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THE NEW AGENDA

A year ago at this time, we wrote about how high flying the oil and gas industry was and how much of the optimistic activity was being fueled by many deep-pocketed capital providers and investors who were eager to get involved in oil and gas.

Since then a lot has changed for E&P and midstream companies, their investors and capital providers. Financial discipline and the search for returns head up the capital agenda today—and alas for some, financial forensics, restructuring and bailouts.

But one thing has not changed: Then as now, there has never been more capital available to the sector, and there has never been a greater need for it. Private equity and private debt funds continue to report impressive new fund raises targeting energy.

Perhaps their motivations have changed, though. Last year the great and growing need was to fund drilling and the midstream build-out while today, the need is for maintaining stability, fending off dire consequences and repairing the balance sheets of companies that were punching above their weight.

Fight to win must be the current mantra, and capital providers of all sorts and sizes remain in your corner, ready to assist. The menu of options is full, from private equity and private debt infusions to asset sales with contingencies, drilling and acquisition joint ventures between private equity and E&Ps, and more. Public markets can be challenging at the moment, but in addition to large private equity or distressed debt funds, institutional investors remain ready to invest alongside you in a more direct way.

The late, great baseball legend Yogi Berra said, "It's tough to make predictions because it's about the future." But we can say that eventually the system will right itself and commodity prices will rise again. In the meantime, this special report presents a few options to consider for your financial future. Our series of profiles brings you more knowledge about some of the leading financial providers who sense opportunity in the current oil and gas environment.

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

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MACRO

Back To the Drawing Board

The context for financing of oil and gas drilling and production or M&A activity hinges on commodity prices–and those remain volatile going into 2016. Here is what some experts think.

Compiled by *Oil and Gas Investor*

The price of crude oil reached a worrisome low of $38.24/bbl on August 24. By September 17 it had recovered to about $47/bbl and since then it has bounced around between $44 and $47, rising briefly as high as $50. Natural gas prices, meanwhile, continue to hover between $2.60 and $3.

This type of volatility and uncertainty has forced senior E&P executives and capital providers back to the drawing board more than once, looking at everything: how to negotiate with vendors and bankers, how to cut back drilling and on which acreage, 2016 spending estimates, personnel needs, G&A and more.

Forward cash flow numbers are likely to be lower than expected even four months ago, and that puts everything on the table as the industry tries to plan for 2016.

These big-picture issues will affect a company's bottom line and the degree to which it will need to source more capital, sell assets or recapitalize its existing balance sheet. Here is what the experts were saying at press time this fall.

Reuters, Sept. 29:

"The major statistical agencies (the U.S. Energy Information Administration, the International Energy Agency and the Organization of the Petroleum Exporting Countries) now predict U.S. oil production will fall sharply in the rest of 2015 and during the first half of 2016.

"With the news flow turning ambiguous and prices no longer falling consistently, hedge funds are less confident the next major price move will be downwards and are taking a more neutral position."

R.W. Baird's 10th Quarterly Survey

Completed in mid-September, this survey had 142 respondents, including 75 buyside investors, 60 energy industry contacts and seven "other" participants. Key findings:

Oil recovery not anticipated until mid- to late-2016. Some 54% of participants see WTI still in the $40 -$50/bbl range in six months, a continuation of the commodity's recent trading range. About 61% expect an uplift to the $50-$60/bbl area over 12 months.

Natural gas expectations. Some 56% of respondents said the 12-month gas price will be $2.50 to $3/MMBtu. Another 29% said $3 to $3.50. On the low side, only 9% said $2 to $2.50 and on the high side, only 4% said $3.50 to $4. More than half said the longer-term equilibrium price will be $3-$3.50.

Use of cash flow. Two-thirds or 66% of participants said they preferred that free cash flow be redeployed into debt repayment. Some 41% of respondents held no emerging play preferences; most still liked the Permian Basin the most.

Barclays Commodities Research, Oct. 12

"We have always believed that prices in the low-to-mid $40s were an inherently unstable equilibrium for U.S. shale supply to help meet incremental demand in 2016 and 2017. Although, from a technical perspective, further gains may be in order, the fundamental supports for this move are limited.

"Crude prices have moved higher … on the expectations that supply adjustments are underway and on bullish sentiment from two industry conferences in New York and London. Yet doubts remain whether the patient has walked out of the doctor's room before being fully treated.

"Though we perceive a sentiment shift, the physical indicators are not yet convincing us, and a repeat of Q2, where a swift price rally slowed the balancing process, risks happening again. Just as supply is showing the first signs of adjustment, reduced economic growth prospects and refined product malaise are likely to set in over the next quarter. This could warrant an even larger supply adjustment than previously expected to fully balance the market."

RBC Capital Markets, Sept. 18

"Our WTI forecasts are now $51/bbl (vs. $56/bbl) in 2015E, and $57/bbl (vs. $72/bbl) in 2016E. We have introduced our forecast for a 2017 WTI price of $65/bbl, and our long-term price has been reduced to $75/bbl (vs. $84/bbl)."

Bernstein, Sept. 21

"In our quarterly gauge of investor sentiment, we find that investors are more bullish than the current price environment would suggest. Investor expectations remain significantly above the forward curve at 30% above WTI and 12% above Henry Hub on a two-year forward basis. There is strong sentiment for oil E&Ps in particular, with 46% choosing the sector as most likely to outperform."

Raymond James

The research team thinks the current price environment is on par with the financial crisis of 2008-2009 and 1998-1999 in terms of severity. "In both cases, the rebound was significant. We believe oil prices are significantly below marginal cost and as they rise, E&Ps will benefit."

"… We could see the fall redetermination season potentially kick off a wave of mergers, property deals, and even some corporate restructuring ... for our small and mid-cap E&P coverage universe; last spring, we thought fall borrowing base redeterminations will likely be more punitive this fall…

"There are numerous reasons that, in our view, this fall's borrowing base season will lead to deeper cuts than in the spring: 1) hedge books continue to deteriorate; 2) PUD values are likely to fall given slowdown in drilling pace; 3) government agencies are getting involved; and 4) the lower oil price deck commercial banks are using this time around. Taking all of this into account, we would expect borrowing bases to be down, on average, closer to 20%-25%."

Barclays on Natural Gas, Oct. 14

"U.S. natural gas prices have averaged $2.79/MMBtu so far this year, down 35% from last year's average. Lower 48 dry gas production levels are up 27% since 2010. …Coal to gas switching has helped clear the market but is a price floor, not a trampoline for gas prices.

"A mild winter will put severe pressure on prices in Q1-Q2 2016. We continue to forecast year-over-year increases in supply of 1.6 Bcf/d next year. This is below growth seen in 2014-2015 of 2.7 Bcf/d (forecast) and 3.9 Bcf/d in 2013-2014.

"U.S. LNG exports are set to average 700 MMcf/d in 2016 and to ramp up to over 8 Bcf/d by the end of 2020, to be the single largest source of incremental demand …"

Deutsche Bank, Oct. 15

"The oil market stands in a mode of tension between gradually lower expectations of U.S. oil supply, uncertainty over the timing of new Iranian volumes, and now lower forecasts of 2016 oil demand growth amidst somewhat weaker GDP estimates.

"What remains clear is that although the process of rebalancing is well underway, it will be a lengthy one with the potential for relapses to the downside. On the bright side, a fresh cycle low in the U.S. oil-directed rig count increases our confidence around the prospects for a significant decline in U.S. oil production in 2016."

RBC Capital Markets, Oct. 15

"While many operators have given an initial indication on what 2016 might look like at various oil price scenarios, we would expect additional color further firming up operators' plans, but in most cases, we expect formal guidance in December or January.

"As we have stated for some time, we expect this borrowing base redetermination season to largely be a nonevent for most operators in our coverage universe, as revolvers are currently under-utilized and, in most cases, credit facilities are not expected to be reduced below the current commitment amount. We believe this will be the case until the next fall redetermination season.

"We expect small asset transactions to persist as financially strong operators seek bolt-ons in core areas while the stressed/distressed operators look to shed noncore assets. We believe it might take a few more months of sub-$50/bbl before we see semi-distressed operators begin to part with core acreage; nonetheless, it appears as if operators are willing to pay up for some core acreage …"

Macquarie Capital, Oct. 15

"Given current commodity prices and continued activity cuts in recent weeks, we see risk of U.S. activity continuing to drift lower, further pushing out a recovery …"

EIA

Global oil demand will grow by the most in six years in 2016, yet non-OPEC supply will stall, according to the U.S. Energy Information Administration. Total world supply is expected to rise to 95.98 MMbbl/d in 2016. Demand is expected to rise 270,000 bbl/d to 95.2 MMbbl/d, partially due to stronger demand growth from China. ■


NOV
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PRIVATE EQUITY

Private Equity Steps Up

Generalists and specialists are focusing on returns rather than absolute price.

By Gregory DL Morris

With the current chill in public equity and debt markets toward the independent upstream sector, private equity is in essence the last man standing. But there is surprisingly little swagger to private equity managers. Yes, they have raised vast new sums—several major funds have closed in the billions of dollars just this year—but they are prudent about committing that capital and are sticking with experienced operating teams.

"Our most recent fund, Quantum Energy Partners VI, closed at a $4.45 billion hard cap in capital commitments, which was almost double the size of our previous fund at $2.5 billion," said Wil VanLoh, president and CEO. "Given the severe crosscurrents in the energy industry, we were very pleased with this outcome given that several other funds recently in the market closed much smaller funds than their predecessor funds."

For over 17 years Quantum has been focused exclusively on the energy sector, and has managed more than $10.5 billion of equity commitments since inception.

Private equity has put itself in a good position as this particular downcycle lingers, VanLoh explained. "The amount of private equity focused on energy is quite significant, as it is estimated that as much as $50 billion to $60 billion of dry powder is currently on the sidelines. That is a lot of money, from both the generalist firms as well as the specialists like us."

Beyond the PE universe, the double dip in oil prices has had something of a chilling effect on other major capital sources. "In the first and early quarters of this year there was a huge amount of public equity and debt issues. That was extraordinary, given a 60% drop in the price of oil."

