VELDRAN
nveldran@hartenergy.com

Publisher
KEVIN HOLMES
kholmes@hartenergy.com

HARTENERGY
MEDIA | RESEARCH | DATA

Vice President, Editorial Director
PEGGY WILLIAMS

Chief Financial Officer
CHRIS ARNDT

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RICHARD A. EICHLER

CAPITAL FORMATION 2018

Energy Market Players

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SURVEYING THE CAPITAL LANDSCAPE

As we head into the second half of 2018, most oil and gas companies find themselves in an unusual financial environment. Out in the field, their drilling efficiency is increasing, their production is increasing and the technology they employ is astounding, even to the point of the use of artificial intelligence and big data analytics. What's more, cash flows are underpinned by the price of West Texas Intermediate crude, which has increased over the past 12 months.

But public markets and institutional investors remain neutral at best, on the sidelines at worst. The call for profitability and working within cash flow has never sounded louder. The demand for shareholder returns has never been more urgent. Forget formerly popular metrics such as production growth per share; today what counts are earnings per share and return on capital employed.

But for the first time in many years, there are plenty of E&Ps that can grow in what is perceived to be a flat commodity price environment. As the oil and gas industry increasingly turns to this new paradigm, investor capital should return. Single-well economics can be impressive in many plays; now the economics of whole corporations must follow suit.

Private-equity funds for energy, however, are as abundant as ever, although even in that arena, the common sentiment among limited partners is increasingly picky. They are calling for greater transparency from their general partners.

In this annual special report, we at *Oil and Gas Investor* have taken a deeper dive into these topics. Here, capital providers will talk about growth capital, structured finance, the challenges and opportunities they face, and more.

—***Leslie Haines***, *Executive Editor-at-Large*

"Poised to Win Back Investors?"
Three institutional investors discuss what it will take. *Oil and Gas Investor/October 2017*

"As Equity Ebbs, So Debt Flows"
Investment bankers comment on the surge of public debt issues, especially high yield, as equity investors grow more wary. *Oil and Gas Investor/ December 2017*

"CPPIB: Canada's PE Heavyweight"
Two managing directors at the Canada Pension Plan Investment Board explain why they fund upstream and midstream companies in the U.S. and Canada. *Oil and Gas Investor/January 2018*

"Adapting and Diversifying"
Five private-equity providers explain their investment philosophies and analyze current market conditions. *Oil and Gas Investor/ March 2018*

For further information, please see oilandgasinvestor.com for archived articles and company profiles, and for the Oil and Gas Investor *Finance Sourcebook.*

DUBIOUS INVESTORS EXAMINE E&P EQUITIES

Coming out of the downturn, equity investors unexpectedly abandoned the sector. These insiders explain why, and what public independents can do.

By Steve Toon

Even in the jubilation of a hard-fought victory, the battlefield can be strewn with much debris. This might explain the lingering disconnect between equity investors and their once-beloved energy sector, according to one such investor. Steve Pattyn, managing member of New York City-based Yaupon Capital Management, likened the conflict between OPEC and U.S. shale producers to an epic battle—one in which shale won.

And yet a conversation he had recently with the COO of a Permian Basin E&P company summed up the aftershock of the skirmish.

"We've grown production, the oil price is at \$60—and our share price is down. It feels hard to say we've won. If this is winning, I sure don't want to see what losing looks like."

Pattyn shared his observations during a panel at IHS Markit's CERAWeek in March, along with other energy capital aficionados addressing the current push and pull of money in the sector.

Gregory Ley, a partner with PointState Capital LP, a hedge fund in New York, concurred with the pervading malaise among generalist investors' sentiment toward energy. "Energy is about 5% of the [Standard & Poor's 500 index]," he said. "To most people, it's not particularly relevant."

However, unlike the class of broadly focused investors that is now underweight energy, Yaupon is game-on for energy investment opportunities, Pattyn said.

In fact, the technology improvements and cost efficiencies achieved during the war with OPEC transitioned shale players from being high-cost producers on the global cost curve to the lowest-cost producers, he said. Combined with currently depressed equity valuations, "in any other industry the pieces would be simple to articulate," Pattyn noted, "vis-a-vis a share-taker in the growth at very reasonable valuations.

"To us, that's the best reason to invest in U.S. E&P."

> "The equity market is there, but I wouldn't consider it hot by any stretch of the imagination."
>
> ***Tim Perry,***
> *Co-head of oil and gas investment banking, Credit Suisse*

Banging one drum

For decades, public E&P companies have spread risk by having assets across multiple basins, but many name-brand independents today are shedding assets at breakneck speed to carve the portfolio down to a single basin. Are investors driving this trend?

"The public markets have always preferred pure plays in the sense that they ascribe single-basin companies a premium multiple vs. larger, more diversified independents," Pattyn said. More recently, though, "there's been an effort by management teams to restructure multibasin companies to fix that dislocation of value, pursuing an aggressive pruning of the asset profile to try and raise that multiple."

Contrarian still, Yaupon likes to "focus on the whole," he said, citing EOG Resources Inc. as an example of a multibasin E&P that trades at a premium multiple. "So it's not impossible to be in multiple basins," he said, but he acknowledged that the public markets do prefer pure plays.

So is the Permian Basin the only basin that matters in equity investors' minds? "There are other basins that deliver exceptional returns, such as the Austin Chalk," Pattyn said. "Focusing on the Permian at the exclusion of other basins is a mistake."

Ley concurred that "overly complicated" companies trade at a discount, but suggested the dynamic may not be as simple as basin count. "What you're starting to see, no matter what basin you're in, is that you need to show you can generate cash. Everyone can grow oil production. You can talk about this or that well or reserves for 100 years, and frankly, nobody cares."

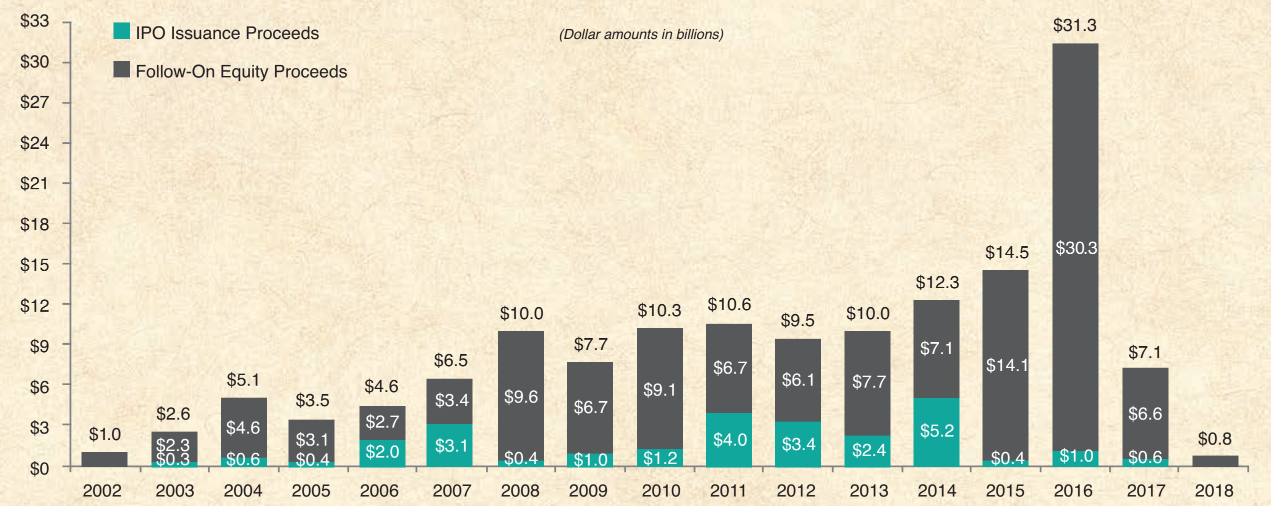
That's a powerful statement from an equity investor well-versed in the language of the business. However, oil and gas executives still want to provide vast operational and technical detail in their investor presentations.

Commodity fears

Another factor holding back equity investments, Ley noted, is the perception that both oil and gas prices are capped, squelching both upside and investment dollars.

"The question is, can you generate cash and have some excess cash to return or to redeploy smartly? That will differentiate companies that will outperform, and not just with energy investor money, but with broader investment money. Can you grow and generate cash?"

U.S. E&P PUBLIC EQUITY OFFERING ACTIVITY SINCE 2002



Source: Bloomberg and Dealogic. As of April 13, 2018. Primary proceeds only.

Although most of the discussion centered on oil dynamics, Bill Marko, managing director at Jefferies, reminded attendees that equity investors have an aversion to natural gas as well. Demand markets are strong, but supply is even stronger, with Permian associated gas expected to double from 8 billion cubic feet per day (Bcf/d) to 16 Bcf/d, along with continued growth in the Marcellus Shale and declining costs in the Haynesville Shale.

"That's the other side of the story—how investors think about natural gas," Marko said. "I used to say '$3 gas forever.' Now I think that's an optimistic view."

Equity dreaming

The lack of investor interest in oil and gas equities naturally has curtailed equity issuances, including as a form of fundraising for A&D transactions.

"Many of the serial acquirers did deals in the second half of 2016 and into 2017 in the lower-price environment when they had valuable equities," Marko said. Now, "investors want them to stop doing deals and to go and chew [on what they've bought]" for a while. It's a combination of investors insisting on companies living within cash flow and demonstrating returns rather than growth.

Tim Perry, co-head of oil and gas investment banking for Credit Suisse, said equity issuances "have dropped off hugely—my pocketbook wishes there were more equity issuances."

Equity issuances spiked in 2016 when the markets were still open and independents drew down cash anticipating a long drought during the impending downturn. That year saw some $35 billion in issuances by the upstream sector, twice as many issuances as the previous record year, according to Perry. That contrasts with $7 billion in issuances by the sector in 2017, one-fifth of the prior year but nonetheless within the $6 billion to $12 billion range considered normal.

Upstream IPOs have suffered as well, with the last E&P company IPO transacted in January 2017. Perry said at least 10 private producers want to price IPOs, although that number is likely conservative. Oilfield services companies have had modest success in the IPO markets since then.

Yet contrary to popular perception, equities markets are not closed to E&Ps, he said. E&Ps are just not willing to sell at the current asking price, with many trading at or near 52-week lows despite rising oil prices.

"We think the equity markets and IPO markets are available" to the upstream sector, "but they're coming at larger discounts to public comps than

PRIVATE CAPITAL RIDES HIGH

While public companies wail and gnash their teeth over the lack of interest in their stocks, private companies are flush with available capital from private-equity providers, according to Neil Wizel, managing director of First Reserve Corp.

"We're still seeing good deal flow in E&P opportunities that are going to present 25%-plus full-cycle economics," he said while presenting at IHS CERAWeek in March. "We also think about consolidation opportunities on the services side."

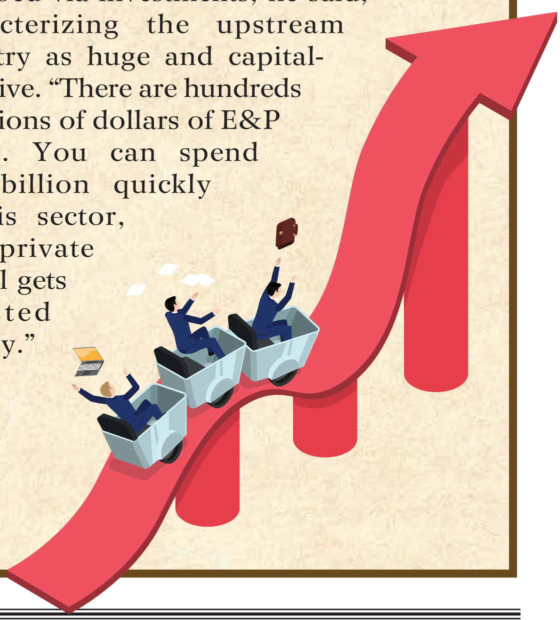
Wizel noted that about 40% of the Lower 48 rig count is controlled by private capital, albeit not all private equity, specifically. Yet, "private equity continues to be very active in the U.S. onshore E&P market."

Over the past several quarters, industry pundits have identified $50 billion in available private equity for the upstream sector, he observed, "but I would say the number is quite a bit bigger than that."

That amount doesn't include several key pockets, he noted, such as generalist private-equity funds with a significant energy mandate, successful hedge fund capital that is focused on doing more in energy, and energy infrastructure funds.

"These pockets of capital are not insignificant," he said. "The number is bigger. I don't know if it's $75 billion or $100 billion."

But even this amount can get quickly absorbed via investments, he said, characterizing the upstream industry as huge and capital-intensive. "There are hundreds of billions of dollars of E&P capex. You can spend $75 billion quickly in this sector, and private capital gets invested quickly." ■



"I used to say '$3 gas forever.' Now I think that's an optimistic view."

Bill Marko,
Managing director,
Jefferies & Co.

many companies would like, so they feel that now is not the optimal time to do issuances. The equity market is there, but I wouldn't consider it hot by any stretch of the imagination."

Buybacks and dividends

The question was raised whether energy investors would flood back into the sector if the oil price reached a certain number or held steady for a particular period of time. Perry confirmed that price is essentially a moot point in the view of Wall Street.

"I don't think $65 or $70 will make a material difference in terms of equity interest into the stocks," Perry said. "What investors really want to see right now is sustainable returns over what we would consider the mid-cycle oil price lasting a very long period of time."

That scenario would look like oil trading at $80 per barrel (bbl) and the forward curve five years out at $75/bbl—combined with companies showing "much higher returns" and returning some capital to shareholders through buybacks and dividends. "That's when you would have a material, lasting change in the sector."

Yaupon's Pattyn concurred. Referencing his conversation with the Permian producer, if the fundamentals of the business are good, production is growing and oil is comfortably above $60/bbl, "then the last thing to solve for is the stock price," he said. The way to do that is via share buybacks.

"Management has been more aggressive about repurchasing shares, we think in a prudent way."

Pattyn said that opportunity is made possible by the strategic shift seen by independents maximizing their businesses' capital efficiencies through the downturn. Many have leveled their growth strategies marked to a $50/bbl or $55/bbl oil price and have vowed not to diminish returns by adding rigs in a higher oil price environment. Thus, as commodity prices rise, excess cash flow produced can be used for share repurchases, he suggested.

"We view that as a very optimistic sign for the industry," Pattyn said, "as companies go from being issuers to purchasers. We think that may be a turning point in the performance of the energy index."

One potential wildcard is anxiety surrounding how electric vehicles (EVs) might impact the sector.

"There is a wall of worry from equity investors about EVs coming in and when that will happen," Perry warned. "Is that 50 years out or 10 years out? Your views on that can make a difference on where you want to go with the sector in terms of increasing your participation."

High yield holds on

However, where the equities markets languish, high-yield investors seem eager to participate.

"The debt markets have been fantastic," Perry said. "A lot of very good companies are in the BB or B range that have gotten high-yield bonds off at rates of 5% to 7%—really fantastic bond rates. As a result, several companies have chosen to go to the bond markets to capitalize themselves because that's a very hot market, and to wait while the equity markets recover."