While prices quickly rebounded to about $60 a barrel, oil has since tumbled back to the mid-$40s. As a result, public equity and debt have been hit hard. High-yield debt is being traded at 30 cents to 40 cents on the dollar for many issuers, regulators are demanding banks tighten their lending requirements, and as hedges roll off this year, some operators may see their leverage balloon from three times Ebitda to four, five or more.

One further element has been the lack of A&D activity. In the old Westerns the cliché was, "It's quiet … too quiet …"

Many observers anticipate a wave of forced selling starting with the autumn bank redeterminations and accelerating through next spring. But VanLoh is not so sure that scenario will play out.

"We have been surprised at the price some PE firms have been willing to pay for assets recently," he said. "We are cautiously optimistic that the underpinnings for a good buyer's market are coming into place, but it has not yet developed. And, of course, if it is a good buyer's market that probably means it is not a good time to sell."

Noting the amount of high-yield and subordinated debt, as well as beaten-down share prices, VanLoh reckoned that "senior secured debt holders will get paid in most cases, but

SELECT PROVIDERS OF ENERGY-FOCUSED PRIVATE EQUITY

Apollo Global Management	Morgan Stanley Energy Partners
Arc Financial Corp.	NGP Energy Capital Management
ArcLight Capital Partners	ORIX Energy Capital
Blackstone	Pearl Energy Investments
The Carlyle Group	PetroCap
Denham Capital	Pine Brook Partners
EIG Global Energy Partners	Post Oak Capital
EnCap Investments	Quantum Energy Partners
EnCap Flatrock Midstream	RedBird Capital
Energy & Minerals Group	Riverstone Holdings
Energy Spectrum Capital	SFC Energy Partners
Energy Trust Partners	THP Partners
Kayne Anderson Capital	Tailwater Capital
KKR	TPG
Lime Rock Partners	Warburg Pincus
Yorktown Energy Partners	

Sources estimate from $60 billion to $100 billion in private equity alone, looking to deploy in the energy space.
Source: OilandGasInvestor.com and company reports

subordinated unsecured debt holders are exposed and thus may be willing to restructure the debt in order to give the underlying company a chance to hold onto its assets and stay in business in hopes that higher commodity prices will save the day. A lot of debt restructuring could throw cold water on any great buyer's market that might be anticipated."

Proximity to markets

Oil and gas acreage is technically real estate, and so location matters. That was underscored by a big transaction in the Haynesville late in August underwritten by GSO Capital Partners, the credit arm of private-equity behemoth Blackstone. GEP Haynesville, a joint venture formed by GeoSouthern Haynesville and funds managed by GSO, is buying Encana's Haynesville assets for $850 million cash.

The Haynesville, primarily a dry-gas play, was among the first to fall out of favor when the gas market turned down. But Dwight Scott, senior managing director of GSO, said that "one reason that we like the Haynesville is that it has good access to the Gulf Coast and potential export markets. Basis matters. Gas pricing and demand are complex, but basis is important."

Encana said it is focusing on its four key producing areas, and the Haynesville was not one of those. "This sale was going to happen despite gas prices being so low," said Scott. "This was one where Encana was reducing exposure in several plays."

"When we do equity structures we work to design them with credit-like profiles," said Scott. "GeoSouthern is putting in common equity for low-cost natural gas assets that they wanted time and capital to develop. The capital structure has been designed to withstand a protracted downturn. They do common and we do preferred. There is no debt, this is 100% equity."


Wil VanLoh, President and CEO, *Quantum Energy Partners*

The common feature in all of GSO's transactions, Scott said, "is that we want to be sure that the production company has the time and capital to drill on the best acreage."

Like its parent, GSO is something of a generalist, but energy is the largest single sector. "As we approach the upstream today, we see great opportunity," said Scott. "The midstream is doing somewhat better, but still not so great, while in the service sector we are all still trying to figure out how bad things are going to be. There is a lack of data yet."

GSO prefers the upstream and midstream sectors for the simple reason that there are hard operating assets. "Generally speaking, we try to move up the capital structure closer to the assets," Scott stressed.


Dwight Scott, Senior managing director, *GSO Capital Partners*

The Encana deal was not an isolated piece of business. "We expect to see more such transactions. Certainly we are looking at other assets," said Scott. "We want to be protected and we want to know that there is capital to drill."

He described a barbell strategy: "For operations with a lot of leverage, we want to be close to the assets. For those that do not have a lot of leverage, it is okay to be in a junior position."

Paying just for current production

For a relatively new firm, founded just a year and a half ago, RedBird Capital Partners has been involved in some ambitious and complex transactions. In July it closed a deal in collaboration with Aethon Energy Management to acquire SM Energy's Ark-La-Tex assets of about 76,300 net acres with current net production of 29 MMcfe/d, 98% gas. Terms were not disclosed.

The deal was the second for RedBird and Aethon in harness; in May they acquired 188,000 Moneta Divide net acres in the Wind River Basin of Wyoming from Encana. For both sets of assets, Aethon will be the operating company.

"Our recent deals show that with the amount of dislocation in the oil patch this year, there are large and small assets that may be noncore to their current owners, but they are not non-quality," said Hunter Carpenter, partner with RedBird.

"We were able to acquire assets, predominantly gas, paying just for the current production profile while having upside via development opportunities that are economic in today's pricing environment."

RedBird hedges the current production at the Henry Hub forward strip. That means all long-term development comes for the asking. The emphasis is on quality assets that are economic at current prices, he reiterates, and only paying for current production.

"We are not underwriting investments for an improvement in the price of the commodity," Carpenter stated emphatically. "We are investing for current markets and hedging most of the production. We hedge at the strip for 80% to 90% of production and lock it in. That takes out the speculation. The optionality and the upside lie in the opportunity to further develop the acreage."

Coming out of a long recession, it seems likely that recovery may be long and slow, which is how RedBird is playing its cards. "The long game is private equity," said Carpenter. "There are some PE investors who are suffering now, but we all have to be patient and to play through the cycles.

"We try to stay close to the entrepreneurs," he added. "They appreciate the type of capital we have—flexible, long-dated capital that enables us to remove the time element from our investment mentality and instead focus on compounding our pre-tax equity value. We are a very patient capital partner for management teams that appreciate the long view and want to compound wealth."

RedBird's partner is a horse of a different color. "We are both a PE firm and the operator," said Albert Huddleston, partner and founder of Aethon Energy Management. "Historically we have invested our own capital, and also that of third parties. On the PE side most of my friends are aggregating capital to buy in distressed situations. They want to pay low prices out of bankruptcy. We think like operators, so we are buying assets that fit the characteristics of what we need."

Hunter Carpenter, Partner
Redbird Capital Partners

Aethon is hydrocarbon agnostic, said Huddleston. "We buy existing cash-flowing properties, onshore in North America, and put in place a multiyear hedging strategy to seal the economics. Once we have secured the asset and locked in the metrics, we are acquiring upside at little or no cost."

Huddleston founded Aethon in 1990. He has more than 35 years of operations, investment and development experience in energy. Since inception of the company, Huddleston has led the acquisition, development, and divestiture of more than $1.3 billion of assets, achieving a net internal rate of return greater than 44%.

Albert Huddleston, Partner and founder, *Aethon Energy Management*

The badge of courage

With dry powder, Huddleston can afford to be selective. "In good times, companies cull from the bottom. In bad times they have to cut from the top, because that is all that is liquid. The indigestion of others breeds opportunities for us. Buying mediocrity at low prices is not attractive to us."

Geographically, Aethon likes the Rockies as well as the ArkLaTex, as indicated by the July deal when it collaborated with RedBird to acquire the aforementioned package from SM Energy.

"We operate," Huddleston reiterates. "And we hedge. When we buy an asset, we hedge at that time, a significant portion of production out five years. There is a lot of acreage out there that is held by production. That gives us opportunities for infill drilling and other ways to optimize. That way we guard against calamity, because we want to be a purchaser in down times. That is why it is important to buy now."

Huddleston reckons that the autumn redeterminations will be difficult, but the real trouble for some producers could be next spring. "I don't know if the banks will force sales or if there will be an orderly process, but either way people will have to deliver."

And while most attention is focused on the operators in trouble, there are some private and public companies that are not. "We just had an exit last week," said VanLoh at Quantum. "We sold to a public company operating in the same basin. In the larger-cap universe there are some clean balance sheets. There are companies out there that are not over-levered."

Each cycle in the industry is different, but as VanLoh looks back, he notes a pattern. "There are major waves of exploration and exploitation and the small- and mid-cap companies love to outspend their cash flow. In any other industry that would get you punished, but in E&P it seems to be the badge of courage."

That particularly was the case in the wake of the 2008-2009 recession. "After that was the real land rush," said VanLoh. "Got to buy, got to buy. But land is not a cash-flowing asset. It takes years before the land can generate revenue.

"There was so much willingness to finance. There was a lot of 'covenant light' debt raised to buy all this land, and the institutional guys did not always have good discernment between good managers and plays and bad managers and plays. There were teams that got money and did well, and others that just destroyed huge amounts of capital."

There are different scenarios of how the current cycle might be resolved, but VanLoh suggests the A&D market might not be as big as some are anticipating. "My personal belief is that there will be more debt restructurings and equity-for-debt swaps. They have the same effect as assets sales, that being cleaning up the balance sheet, but they don't result in assets getting put on the market. So, we are talking to companies that may need to sell assets as well as to their bond holders who might prefer a different route. Either way, we are going to be very busy." ■

PRIVATE EQUITY

Great Pairs

Partnerships between capital providers and savvy management teams are like aces in the hole.

By Gregory DL Morris

Some of the biggest successes in E&P have been the result of pairing good management teams with smart private equity players. Despite commodity upheavals, private equity continues to fund new companies with the future in mind. Here, we provide a peek into a few recent pairings.

NGP and Centennial Resources; and WildHorse Resources II

One of the few positive signs through the long cold winter of 2014-2015 was the news that NGP Energy Capital Management had hit its hard cap with a final closing of NGP Natural Resources XI, at total commitments of $5.325 billion, for investing in the upstream, midstream and services sectors.

"It is hard to imagine more favorable timing for closing a new fund," said Tony R. Weber, managing partner and chief operating officer. "NGP XI is extremely well positioned to take advantage of investment opportunities created by the recent upheaval in the energy markets."

Two of the operating companies NGP is backing are Centennial Resource Development and WildHorse Resources II. Centennial is in the Wolfcamp and Bone Spring formations of the Permian Basin, while WildHorse focuses on northern Louisiana.

Jay Graham, CEO,
WildHorse Resources II

One important advantage to solid management and good rock is that those qualities help support exits despite prevailing headwinds. "We have a history of creative dealsmanship on entry and exit," says NGP's Chris Carter. "We were extremely active on exits in 2013 and 2014 during the peaks of the market, and completed seven IPOs since 2014. Investments going out in 2015 and 2016 are likely to have a longer timeline to exit, but not a different strategy. We did the same thing in 2008-09. We change the duration, but not the philosophy."

Centennial Resources

Just two years old, Centennial is working 40,000 net acres in Reeves County, Texas, at the south end of the Delaware Basin. It has one rig running, down from four at the peak, putting horizontal wells into the stacked pay of the Wolfcamp and Third Bone Spring. Liftings are about three-quarters oil.

Chris Carter, Managing partner,
NGP Energy Capital Management

"We were down to zero rigs running in February," says Ward Polzin, chief executive officer, "but we brought one back in May when we saw that service prices had come down enough. We could get more growth from more rigs, but we are saving our liquidity. We do have more dry powder to draw upon from the banks and from NGP, when the time is ripe."

One of the things Polzin likes about working with NGP is that capital comes from the fund, and also directly from some limited partners. That approach has several advantages. It enables LPs to vote with their dollars, giving NGP managers a very clear message about what their backers like in the field. It also keeps operations in the family, avoiding complications of creating syndicates or clubs. And it also gives flexibility for midcourse adjustments as well as exits.

Polzin has a rare perspective on PE, given that he is petroleum engineer and a former investment banker, with the ability to see from both sides. He concurs that other sources of funding are much tighter, but that it might be overly dramatic to say that PE is the last man standing.

"If you look at the Concho Resources equity deal just recently, it is clear that for very solid companies the markets are still open. But in general it is true that public equity is a lot less available, and public debt is a lot less available."

WildHorse Resources II

This company has about 100,000 net acres in northern Louisiana with 460 operated wells and production of 45 million cubic feet a day of essentially dry gas. CEO Jay Graham has one rig running, down from two, working east of the Terryville Field in North Louisiana. Despite the numerical name, WHII is actually the third operating company that NGP has backed with Graham and his team.

"From an operator's perspective, the keys to the A&D business are both to buy at good prices and also to have the management skills to exploit those opportunities. We believe we can drill faster and complete less expensively so we can make dry gas work."

In this case the good rock is deep, overpressured Cotton Valley. Graham says that WHII wells have seen initial rates of 30 MMcf/d on extended laterals.

"We recently saw the deal where GeoSouthern, backed by GSO/Blackstone, picked up Encana acreage with the same deep, overpressured nature. This shows that we are in the right basin."

Sketching in the curve, Graham observes that, "publicly gas is still out of favor, but I think private equity is trying to stock up on Gulf Coast gas to get close to the new LNG export terminals that are soon to be completed. We are very well set up for that."

Based on eight years of working with NGP, Graham summarizes the experience: "They are financial guys, they don't do deep dives into the geology, but they do understand the business and they have great relationships. WHII is focused exclusively on north Louisiana, but NGP has investments in other areas, so they can get us together one-on-one with our sister companies to trade information on drilling and completion."

Though there is still some competition with other portfolio companies, there is commonality of purpose. "We can feed off each other, and NGP is bridging those relationships."

Murphy Markham,
Managing Partner, *EnCap*

EnCap and Broad Oak Energy II

Several big energy funds closed at or beyond their targets this year, despite the deep down cycle in the industry. One of the biggest is EnCap Investments LP's Fund X which closed at $6.5 billion in April.

"We've already committed half of that to nine management teams," said Murphy Markham, managing partner. "Consistent with what we've done in the past, half of the teams are repeat performers for us. Some teams we have backed three, four, or even five times. The teams that are entirely new for us are either known money-makers or teams with strong technical capabilities and a sound business plan."

While XTO's success in creating value was truly extraordinary, EnCap's target return, said Markham, is a much more repeatable goal of turning $1 into $2.

"Typically we allocate a fund over the course of two years, and then make actual investments over the course of five years. Our return objective has never changed: turn a dollar into two at an internal rate of return of 25%."

EnCap's actual return over 28 years has been turning a dollar into $2.30 at IRRs of 45%.

"We generally employ two types of strategies: acquire and exploit (A&E) and lease and drill (L&D). A&E is underpinned by proven, developed, producing assets," said Markham. "It means buying producing assets and creating value through lowering costs, increasing production, increasing efficiency and further exploiting the reserve base."

Ten years ago 80% of the teams EnCap backed pursued A&E strategies. That evolved over time with the advent of the resource plays, where developing low risk drilling opportunities through an L&D strategy created significant value.

"About 80% of Fund VIII was pursuing L&D strategies," according to Markham. "But today there are very few basins that are economical to drill at current prices— the Permian, the Marcellus, the Midcontinent's Stack play and the Eagle Ford. A&E is now the focus again in this lower price environment. We have invested over $750 million in acquisitions over the last twelve months."

> **"Private equity brings fast scale.**
> **Family and friends are great, but they do not have scale.**
> **PE can do deals very quickly."**
>
> *—Rick Jennings, CEO, Atlantic Resources*

A big win for EnCap was backing the original management team behind XTO Energy, eventually bought by Exxon in 2009 for $41 billion. A dollar invested in XTO at its inception and held through the Exxon transaction would have yielded $56.

Markham notes that the nature of the buyer universe has changed.

"The large and small-cap public companies used to be the predominant buyers, but today it is private equity-backed companies. There are lots of private equity firms and their management teams looking for opportunities, so we have to be patient. We are not going to try to chase highly marketed deals and overpay to win bidding wars. Instead, our teams are out there looking for attractive opportunities that we think we will continue to see as the downturn progresses."

Broad Oak produces about 5,500 boe/d net, from 32 horizontal Wolfcamp wells on 23,000 acres of the Midland Basin in Irion County, Texas. It has one rig running. Jim Sherrill, co-president, said, "We anticipate continuing that. Our well costs are down dramatically, and we are getting better EURs due to improved frack design. We are hopefully near the bottom of another industry bust, but we feel about as fortunate as a production company can be in this environment."

Carl Tricoli, Managing Partner and Co-president, *Denham Capital*

A $300-million commitment from EnCap may have more than a little to do with such enthusiasm.

Sherrill is focused on operational efficiency and cost control. "We think we are one of the best operators in the basin," he said. "That is due to our people and how we coordinate in the field with our service providers so they can get in, do their job, and get on to the next job. Better coordination, knowing they won't have to sit around, means better pricing for us."

That kind of focus certainly yielded results the last time around: Broad Oak I was sold to Laredo Petroleum for $1 billion. Broad Oak II has 90% of the same staff, and is working just about 20 miles away.

Denham Capital and Atlantic Resources

"The most important thing in any market environment is to focus on the assets," says Carl Tricoli, managing partner and co-president of Denham Capital. "It's all about the margin, more so than the price. Quality assets can make a margin in almost any price environment, within reason of course. That is because as prices come down, costs come down. Not in lock step, but in relationship."

Rick Jennings, CEO
Atlantic Resources

In the current price environment Denham is focused on "assets that would not otherwise be available," Tricoli said. "That is more important than having any huge bargain. Even if returns are modest in the current environment, it is still key to have access to assets."

Although Tricoli believes a recovery is not far off, "I think it will get worse before it gets better. The bank redeterminations this spring were a non-event. And I don't think the other capital markets are going to show up in 2016 the way they did this year. As prices came down, the floodgates opened and all this money came in, but it did not fix anything. So 2016 is shaping up to look like a good year for PE. The other capital markets are shot."

That said, Tricoli figures that the way assets become available will vary with the strength of the selling company: the weakest ones will sell assets, the viable ones will form joint ventures, and the healthiest ones will arrange a farm-in to raise cash to drill.

Atlantic Resources

Rick Jennings, CEO of Atlantic Resources, has been in the Permian Basin for decades, and his first turn at the helm of a production company came in 1998. Initially funding came from family and friends, then from a private equity investor, and most recently from Denham Capital.

"We wanted to go back with PE, and had friends who work with Denham. We liked the team there, and there was a good fit with their philosophy. They also had a limited number of other teams in the same basin."

Atlantic will spud its first well soon, but it operates some legacy assets that have been around through several iterations. "We have not yet teed off on a drilling program or a large acquisition, but we are sitting on a pile of cash," said Jennings. "Service prices have come down, but transaction prices have not. We are in a good position when they do."

The key to private equity funding upstream companies is its patience, he said. "PE also brings fast scale. Family and friends are great, but they do not have scale. PE can do deals very quickly." ■

MANAGEMENT STRATEGY

Fight To Win

In the low-price arena, competitive muscle and financial fitness drive the capital agenda and ultimate survival. What is your fighting weight, and will you come out on top?

By Vance Scott, EY

Several factors contribute to any oil and gas company's financial, reserve and operating strength. Traditional E&P strategic analysis focuses on financial measures alone. Our approach includes these, but also explores alternative strength indicators through unique and proprietary lenses. Specifically, our analysis into External Pressure Exposure™ and Reserve Resilience™ delivers several intriguing perspectives. These and other key factors defining relative strength and weakness are discussed here.

Financial strength

E&P financial strength is driven by the fixed cost coverage, hedging impacts and External Pressure Exposure™. Fixed cost coverage (covering commitments to creditors, investors and in-process capital programs) is key to preserving equity values and future options.

Although many E&P companies will be in trouble with an extended low oil price, more than half cover their fixed charges at US$45/bbl oil and US$2.50/MMBtu gas. However, many will remain under water even if oil returns to $75/bbl and gas to $3.50/MMBtu.