"These pockets of [private] capital are not insignificant."

Neil Wizel,
Managing director,
First Reserve Corp.

Debt investors gained confidence in the sector, he said, for those companies that demonstrated they could survive for a period of time at $28/bbl oil while lowering costs, improving margins and de-levering. "Most high-yield investors today think these are enduring companies and so they are comfortable with these investments."

PointState's Ley, however, chimed in that, "as an equity investor, I don't think the E&P space should be very levered at all—it's very cyclical." He also added that he didn't believe leverage was necessary to achieve production growth.

The model is changing, Perry said. Before 2014, a 3x debt-to-EBITDA ratio was normal in the E&P sector. "Frankly, now, if companies are more than 2x levered, they're being punished. The new model is staying within cash flow." ■

GREEN SHOOTS IN BANKING

The climate for banking in the upstream sector is optimistic, but interest rates could stymie further progress.

By Chris Sheehan

A rapid tour of financial instruments in and around the commercial banking sector was offered by David Tameron, managing director with Wells Fargo Energy, when he spoke at the Energy M&A and Financing Forum hosted recently by Denver-based law firm Davis Graham & Stubbs LLP. Tameron formerly was an analyst covering energy equities at Wells Fargo Securities.

After two difficult years for commercial banks serving the energy sector, the business climate has significantly improved—and become markedly more competitive—according to Tameron.

"If you compare those years to where we are today, on a relative basis it's pretty darn good right now," he said.

"If you look at the lender market today, I would say there are probably 25 to 30 active lenders and more if you include some of the one-offs. But with 25 to 30 active lenders, with an average allocation of somewhere in the $40 million to $45 million range, it's a deep market. As a reference point, if you went back a few years to the low point, there were probably only seven to eight active lenders, so the market has definitely deepened."

In addition, a formerly cautious outlook has given way to greater optimism as commodity prices have improved, he noted.

"Right now, the market's good. If anything, it's aggressive on the lending side in some of the terms that are being thrown out," he said. "Now we're seeing a group of lenders that are a lot more aggressive than even a year ago. And some of the regional banks have also stepped up."

At the time he spoke with *Oil and Gas Investor*, the spring bank borrowing redetermination season had just begun. Tameron pointed to improving fundamentals from a borrower's standpoint:

"I'd sum it up by saying it's a good market, lenders are more aggressive and right now things are moving in the borrower's favor."

To provide some direction in terms of where borrowing bases have been—and where they're headed—he said that about 80% of the redeterminations at Wells Fargo last fall were either reaffirmed or were increased. "And of those increases, more than half were up 30%, driven in large part by a higher price deck, but also an acceleration of development as production comes online from earlier drilling."

Better terms

Pricing has come down, even as recently as in March, according to Tameron. Terms range from 175-275 basis points over Libor for higher-quality credits to 250-350 basis points for lesser credits, with pricing having tightened by probably 75-100 basis points over the last six to nine months, he said.

For some of the publicly traded E&Ps operating in the Permian Basin with existing bank relationships, "you'll see numbers tighter than that," he added, with some having terms as low as 125 basis points over Libor.

In terms of a total leverage metric, as compared with a senior secured debt metric used several years ago, companies in the upstream sector should ideally carry debt-to-EBITDA ratios no higher than 3.25x to 3.50x, Tameron advised. And, when initiating a banking relationship, they are often slightly lower "at closer to 2.75x to 3x."

"Right now, the market's good. If anything, it's aggressive on the lending side in some of the terms that are being thrown out. Now we're seeing a group of lenders that are a lot more aggressive than even a year ago. And some of the regional banks have also stepped up."

David Tameron,
Managing director,
Wells Fargo Energy

Tameron emphasized the importance of good lines of communication between the bank and its clients. "We want to be your partner. We want to help you so when you win, we win," he said. "Keep that dialogue flowing; We want to get deals done. We're in business to lend money. We're in business to do transactions; the more communication, the better."

DrillCos and Term B's

Ryley Hegarty, CFO of Denver-based Camino Natural Resources, added other financial instru-

ments including DrillCos to the panel discussion, where he joined Tameron.

"Bank debt is obviously the cheapest [financing source] out there. It's very simple," Hegarty said. "It's a great way to continue to grow your business if you have access to it. The downside is that it's not necessarily long-term capital."

By contrast, the attraction of the DrillCo is that "a lot of these deals are being structured as wellbore-only, so there is no recourse to the overall business," he observed. "That's something we've definitely seen over the last six to 12 months."

Tameron noted that recently, more unitranche deals were being done after a period in which they had seemingly disappeared. "The unitranche market is definitely open and active for the right transaction."

Term Loan B facilities have been used widely in other sectors, but in energy they have been restricted mainly to the midstream sector. Tameron ascribed Term Loan B facilities' use in midstream to the differing regulatory environment between midstream and upstream operations, which reflects the different operating risks between the two sectors.

In various non-energy sectors, almost 140 Term Loan B transactions have been completed in the last 18 months, according to Tameron, who put the average transaction size at $1.8 billion. "There's a lot of money on the institutional side chasing some of this bridge financing," he observed.

"On the midstream side, Term Loan B's are taking out the revolvers in a lot of instances," he said. In addition to being relatively cheaper financing, Term Loan B's can be pre-paid and usually are light in terms of covenants relative to other debt instruments. "If you're a single-B credit, you could probably get something in the high-5% range in terms of an interest rate. It's attractive capital."

In the high-yield market, relatively low yields seen toward the end of 2017 started to move higher as of February, Tameron noted. Concurrently, there was an outflow of money, resulting in an investor base "that got a lot more selective. We saw a couple of deals that tried to come to market and didn't get off. The demand was there—just not the right price," he said.

"The high-yield market was red-hot at the end of last year. But our house view is that in the near term, you'll face a little bit of headwinds throughout the year given rising expectations on interest rates. Permian names are trading in a high-5% to low-6% range; Haynesville names at 7%-plus. So there's more pressure on the gas names, which investors have definitely shied away from." ■

CAPITAL MARKETS NEWS

In case you missed it

CAPEX GUIDANCE

Of the 65 E&P firms tracked by **Cowen & Co.**'s E&P analysts, 58 (accounting for about 95% of 2017 capex) have provided 2018 capex guidance. The numbers so far indicate an 11% aggregate year-over-year increase in industry spending by these companies. Some of the biggest spending increases over 2017 levels included EOG Resources Inc.

PRIVATE-EQUITY NEWS

Drillcore Energy Partners LLC, a New York-based private-equity firm, said it seeks a target of $250 million for its first fund. It plans to make value-enhancing investments in the upstream oil and gas sector in the continental U.S. Drillcore is led by founder and managing partner Evan Turner, formerly a director and head of energy at StormHarbour Partners and a founding member of CohnReznick Capital's oil and gas group. Previously, Turner worked for Canaccord Genuity.

Drillcore works in the middle-market upstream sector often overlooked by larger funds, targeting investments around $75 million in size.

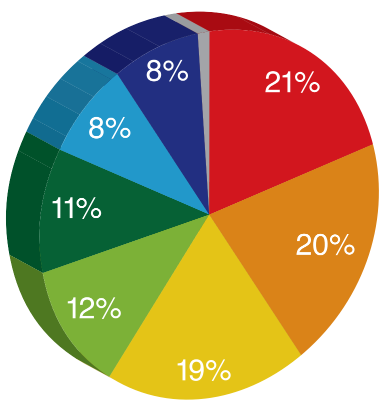
Lime Rock Partners is working on a liquidity process for its fourth oil and gas fund, which has most of its value in one investment, an E&P company called **CrownRock Operating LLC** based in Midland, Texas, according to *PE Hub*. CrownRock is a joint venture (JV) between the company and Midland-based private firm CrownQuest Operating.

The general partner, based in Houston and Connecticut, seeks to deliver liquidity to its limited partners (LPs) in Fund IV, which expires this year. It has lined up investors, including **HarbourVest Partners**, as part of the deal, two sources said. **Evercore** is advising on the deal, *PE Hub* said.

Lime Rock would move assets, most of which are in CrownRock, out of Fund IV and into a special-purpose vehicle with a term of about five years, sources said. The existing LPs can either roll into the new vehicle or cash out of their stakes in Fund IV, locking in strong gains.

Apollo Global Management LLC said it seeks to raise more than $4 billion for its third natural resources-focused private-equity fund, according to a *Reuters* report.

Where Producers Will Source Capital In 2018



- 21% Cash flow from operations
- 20% Credit lines from banks
- 19% Private-equity firms
- 12% Joint ventures with private-equity firms (DrillCo, Farm-out)
- 11% Debt from capital markets
- 8% Equity from capital markets
- 8% Debt from private-equity firms
- 1% Other

Note: Respondents could select more than one source.

Source: Haynes and Boone Spring 2018 Survey

REDETERMINATIONS

More than 80% of lenders and borrowers surveyed expected to see E&P companies' borrowing bases increase during the recent redetermination season, according to the "Spring Borrowing Base Redetermination Survey" conducted by **Haynes and Boone LLP**. The Dallas-based law firm received responses from 108 people: 33% were oil and gas lenders, 27% were borrowers and 27% were professional services providers.

It reported that more than 20% of lenders said they expected at least a 10% increase. Nearly 10% of respondents expected a greater increase of up to 20%. Many more E&Ps were hedging as commodity prices rose during the first quarter.

Range Resources Corp. announced a new revolving credit facility. The five-year agreement with a syndicate of 27 financial institutions has a maximum facility size of $4 billion. It maintains a borrowing base of $3 billion with $2 billion in commitments. The agreement maintains existing borrowing costs and structure, including the option to release all collateral upon the receipt of a single investment-grade rating. The maturity of the facility was extended by five years to April 13, 2023.

Rosehill Resources Inc. successfully syndicated a new revolving credit facility, increasing the borrowing base 100% to $150 million, with a $500 million total capacity. **J.P. Morgan Chase** led the five banks involved in the syndicate. The revolver matures in 2022.

DRILLING JVS

Nickel Road Operating LLC, based in Denver, partnered with private-equity firm **Vortus Investment Advisors LLC** of Fort Worth, Texas, to further

PRUDENTIAL CAPITAL GROUP

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Oil & Gas

Capital that Spans the Energy Value Chain

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.

Capital Characteristics

- Investment grade and below investment grade debt. Typically, fixed-rate, long-term senior notes and select floating-rate financings
- Junior capital: second lien, mezzanine and non-control equity investment capacity
- Energy infrastructure project finance, joint venture financing and equity participation capabilities
- Ability to accommodate long-term investment horizons

Typical Investment Size

Senior Debt	$10 - $400	million
Mezzanine Debt	$10 - $50	million
Equity	$10 - $50	million

Issuer Benefits

- Single-source financing relationship, which allows for post-closing continuity
- Ability to provide both debt and equity capital in the same transaction
- Broad investment interest allows participation in project, joint venture and structured financings
- Ability to evaluate and structure transactions on either an asset or cash flow basis

Scale and Commitment

- A team of 12 experienced investment professionals
- Average tenure of investment staff is 15 years
- $6.8 billion investment portfolio as of 3/31/17
- Committed capital through all market cycles
- Debt and equity appetite in excess of $1 billion annually

Senior Debt | **Mezzanine Debt** | **Private Equity**

For more information contact:

Brian Thomas
Managing Director
(214) 720-6216
brian.thomas@prudential.com

Matt Baker
Senior Vice President
(214) 720-6253
matt.baker@prudential.com

prudentialcapitalgroup.com

Prudential

acquire, lease and develop oil and natural gas assets in the Denver-Julesburg (D-J) Basin. Nickel Road was recently formed by Andrew Haney and Kit Tincher following an acreage contribution by Cobalt Oil & Gas LLC and Prelude Petroleum LLC. Cobalt and Prelude have been active in the D-J Basin since 2014. Vortus targets privately negotiated transactions in the lower to middle market requiring $25 million to $75 million of equity capital.

Chaparral Resources Inc. has a 30-well drilling JV program, funded by **Bayou City Energy**, in order to accelerate development on its Garfield and Canadian counties acreage in Oklahoma. This JV began drilling in late 2017, but it expects to complete the current 30-well program in 2018, with a focus on the Meramec and Woodford formations. In 2018, it anticipates combined production for both partners from its JV to be between 1,900 barrels of oil equivalent per day (MBoe/d) and 2.1 MBoe/d.

GLOBAL DEFAULT RATES

The 2018 global corporate default tally increased to 27 after Alberta, Canada-based oilfield services provider NCSG Crane

& Heavy Haul Corp. and Ohio-based utility provider FirstEnergy Solutions Corp. defaulted, according to **S&P Global Fixed Income Research**. "The oil and gas sector leads this year's default tally with seven, followed by retail and restaurants with four," said Diane Vazza, head of S&P Global Fixed Income Research.

Of the 27 defaults this year, 19 occurred in the U.S. Three each were from emerging markets and other developed regions (Australia, Canada, Japan and New Zealand), and two were from Europe.

"So far in 2018, distressed exchanges are the leading reason for defaults, with 10 (37%), followed by 8 bankruptcies (30%). Missed principal and interest payments account for 7 defaults (26%). The remaining two defaults were confidential," S&P said.

CORPORATE CREDITS

Morningstar Credit Ratings published its latest chartbook on oil and gas credit trends, an update from the December 2017 version. Despite positive trends such as higher oil prices and surging oil and gas production with lower costs, energy bond spreads have modestly widened since December, the group said, after near-continuous tightening from January 2016.

The group forecasts a 2018 oil price between $55 per barrel (bbl) and $60/bbl. "Commensurate with this, we expect overall credit quality of companies in the energy sector will continue to gradually improve."

COSTS OF PRIVATE CAPITAL

Pepperdine University's **Graziadio School of Business and Management** first launched a survey on the costs of private capital in 2007. Its latest survey, summarized in the "2018 Private Capital Markets Report," was deployed in second-half 2017. It polled the expectations of senior lenders, asset-based lenders, mezzanine funds, private-equity groups, venture capital firms and angel investors, and also asked limited partners and investment bankers their opinions.

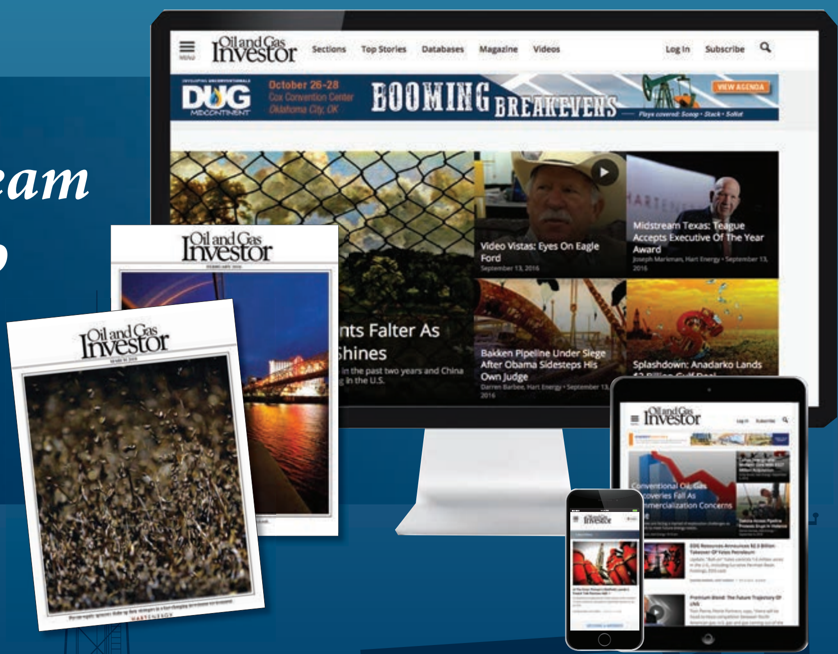
Although the survey was not specifically or solely tied to oil and gas finance, some of its findings may apply as far as general trends or sentiments go. Craig R. Everett, Ph.D, led the study. He noted that the cost of capital for private business varies significantly by capital type and sizes of deals, and therefore, the risk assumed by the capital provider.

Bank loan providers typically expect anywhere from 3% to 6% required rate of return, depending on the size of the loan. If the loan is asset-backed rather than cash-flow-backed, the expected rate is wider, 3% to 10%.

Mezzanine finance varies more widely with expected returns from 11% to 21%. Investor groups providing venture capital and angel loans expect the highest return, anywhere from 28% to 55%, the Pepperdine survey found. ■

For further information:

See oilandgasinvestor.com and oilandgasinvestor.com/sourcebook.



PRIVATE MARKETS ARE NOT RETICENT

Private-equity players will write big checks, but they're eager to find value that is overlooked or out of favor.

By Gregory DL Morris

Under the heading of making it look easy from the outside, EnCap Investments LP raised $7 billion for Fund XI at the end of last year, and its midstream affiliate, EnCap Flatrock Midstream, raised $3.25 billion for Fund IV in January. But like the swan gliding smoothly on the surface, there is a lot of paddling going on below.

"As the LP [limited partner] universe has built out its roster of GPs [general partners], they are no longer just looking for exposure to energy," explained Charles W. Bauer, managing director, EnCap Investments. "Through 2013-2014, people were just looking for exposure. But through 2017-2018 and beyond, people are beginning to get a mature energy portfolio. They are looking for two or three main names upstream and one in the midstream, maybe one or two boutique positions."

That greater introspection became clear during the last fundraising season. "People were being more selective," Bauer said. "[Limited partners] LPs are seeking more transparency, not because they want to influence the GPs—our LPs rely on our 30 years of experience—but because they are doing their own X-ray to ensure they are not over- or underexposed to certain plays or segments."

As LPs build out their portfolios, Bauer noted that increased interest in nonoperated positions and investment in minerals are both ways to vary structures within the upstream sector. "That is good diversification," he said. "We have taken a position in minerals. That means not being in control of development, but when the rock is well-known then there is a comfort level. There is also an advantage in yield."

Volatility in capital markets is also having an effect, Bauer added. "If the A&D market slows, then exit strategies may slow, then return of capital can slow, which can affect LPs' budgets for the next deployment. We have not seen our business slow, but it is something we are alert to."

The initial approach to building the perfect beast is bottom-up, according to Bauer: "How are the rocks? Who are the managers and the operators around us? What are the single-well economics? What are the capital requirements?"

As an asset matures, exit options for the holder start to coalesce. "Every portfolio company hits an inflection point where we start to ask if we have created enough value for the next owner to come in and deploy hundreds of millions of dollars, or, is the market not agreeable so we hold a little longer. Our LPs are patient, and they want us to be patient too."

To underscore that point, Bauer noted that EnCap was able to execute several exits last year into a market that was widely seen as having more sellers than buyers, especially with public equity being so constrained. Those deals included EagleClaw Midstream, Lucid Energy Group II LLC, Rangeland Energy and Forge Energy LLC.

It also bears mentioning that while GPs do have a charter mandate to return capital to their LPs, usually there is not a hard "sell-by" date. LP agreements are negotiated contracts, so it can be difficult to generalize. That being said, many have commitment terms of 10 years plus two one-year extensions. The expectation is that capital will be called and deployed over the first five years or so and then returned over the second half of the term. Also, there are financial considerations, notably, carried interest.

"LPs are seeking more transparency, not because they want to influence the GPs—our LPs rely on our 30 years of experience—but because they are doing their own X-ray to ensure they are not over- or under-exposed to certain plays or segments."

Charles W. Bauer,
Managing director,
EnCap Investments LP

Writing the big checks

One of the largest private-equity (PE) transactions in the past year also demonstrated that major positions can go from public to private, not just the other way. Quantum Energy Partners' portfolio company, HG Energy II, paid close to $1.2 billion for all of publicly held Noble Energy Inc.'s assets in the Appalachian Basin. The deal included production of about 415 million cubic feet equivalent per day, of which 88% is natural gas, and a full working interest in about 385,000 acres across West Virginia.

"It was a neat transaction," said Dheeraj (D) Verma, president of Quantum Energy Partners. "We were able to acquire quickly and take over operations on a sizeable asset base and give Noble a clean, one-stop opportunity to exit the basin. Similarly, we had a chance to buy Samson Resources completely out of their East Texas holdings last year." Quantum has a few other deals in the works, but Verma could not discuss the details.

"There is very little capital for gas assets these days, especially large gas positions," Verma noted. "People seem to be scared of gas. Also, there is even less capital available when the size of the transaction gets beyond $1 billion. There is a small group of firms who can write that equity check for a sizable asset or business today."

The PE world seems to be bifurcating into the haves and the have-nots, Verma suggested, with some firms like Quantum still active and growing. And yet, he said, there are "quite a few firms that are having a hard time raising capital or being able to attract new management teams. This commodity downturn has truly tested the track record of the PE sector, and many have not been able to survive this downturn."

He added that current conditions "are creating opportunities for the successful firms, particularly since the public markets for equity and debt issuance are anemic for the energy sector right now."

Quantum has shown an affinity for creativity and big deals on the way out. One notable example was the recent sale of a $1 billion position in the Delaware Basin to Carrizo Oil & Gas Inc.

"They are a good group, very innovative, and the assets were a good fit for them," Verma said, "but the transaction was too big for them in one bite. So we came up with a way for them to buy an 80% operated working interest while we retained the rest. This allowed us to move those properties into the hands of long-term owners while retaining some of the upside. We then found a buyer for the 20% nonoperated interest, an insurance

Client relationships, combined with a passion for what we do, power our steadfast commitment to the energy industry. Our team tailors financial solutions to help upstream and midstream clients succeed, both in the boardroom and in the field.

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company. It took some creativity and patience for everyone involved."

Creativity was a word not used much in the wake of the financial crisis, but it is coming back with a more positive connotation. "We are active across the energy spectrum," Verma said. "While still active in the Permian, it is harder and harder to get value. We have been active in the Powder River Basin, the Marcellus and the Haynesville. We're also building a big position in the dry gas window of the Eagle Ford. Being somewhat contrarian, we were also brave enough to acquire a legacy oily position in California."

The wide array of transactions and basins highlights the increasingly larger role PE is playing across energy markets today.

Second through fourth innings

Blackstone Energy Partners has always been actively providing growth capital to E&P firms. It currently has 11 upstream investments worth $6.5 billion. "The focus is on great rocks that have the ability to get better over time with active risk management," said Angelo Acconcia, senior managing director and head of the upstream practice at Blackstone.

"To use the baseball analogy, we like the second through the fourth innings. We have done and will do some exploration, but mostly we're looking at how to optimize return on capital with technology—drilling and completion design, lift design, spacing. Those things enable us to generate Alpha that insulates us from commodity price volatility."

Blackstone is agnostic to geography, or size, or state of matter. "We have grown a $2 million company to $560 million. Each basin has its maturity curve and there are not too many that are far along the curve. Those few that are might be the Barnett, the Fayetteville and some Rockies gas, where there is not a lot of meat left on the bone."

He stated categorically that the Permian is one that is not too far along the maturity curve. "It is absolutely not too far down," despite being a few years shy of a century in production, Acconcia said.

Broadly, Blackstone's investment thesis has four points: assets, team, liquidity and time. "It starts with great rocks and a solid team," Acconcia said. "We like to back repeat successes. Liquidity is essential. We keep an under-levered capital structure. That is how you avoid losing the keys. You make money in the upstream through return on assets. Alpha comes through operational and technical improvement, not by magnifying leverage on top of commodity price volatility. And time means flexibility. We look at five-year returns, seven-year returns, even 'forever' returns."

That does not mean Blackstone considers being a Buy-and-Hold investor. It is still a PE house with a mandate to return capital to investors.

"But we are exit-agnostic," Acconcia said. "Consolidation needs to happen in the upstream sector, but that is not the situation today. Today, public companies are focused internally. They do not have the money to make acquisitions and they are not being rewarded to do so. But that is cyclical, not secular. That will change."

As evidence, Acconcia noted that through the first three months of 2018, only $600 million of public equity was issued in the upstream sector. "Annualized, that would make this year the lowest since 2001. People are risk-off. That will change: people will be able to put risk on. That is how this machine gets going again. People will start to appreciate top assets and see the opportunities for economy of scale in a very fragmented industry."

> "Alpha comes through operational and technical improvement, not by magnifying leverage on top of commodity price volatility."
>
> ***Angelo Acconcia,***
> *Senior managing director, head of energy practice,*
> *Blackstone Energy Partners*

Overcoming volatility and crowding

"I don't believe capital markets volatility is the biggest hindrance to fundraising," said Stewart Coleman, managing director of Pearl Energy Investments. "But volatile capital markets absolutely impact the ability of general partners to exit investments. That ultimately impacts overall investment returns and the pace of capital being distributed back to the limited-partner universe, which is then available to be redeployed via new fund commitments."

Even with volatile markets, there is a plethora of players these days. "Crowded private marketplaces are a fact of life across all industry sectors, not just E&P, and are the result of monetary policy actions and economic expansion since the Great Recession," he said.

Pearl closed its second fund in July 2017 at its $600 million cap after starting the fundraising process in May. Coleman credits reaching the target in a quick three months to investors "who are confident and excited about the quality of the team and portfolio we have assembled since launching the firm in the summer of 2015."

That said, he noted that investors are becoming more demanding and selective, asking for more transparency from the managers of funds.

"Increased selectivity and the demand for more transparency on the part of GPs has been a one-way trend in the industry over the past five to 10 years, and one we expect to continue," Coleman said. "We take a true partnership approach with our limited partners, and strive to maintain open, responsive and transparent communication with them. Not only do we believe it's the right thing to do, but building constructive, long-term relationships with our partners is critical to building a lasting franchise."

Most fund managers would say that ultimately, LPs want net returns that meet or outperform the benchmarks they have set internally for the asset class they are investing in.

"My view is that it is the GPs' job to determine how to deliver those returns, whether it be by investing in oil vs. gas, Permian vs. other shale basins, or other criteria," Coleman said.

It has been widely observed that there are more sellers than buyers these days. Some managers have had to increase cycle times, seek new types of buyers including other PE funds, or otherwise modify their exit strategies.

"Crowded private marketplaces are a fact of life across all industry sectors, not just E&P, and are the result of monetary policy actions and economic expansion since the Great Recession."

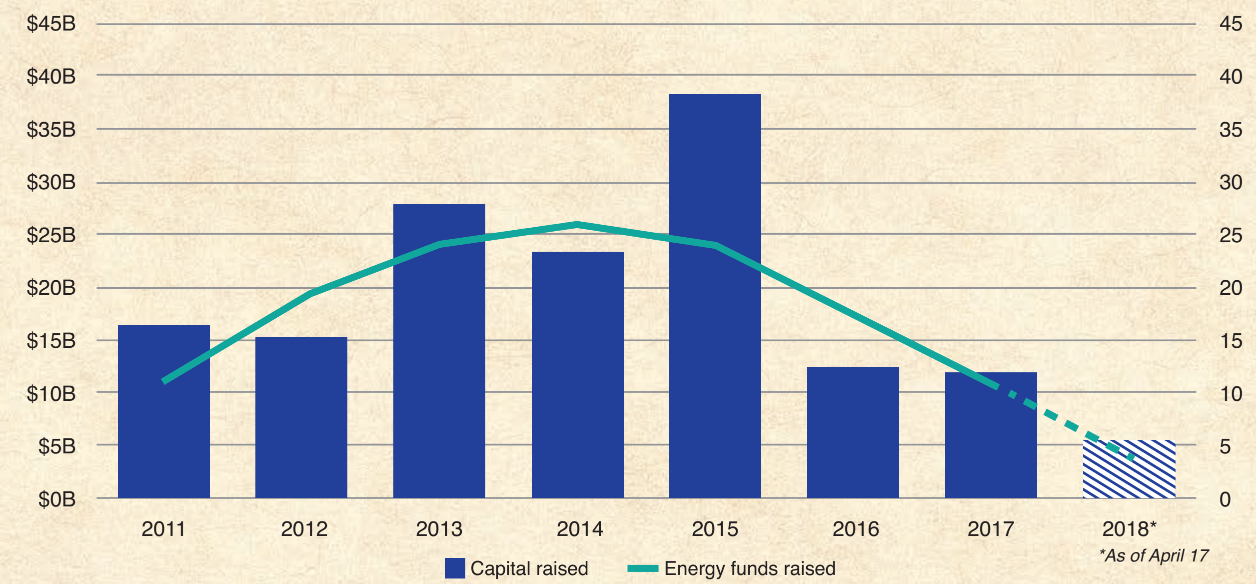
Stewart Coleman,
Managing director,
Pearl Energy Investments

"We have been careful not to make investment decisions that are contingent upon the ability to flip or exit an asset in a 12- to 18-month period," Coleman said.

"If we happen to sell something quickly because of certain market dynamics, that's great, but when we underwrite assets and determine how to best capitalize them, we do it with a long-term hold in mind."

There has also been some new awareness of subscription financing as a tool to cover short-

PUBLIC EQUITY AND ENERGY FUNDS RAISED, 2011-2018



Source: PitchBook

term needs and reduce the number of capital calls. It has been more common in real estate but some note its use in energy funds.

"I think the use of subscription lines has become relatively common across private equity, with the real difference being in how they are used," Coleman said. "Whereas some firms, like Pearl, utilize these lines on a very short-term basis to ease the administrative burden of multiple small capital calls, you have seen others take a more aggressive approach and use these facilities to inflate internal rates of return by delaying capital calls for longer periods."

Creative ways to monetize

Early in 2017, at a time when public markets were starting to become more selective in their view of public operators buying upstream assets, Kayne Anderson Energy Fund (KAEF) VI closed several successful asset sales, including the sale of Panther Energy Co. II's Delaware Basin assets to WPX Energy Inc. Even more notable, KAEF has already formed its next venture with the team to pursue investments in the Permian and Midcontinent regions.