Hedging protects many companies from the full impact for a time, but many leveraged companies face lower flexibility as their hedges roll off. A concern is well-hedged companies deferring structural business changes while hoping for an oil price rebound.

Although a rapid oil price recovery may occur with an unexpected event (such as Middle Eastern supply instability or an OPEC/Russia rapprochement), we believe structural changes from the source rock revolution and Asian economic challenges provide strong headwinds.

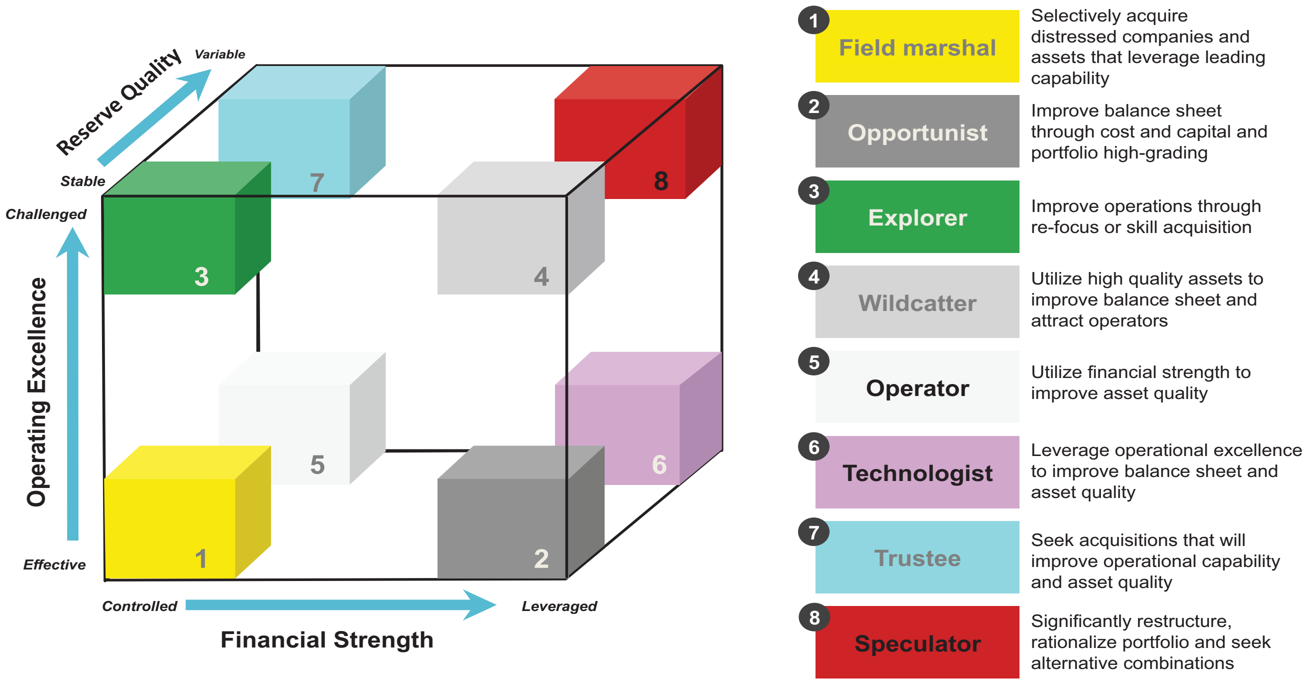
If the oil price does not rebound, nearly half of the North American E&P players in our analysis will experience more than a 30% revenue decline. Concerns escalate for those companies that are highly hedged and highly leveraged.

External pressure exposure

A new development in this cycle, one that may not yet be fully appreciated by E&P executives, is increased regulatory scrutiny of bank lending. U.S. government oversight has clearly increased as a direct outcome of the Great Recession financial crises. Our analysis anticipates potential downgrades, which could impact borrowing capacities.

Any credit exposure that exceeds the lending limits is highly scrutinized, creating pressure for banks to reduce exposure or drive borrowers to lower their credit facilities. As this occurs, lead banks are required to communicate downgrades to all syndicates, effectively restricting alternate bank financing for E&P operators.

EY'S PROPRIETARY EVALUATION TOOL



Source: EY. EY's proprietary evaluation tool not only identifies companies likely to take action in this environment, but more importantly, the motivation for that action.

Our External Pressure Exposure™ analysis indicates approximately 20% of the E&P players in our analysis set could have challenges with Lenders "Payback Period" and "Interest Coverage" tests, and nearly 10% will have issues with a "Leverage" test. Several players will potentially have problems with all three.

Companies with better performance across all financial strength dimensions have greater ability to weather low oil price impacts and the flexibility to access debt financing to capitalize on both asset and company acquisitions. Lower performers are at greater default and survival risk.

Reserve strength

Reserves are critical to flexibility, and companies with high-quality reserves have stronger options. We have witnessed commodity price impacts across many cycles. In the supercycle, supply-demand balances drove price, which drove cash flow, which impacts capital investment timing—particularly exploration capital.

This also impacts economic limits and follows through to reserve valuations. Declining reserves impact credit covenants and equity values (which then further impact credit). Companies with larger and balanced reserves clearly have an advantage.

Another advantage occurs when future project portfolios are robust relative to commodity price volatility. For example, companies that defer or eliminate fewer exploration and development projects with declining oil price have an inherent strength and advantage. Our proprietary Reserve Resilience™ analysis considers the changing oil and gas price impact on an E&P company's reserve base and highlights stronger and weaker E&P players.

Operating capability

As always, strong operating capability is critical. Most marginal production remains economic at US$30/bbl. Our analysis places roughly a third of the companies in our analysis in the strong category. If the low oil price environment persists, the remaining companies must improve F&D or optimize developed asset performance to weather a prolonged downturn.

Furthermore, in a low price environment, companies with stronger transaction capabilities are positioned to acquire valuable assets and companies. Unfortunately, most E&P companies have a mixed record for delivering shareholder value through transaction activity. That said, there is a select set with proven results for both company and asset acquisitions that are best-positioned to capture opportunities—provided they can access capital!

The capital agenda

Traditional E&P strategic approaches may no longer be viable in the changing hydrocarbon landscape of 2015 and 2016. Instead, a better approach is logically reviewing the strategic set and determining which levers have the greatest impact given your competitive position.

In distressed situations, a comprehensive strategic option set is critical. This is best accomplished by considering all the options and the appropriate sequence across what we call The Capital Agenda: 1) preserving capital, 2) optimizing capital, 3) raising capital and 4) investing capital.

Preserving capital. For example, a company positioned as a "trustee" has financial flexibility but needs to make gains in developing its reserves and operating effectively. In this low oil price environment, the first reaction will be preserving capital by pulling back on exploration and development drilling.

A better path, given a trustee's relative financial strength, can be seeking to acquire other companies (or potentially form a JV) with the "opportunists," which have strong reserves and operating capability but are highly leveraged.

To further illustrate this line of reasoning, consider a firm in the "speculator" position. Its first move is to accurately understand its cash flow position under different price scenarios relative to debt obligations. Next is "preserving capital" by high-grading exploration, drilling and development programs and stopping spending to the degree possible, including rapid contract renegotiation.

Optimizing capital. A view through the "optimizing capital" lens can then inform actions to structurally reduce costs, such as revisiting the business model, assessing pay scales, benchmarking drilling and production costs and practices, reexamining IT and support costs, and evaluating supply chains to eliminate duplication and inefficiency.

Once the first level of preserving and optimizing capital opportunities is understood, corporate leadership can reevaluate the cash position under a "fit and strong" operation (as opposed to severely lean or anorexic) and determine appropriate next actions.

If the fit and strong model cannot enable success, the next step is evaluating second-level options.

For example, the firm can potentially go deeper into preserving capital by exploring restructuring credit facilities and borrowing terms, or changing its legal business structure to optimize tax.

Raising capital. For a speculator this will be challenging, so it must consider the portfolio divestment options and determine which assets capture the needed capital, while preserving future growth options and ensuring balanced portfolio risk. Finally, if these directly controlled alternatives do not position the speculator for success, it will need to evaluate potential mergers, and even reset options, including a workout or Chapter 11 alternatives.

Conclusion

Executives who understand their relative financial strength, reserve strength and operating capability—and how oil price dynamics impact their competitive position—will have deeper insight into their own strategic options and, more importantly, their competitors' situation and responses. With this insight, leadership teams can act with increased confidence under the current uncertainty, enabling them to survive and win in the low oil price arena. ■

Vance Scott serves as the EY Americas Oil & Gas Leader of Transaction Advisory Services. The views reflected in this article are the views of the author and do not necessarily reflect the views of the global EY organization or its member firms

MANAGING DEBT

Head Winds in High Yield

When it comes to accessing the high-yield market, the gap between the "haves" and "have-nots" has widened as the outlook for a price recovery extends further out.

By Chris Sheehan, CFA

The heady times of 2014 have given way to a narrowing range of options for companies with high debt loads.

The "lower for longer" outlook on oil and gas prices has gained widespread acceptance, thus widening the gap between the "haves" and "have nots" in terms of E&P companies' ability to access the high yield market. Barring an unanticipated upturn in commodity prices, the range of options for many E&Ps to tap into potential new financing sources—high yield or otherwise—has narrowed considerably.

“There’s a big bifurcation between the ‘haves’ and ‘have nots’ and the trend is that the bifurcation continues to get larger and larger,” said James Spicer, Wells Fargo Securities’ senior analyst in high yield research. “In today’s market, there is a very small subset of very high quality companies that can still access the high yield market.”

A large factor influencing the diminished access to high yield is the more widely accepted view that crude prices will stay “lower for longer,” according to Spicer. While near-month futures contracts for West Texas Intermediate (WTI) have recently hovered around the mid-$40s, contracts trading further out towards the long end of the commodity curve have fallen by $8 or more per barrel, he noted.

“That move reflects what now is a consensus viewpoint that we’re probably going to stay around these oil prices for a while,” said Spicer. Whereas earlier expectations were for a rapid bounce back to $60/bbl in 2016, the recent Nymex forward curve doesn’t reach that level until after the year 2020, he noted.