Today, public markets are much less receptive to public E&P operators acquiring upstream assets. Chuck Yates, managing partner at KAEF, recalled a recent conversation with an investor on this topic. "He said he used to pay me to find opportunities to buy. Now he pays me to find creative ways to monetize these opportunities."

Finding a buyer for assets in a hot basin and then immediately finding new acreage with upside potential in the same hot basin seems like a neat trick. Investors alongside KAEF performing "smaller, niche, pure middle-market-focused hard work [that was] needed to find attractive entries into core rock" can now also appreciate KAEF's portfolio companies' ability to tap into economic extensions of core acreage as well as simply overlooked rock.

"We are willing to hustle for smaller core-of-the-core positions even if it takes us a year or more to close the deal," Yates said. "It is worth it to us, even if it may not be to a bigger operation. The second category of assets we seek is extensions of the core. At KAEF, half of our partners are engineers; this provides us with a deep understanding of the technical risks and potential reward when our portfolio companies look to extend the economic boundaries of a known core play."

He added, "We have sent capital calls to investors to fund Midland Basin delineation drilling pushing the boundaries in Howard County [Texas], and we received phone calls asking if we were serious. We replied: 'Stick with us on this core-plus approach.'"

The third category of asset the firm likes to target is in underappreciated areas. "Remember in the spring of 2016 the U.S. was down to about 350 oil rigs running?" Yates recalled. "People were talking [about how] the only good rock in the country was in 12 or 15 counties in the Permian, Scoop or Stack, and maybe one in the [Denver-Julesburg] Basin? Well that was not the only good rock. There were lots of other reasons why development was cut back around the country. To be active, an operator has to have a clean balance sheet, supportive funding and good service contracts."

As an example, Yates cited the Powder River Basin, where there were 33 rigs running in the spring of 2014 and none by the spring of 2016. "The narrative was 'bad rock.' But look at who was running those rigs. One large operator in the area had balance-sheet problems. Another shifted its focus to the Permian, but that only meant the Permian was a better move for that company at that particular time. Then there are a lot of mom-and-pop operators that just don't drill when prices are low. None of that necessarily means it is bad rock."

"Stick with us on this core-plus approach."

Chuck Yates,
Managing partner,
Kayne Anderson

Broadly, Yates said, Kayne Anderson seeks to establish a position in underappreciated areas before the greater industry buys in.

"Look at the Texas Panhandle. It was carpet-bombed for gas at the height of the shale boom. There were something like 5,600 horizontal wells drilled in the Granite Wash, Cleveland and Tonkawa. But not many of those were more than 4,500-foot laterals. Today's long laterals have not touched the Panhandle."

At a time when oil prices have recovered about half of what they lost from the peak, investors seek to make money on a risk-adjusted basis, Yates said. "They invest to make money, but they are alert to how it is made. Beyond that, some prefer to buy production, while others are looking for investments in specific basins or specific sectors such as E&P, midstream or services." ■

SEVEN MONTHS OF SELECTED FINANCING DEALS

The deals presented here are from fourth-quarter 2017 through April 2018. They represent top financing agreements for that time frame.

Conditions for raising public equity continued to be tough in second-half 2017 and in the first quarter of 2018, with many issuers having to offer deep discounts from their prior day closing prices—even though many of these offerings were upsized. Private equity fundraises continued to be fairly strong as most limited partners renewed their commitments with general partners. The markets remained open for senior debt offerings. The few IPOs were for service and supply companies.

PRIVATE EQUITY FUNDRAISES

Company	Amount ($MM)	Comments
EnCap Investments LP	$7,000	Growth capital for upstream.
EnCap Flatrock Midstream Fund IV	$3,250	Growth capital for midstream.
Kimmeridge Energy Management Fund IV	$650	Invest in unconventional assets and equities.
Post Oak Energy Capital LP	$600	Support North American oil and gas companies, oilfield infrastructure.

PRIVATE EQUITY COMMITTED/DEPLOYED

Company	Amount ($MM)	Comments
Double Eagle Energy Holdings III	$1,000	**Apollo Global Management**; Permian focus.
Luxe Energy LLC	$820	NGP Natural Resources Fund XI.
ATX Energy Partners	$780	**Warburg Pincus, Yorktown Partners, Pine Brook**. Successor to Brigham. Emerging unconventional plays.
FourPoint Energy LLC	$525	**Quantum Energy Partners** and existing equity holders.
CrownRock Holdings LP	$475	**Magnetar Capital, EIG Global Energy Partners**. Closed on perpetual preferred equity.
Black Stone Minerals LP	$300	Cumulative convertible preferred issued to **The Carlyle Group**.
Pegasus Resources LLC	$300	**EnCap Investments**. To pursue minerals.
Ridge Runner Resources LLC	$300	**Warburg Pincus**. Delaware Basin focus.
Bayswater E&P LLC	$390	Raised third fund; will develop acreage in D-J & Midland basins.
Stronghold Energy II Holdings	$150	**Warburg Pincus**; Central Basin Platform.

PUBLIC EQUITY

Company	Amount ($MM)	Comments
Black Stone Minerals LP	$300	**BofA Merrill Lynch**, et al.
Matador Resources Co.	$82	**SunTrust Robinson, Seaport Global Securities**, et al.
Halcon Resources Corp.	$55.2	**J.P. Morgan**; Delaware Basin.

IPOs

Company	Amount ($MM)	Comments
Cactus Inc.	$405.8	**Citigroup, Credit Suisse**, et al.
FTS International	$403.6	**Credit Suisse, Morgan Stanley**, et al.
Sentinel Energy Services Inc.	$300	SPAC. **Citigroup, Goldman Sachs**.
Liberty Oilfield Services Inc.	$194.5	**Morgan Stanley, Goldman Sachs**, et al.
Nine Energy Service Inc.	$161	**J.P. Morgan, Goldman Sachs, Wells Fargo**, et al.
Oasis Midstream Partners LP	$119	**Morgan Stanley, Wells Fargo**, et al.
Quintana Energy Service Inc.	$92.5	**BofA, Simmons**, et al.

PUBLIC DEBT

Company	Amount ($MM)	Comments
EQT Corp.	$3,000	Priced 4 tranches of notes. **Citigroup, Deutsche Bank**, et al.
Concho Resources Inc.	$1,800	Priced 2 tranches of senior unsecured notes.
Southwestern Energy Co.	$1,150	Series of senior unsecured notes. **BofA, J.P. Morgan, Citigroup**, et al.
Whiting Petroleum Corp.	$1,000	Senior notes at 6.625% due 2026.
PDC Energy Inc.	$600	Senior unsecured notes at 5.75% due 2026.

PRIVATE DEBT PLACEMENTS

Company	Amount ($MM)	Comments
CrownRock LP	$1,000	Senior notes due 2025 at 5.625%.
Continental Resources Inc.	$1,000	Senior unsecured notes at 4.375% due 2028.
Chesapeake Energy Corp.	$850	Senior notes at 8% due 2025.
Parsley Energy LLC	$700	Senior unsecured at 5.625% due 2027.
Extraction Oil & Gas Inc.	$750	Senior unsecured notes at 5.625%.
Indigo Natural Resources LLC	$650	Senior unsecured notes, upsized at 6.875%.
Jonah Energy LLC	$600	Senior unsecured notes at 7.25%, upsized.
SRC Energy Inc.	$550	Senior unsecured notes due 2025.
Vine Oil & Gas LP	$530	Senior unsecured notes due 2023 at 8.75%.
Sanchez Energy Corp.	$500	Senior secured first-lien notes at 7.25%.
Centennial Resource Development Inc.	$400	Senior unsecured notes due 2026.
Covey Park Energy LLC	$175	Senior notes at 7.5%.

Details on these and many more deals are available in a real-time searchable database at oilandgasinvestor.com.

QUESTIONS TO ASK BEFORE AN IPO

Are there advantages to going public? Certainly, but senior management should ask some basic questions first.

By Hillary H. Holmes, Gerry Spedale and James Chenoweth

There are two truisms about IPOs. Market opportunity windows open and close quickly and preparation and execution are necessary for success.

Private investors in the E&P or midstream business will seek the liquidity and value uplift provided by an IPO throughout the next year, but management must be prepared and nimble. With these factors in mind, we offer high-level thoughts on four practical questions often asked in advance of an IPO.

1. What are the benefits?

Cash—The most obvious benefit from an IPO is the receipt of a large amount of cash. If the issuer is selling the equity, a primary offering, it may choose to use the cash received to fund growth through an acquisition, expansion of facilities or paying down debt.

Private-equity sponsors and founding shareholders often sell part of the equity in the IPO as a way to partially exit their investment, a secondary offering. Recent energy IPOs have involved sales by both the issuer and the private-equity shareholders.

Access to capital—A business typically experiences a market value increase upon closing an IPO and, ideally, for a time thereafter, although this is not guaranteed. A public company can raise cash for its capital needs by issuing securities in the public markets or privately—presumably at a higher price than it could as a private company. The liquidity of its equity provides access to a greater universe of investors and even makes obtaining bank financings easier.

In addition, public equity can be an attractive currency in acquisitions by reducing the company's need for cash or debt and providing an attractive tax deferral for the target's shareholders.

Equity compensation—Equity-based compensation is used to attract, motivate and retain key employees. Stock options or other equity-based grants for private companies can be a risky proposition if the business is unsuccessful or if it never reaches liquidity.

An E&P or midstream business typically experiences a market value increase upon IPO and, ideally, for a time thereafter.

The ability to sell the shares underlying the equity compensation in the stock market provides more visibility to actual cash returns, making the compensation more attractive.

Publicity—IPOs often make the business known to a new group of potential investors and industry relationships. During the IPO process, underwriters aim to place the shares with high-quality, longer-term investors, a move intended to contribute to stability in the market value.

The company will also develop relationships with research analysts, who increase public awareness of the company through ongoing research coverage and provide feedback to management over time.

After the IPO, the company will provide continuing disclosure through U.S. Securities and Exchange Commission (SEC) filings, quarterly earnings calls and investor presentations on the active conference circuit.

2. What are the costs?

Compliance and disclosure—The other side of being able to access capital from the public is being required to publicly disclose sufficient information. Companies that are publicly traded are subject to detailed disclosure laws about their financial condition, operating results, management compensation and other areas of their business.

The underlying basis of the SEC's reporting requirements is to keep markets informed on a regular basis, in a transparent manner. The company must not only disclose positive information but also adverse events and risks. It must put in place disclosure controls and procedures and internal control over financial reporting and disclose the effectiveness of these controls.

These disclosure and control requirements are extensive, increase general and administrative expense and require liability management. Establishing the processes necessary to meet these obligations is a significant undertaking and may require hiring personnel or consultants. It is beneficial to address them systematically over time rather than all at once.

Less control—Even if the sponsor or original owners maintain control of the board of directors of the issuer, whether through an MLP structure or by owning more than 50% of the public equity, the public company must comply with certain governance requirements after the IPO. Among other requirements, the company must maintain an audit committee comprising three independent directors and, depending on its structure, may be required to have a majority independent board.

3. What should I expect from the SEC process?

Management should understand and review with securities counsel the technical aspects of the SEC process, which are covered in the *Gibson Dunn IPO Guidebook*. We also offer the following insights:

Current SEC climate—The regulatory climate is good for IPOs. Between the JOBS Act of 2012 and the FAST Act of 2015, Congress has taken significant steps to lessen the disclosure and accounting burden of an IPO process.

21%
Coporate tax rate

Tax On $100 Of Earnings

	2017	2018-2025	2026 and Beyond
Corporations & Shareholders (combined)	$50.47	$39.80	$39.80
MLP Unitholders	$43.40	Effectively $33.40	$43.40
Delta	$7.07	$6.40	($3.60)

100%
Bonus Depreciation

PV-10 Of Depreciation Deductions

	35% Rate	21% Rate	Expensing
Gathering System (7-year MACRS)	$0.28	$0.17	$0.21
Unregulated Pipeline (15-year MACRS)	$0.20	$0.12	$0.21

**Regulated business excluded*
**Phases out in 20% increments annually beginning 2023 until it is zero in 2027*

Tables courtesy Gibson, Dunn & Crutcher

The SEC has also taken steps to affirmatively encourage capital formation, the new chairman of the SEC has expressed a desire to see more publicly traded companies, and the number of staff comments seems to have decreased. The staff has also expressed a willingness to review requests for waivers of certain financial statement requirements. There are also new proposals to simplify disclosure and rulemaking, which could streamline the IPO process further over the course of the next year.

SEC review—Every IPO registration statement will be reviewed by the SEC's Division of Corporation Finance. Typically, one attorney and one accountant are assigned to a registration statement. Open dialogue between counsel and the staff will be important.

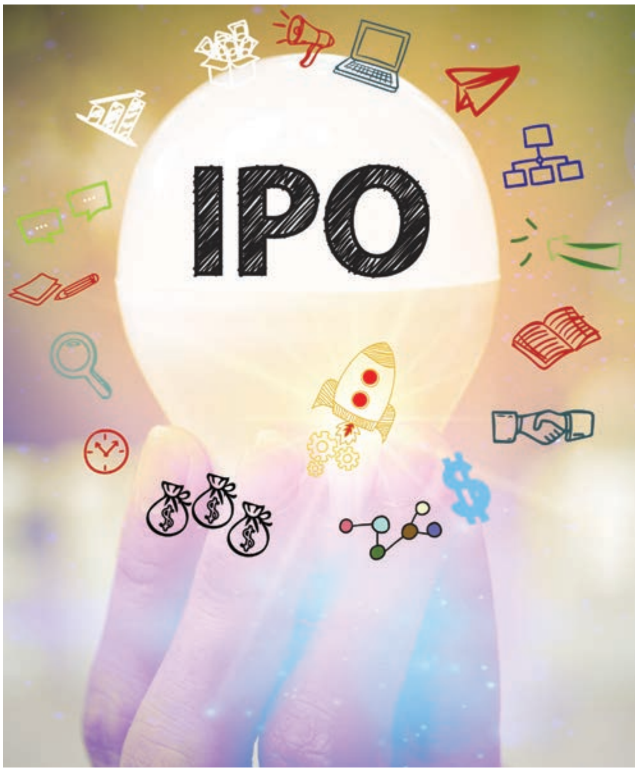
The review process is one of comment on disclosure, not merit. The SEC does not pass on the quality of the company. The staff asks questions and makes comments about the registration statement and related offering materials. The staff also might suggest more disclosure on a certain topic, and might require additional information to ensure that the company complies with the disclosure rules.

Expect comments on the first filing in 30 days and half the response time for each subsequent amendment (i.e., 30 days, 15 days, seven to eight days). The review process will be longer if new financial statements are required or the staff issues difficult accounting comments.

Hot-button issues—When preparing the registration statement and its financials, anticipate the SEC's hot-button issues. Areas of focus in disclosure currently include cybersecurity risks and their management, fulsome but tailored risk-factor disclosure, the impact of tax law changes, related-party transactions and non-GAAP financial measures.