Lower oil prices have in turn taken their toll, prompting an abrupt drop in issuance of high-yield paper.

While such issuance was fairly robust in the first part of 2015, “it’s fallen off a cliff since oil prices started declining again in May,” observed Gary Stromberg, Barclays Capital’s senior energy analyst covering high yield. From January through May, E&Ps issued $16 billion of high-yield paper—but from June 1 through the latter part of September, issuance fell dramatically to around $2 billion, he noted.

Often, high yield E&P credits are grouped into three categories. The top tier is comprised of issuers with strong balance sheets, good liquidity and high quality assets, whose credits trade firmly on a single-digit yield basis. Concho Resources is cited by Stromberg as an example.

The middle tier is made up of credits reflecting liquidity levels that currently look adequate, but less so if the “lower for longer” outlook lasts for another couple of years. Carrying somewhat higher debt than ideal in a $40- to $50/bbl world, these may trade on a high single-digit or low double-digit yield basis. Examples at press time include EP Energy Corp., Oasis Petroleum Inc. and Sanchez Energy Corp.

In addition, there is a lower tier of issuers, whose debt is typically trading at 50 cents on the dollar and lower. These companies are clearly candidates for restructuring—even in the event oil should move back up to $70/bbl—with their debt likely to be "equitized" in an attempt to reduce the interest burden and bring spending more in line with cash flow.

For the lower tier E&Ps, the market "is effectively shut down in terms of access to capital on an unsecured basis, and it is becoming shut down on a second-lien basis," said Stromberg. "There's been deteriorating liquidity each month since May."

According to Barclays' data, about $24 billion, or 17%, of the $140 billion in face value of bonds issued by the E&P and oilfield service sectors are trading below 50 cents on the dollar.

Gary Stromberg, Barclays Capital's senior energy analyst covering high yield, noted that from January through May, E&Ps issued $16 billion of high-yield paper—but from June 1 through the latter part of September, issuance fell dramatically to around $2 billion.

No doubt, tougher conditions face the energy sector, and that's reflected in the wider spreads over U.S. Treasuries that the high yield market now demands. Since early this year, the spreads for E&P issuers have widened by roughly another 300 basis points from the earlier record levels for the energy sector. The peak spread over U.S. Treasuries reached approximately 930 basis points in early September, Spicer said.

"It's been driven primarily by the lower credit quality half of the universe, which continues to get beaten up in this environment," he said. "The market filters all the information available, and decides which issuers are likely to be the survivors and which are likely to be restructuring candidates."

"In today's market, there is a very small subset of very high quality companies that can still access the high-yield market," according to James Spicer, Wells Fargo Securities' senior analyst in high-yield research.

Looking at the trailing twelve months ending August 31, the Barclays High Yield Energy Index showed a negative total return of roughly 20%. According to Stromberg, this resulted in an estimated $60 billion in market value of bonds being erased over the preceding year—"a pretty astonishing figure."

For 2015 through mid-September, the high yield market, excluding energy, had a total return of about 0.4%, with the aggregate high yield market, including energy, showing a negative return of 1.1%, according to Barclays. High yield in energy had a negative return of 10.1%, with the E&P sector showing a negative return of 17.2% and oilfield service a negative return of 9.5%.

Challenges looking ahead

Looking ahead to the latter part of 2015 and into 2016, the outlook is challenging on more than one front.

Assuming no benefits from hedges in 2016, as well as conservative capex at levels needed to hold production flat, the E&P issuers of high yield covered by Barclays would need an average WTI price of $68/bbl to break even on a cash flow basis, according to Stromberg. As of early September, only two E&Ps were able to break even on a cash flow basis below the 12-month strip price at that time, which was around $49/bbl.

Examining the issue from a different angle, at a $50/bbl WTI price--and without the benefit of hedges--some 75% of the peer group would generate EBITDA at levels that would fall short of, or only just match, maintenance capex, i.e. the capex required to hold production flat.

In addition, the ratio of debt-to-EBITDA for the E&P peer group is projected to climb to 5.4x in 2016, up from an average of 4.5x in 2015. Typically, according to Stromberg, bank covenants stipulate a debt-to-EBITDA ratio of no higher than 4.0-4.5x. But he notes that about 45% of E&P issuers are projected to have higher debt than that, at levels over 5.0x EBITDA in 2016, with 33% exceeding 6.0x.

And, of course, there is the fallout from the October 2015 borrowing base redetermination season, and the prospect of another—perhaps more challenging—redetermination in the spring of 2016. As for the autumn redetermination, a frequently cited expectation was for a 10%-20% decline in borrowing bases, affecting mostly those E&Ps

HIGH-YIELD ENERGY EBITDA AND LEVERAGE ($MM)

	EBITDA			Gross Debt/EBITDA		
	2014	2015	2016	2014	2015	2016
E&P						
Antero Resources Corp.	1,162	1,163	1,413	3.8x	3.9x	3.8x
Baytex Energy Corp.	1,217	676	677	1.7x	2.5x	2.3x
BreitBurn Energy Partners LP	474	639	535	NM	4.7x	5.5x
California Resources Corp.	2,548	791	704	2.5x	8.4x	9.9x
Chaparral Energy Inc.	455	393	220	3.6x	4.2x	8.0x
Chesapeake Energy Corp.	4,945	2,534	1,575	2.4x	4.5x	7.8x
Concho Resources Inc.	2,033	1,706	1,647	1.7x	2.0x	2.4x
Denbury Resources, Inc.	1,402	965	627	2.5x	3.6x	5.9x
EXCO Resources Inc.	391	255	200	3.7x	6.0x	8.6x
EP Energy Corp.	1,547	1,611	1,348	3.0x	3.1x	3.7x
Halcón Resources	782	699	575	4.8x	4.4x	5.5x
Hilcorp Energy Co.	1,261	1,558	843	1.5x	1.0x	1.9x
Linn Energy LLC	2,235	1,663	1,409	4.6x	5.8x	6.8x
MEG Energy Corp.	979	457	609	4.5x	10.8x	8.1x
Memorial Production Partners	310	358	351	5.1x	5.2x	5.4x
Paramount Resources Corp.	210	251	460	5.8x	6.2x	3.7x
Rice Energy Inc.	247	421	487	3.7x	3.8x	4.3x
Range Resources Corp.	1,201	901	907	2.6x	3.7x	3.7x
RSP Permian Inc.	215	262	263	2.3x	2.8x	3.6x
SandRidge Energy Inc.	873	479	322	3.7x	8.7x	11.3x
Stone Energy Corp.	449	320	272	2.3x	3.3x	4.5x
Teine Energy Ltd	244	151	165	1.6x	3.3x	3.1x
Whiting Petroleum Corp.	2,149	1,391	1,292	2.6x	3.8x	4.1x
WPX Energy Inc.	967	966	868	2.4x	3.4x	4.6x

If oil prices remain depressed, bonds will face equitization to eliminate the interest burden and bring spending more in line with cash flow. Source: Barclays

with already high utilization of their bank revolvers, and which were unable to expand meaningfully their reserve base.

A recent Macquarie Capital research report forecast a 10%-15% decline in borrowing bases across the industry in October, with the spring 2016 redetermination posing a higher risk if commodity prices stay low. Over an 18-month period from the fall of 2014 to spring 2016, Macquarie estimated that E&P borrowing bases, under given assumptions, would decrease by 30%-35%.

"For those companies that already had stressed balance sheets, the borrowing base redetermination season may simply accelerate the downward spiral that these companies were already facing, widening the gulf between the 'haves' and the 'have nots,'" commented Spicer. "Every day that goes by with oil prices in the $40s creates a bigger hole from which companies have to dig themselves out."

In early 2015, Stromberg estimated that about 5% of high yield energy bonds could default this year, with the number growing cumulatively to 20% in 2016, should WTI prices remain below $60/bbl. The forecast is one that he continues to stand by.

"Early in the year a lot folks thought we were dead wrong, because the financing was available and companies rushed to extend their liquidity window," he said. "Now that market is basically not there for a lot of these companies to continue to do that."

With more traditional financing sources under pressure, has there been much evidence that funds specializing in distressed energy credits—funds raised by such sponsors as The Blackstone Group, Riverstone Holdings, etc.—have been participating in the high yield sector?

"I think they're doing more on the direct lending side, where they're able to structure first-lien lending with tight

LIQUIDITY ANALYSIS ($MM)

	As of 6/30/15 Borrowing Base	Available	Cash	Liquidity	2H15E FCF	Debt/Equity Adjustments [1]	2016E FCF	Debt/Equity Adjustments [1]	2016E Liquidity	Runrate Years
E&P										
Antero Resources Corp.	5,000	3,407	143	3,550	(150)		(874)		2,526	2.9
Baytex Energy Corp.	1,200	1,012	0	1,012	(40)		156		1,128	NM
BreitBurn Energy Partners LP	1,800	465	10	474	107		178		759	NM
California Resources Corp.	1,250	660	37	697	(58)		(345)		294	0.9
Chaparral Energy, Inc.	550	122	28	150	32		(119)		63	0.5
Chesapeake Energy Corp.[1]	4,000	3,985	2,051	6,036	(440)	(396)	(1,699)	(500)	3,002	1.8
Concho Resources Inc.	2,500	2,294	0	2,294	325		(465)		2,154	4.6
Denbury Resources Inc.	1,600	1,238	4	1,243	(11)		(196)		1,035	5.3
EXCO Resources Inc.	725	301	50	351	(21)		(141)		189	1.3
EP Energy Corp.	2,750	1,571	29	1,600	115		(76)		1,639	21.4
Halcón Resources	850	825	10	835	24		(100)		759	7.6
Hilcorp Energy Co.	1,400	749	148	898	427	(56)	(46)		1,223	26.7
Linn Energy LLC	3,550	1,489	4	1,493	516	(1,091)	71		990	NM
MEG Energy Corp.	2,500	2,500	438	2,938	(32)		(101)		2,805	27.7
Memorial Production Partners	1,300	653	0	653	(16)		(30)		607	20.1
Paramount Resources Corp.	1,000	202	141	343	39		(145)		237	1.6
Rice Energy Inc.	1,400	1,168	257	1,425	(274)		(635)		515	0.8
Range Resources Corp.	2,000	1,527	1	1,528	183	(519)	(39)		1,153	29.5
RSP Permian Inc.	600	500	44	544	(387)	458	(257)		358	1.4
SandRidge Energy, Inc.	500	473	984	1,457	(210)	(95)	(377)	(250)	526	1.4
Stone Energy Corp.	500	481	142	622	(77)		(168)		378	2.3
Teine Energy Ltd	250	198	2	199	(25)		(13)		161	12.6
Whiting Petroleum Corp.	3,500	3,495	60	3,555	(128)		1		3,428	NM
WPX Energy Inc.	1,750	1,750	317	2,067	(2,547)	1,984	(656)		848	1.3

Barclays forecasts aggregate negative free cash flow for the E&P peer group in 2016 at $6 billion. Source: Barclays

covenants at the top of the capital structure, as opposed to playing the high yield market that involves unsecured debt with very weak covenants, and where you can get layered quickly with secured debt," said Stromberg.