Areas of focus in accounting include cheap stock (i.e., granting stock to employees pre-IPO at below-market value even if market value is increased as a result of the IPO valuation), reporting segments and the new revenue recognition standard. If there are any questions, a pre-filing conference with the staff can make the review process more efficient.

Financial statements—One of the key areas of delay is the availability of financial statements. This is particularly true when the company has built its business through acquisition of businesses over time. The company will be required to present two or three years of GAAP financial statements, audited and reviewed in accordance with Public Company Accounting Oversight Board (PCAOB) and SEC standards.



The company may also be required to present financial statements for recently acquired businesses. In light of the critical nature of financial statements in the IPO process, in the two or three years before the IPO it is helpful to engage a PCAOB audit firm to review financial statements on a quarterly basis.

Changing auditors at the time of the IPO causes delay and expense. In addition, M&A agreements should provide the company with the right to receive financial statements of the target that are required, or deemed appropriate, under securities regulations.

Communications—It is important to understand and educate all company personnel about the limitations on communications in specified periods before, during and after the IPO process. The rules around communications are strict and can be tough to navigate, particularly given that most companies keep registration statements confidential until a few weeks before launching the IPO.

There are acceptable methods for communicating with the market in advance of the IPO (e.g., "testing the waters" meetings with investors in emerging growth companies).

Regular communications with customers and others may also be acceptable if proper protocols are followed. The SEC and plaintiffs' lawyers are monitoring these communications, and the SEC will ask for copies of certain materials.

Violation of communications rules can result in a delay in the IPO process, rescission rights for investors in the IPO and liability for the company.

The SEC review process is one of comment on disclosure, not merit.

4. What is the impact of tax reform?

We cannot overstate tax reform's impact on domestic growth, including in the midstream sector, which may impact the timing of the IPO. Tax can seem complex, but one can remember two of tax reform's largest drivers of such growth with two numbers: 21% and 100%.

21%—A large, and notably, permanent, change in tax reform was the reduction of corporate tax rates from 35% to 21%. One rarely sees such a deep reduction in corporate tax rates and even more rarely sees it as a permanent item now that so many tax changes occur through the budget reconciliation process, which often necessitates sunset provisions.

The 21% rate changes the comparative after-tax benefits of flow-through and corporate structures—possibly permanently.

The accompanying table shows the amount of federal taxes payable by corporations and their shareholders relative to those of flow-through MLP unitholders. Under prior law, the delta was approximated $7.07 per $100 of earnings (assuming the corporation distributes all of its after-tax earnings or has sufficient shareholder turnover such that shareholders regularly pay long-term capital gains taxes).

Tax reform mitigates that $7 benefit during the period of 2018-2025 because of the new 21% corporate tax rate, and a new 20% trade or business deduction on flow-through income does not entirely overcome the difference.

Note the 20% deduction has certain limitations, but MLP unitholders generally receive its benefit, resulting in an effective 33.4% tax rate.

Importantly, the tax preference for flow-through taxation flips in 2026 and beyond if the sunset provisions take effect. This could be a dubious assumption, given that sunsetting taxpayer-favorable provisions often get extended as lawmakers kick budgetary concerns down the road.

A number of federal elections before 2026 will impact the direction of tax laws and this delta between MLPs and corporations, two midterm (2018 and 2022) and two presidential (2020 and 2024).

Political uncertainty means one can only guess as to how much MLPs' $6.40 tax benefit on $100 earnings remains long-term.

100% bonus—The new 100% bonus depreciation rule will also drive domestic growth. The tax code has had bonus depreciation for years, but never a rule this generous, to apply to all of the costs and to pre-existing assets that are out there in the market.

Under the new rule, a taxpayer may take a full deduction even for buying a used pipeline from a third party.

The accompanying table illustrates the value of the deduction by comparing the PV-10 of the tax benefits of placing in service a gathering or interstate pipeline asset under general depreciation rules, which at a 21% tax rate amounts to about 17 cents and 12 cents, respectively, on every dollar of investment. The 100% bonus enhances that tax value to 21 cents on the dollar.

Note that the rule excludes regulated gas businesses from bonus. To explain why, it is best to understand a regulated business, like an electric utility. A utility wants to be excluded from bonus depreciation because a utility must pass the tax benefit through to its rate payers anyway. Any bonus depreciation would not spur new domestic investment, and to pay for bonus depreciation, the government raises revenue with a limitation on the deductibility of interest expense in a trade or business, and that limitation would hurt electric utilities. Therefore, electric utilities are excluded from bonus depreciation and avoid new limitations on interest deductibility.

Natural gas (but not crude oil) pipelines get caught up in the same regime if a gas pipeline's rates or prices charged to customers are approved or directly set by federal, state or local agencies—essentially capturing them in the electric utility exception. ■

PV-10 Of Depreciation Deductions

	35% Rate	21% Rate	Expensing
Gather system, 7-year MACRS*	$0.28	$0.17	$0.21
Unregulated Pipeline, 15-year MACRS	$0.20	$0.12	$0.21

** Modified Accelerated Cost Recovery System*

The authors are partners in the Houston office of Gibson, Dunn & Crutcher.

WHO'S WHO IN ENERGY FINANCE
A DIRECTORY

I = Investment banking;
C = Commercial banking;
M = Mezzanine;
P = Private equity/debt;
A = Adviser

The information included here is considered accurate to the best abilities of the editorial staff. To submit corrections or information, contact Erin Pedigo at epedigo@hartenergy.com.

A

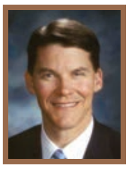
ABN AMRO Bank USA (I)
Darrell Holley
Managing Director - Global Head of Oil & Gas
972-543-6404
darrell.holley@abnamro.com
5800 Granite Parkway, Ste. 265
Plano, TX 75024

ACON Investments (P)
Mo Bawa
Partner
202-454-1100
mbawa@aconinvestments.com
1133 Connecticut Ave. NW, Ste. 700
Washington, DC 20036

Aegis Energy Advisors Corp. (I)
James Smith
Managing Director
212-245-2552
jsmith@aegisenergy.com
708 Third Ave., 6th Floor
New York, NY 10017

Aldwych Capital Partners (I, P, M)
Steven Cowan
Managing Director, Co-Head of Energy
832-390-2563
scowan@acpfn.com
700 Louisiana St.
Houston, TX 77002
Preferred deal size: $10MM-$20MM

AltaCorp Capital (A, I)
Leslie Kende
Managing Director, A&D
403-539-8622
lkende@altacorpcapital.com
410, 585 – 8 Avenue SW
Calgary, AB T2P 1G1

Amegy Bank of Texas (C, I, M)

Steve Kennedy
Executive Vice President & Head of Energy Banking
713-235-8870
steve.kennedy@amegybank.com
4400 Post Oak Parkway
Houston, TX 77027
Preferred deal size: $10MM-$50MM, up to $300MM via syndication

Angelo Gordon & Co. (P)

Todd Dittmann
Managing Director
713-999-4320
tdittmann@angelogordon.com
712 Main Street, 13th Floor
Houston, TX 77002

Apollo Global Management LP (M, P)

Gregory A. Beard
Global Head of Natural Resources
212-822-0750
gbeard@apollolp.com
9 West 57th St., 48th Floor
New York, NY 10019
Preferred deal size: $25MM mezz: up to $3B PE

ARC Financial Corp. (P)
Rob Cook
Managing Director
403-292-0390
rcook@arcfinancial.com
4300, 400-3 Ave. SW
Calgary, AL T2P 4H2
Preferred deal size: $50MM-$200MM

Arcadius Capital Partners (P)
Tym Tombar
Managing Director
713-437-5068
ttombar@arcadiuscapital.com
711 Louisiana St., Ste. 1400
Houston, TX 77002

ArcLight Capital Partners (P)
Daniel Revers
Managing Partner & Founder
617-531-6300
drevers@arclightcapital.com
200 Clarendon St., 55th Floor
Boston, MA 2116

Ares Management LP (P)
Nate Walton
Partner, Co-Head of North American Private Equity
310-201-4100
nwalton@aresmgmt.com
2000 Avenue of the Stars, 12th Floor
Los Angeles, CA 90067

Argus Energy Managers (P)
Charles Cherington
Managing Partner/Co-Founder
713-337-9150
charles@argusem.com
109 N. Post Oak Lane, Ste. 530
Houston, TX 77024

Associated Bank (C)

Tim Brendel
Head of Oil & Gas Banking
713-588-8205
timothy.brendel@associatedbank.com
333 Clay St., Ste. 2823
Houston, TX 77002

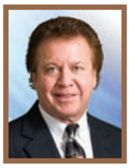
B

Bank of America Merrill Lynch (A, I)

Mark DeVito
Managing Director,
Global Energy & Power
646-855-2988
mark.devito@baml.com
One Bryant Park, 22nd Floor
New York, NY 10036

Barclays (A, C, I, M, P)

Steve Almrud
Managing Director
713-401-6800
steven.almrud@barclays.com
Fullbright Tower
1301 McKinney St., Ste. 400
Houston, TX 77010

Bay Capital Corp. (M)

Rob Lindermanis
Owner
832-980-8074
robl@baycapcorp.net
4400 Post Oak Parkway,
Ste. 2100
Houston, TX 7727

Bayou City Energy Management LLC (P)

William McMullen
Founder &
Managing Partner
713-400-8200
will@bayoucityenergy.com
1201 Louisiana St., Ste. 3308
Houston, TX 77002
Preferred deal size: $5MM-$50MM

BB&T Capital Markets (C, I)

Jeff Forbis
Senior Vice President,
Corporate Banking
Team Leader
713-797-2141
jforbis@bbandt.com
330 Clay St., Ste. 3800
Houston, TX 77002
Preferred deal size: $10MM+

BBVA Compass (C, I, M)
Kathleen J. Bowen
Managing Director,
Oil & Gas Finance
713-968-8273
kathy.bowen@compassbank.com
15 20th St. South
Birmingham, AL 35233

Benefit Street Partners (P)

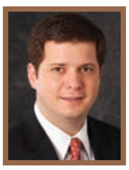
Tim Murray
Managing Director
& Head of Energy
Origination
713-345-4610
tim.murray@provequity.com
1401 McKinney St., Ste. 1825
Houston, TX 77010

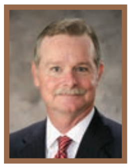
Blackgold Capital Management (P, M)
Christopher Jacobe
Director, Client Solutions
832-871-4233
cjacobe@blackgoldcap.com
109 N. Post Oak Lane, Ste. 500
Houston, TX 77024

Blackstone Energy Partners (P)
Angelo Acconcia
Sr. Managing Director
212-538-5211
acconcia@blackstone.com
345 Park Ave., Ste. 1100
New York, NY 10154

BlueRock Energy Partners (M, P)

Stuart Rexrode
Managing Partner
281-376-0111 x305
srexrode@bluerockep.com
20445 State Highway 249
3 Chasewood Park, Ste. 160
Houston, TX 77070
Preferred deal size: $1MM-$10MM

BMO Capital Markets (I)

Jon Marinelli
Group Head, Investment
& Corporate Banking,
U.S. Energy
713-223-4400
Jon.marinelli@bmo.com
700 Louisiana St., Ste. 2100
Houston, TX 77002
Preferred deal size: $50MM+

BOK Financial (C)

Mickey Coats
Executive Vice President
918-588-6409
mcoats@bokf.com
One Williams Center
Tulsa, OK 74172

BSI Energy Partners (P)
Jeff Katersky
805-850-0177 x107
jkatersky@bsienergypartners.com
1746-F S. Victoria Ave., Ste. 382
Ventura, CA 93003
Preferred deal size: $1MM-$10MM

Brycap Investments Inc. (P)
Harrison Holmes
Vice President
469-248-3089
hholmes@brycap.com
2602 McKinney Ave., Ste. 200
Dallas, TX 75205
Preferred deal size: $10MM- 50MM

C

Capital One Energy Banking (C)
Bob Mertensotto
Senior Managing Director
713-435-7200
1000 Louisiana St., Ste. 2950
Houston, TX 77002

Capital One Securities (A, I)
Pierre E. Conner III, P.E.
Head of Research Sales & Trading
504-593-6108
pierre.conner@capitalone.com
909 Poydras St., Ste. 1000
New Orleans, LA 70112

Capital One Energy Banking (C)
Russell Johnson
Senior Vice President & Head of
Energy Origination
713-435-5342
Russell.johnson@capitalone.com

1000 Louisiana St., Ste. 2950
Houston, TX 77002

Carlyle Group LP (P, M)
Rahul Culas
Managing Director &
Co-Head of Energy
Credit Group
212-813-4564
rahul.culas@carlyle.com
520 Madison Ave.
New York, NY 10022

Carnelian Energy Capital (I)
Thomas Ackerman
Partner
713-322-7310
info@carnelian.com
2229 San Felipe, Ste. 1450
Houston, TX 77019

Castlelake (P)
Luke Beltnick
Partner
612-851-3000
4600 Wells Fargo Center

90 South Seventh St.
Houston, TX 77019

Cathay Bank (C)
Dale Wilson
Senior Vice President
832-517-6151
Dale.wilson@cathaybank.com
9440 Bellaire Blvd., Ste. 118
Houston, TX 77036

CCMP Capital Advisors LLC (P)
Will Jaudes
Principal - Energy
281-363-2013
william.jaudes@ccmpcapital.com
24 Waterway Ave., Ste. 750
The Woodlands, TX 77380
Preferred deal size: $25MM+

Chambers Energy Capital (I)
Phillip Pace
Partner
713-554-6773
info@chambersenergy.com

600 Travis St., Ste. 4700
Houston, TX 77002

Chiron Financial LLC (I)
Scott Johnson
Managing Director
713-929-9081
sjohnson@chironfinance.com
1301 McKinney St., Ste. 2800
Houston, TX 77010
Preferred deal size: $10MM-$500MM

CIBC (A, I)
Jordan Horoschak
Managing Director – Energy
Investment Banking
713-452-1593
jordan.horoschak@cibc.com
1001 Fannin St., Ste. 4450
Houston, TX 77002

Cibolo Energy Partners (P)
J.W. Sikora
Managing Partner
713-357-7570
jw@ciboloenergy.com

1455 W. Loop South, Ste. 230
Houston, TX 77027

CIT Energy Finance (C, I)
Mike Lorusso
Managing Director & Group Head
212-771-6002
Mike.Lorusso@cit.com
11 West 42nd St., 11th Floor
New York, NY 10036

Citi (A, I, C)
Steve Trauber
Vice Chairman and
Global Head of Energy
713-821-4800
Stephen.trauber@citi.com
811 Main St., Ste. 3900
Houston, TX 77002

Comerica Inc. (C)
Mark Fuqua
EVP
214-462-4424
mfuqua@comerica.com
P.O. Box 650282
Dallas, TX 75265
Preferred deal size: $10MM+

Conquest Structured Products (P)
Dave McAdams
Business Development
214-219-7555
dave@coquest.com
12222 Merit Drive, Ste. 1130
Dallas, TX 75251