"We've seen that money be very patient in terms of deployment. And it's been the right call, given the movement in bond prices."

Other choices

Are there other avenues to explore in terms of financial instruments to help get E&Ps to the "other side" of the downturn?

Addressing recent use of third-lien loans in restructurings, Stromberg noted that these had been used by only a handful of E&Ps, and they did not really involve a new issue, but rather an exchange in which third-lien bonds are swapped for unsecured bonds. The latter are purchased at a significant discount to par, but often at a premium to the recently depressed market price. For example, Halcon Corp. recently swapped $1.02 billion of third-lien senior secured notes for $1.57 billion of three previously issued unsecured notes.

This reduces the face amount of debt, but usually involves a higher interest rate than before—in the Halcon case, a 13% coupon in place of coupons of 8.875% and 9.75% previously.

With the higher interest rate, commented Spicer, "it doesn't dig you out of the hole you're in; it really just buys you more time. That's really what everyone is trying to do. They're trying to preserve liquidity and buy as much time as they can to make it through to the other end of the tunnel. But if companies choose to add high-cost debt to an already overleveraged balance sheet, they may get to the other end of the tunnel only to find that their capital structure is still not sustainable."

As an example of a firm targeting a sustainable cost structure at the end of a debt restructuring, Stromberg cited Hercules Offshore Inc. The shallow-water driller and marine services company took a pro-active approach and filed a "pre-packaged plan" for bankruptcy, even as it still had some $200 million of cash and no looming liquidity event, he said.

Hercules recognized it had taken on debt to the point that its debt service costs made it no longer competitive. The company needed to change its cost structure to make it sustainable. To do this, it implemented a debt-for-equity swap with its bond holders.

For an E&P counterpart to Hercules, who is aiming at a sustainable cost structure, "it's hard to justify 12%-13% debt when you're drilling projects that generate 10%-15% returns," said Stromberg. From a financial viewpoint, "it's kind of a hard message," he said. "But if you have breakeven costs of $80/bbl, you're just delaying the inevitable."

A hard message for hard times. ■


NOMAC
RIG
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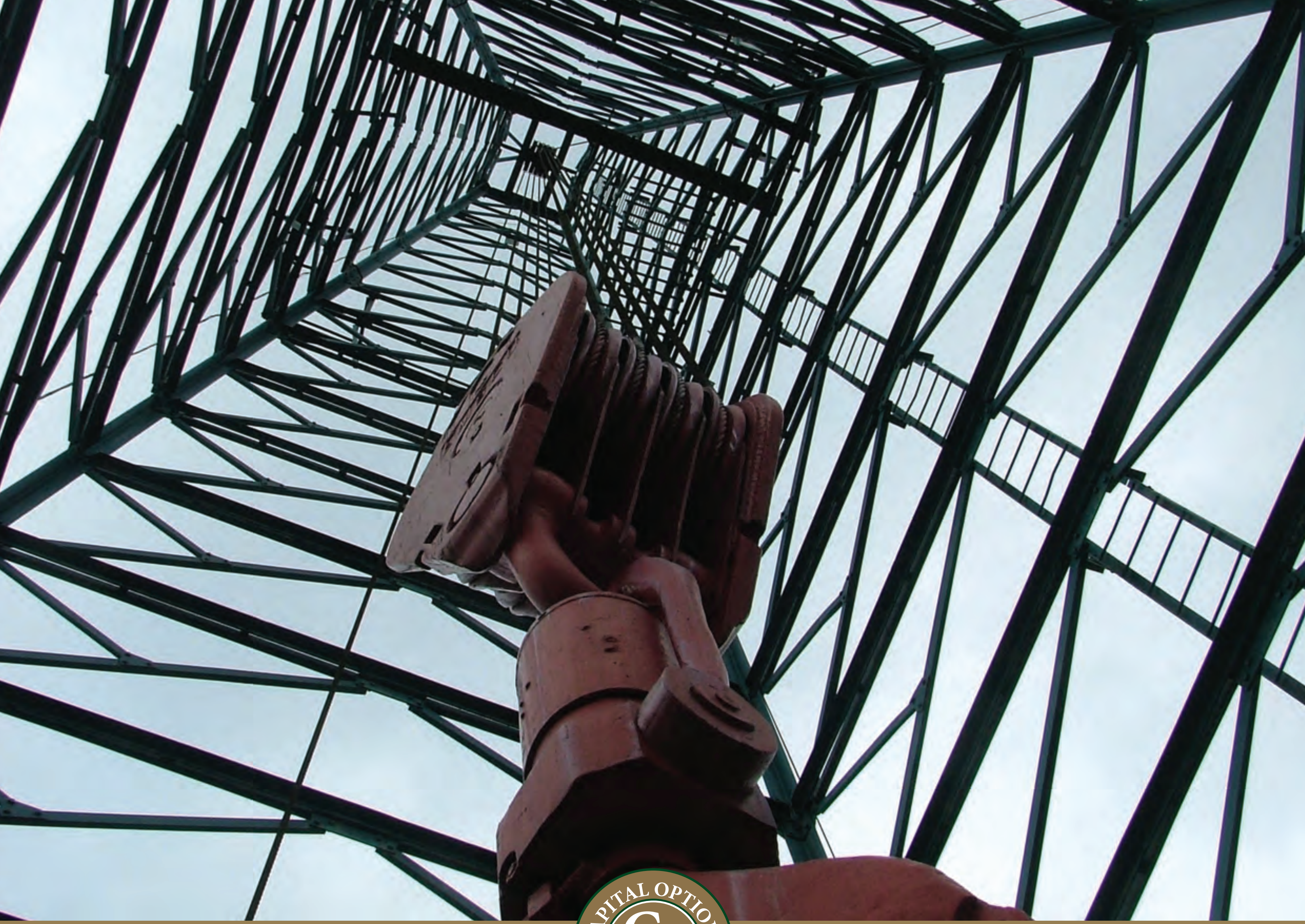


DRILLING STRUCTURES

Drilling down into the DrillCo

Variations on the JV theme can provide additional capital.

By Leslie Haines

In 2015 many companies with stretched balance sheets but high ambitions are coming up with creative ways to bring in capital and live to drill or acquire another day. It's been quite common for private capital providers to fund private E&P companies and start-ups, but this year we're seeing them become more involved with public E&Ps and MLPs.

No better example exists than Linn Energy LLC, which has inked deals with two large private capital providers, GSO Capital Partners LP and Quantum Energy Partners. Jefferies handled the transactions for Linn. Here are some of the details.

Linn and its affiliate, LinnCo LLC, are working with GSO, the credit platform of The Blackstone Group LP, to fund oil and gas development drilling (the "DrillCo Agreement"), with a five-year time frame. GSO and its affiliates agreed to commit up to $500 million for drilling on locations provided by Linn. Depending on the asset characteristics and return expectations of the selected drilling plan, GSO agreed to fund up to 100% of the costs associated with new wells drilled under the agreement.

GSO is expected to receive an 85% working interest in these wells until it achieves a 15% internal rate of return on annual groupings of wells, while Linn is expected to receive a 15% carried working interest during this period. Upon reaching its IRR target, GSO's interest will be reduced to 5% and Linn's will increase to 95%.

This structure allows Linn to develop assets without increasing capital intensity and it adds a steady and growing cash flow stream with no capital requirement, the company said when announcing the deal.

The transaction increases Linn's long-term ability to fund all oil and natural gas development capital and the distribution from internally generated cash flow; and potentially broadens its acquisition universe.

In July, Linn announced another definitive agreement, this time with Quantum Energy Partners, to fund selected oil and gas acquisitions and development of them. Quantum agreed to initially commit as much as $1 billion of equity to fund the buys and subsequent development.

Linn has the ability to participate in all acquisition opportunities that come up, with a direct working interest ranging from 15% to 50%. It will manage the acquired assets in exchange for reimbursement of general and administrative expenses. After certain of Quantum's return hurdles are met, Linn can earn a promoted interest in AcqCo. Finally, upon the sale of any assets within AcqCo, Linn will be given the right of first offer to acquire the assets. ■

STRUCTURE COMPARISON: TRADITIONAL STRATEGIC JV VS. DRILLCO

Item	Traditional Strategic JV	DrillCo Transaction
Deal Structure	Sale of working interest across acreage position	Temporary conveyance of working interest in wellbores
Consideration	Cash and/or Drilling Carry	Drilling Carry or Cash + Reversionary Working Interest
Buyers/Investors	International O&G Companies	Financial Institutions
Capital Availability	$250 MM – $2.0 B+	$250 MM – $2.0 B+
Term	Perpetua	3 – 6 Years (until reversion)
% of Assets Sold	25% - 50%	1% - 5%
Cost of Capital	20% - 30%	12% - 20%
Reversionary Interest	None	Up to 95% of the well
Effective Collateral	WI% across entire asset base	Limited to selected wellbores

Source: Jefferies

DRILLING PARTNERSHIPS

Partnerships Provide Time and Money to Drill Another Day

Structuring transactions that cede some control, yet bring capital in for drilling, may be effective if an outright asset sale isn't possible.