Coral Reef Capital (P)
Jared Powell
Partner
646-599-9676
contact@coralreefcapital.com
45 Rockefeller Plaza, Ste. 2300
New York, NY 10111

Credit Agricole (C, I)
Patrick de Talance
Managing Director/Head
713-890-8601
Patrick.detalance@ca-cib.com
1100 Louisiana St.
Houston, TX 77002

Credit Suisse Securities (USA) (I)
Tim Perry
Global Co-Head of
Oil & Gas
713-890-1400
timothy.perry@
credit-suisse.com
700 Louisiana St.
Houston, TX 77002

Crestmark Bank (C)
Steve Hansen
Regional First Vice President,
West Division Sales Manager
713-628-0101
shansen@crestmark.com
5480 Corporate Dr., Ste. 350
Troy, MI 48098

CrossFirst Bank (C)
Henry Smith
918-497-5225
Henry.smith@crossfirstbank.com
7120 S. Lewis Ave.
Tulsa, OK 74136

CSG Investments Inc. (P)
Hans Hubbard
Managing Director
713-353-4642
hhubbard@csginvestments.com
6000 Legacy Drive
Plano, TX 75025
Preferred deal size: $50MM-$550MM

CSL Capital Management (P)
Charlie Leykum
Managing Partner
281-407-0686
charlie@cslenergy.com
1000 Louisiana St., Ste. 3850
Houston, TX 77002
Preferred deal size: $10MM-$50MM

D

Denham Capital Management (P)
Jordan Marye
Managing Partner
713-217-2700
Jordan.marye@
denhamcapital.com
700 Louisiana St., Ste. 3700
Houston, TX 77002

Development Capital Resources (M, P)
Ronnie Scott
President & CEO
713-568-5310
rscott@dcrlp.com
712 Main St., Ste. 920
Houston, TX 77002
Preferred deal size: $100MM-
$800MM

Donovan Ventures LLC (A, P)
John W. Donovan Jr.
Founder
713-812-9887
jwd@dv-llc.com
2121 Sage Rd., Ste. 225
Houston, TX 77056
Preferred deal size: $25MM-$50MM

Drillcore Energy Partners LLC (P)
Evan Turner
Managing Partner
203-822-3024
Evan.turner@drillcorePartners.com

E

East West Bank (C)
Christina Kitchens
Managing Director of
National Energy Finance
469-801-73667
christina.kitchens@
eastwestbank.com
5001 Spring Valley Rd., Ste. 825W
Dallas, TX 75244
Preferred deal size: $5MM-$500MM

Edge Natural Resources (P)
Roy Aneed
Partner
214-774-9635
info@edgenr.com
5950 Berkshire Lane, Ste. 1000
Dallas, TX 75225
Preferred deal size: $25MM-$75MM

EIG Global Energy Partners (M, P)
Rob Chuchla
Associate - Oil & Gas
713-615-7400
rob.chuchla@eigpartners.com
333 Clay St., Ste. 3500
Houston, TX 77002

EnCap Flatrock Midstream (P)
Bill Waldrip
Managing Partner & Founder
210-494-6777
bw@efmidstream.com
1826 North Loop 1604 W, Ste. 200
San Antonio, TX 78248

EnCap Investments LP (P)

Murphy Markham
Managing Partner
214-599-0800
mmarkham@encapinvestments.com
3811 Turtle Creek Blvd., Ste. 2100
Dallas, TX 75219
Preferred deal size: $10MM-$100MM

Energy Capital Solutions LP (A, P)
Russell Weinberg
Managing Director
214-219-8201
rweinberg@nrgcap.com
2651 N. Harwood St., Ste. 410
Dallas, TX 75201
Preferred deal size: $20MM-$1B

Energy Special Situations Fund (P)
Jonathan S. Linker
Founder
713-869-0077
jlinker@essfunds.com
1801 Patterson St.
Houston, TX 77007

Energy Spectrum Capital (P)
James P. Benson
Managing Partner
241-987-6103
jim.benson@energyspectrum.com
5956 Sherry Lane, Ste. 900
Dallas, TX 75225
Preferred deal size: $5MM-$50MM

Energy Trust Partners (P)
Leland White
Founding Partner
214-987-6104
leland.white@energyspectrum.com
5956 Sherry Lane, Ste. 900
Dallas, TX 75225
Preferred deal size: $5MM-$50MM

Enstream Capital (A, I, M, P)
Daniel Mooney, CPA, CFA
Managing Director
214-468-0900
dmooney@enstreamcapital.com
5646 Milton St., Ste. 318
Dallas, TX 75206
Preferred deal size: $20MM-$200MM

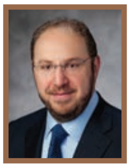
Entoro Capital LLC (A, I)

James C. Row, CFA
Managing Partner
713-823-2900
jrow@entorocapital.com
4900 Woodway Dr.,
Ste. 1100
Houston, TX 77056

EV Private Equity (P)
Anoop Poddar
Senior Partner
281-768-6725
10777 Westheimer, Ste. 1175
Houston, TX 77042

Evercore (I, P)
Curtis Flood
Vice President
(713) 427-5706
Curtis.Flood@Evercore.com
2 Houston Center, Ste. 1700
909 Fannin St.
Houston, TX 77010

F

First Reserve Corp. (P)

Neil A. Wizel
Managing Director -
Houston
713-227-7890
nwizel@firstreserve.com
600 Travis St., Ste. 6000
Houston, TX 77002

First Tennessee Bank (C)

John Lane
Executive Vice President
832-839-5556
jblane@ftb.com
3009 Post Oak Blvd.,
Ste. 1210
Houston, TX 77056

Five Point Capital Partners (P)
Matt Morrow
Managing Partner
713-351-0703
matt@fivepointcp.com
825 Town & Country Lane, Ste. 700
Houston, TX 77024

Five States Energy Capital (M, P)
Thomas Edwards
Business Development Associate
972-860-1183
tedwards@fivestates.com
4925 Greenville Ave., Ste. 1220
Dallas, TX 75206
Preferred deal size: $1MM-$25MM

Frost Bank (C)
Elise Nieser
Associate Relationship Manager,
Energy Finance
713-388-7757
elise.nieser@frostbank.com
1 BLVD Place
1700 Post Oak Blvd., Ste. 300
Houston, TX 77056

G

Galway Capital LP (I, A)
Hal Miller
Chairman
713-952-0186
hmiller@galwaygroup.com
3009 Post Oak Blvd., Ste. 950
Houston, TX 77056

Glendale Energy Capital (P)
Brent Grundberg
Head of Energy & Infrastructure
Capital
832-982-1100
bgrundberg@glendalecap.com
440 Louisiana St., Ste. 900
Houston, TX 77002

GMP Securities (I)
Harris Fricker
CEO
416-367-8600
harrisf@gmpsecurities.com
145 King St. West, Ste. 300
Toronto, ON M5H 1J8

Goldman Sachs & Co (I, P)
Suhail Sikhtian
Co-Head of Global Natural Resources
713-276-3512
suhail.sikhtian@gs.com
1000 Louisiana St., Ste. 550
Houston, TX 77002

GSO Capital Partners (M, P)
Larry Tharp
Managing Director
713-358-1367
Larry.Tharp@gsocap.com
1111 Bagby St., Ste. 2050
Houston, TX 77002

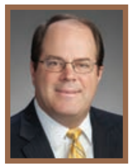
Guggenheim Partners (M, P)
Mike Beman
Director
713-300-1333
Mike.Beman@guggenheimpartners.com
1301 McKinney St.
Houston, TX 77002

H

Houlihan Lokey (A, I)
J.P. Hanson
Managing Director & Head of
E&P Group
212-497-4262
jphanson@HL.com
245 Park Ave., 20th Floor
New York, NY 10167

Huntington Bank (I)
Stephen Hoffman
Managing Director - Energy Banking
617-316-8910
stephen.hoffman@huntington.com
2 Oliver St.
Boston, MA 21109

I

IBERIABANK (C)

Bryan Chapman
Market President -
Energy Lending
713-624-7731
bryan.chapman@
iberiabank.com
11 Greenway Plaza, Ste. 2900
Houston, TX 77046
Preferred deal size: $10MM-$35MM

Imperial Capital (I)
Kevin Andrews
Managing Director, Head of Energy
713-892-5614
kandrews@imperialcapital.com
1330 Post Oak Blvd., Ste. 2160
Houston, TX 77056

Independent Bank (C)
Bob Glosson
Senior Vice President, Energy
214-720-1211
bglosson@ibtx.com
2100 McKinney Ave., Ste. 1200
Dallas, TX 75201

ING Capital LLC (C, I)
Charles Hall
Managing Director
713-403-2424
charles.hall@ing.com
1221 McKinney St. Ste. 3375
Houston, TX 77010

Intrepid Financial Partners (A)
Neil Chen
Vice President
646-979.3452
chen@intrepidfp.com
540 Madison Ave.
New York, NY 10022

IOG Capital LP (P)
Michael T. Arnold
Vice President
214-272-2702
marnold@iogcapital.com
2911 Turtle Creek Blvd., Ste. 900
Dallas, TX 75219
Preferred deal size: $50MM+

J

Jefferies (I)
Steve Straty
Head of Energy Corporate Finance
281-774-2145
sstraty@jefferies.com
3 Allen Center, 333 Clay St., Ste. 1000
Houston, TX 77002

Johnson Rice & Co. (I)
Joshua Cummings
Head-Energy Investment Banking
504-584-1247
cummings@jrco.com
639 Loyola Ave., Ste. 2775
New Orleans, LA 70113

JP Morgan (I)

Mike Lister
Group Head - Energy
Corporation Banking
214-965-2891
mike.lister@jpmorgan.com
2200 Ross Ave., 5th Floor
Dallas, TX 75201

Juniper Capital (P)
Richard K. Gordon
Partner
713-335-4715
rgordon@juncap.com
2323 S Shepherd Dr., Ste. 1150
Houston, TX 77019
Preferred deal size: $25MM-$75MM

K

Kayne Anderson Energy Funds (P)

Chuck Yates
Managing Partner- Energy
Private Equity Activities
713-493-2000
cyates@kaynecapital.com
811 Main St., 14th Floor
Houston, TX 77002

Kessey Capital Partners LLC (A)
Scott Kessey
Founder
713-385-8245
tpk@kesseycap.com
3016 Ella Lee Lane
Houston, TX 77019
Preferred deal size: $25MM-$50MM

KeyBanc Capital Markets (A, C, I)
Keith Buchanan
Managing Director, Head of Oil & Gas Investment Banking
713-221-3970
keith.buchanan@key.com
600 Travis St., Ste. 3100
Houston, TX 77002

Kimmeridge Energy (P)
Ben Dell
Managing Partner
646-517-7250
Ben.dell@kimmeridgeenergy.com
400 Madison Ave., Ste. 14C
New York, NY 10017
Preferred deal size: $10MM-$200MM

KKR (P)
David C. Rockecharlie
Member & Head of Energy
Real Assets
713-343-5142
David.rockecharlie@kkr.com
5051 Westheimer Rd., Ste. 300
Houston, TX 77056

KLR Group LLC (I)
Edward Kovalik
CEO
713-321-2555
ek@klrgroup.com
BG Group Place Building
811 Main St., 18th Floor
Houston, TX 77002

L

Ladenburg Thalman & Co. (I)
Barry Steiner
Managing Director
212-409-2000
bsteiner@ladenburg.com
277 Park Ave., 26th Floor
New York, NY 10172

Lazard Ltd. (A, I)
Kevin Bonebrake
Managing Director
713-236-4625
kevin.bonebrake@lazard.com
JPMorgan Chase Tower,
600 Travis St., Ste. 3300
Houston, TX 77002

Legacy Texas Bank (C)
Chris Parada
Managing Director - Head of Energy Finance
214-217-7084
chris.parada@legacytexas.com
5949 Sherry Lane, Ste. 600
Dallas, TX 75225
Preferred deal size: $5MM-$40MM

Lime Rock Partners (P)
Brian Berger
Associate
713-292-9500
bberger@lrpartners.com
Heritage Plaze, 1111 Bagby St.,
Ste. 4600
Houston, TX 77002
Preferred deal size: $50MM-$150MM

M.M. Dillon & Co. (C, I, M)
Michiel McCarty
Managing Director & Head of
Investment Banking
203-569-6800
mmccarty@mmdillon.com
1 Sound Shore Dr.
Greenwich, CT 6830

M1 Energy Capital Mgmt. (A, I, M)
Rich Bernardy
President
713-300-1422
rbernardy@mecapital.com
3701 Kirby Ave., Ste.1086
Houston, TX 77098
Preferred deal size: $10MM-$500MM

Macquarie Bank Ltd. (C, I, M)
F. Brady Parish Jr.
Head of U.S. Oil & Gas
713-275-6810
Brady.parish@macquarie.com
One Allen Center
500 Dallas St., Ste. 3300
Houston, TX 77002

Mason Capital Partners (A)
Albert D. Mason
Managing Partner
617-228-5190
office@mason-capital.com
50 Congress St., Ste. 843
Boston, MA 02109

Morgan Stanley (I)
Ryan P. Synnott
Managing Director
713-512-6633
Ryan.Synnott@morganstanley.com
600 Travis St., Ste. 3700
Houston, TX 77002

Morgan Stanley Energy Partners (P)

John Moon
Head of Morgan Stanley
Energy Partners
212-761-0591
john.moon@
morganstanley.com
JP Morgan Chase Tower
600 Travis St., Ste. 3700
Houston, TX 77002

Mountain Capital Management (P)

Sam Oh
Managing Director -
Head of Oil & Gas
713-357-9600
sam@mountainlp.com
811 Louisiana St., Ste. 2550
Houston, TX 77002

MUFG Union Bank (C, I)
Jamie Conn
Managing Director - Head of Oil & Gas
713-655-3814
jamie.conn@uboc.com
1100 Louisiana St., Ste. 4850
Houston, TX 77002

Mutual of Omaha Bank (C)
Mike Turner
Market President, Houston
713-405-1570
mike.turner@mutualofomahabank.com
520 Post Oak Blvd., Ste. 700
Houston, TX 77027

N

NGP Energy Capital Management (P)
Tony Weber
Managing Partner
972-432-1440
inquiries@ngptrs.com
5221 N. O'Connor Blvd., 11th Floor
Irving, TX 75039

O

Old Ironsides Energy (P)
Sean O'Neill
Managing Partner
617-366-2033
soneill@oldironsidesenergy.com
10 St. James Ave., 19th Floor
Boston, MA 02116

OnyxPoint Global Management (P)
Shaia Hosseinzadeh
Managing Partner
212-235-2013
shosseinzadeh@opglp.com
One World Trade Center, 46th Floor
New York, NY 10007

Origami Capital Partners (P)
Darren O'Brien
Partner
312-263-7800
darren@origamicapital.com
191 N. Wacker Dr., Ste. 2350
Chicago, IL 60606
Preferred deal size: Equity of $20MM-$50MM

Orion Energy Partners (P)
Ethan M. Shoemaker
Managing Director
832-390-2524
Ethan@OrionEnergyPartners.com
700 Louisiana St., Ste. 3950
Houston, TX 77002

ORIX USA Capital (M, P)

Jay Mitchell
Managing Director
214-237-2266
jay.mitchell@orix.com
1717 Main St., Ste. 1100
Dallas, TX 75201

Outfitter Energy Capital (P)

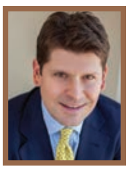
George McCormick
Managing Partner
281-402-8185
gmccormick@outfitterenergy.com
711 Louisiana St., Ste. 2160
Houston, TX 77025

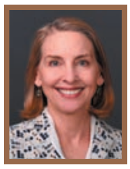
P

Parallel Resource Partners (P)

John Howie
Managing Director
713-238-9500
919 Milam St., Ste. 550
Houston, TX 77002

Parkman Whaling LLC (A)
Darin S. Ackerman
Investment Banking - Energy
713-333-8400
info@parkmanwhaling.com
600 Travis St., Ste. 600
Houston, TX 77002

Pearl Energy Investments (P)

Billy Quinn
Managing Partner
214-308-5275
bquinn@pearl-energy.com
2100 McKinney Ave., Ste. 1675
Dallas, TX 75201
Preferred deal size: $25MM-$75MM

Pegasus Bank (C)

Mynan Feldman
Executive Vice President, Energy
214-353-3070
mfeldman@pegasusbankdallas.com
5940 Forest Lane
Dallas, TX 75230
Preferred deal size: $5MM-$10MM+

Pelican Energy Partners (P)
Mike Scott
Managing Partner
713-559-7112
mscott@pep-lp.com
2050 W. Sam Houston Parkway S, Ste. 1550
Houston, TX 77042

Petrie Partners (A, I)

Andrew Rapp
Co-Founder
303-953-6768
andy@petrie.com
1700 Lincoln St., Ste. 3900
Denver, CO 80203

Petro Capital Group (P)
Garrett Mayer
Business Development
214-661-7765
3710 Rawlins St., Ste. 1000
Dallas, TX 75219

Petro Capital Securities (I)
Marvin Webb
Managing Director
214-572-0771
marvin@petro-capital.com
3710 Rawlins St., Ste. 1000
Dallas, TX 75219

PetroCap Inc. (P)
David Hopson
Partner
214-871-7967
dhopson@petrocap.com
3333 Lee Parkway, Ste. 750

Dallas, TX 75219
Preferred deal size: $25MM-$75MM

P.J. Solomon (A, I)
George R. Ward
Managing Director
346-571-1592
gward@pjsc.com
333 Clay St., Ste. 4340
Houston, TX 77002

Pine Brook Road Partners (P)
Rich Aube
Co-President
832-924-9950
raube@pinebrookpartners.com
1301 McKinney St., Ste. 3550
Houston, TX 77010

PNC Bank (C)
Tom Byargeon
Managing Director
713-658-3940
tom.byargeon@pnc.com
1200 Smith St., Ste. 830

Houston, TX 77002
Preferred deal size: $75MM-$2.5B

Post Oak Energy Capital (P)
Clint Wetmore
Managing Direct & Founding Partner
713-554-9404
wetmore@postoakenergy.com
34 S. Wynden Dr., Ste. 300
Houston, TX 77056

PPHB (I)
Len Paton
Co-founder & Managing Partner
713-580-2710
lpaton@pphb.com
1900 Saint James Place, Ste. 125
Houston, TX 77056

Premier Capital Ltd. (A)
J.W. Brown
General Partner
214-808-3540
jbrown@precap.com
3604 Potomac Ave.

Dallas, TX 75205
Preferred deal size: $10MM-$100MM

Prudential Capital Group (P)

Brian N. Thomas
Managing Director,
EFG Oil & Gas
214-720-6216
brian.thomas@
prudential.com
2200 Ross Ave., Ste. 4300
Dallas, TX 75201
Preferred deal size: Senior Debt
$10MM-$300MM, Junior Debt/
Equity: $10MM-$50MM

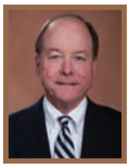
Quantum Energy Partners (P)
Eric Nielsen
Managing Director - Business
Development
713-452-2050

enielsen@quantumep.com
1401 McKinney St., Ste. 2700
Houston, TX 77010

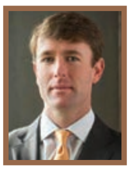
Quintana Energy Partners (P)
Rogers Herndon
President & CEO
832-518-4094
rherndon@qeplp.com
1415 Louisiana St., Ste. 2900
Houston, TX 77002
Preferred deal size: $10MM-$125MM Equity

R

R. W. Baird (I, M)
T. Frank Murphy
Managing Director & Co-Head of Energy Group
314-445-6532
fmurphy@rwbaird.com
8000 Maryland Ave.
St. Louis, MO 63105

Raymond James (I)

Michael P. Ames
Managing Director
713-278-5268
mike.ames@raymondjames.com
5847 San Felipe, Ste. 1800
Houston, TX 77057

RBC Capital Markets (C, I)
Jim Allred
Head of U.S. Energy – Corporate Banking
713-403-5641
Jim.allred@rbccm.com
Williams Tower, 2800 Post Oak Blvd., Ste. 3900 & 4325
Houston, TX 77056

Red Bird Capital (P)

Hunter Carpenter
Partner
214-238-4004
hcarpenter@redbirdcap.com
667 Madison Ave., 16th Floor
New York, NY 10065

Regions Bank (C)

Brian D. Tate
EVP & Executive Managing Director Specialized Industries, Head of Energy & Natural Resources Group
980-287-2811
brian.tate@regions.com
615 South College St., Ste. 400
Charlotte, NC 28202

Ridgemont Equity Partners (P)
John Shimp
Partner
704-944-0914
Jshimp@ridgemontep.com
150 North College St., Ste. 2500
Charlotte, NC 28202
Preferred deal size: $25MM-$125MM

Riverstone Holdings LLC (P)
John Lancaster Jr.
Managing Director - Energy Industry
212-993-0076
john@riverstonellc.com
712 5th Ave, Ste. 36
New York, NY 10019

Rivington Holdings LLC (A, P)
Christopher R. Wagner
Partner
713-750-0900
cwagner@rivingtoncap.com
1021 Main St., Ste. 1500
Houston, TX 77002
Preferred deal range: $50MM-150MM

Roth Capital Partners (I)
Alexander Montano
Managing Director
949-720-5770
amontano@roth.com
888 San Clemente Dr.
Newport Beach, CA 92660

S

Sage Road Capital (P)
Josh L. Batchelor
Managing Partner & Co-Founder
713-364-1400
info@sagerc.com
2121 Sage Rd., Ste. 325
Houston, TX 77056

Sand River Capital Advisors LLC (P)
Jason Whitt
Managing Partner
432-848-3020
jason.whitt@sandriver.com
3300 North A St., Bldg. 2, Ste. 101
Midland, TX 70705

SCF Partners (I, P)
Andrew L. Waite
Co-President
713-227-7888
awaite@scfpartners.com
600 Travis St., Ste. 6600
Houston, TX 77002

Scotiabank (A, I, C)

Doug Reynolds
Managing Director & Head-Corporate Banking Energy
713-752-0900
douglas.reynolds@scotiabank.com
711 Louisiana St., Ste. 1400
Houston, TX 77002

Seaport Global Securities (I)
Edward Lainfiesta
Partner, Executive Managing Director of Equity Sales & Trading
949-274-8044
elainfiesta@seaportglobal.com
600 Anton Blvd., Ste. 1700
Costa Mesa, CA 92626

SFC Energy Partners (M, P)
Michael T. Stolze
Vice President of Origination
303-893-5007
mstolze@sfcepartners.com
1225 17th St., Ste. 2575
Denver, CO 80202

Siemens Financial Services Inc. (C, M, P)
Kirk H. Edelman
President & CEO
800-327-4443
kirk.edelman@siemens.com

170 Wood Avenue South
Iselin, NJ 08830

Simmons & Co. International (I)
Damon Box
Managing Director, Energy Investment Banking
713-546-7224
damon.f.box@simmonspjc.com
700 Louisiana St., Ste. 1900
Houston, TX 77002

Skyway Capital Markets (C)
Eric Alfuth
Managing Director – Head of Energy Group
813-210-9522
100 N. Tampa St., Ste. 3550
Tampa, FL 33602

Sprott Global Resources Investment Ltd. (P)
Rick Rule
Founder, Global Companies
800-477-7853
rrule@sprottglobal.com
1910 Palomar Point Way
Carlsbad, CA 92009
Preferred deal size: $10MM-$100MM

Stellus Capital Management (P)
Todd A. Overbergen
Partner
713-292-5402
toverbergen@stelluscapital.com
4400 Post Oak Parkway, Ste. 2200
Houston, TX 77027
Preferred deal size: $30MM-$100MM

Stephens Group LLC (I, P)
Jim Jacoby
Managing Director
501-377-3401
jjacoby@stephensgroup.com
100 Morgan Keegan Dr., Ste. 500
Little Rock, AR 72202

Stephens Inc. (I)
Keith Behrens
Managing Director, Head of Energy
214-258-2762
keith.behrens@stephens.com
300 Crescent Court, Ste. 600
Dallas, TX 75201

Stifel Nicolaus & Co. (A, I, P)
Christian Gibson
Managing Director, Co-Head, Energy Investment Banking
713-237-4515
Chris.gibson@stifel.com
700 Louisiana St., Ste. 2350
Houston, TX 77002

Sumitomo Mitsui Bank Corp. (C, I, M)
James Weinstein
Deputy General Manager, Head of Energy/Natural Resources
212-224-4120
jweinstein@smbclf.com
277 Park Avenue,
New York, NY 10172

SunTrust Robinson Humphrey (A, I)
Jim Warren
Managing Director, Head of Energy Investment Banking
(713) 247-7602
Jim.warren@suntrust.com
333 Clay Street, 41st Floor
Houston, TX 77002

Tailwater Capital (P)

Edward Herring
Managing Partner
214-269-1183
eherring@tailwatercapital.com
20121 McKinney Ave., Ste. 1250
Dallas, TX 75201

Talara Capital Management (P)

David Zusman
Managing Partner
713-437-3450
privatedeals@talaracapital.com
1001 Fannin St.
Houston, TX 77002
Preferred deal size: $50MM-$150MM

Tenaska Capital Management LLC (P)
Ryan Schroer
Managing Director
402-938-1610
rschroer@tenaskacapital.com
14302 FNB Parkway
Omaha, NE 68154
Preferred deal size: $50MM+

Texas Capital Bank (C, I)

Lester J.N. Keliher
Executive Vice President
469-399-8562
lester.keliher@texascapitalbank.com
2000 McKinney Ave., Ste. 700
Dallas, TX 75201

Tortoise Capital Resources (P)
Robert Thummel
Managing Director & Portfolio Manager -- Energy
913-981-1020
rthummel@tortoiseadvisors.com
11550 Ash St., Ste. 2300
Leawood, KS 66211

Trilantic Capital Management LP (P)

Glenn Jacobson
Partner
512-362-6252
gjacobson@trilantic.com
301 Congress Ave.,
Ste. 2050
Austin, TX 78701

Trive Capital (P)
Jeff Leatherman
Business Development
303-507-0262
jeffleatherman@trivecapital.com
2021 McKinney Ave., Ste. 1200
Dallas, TX 75201

Tudor, Pickering, Holt & Co. (I)

Bobby Tudor
Chairman
713-333-7100
btudor@TPHco.com
1111 Bagby St.,
49th Floor
Houston, TX 77002

U

U.S. Bank (C)
Mark Thompson
Senior Vice President
303-585-4213
mark.thompson@usbank.com
950 17th St., 4th Floor
Denver, CO 80202
Preferred deal size: $20MM-$150MM

UBS (I)
Miles Redfield
Managing Director
713-331-4685
miles.redfield@ubs.com
Five Post Oak Park
4400 Post Oak Parkway, Floors 16, 17
Houston, TX 77027

V

Varde Partners (P)
Markus Specks
Managing Director
713-335-4470
energy@varde.com
609 Main St., Ste. 3925
Houston, TX 77002

Vortus Investment Advisors (P)
Brian Crumley
Managing Partner
817-945-2400
407 Throckmorton St., Ste. 560
Fort Worth, TX 76102
Preferred deal size: $50MM-$75MM

W

Warburg Pincus LLC (P)
Peter R. Kagan
Managing Director & Head of Energy
212-878-0600
Peter.kagan@warburgpincus.com
450 Lexington Ave.
New York, NY 10017

Waterous Energy Fund (P)
Michael Buckingham
713-291-5785
Michael.buckingham@waterous.com
301 8th Ave. SW, Ste. 600
Calgary, AB T2P 1C5
Preferred deal size: $200MM-$400MM

Weidner Advisors (A)

Bill Weidner
Owner
207-761-2600
bill@weidneradvisors.com
45 Exchange St.,
Ste. 300E
Portland, ME 4101

Wells Fargo Energy Group (C)

Bart Schouest
Executive Vice President
& Group Head
713-391-1850
bart.schouest@wellsfargo.com
1000 Louisiana St., Floor 12
Houston, TX 77002

Wells Fargo Securities LLC (I)
Scott Warrender
Managing Director & Group Head-E&P IB
713-346-2823
scott.warrender@wellsfargo.com
1000 Louisiana St., 12th Floor
Houston, TX 77002

West Texas National Bank (C)
Sid Smith
Senior Vice President
Oil & Gas Lending
432-685-6520
ssmith@wtnb.com
300 North Marienfeld, Ste. 100
Midland, TX 79701

White Deer Energy (P)

Thomas Edelman
Managing Partner
713-581-6900
tedelman@whitedeerenergy.com
700 Louisiana St., Ste. 204
Houston, TX 77002
Preferred deal size: $50MM-$150MM

Wilcox Swartzwelder & Co. (I)
Jason Wilcox
Founder & Managing Director
972-831-1300
jason@ws-ibank.com
102 Decker Court, Ste. 204
Irving, TX 75062

William Blair and Co. (I)
Joe Niemiec
Managing Director, Industrials
312-364-5315
jniemiec@williamblair.com
222 West Adams St.
Chicago, IL 60606

Wynnchurch Capital Ltd. (I)
Michael Teplitsky
Managing Director
847-604-6120
mteplitsky@wynnchurch.com
6250 North River Rd., Ste. 10-100
Rosemont, IL 60018

Y

Yorktown Partners LLC (P)
Peter Leidel
Partner
212-515-2113
pleidel@yorktownenergy.com
410 Park Ave., Ste. 1900
New York, NY 10022
Preferred deal size: $10MM-$70MM