By Scott Cockerham

Hindsight is a curious thing, and nowhere is the futile act of second-guessing and I-told-you-so's more at play than in the E&P space right now. If we all knew that the spot price of oil would swoon from $65/bbl in May and June 2015 to the $40s, what would we have done then? Would some operators have contracted new rigs? Probably not. Would others have rolled over their hedge protection? Absolutely.

Hindsight is for bystanders and rubberneckers. The dominant issue facing operators now, caught in the throes of this down market, is how to survive a

downturn in oil prices that is entrenched and may not abate until 2017.

Selling down or divesting en masse are strategies best reserved to fund growth or new drilling programs in an elevated price environment. Assets are freeing up now, and will soon flood the market at bargain basement valuations. In a depressed market, triage is required that preserves value for struggling companies.

When Noble Energy acquired Rosetta Resources in an all-stock transaction in July 2015, it set a fairly prescient precedent. Noble gained complementary assets and protected its cash for stormy weather ahead. Rosetta salvaged value for its shareholders and earned upside in Noble's subsequent efforts on the assets. The challenge for smaller companies is finding partners for their programs when an outright sale with upside is not available.

Not everyone has Noble's deep pockets, but good partners do exist, and the tenets of the Rosetta transaction have utility. Structuring transactions that cede control or appreciable working interests in drilling programs allows operators to live to drill another day and set valuations at levels that may not be as predatory as that of assets on the open market.

A change in operatorship, coupled with a shift of funding responsibility to the new party, and the opportunity for the operator to earn increased payouts for performance, create a model where both parties are incentivized to drill. Economic, and not necessarily blockbuster, wells are crucial to creating such a structure. Technically this is selling down a position, but the retained working interest by the legacy operator is substantial enough in this hypothetical case that it is not reduced to passivity and can lend its experience to future drilling.

Some of the mechanisms common to mezzanine debt facilities may be useful to a distressed operator negotiating with offset operators or peers familiar with their play. In addition to the conferring of operatorship described here, a company can lend interests in a program at a favorable valuation to the borrower, which provides capital to the distressed company, potentially for drilling but not necessarily so.

The producer could choose to use paid-in-kind (PIK) debt, a running tab with interest; net profits interests; or out-of-the-money warrants that vest as a program's assets appreciate. These give a company in need of capital upside that would not otherwise be available by selling assets outright. Additionally, reducing the borrower's costs, to potentially as low as debt service, allows it to hold cash in reserve during a challenging market.

Skin in the game

The trailing nature of these paradigms speaks to two critical elements for an E&P company to consider before embarking on a joint venture: competence and skin in the game. It is important to note that competence speaks explicitly to operators who are technically capable. There are plenty of solid management teams that have stubbed their toes in the downturn due to poor timing, ill-advised capital structuring, or a paucity of financial oversight. But, teams that can drill great wells will always have the benefit of consideration from potential partners, albeit with strict financial constraints attached.

Skin in the game also is a key differentiator for future partners. Smaller companies compelled to sell their assets outright over the next year more likely than not will do so with guns to their heads. The ability to use alternative financing sends a clear signal to partners that a legacy operator has conviction in the profitability of its assets and is willing to risk its existence on their development. That type of confidence is attractive to partners.

The driving foundation of these partnership concepts is their ability to mitigate risk for all parties while exercising flexibility. In the past the industry has been able to point to the capital raised solely for energy investing by financial sponsors and see it as a vast source of funding. There truly is a staggering amount of capital available from institutional investors, but there's a limit to its reach.

Financial sponsors, and there are always exceptions to any rules about their practices, are currently looking for distressed assets for development by vetted teams.

Some sellers' assets may not meet financial buyers' criteria for a host of reasons. Likely assets, not companies, will receive funding. It makes sense to approach such investors, but it is also important to utilize their structuring levers in creating entities with potential partners. If there was an opportunity to gain a partner who granted upside for performance similar to a private equity waterfall, that would surely be more preferable than folding up a drilling program.

Operators in extremis may feel their only option is to sell their assets outright and seek to reassemble their efforts in a new, recapitalized program that, one hopes, takes advantage of a buoyed price environment when the downturn abates. No entrepreneur would willingly take that course unless he felt he had no other choice. Creativity and flexibility may enable some players to stick it out and survive until the price of oil comes around. Unfortunately for others, assets are hitting the market, and the auction block is growing crowded. ■

Scott Cockerham is a managing director of Conway MacKenzie Capital Advisors, an energy investment bank in Houston and an affiliate of Conway MacKenzie Inc. He was previously a partner of Parkman Whaling LLC and worked at Goldman Sachs and Deutsche Bank.

RECENT NOTABLE JOINT VENTURES

Announced Date	Buyers	Sellers	Transaction Value ($MM)	Description	Primary Locations
Sep-15	Questar Corp.; Wexpro Co.	Laramie Energy II LLC; Piceance Energy LLC	$65	JV in Piceance Basin	Colorado
Aug-15	Undisclosed company(ies)	Enerjex Resources Inc.	NA	Joint venture arrangement	U.S.-Diversified
Aug-15	Paloma Petroleum Ltd.	Empire Energy Corp.	NA	50/50 JOA to develop 4,160 acres in Kansas	Kansas
Aug-15	Breitling Energy Corp.	Undisclosed company(ies)	NA	JV in Permian Basin	Texas
Aug-15	Koch Exploration Co. LLC	Emerald Oil Inc.	23	North Dakota Bakken Shale drilling venture	North Dakota
Jul-15	TPG Capital LP	Legacy Reserves LP	150	JV on Permian Basin unconventional liquids plays	Texas
Jun-15	Matador Resources Co.	HEYCO Energy Group	14	1,900 net Delaware Basin acres	Texas; New Mexico
Mar-15	ArcLight Capital Partners LLC	Rex Energy Corp.	67	Private equity funding for Marcellus Shale development	Pennsylvania
Jan-15	Nighthawk Energy Plc	Cascade Petroleum LLC	NA	JV on Colorado acreage; El Dorado JV	Colorado

Source: Conway MacKenzie

PRIVATE ENERGY CREDIT

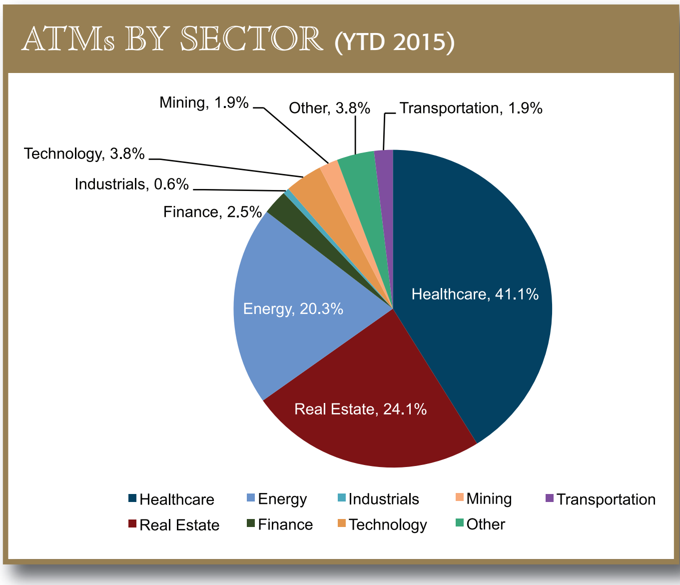
And Two More

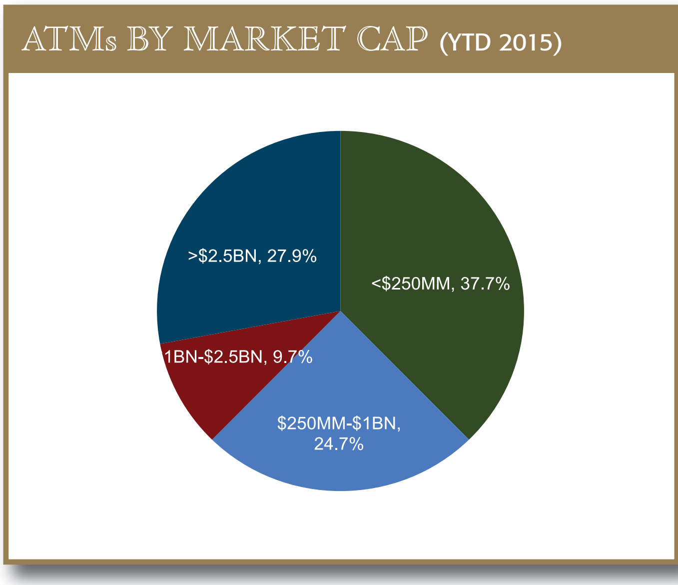
Here are two more options for accessing capital, especially for middle-market companies: private energy credit and ATMs.

By Bill Hurt

The continued volatility of the energy markets over the past year is now creating financing challenges, especially for smaller, middle-market energy companies. Commercial bank lending, which has always been the cheapest financing vehicle for the domestic industry and the main source of liquidity for drilling programs, is sharply constrained by the recent drop in global crude oil prices and structurally low U.S. natural gas prices. This combination severely limits the borrowing base revolver capacity available for many banking clients.

Adding further downward pressure is the combination of increased regulatory scrutiny by the Federal





Note: As of August 31, 2015. Source: Dealogic, Bloomberg, USCA.

Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation on banks in the energy lending business, due to concerns over corporate leverage, the banks' capital adequacy and the potential for systemic credit issues.

Smaller energy players see few attractive alternatives. Most would be loath to sell assets to raise cash, given the discounted and distressed valuations likely needed to transact in the current M&A market. Simply cutting capital spending may not be possible given leasehold drilling requirements and off-take commitments, pointing to further negative free cash flow and a continued need for external financing.

Given the sector's woeful trading performance over the past 12 months, the public debt and equity capital markets remain difficult to access—if not closed—for most new, middle market and small-cap energy companies, particularly oil-leveraged names.

Yes, there is approximately $80 billion in private equity earmarked for energy, based on estimates by U.S. Capital Advisors, but this money entails ownership dilution and loss of management control for the E&P client, making it unattractive for many family-owned enterprises. And most energy-focused alternative credit funds are now targeting either larger-cap opportunities in the liquid energy markets, or distressed energy bond plays.