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Who's Who By Contact Person

Acconcia, Angelo	Blackstone Energy Partners
Ackerman, Thomas	Carnelian Energy Capital
Ackerman, Darin S.	Parkman Whaling
Alfuth, Eric	Skyway Capital Markets
Allred, Jim	RBC Capital Markets
Almrud, Steve	Barclays Investment Bank
Ames, Michael P.	Raymond James
Andrews, Kevin	Imperial Capital
Aneed, Roy	Edge Natural Resources
Arnold, Michael T.	IOG Capital
Aube, Rich	Pine Brook Road Partners
Batchelor, Josh L.	Sage Road Capital
Bawa, Mo	ACON Investments
Beard, Gregory A.	Apollo Global Management
Behrens, Keith	Stephens Inc.
Beltnick, Luke	Castlelake
Beman, Mike	Guggenheim Partners
Benson, James P.	Energy Spectrum Capital
Berger, Brian	Lime Rock Partners
Bernardy, Rich	M1 Energy Capital Management
Bonebrake, Kevin	Lazard
Bowen, Kathleen J.	BBVA Compass
Box, Damon	Simmons & Co. International
Brendel, Tim	Associated Bank
Brown, J.W.	Premier Capital
Buchanan, Keith	KeyBanc Capital Markets
Buckingham, Michael	Waterous Energy Fund
Byargeon, Tom	PNC Bank
Carpenter, Hunter	Red Bird Capital
Chapman, Bryan	IBERIABANK
Chen, Neil	Intrepid Financial Partners
Cherington, Charles	Argus Energy Managers
Chuchla, Rob	EIG Global Energy Partners
Coats, Mickey	BOK Financial
Conn, Jamie	MUFG Union Bank
Conner III, Pierre E.	Capital One Securities
Cook, Rob	ARC Financial Corp.
Cowan, Steven	Aldwych Capital Partners
Crumley, Brian	Vortus Investment Advisors
Culas, Rahul	Carlyle Group
Cummings, Joshua	Johnson Rice & Co.
de Talance, Patrick	Credit Agricole
Dell, Ben	Kimmeridge Energy
DeVito, Mark	Bank of America Merrill Lynch
Dittmann, Todd	Angelo Gordon & Co.
Donovan Jr., John W.	Donovan Ventures
Edelman, Kirk H.	Siemens Financial Servives
Edelman, Thomas	White Deer Energy
Edwards, Thomas	Five States Energy Capital
Feldman, Mynan	Pegasus Bank
Flood, Curtis	Evercore
Forbis, Jeff	BB&T Capital Markets
Fricker, Harris	GMP Securities
Fuqua, Mark	Comerica
Gibson, Christian	Stifel Nicolaus & Co.
Glosson, Bob	Independent Bank
Gordon, Richard K.	Juniper Capital
Grundberg, Brent	Glendale Energy Capital
Hall, Charles	ING Capital
Hansen, Steve	Crestmark Bank
Hanson, J.P.	Houlihan Lokey
Herndon, Rogers	Quintana Energy Partners
Herring, Edward	Tailwater Capital
Hoffman, Stephen	Huntington Bank
Holley, Darrell	ABN AMRO Bank USA
Holmes, Harrison	Brycap Investments
Hopson, David	PetroCap
Horoschak, Jordan	CIBC
Hosseinzadeh, Shaia	OnyxPoint Global Management
Howie, John	Parallel Resource Partners
Hubbard, Hans	CSG Investment
Jacobe, Christopher	Blackgold Capital Management
Jacobson, Glenn	Trilantic Capital Management
Jacoby, Jim	Stephens Group
Jaudes, Will	CCMP Capital Advisors
Johnson, Russell	Capital One Energy Banking

Johnson, Scott .... Chiron Financial
Kagan, Peter R. .... Warburg Pincus
Katersky, Jeff .... BSI Energy Partners
Keliher, Lester J.N. .... Texas Capital Bank
Kende, Leslie .... AltaCorp Capital
Kennedy, Steve .... Amegy Bank of Texas
Kessey, Scott .... Kessey Capital Partners
Kitchens, Christina .... East West Bank
Kovalik, Edward .... KLR Group
Lainfiesta, Edward .... Seaport Global Securities
Lancaster Jr., John .... Riverstone Holdings
Lane, John .... First Tennessee Bank
Leatherman, Jeff .... Trive Capital
Leidel, Peter .... Yorktown Partners
Leykum, Charlie .... CSL Capital Management
Lindermanis, Rob .... Bay Capital Corp.
Linker, Jonathan S. .... Energy Special Situations Fund
Lister, Mike .... JP Morgan
Lorusso, Mike .... CIT Energy Finance
Marinelli, Jon .... BMO Capital Markets
Markham, Murphy .... EnCap Investments
Marye, Jordan .... Denham Capital Management
Mason, Albert D. .... Mason Capital Partners
Mayer, Garrett .... Petro Capital Group
McAdams, Dave .... Conquest Structured Products
McCarty, Michiel .... M.M. Dillon & Co.
McCormick, George ...... Outfitter Energy Capital
McMullen, William .... Bayou City Energy Management
Mertensotto, Bob .... Capital One Energy Banking
Miller, Hal .... Galway Capital
Mitchell, Jay .... ORIX USA Capital
Montano, Alexander ..... Roth Capital Partners
Moon, John .... Morgan Stanley Energy Partners
Mooney, Daniel .... Enstream Capital
Morrow, Matt .... Five Point Capital Partners
Murphy, T. Frank .... R.W. Baird
Murray, Tim .... Benefit Street Partners
Nielsen, Eric .... Quantum Energy Partners
Niemiec, Joe .... William Blair and Co.
Nieser, Elise .... Frost Bank
O’Neill, Sean .... Old Ironsides Energy
O'Brien, Darren .... Origami Capital Partners
Oh, Sam .... Mountain Capital Management
Overbergen, Todd A. .... Stellus Capital Management
Pace, Phillip .... Chambers Energy Capital
Parada, Chris .... Legacy Texas Bank
Parish Jr., F. Brady .... Macquarie Bank
Paton, Len .... PPHB
Perry, Tim .... Credit Suisse Securities
Poddar, Anoop .... EV Private Equity
Powell, Jared .... Coral Reef Capital
Quinn, Billy .... Pearl Energy Investments
Rapp, Andrew .... Petrie Partners
Redfield, Miles .... UBS Investment Bank
Revers, Daniel .... ArcLight Capital Partners
Rexrode, Stuart .... BlueRock Energy Partners
Reynolds, Doug .... Scotiabank
Rockecharlie, David C. . KKR
Row, James C. .... Entoro Capital
Rule, Rick .... Sprott Global Resources Investment
Schouest, Bart .... Wells Fargo Energy Group
Schroer, Ryan .... Tenaska Capital Management
Scott, Ronnie .... Development Capital Resources
Scott, Mike .... Pelican Energy Partners
Shoemaker, Ethan M. ... Orion Energy Partners
Shimp, John .... Ridgemont Equity Partners
Sikhtian, Suhail .... Goldman Sachs
Sikora, J.W. .... Cibolo Energy Partners
Smith, James .... Aegis Energy Advisors Corp.
Smith, Henry .... CrossFirst Bank
Smith, Sid .... West Texas National Bank
Specks, Markus .... Varde Partners
Steiner, Barry .... Ladenburg Thalman & Co.
Stolze, Michael T. .... SFC Energy Partners
Straty, Steve .... Jefferies
Synnott, Ryan P. .... Morgan Stanley
Tate, Brian D. .... Regions Bank
Teplitsky, Michael .... Wynnchurch Capital
Tharp, Larry .... GSO Capital Partners
Thomas, Brian N. .... Prudential Capital Group
Thompson, Mark .... U.S. Bank
Thummel, Robert .... Tortoise Capital Resources
Tombar, Tym .... Arcadius Capital Partners
Trauber, Steve .... Citi
Tudor, Bobby .... Tudor, Pickering, Holt & Co.
Turner, Evan .... Drillcore Energy Partners
Turner, Mike .... Mutual of Omaha Bank
Wagner, Christopher R. . Rivington Holdings
Waite, Andrew L. .... SCF Partners
Waldrip, Bill .... EnCap Flatrock Midstream
Walton, Nate .... Ares Management
Ward, George R. .... P.J. Solomon
Warren, Jim .... SunTrust Robinson Humphrey
Warrender, Scott .... Wells Fargo Securities
Webb, Marvin .... Petro Capital Securities
Weber, Tony .... NGP Energy Capital Management
Weidner, Bill .... Weidner Advisors
Weinberg, Russell .... Energy Capital Solutions
Weinstein, James .... Sumitomo Mitsui Bank
Wetmore, Clint .... Post Oak Energy Capital
White, Leland .... Energy Trust Partners
Whitt, Jason .... Sand River Capital Advisors
Wilcox, Jason .... Wilcox Swartzwelder & Co.
Wilson, Dale .... Cathay Bank
Wizel, Neil A. .... First Reserve
Yates, Chuck .... Kayne Anderson Energy Funds
Zusman, David .... Talara Capital Management

Who's Who By Category

COMMERCIAL BANKS

Amegy Bank of Texas
Associated Bank
Barclays
BB&T Capital Markets
BBVA Compass
BOK Financial
Brycap Investments
Capital One Energy Banking
Cathay Bank
CIT Energy Finance
Citi
Comerica
Credit Agricole
Crestmark Bank
CrossFirst Bank
East West Bank
First Tennessee Bank
Frost Bank
IBERIABANK
Independent Bank
ING Capital
KeyBanc Capital Markets
Legacy Texas Bank
M.M. Dillon & Co.
Macquarie Bank
MUFG Union Bank
Mutual of Omaha Bank
Pegasus Bank
PNC Bank
RBC Capital Markets
Regions Bank
Scotiabank
Siemens Financial Services
Skyway Capital Markets
Sumitomo Mitsui Bank
Texas Capital Bank
U.S. Bank
Wells Fargo Energy Group
West Texas National Bank

INVESTMENT BANKS

ABN AMRO Bank USA
Aegis Energy Advisors Corp.
Aldwych Capital Partners
AltaCorp Capital
Amegy Bank of Texas
Associated Bank
Bank of America Merrill Lynch
Barclays
BB&T Capital Markets
BBVA Compass
BMO Capital Markets
Capital One Securities
Chambers Energy Capital
Chiron Financial
CIBC
CIT Energy Finance
Citi
Credit Agricole
Credit Suisse Securities
Energy Capital Solutions
Enstream Capital
Entoro Capital
Evercore
Galway Capital
GMP Securities
Goldman Sachs
Houlihan Lokey
Huntington Bank
Imperial Capital
ING Capital
Jefferies
Johnson Rice & Co.
JP Morgan
KeyBanc Capital Markets
KLR Group
Ladenburg Thalman & Co.
Lazard
M.M. Dillon & Co.
M1 Energy Capital Management
Macquarie Bank
Morgan Stanley
MUFG Union Bank
P.J. Solomon
Petrie Partners
Petro Capital Securities
PPHB
R.W. Baird
Raymond James
RBC Capital Markets
Roth Capital Partners
SCF Partners
Scotiabank
Seaport Global Securities
Simmons & Co. International
Stephens Group
Stephens Inc.
Stifel Nicolaus & Co.
Sumitomo Mitsui Bank
SunTrust Robinson Humphrey
Texas Capital Bank
Tudor, Pickering, Holt & Co.
UBS
Wells Fargo Securities
Wilcox Swartzwelder & Co.
William Blair and Co.
Wynnchurch Capital

PRIVATE EQUITY

Aldwych Capital Partners
Angelo Gordon & Co.
Apollo Global Management
ARC Financial Corp.
Arcadius Capital Partners
ArcLight Capital Partners
Ares Management
Argus Energy Managers
Barclays
Bayou City Energy Management
Benefit Street Partners
Blackgold Capital Management
Blackstone Energy Partners
BlueRock Energy Partners
BSI Energy Partners
Carlyle Group
Carnelian Energy Capital
Castlelake
CCMP Capital Advisors
Cibolo Energy Partners
Conquest Structured Products
Coral Reef Capital

CSG Investment
CSL Capital Management
Denham Capital Management
Development Capital Resources
Donovan Ventures
Drillcore Energy Partners
Edge Natural Resources
EIG Global Energy Partners
EnCap Flatrock Midstream
EnCap Investments
Energy Special Situations Fund
Energy Spectrum Capital
Energy Trust Partners
Enstream Capital
EV Private Equity
Evercore
First Reserve
Five Point Capital Partners
Five States Energy Capital
Glendale Energy Capital
Goldman Sachs
GSO Capital Partners
Guggenheim Partners
IOG Capital
Juniper Capital
Kayne Anderson Energy Funds
Kimmeridge Energy
KKR
Lime Rock Partners
Morgan Stanley Energy Partners
Mountain Capital Management
NGP Energy Capital Management
Old Ironsides Energy
OnyxPoint Global Management
Origami Capital Partners
Orion Energy Partners
ORIX USA Capital
Outfitter Energy Capital
Parallel Resource Partners
Pearl Energy Investments
Pelican Energy Partners
Petro Capital Group
PetroCap
Pine Brook Road Partners
Post Oak Energy Capital
Prudential Capital Group
Quantum Energy Partners
Quintana Energy Partners
Red Bird Capital
Ridgemont Equity Partners
Riverstone Holdings
Rivington Holdings
Sage Road Capital
Sand River Capital Advisors
SCF Partners
SFC Energy Partners
Siemens Financial Servives
Sprott Global Resources Investment
Stellus Capital Management
Stephens Group
Stifel Nicolaus & Co.
Tailwater Capital
Talara Capital Management
Tenaska Capital Management
Tortoise Capital Resources
Trilantic Capital Management
Trive Capital
Varde Partners
Vortus Investment Advisors
Warburg Pincus
Waterous Energy Fund
White Deer Energy
Yorktown Partners

MEZZANINE

Aldwych Capital Partners
Amegy Bank of Texas
Apollo Global Management
Barclays
Bay Capital Corp.
BBVA Compass
Blackgold Capital Management
BlueRock Energy Partners
Carlyle Group
Development Capital Resources
EIG Global Energy Partners
Enstream Capital
Five States Energy Capital
GSO Capital Partners
Guggenheim Partners
M.M. Dillon & Co.
M1 Energy Capital Mgmt.
Macquarie Bank
ORIX USA Capital
R.W. Baird
SFC Energy Partners
Siemens Financial Servives
Sumitomo Mitsui Bank

ADVISERS

ACON Investments
AltaCorp Capital
Associated Bank
Bank of America Merrill Lynch
Barclays
Capital One Securities
CIBC
Citi
Donovan Ventures
Energy Capital Solutions
Enstream Capital
Entoro Capital
Galway Capital
Houlihan Lokey
Intrepid Financial Partners
Jefferies
Kessey Capital Partners
KeyBanc Capital Markets
Lazard
M1 Energy Capital Management
Mason Capital Partners
Parkman Whaling
Petrie Partners
Premier Capital
Rivington Holdings
Scotiabank
Stifel Nicolaus & Co.
SunTrust Robinson Humphrey
Weidner Advisors

CIBOLO ENERGY PARTNERS

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JW Sikora
Managing Partner, Co-Founder

Justin Teltschik
Managing Partner, Co-Founder

1455 West Loop South, Suite 230, Houston, TX 77027
(713) 357-7570   info@ciboloenergy.com   www.ciboloenergy.com