Consequently, there is a pressing need for new sources of private capital to bridge the financing gap facing smaller operators in the industry.

Many private middle-market energy companies with experienced management teams and attractive asset bases need expansion capital for organic projects and bolt-on acquisitions. This presents an opportunity for private capital providers with a lower middle-market focus, investment expertise across the energy value chain and the ability to commit capital quickly.

Junior debt

By providing intermediate-term, junior debt to such smaller players—mainly in the form of second-lien loans and subordinated notes, often coming in behind an existing first-lien bank facility—they can proceed with development plans and create a financing bridge to a better point in both the commodity and credit cycles.

While higher-cost and well-structured in terms of covenant protections, such private junior debt can be more flexible than private equity, with minimal dilution for shareholders and no loss of control for management teams.

By partnering with the right private energy credit provider, middle-market borrowers are able to tap into the credit expertise and public energy markets knowledge base of these specialty lenders, which should prove valuable down the road as these companies continue to grow.

ATMs

At-the-market (ATM) offerings provide a lower-cost alternative to a follow-on equity offering with potentially less price disruption. Specifically they provide an opportunity to raise equity by selling newly issued shares incrementally into the secondary market through a designated broker-dealer (or sales agent) at prevailing market prices. They were originally used primarily by utilities in the 1980s, but over time, public companies in other industries such as health care and REITs adopted this financing vehicle and raised significant amounts of capital.

Within the last several years, MLPs (including both pipeline and E&P MLPs) have become prominent ATM issuers with close to 50% of publicly traded MLPs having a current filed shelf registration allowing for ATM issuance. Given the continuous need to access capital markets, MLPs can benefit from an ATM program by decreasing the number of follow-on offerings in a given year. MLPs raised over $7.8 billion via ATMs in 2014 and another $5.6 billion through June 30, 2015.

Some observers question why E&P companies have not done more via ATMs. They cite major concerns including the appearance of potential equity dilution by the issuer without a stated use of proceeds, downward pressure on the stock price due to a perceived overhang of shares soon to be issued, and a preference by investors for companies to use lower cost capital, such as debt, for development spending

According to Dealogic, only 10 public (non-MLP) E&P companies have a current shelf registration for an ATM program. The combined size of their ATM programs, $760 million, is small compared with the approximately $24 billion of ATM programs for MLPs. Additionally the 10 E&P companies have an average market cap of approximately $120 million, much smaller than the average $7.5 billion market cap of MLPs with ATM programs.

Will the significant potential cost savings cause this to change? Underwriting fees in a traditional follow-on offering run around 3.5%. That compares with 1% fees paid on issuance under an ATM program. Over time, the lower financing costs may attract more E&P companies to set up ATM programs.

E&P COMPANIES WITH CURRENTLY FILED ATMS
Bill Barrett Corp.
Emerald Oil Inc.
Gastar Exploration Inc.
Halcon Resources Corp.
Harvest Natural Resources Inc.
Magellan Petroleum Corp.
Magnum Hunter Resources Corp.
PostRock Energy Corp.
Royale Energy Inc.
ZaZa Energy Corp.

Over time, the lower financing costs may attract more E&P companies to set up ATM programs. Source: Dealogic

How it works

Setting up an ATM can be accomplished in a few weeks. The basic elements include a shelf registration statement (Form S-3) and execution of a sales agreement with one or more broker-dealers who will act as sales agents.

Immediately prior to commencing the program, the issuer files a prospectus supplement describing the general terms of the proposed ATM offering program, including the plan of distribution, the maximum number of shares to be sold, and names the designated placement agent as required by SEC guidance. There are certain "blackout periods" when shares may not be sold, usually before and after earnings release dates.

Once filings are completed, the issuer designates one sales agent to be active in selling. Only one may be active at a time, and all selling is on an unsolicited basis.

The issuer may provide specific instructions to the sales agent, such as "Sell $75 million of stock at $71.30 or better," on a given day and modify those instructions during the day and each day while the sales agent is requested to be selling.

After a period of time at the discretion of the issuer, it may rotate to designate another sales agent as the active seller. Information about whether the issuer is actively selling or the volume and prices of shares sold is kept confidential. The issuer is required to report the amount of proceeds realized from the ATM program in the quarterly 10-Q or annual 10-K filings. ■

William R. (Bill) Hurt is senior managing director, investment banking, for U.S. Capital Advisors LLC in Houston.


Wyoming Casing

The Right Partner

It's our pleasure to furnish you with a compendium of capital providers that specialize in a variety of areas of energy-related finance. At a time when commodity market weakness has restricted access to public markets for many, it is all the more important to be able to evaluate a full range of capital options, whether in public or private spheres.

These may include energy lending groups providing conventional and stretch loans; private equity sponsors specifically focused on the E&P and midstream sectors; providers of mezzanine finance for a specific project or other use; investment banks specializing in medium- and small-cap companies that have high growth characteristics; or those providing a mixture of the above financial tools.

Key in the process is finding the right match, not only in financial instrument, but also in investment philosophy and strategy. It's surely better to spend the extra time upfront to ensure you have aligned the right type of capital to meet the objectives needed in developing a certain asset or play. The deal structure may ultimately prove as important, in some ways, as the nominal cost of capital.

But the ongoing dialogue will also depend on the ability to build that personal relationship. Partners who have not only aligned their goals and interests, but also have built up trust and confidence with one another, tend to be those who go on to conclude repeat deals between capital providers and management teams in the E&P and midstream sectors.

And remember, although oilfield service costs have come down an estimated 20% to 30% or more, the pressing priority is to stretch the most out of each very valuable capital dollar during this commodity slump!

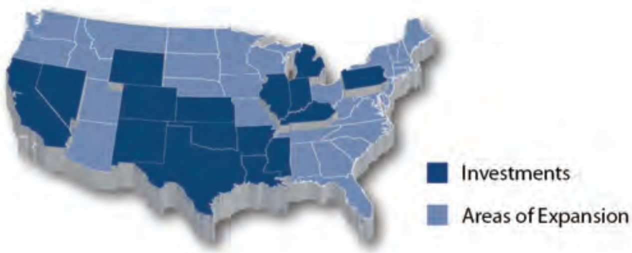
—Chris Sheehan, CFA

BlueRock Energy Partners

The Unique Capital Partner for Small Producers

BlueRock is like you, and we want to be your partner. We provide more capital than banks, our deal structure is non-recourse, and our approach is a lower cost alternative to selling down working interest equity. This combination is unique to BlueRock and provides clients with the ability to retain significantly more upside in their projects. Our passion is helping small producers grow. Let us help you.

- Investment size between $1MM and $20MM
- Client retains upside and control of project
- No 3rd party engineering reports required
- No personal, corporate guarantees or board seats required
- Investment team made up of engineers, geologists and financial professionals
- Simple deal structure and reporting
- Repeatable and expandable
- Favorable tax and accounting treatment may apply



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BlueRock Energy Partners

For more than 20 years, BlueRock Energy Partners has been providing growth capital to independent E&P companies, often providing funds for projects that fall below the traditional minimum deal size of most project finance shops. In total, BlueRock has provided more than $400 million in transactions.

> "Our uniqueness is perhaps more important than ever in a market cycle like we have today."
>
> —*Stuart Rexrode*

Typically BlueRock provides capital ranging from $1 million to $20 million to producers for reserve-based acquisitions, and monetizations with associated production enhancement and/or development. Recently, BlueRock has been particularly focused on the $10 million to $20 million deal size market, and has closed transactions in this range.

BlueRock Energy Partners calls itself ***the unique capital provider for small producers***.

"This uniqueness is perhaps more important than ever in a market cycle like we have today," says Stuart Rexrode, managing partner of BlueRock Energy Partners. "There are significant differences in both how we calculate our advance rate and how we structure our transaction. Typically, BlueRock will advance up to 75% more than a borrowing-base bank facility on the same asset base, and we do not require hedging, so upside price optionality is maintained by the client.

"This is particularly important in today's environment where many clients may be under water on their renewed borrowing-base capacity. BlueRock can often refinance the bank debt and provide additional growth capital at the same time, thereby solving two problems for the client. Our growth risk capital provides clients with a lower-cost alternative to selling equity."

Deal structure

From a structuring standpoint, BlueRock provides the growth capital for clients, in return for a financial production payment, structured as a temporary overriding royalty interest, until a contractual rate of return is achieved.

Once the rate of return is met, the temporary ORRI is conveyed back to the client, and BlueRock may retain a small permanent override in the project. The results of a sound upside development plan should be sufficient to pay the transaction off within four to six years, including Blue Rock's contractual rate of return.

"It is non-recourse, no personal guarantees or board seats are required, and you maintain your interests, upside, and control in the project. The level of cash flow and value you ultimately receive is far greater than if you sold down your working interest to a typical industry partner," Rexrode explains. "We take production, reserve, and price risk right alongside the producer. We will fund development drilling and production enhancement projects. However, we do not fund pure exploration plays."

BlueRock's partners include engineers and finance professionals, all having extensive industry experience. "We understand our clients' obstacles because we have lived them ourselves. We understand the challenges, especially in markets like today, and we pride ourselves on helping our clients through difficult times," says Rexrode. "That's what truly differentiates us from other capital providers." ■

BLUEROCK ENERGY PARTNERS

www.bluerockep.com

Denham Capital

With oil prices down and the medium-term outlook dour, this may seem like a terrible time to start an E&P company.

"We think this is a great time," says Jordan Marye, a partner at Denham Capital in Houston. "It is going to be difficult, but it is a great time to be starting an E&P or midstream company. The market is going through a fundamental re-sorting and opportunity will be the result. The discipline and competency required to be successful are going to be the same whether the oil price is in the $40s or $100."

Denham's track record illustrates that discipline and competence. The firm has 15 investment professionals dedicated to the oil and gas space and has invested over $2 billion in more than 25 oil and gas portfolio companies. The firm's oil and gas team mixes financial and investment experience with specific technical expertise.

Stuart Porter, the firm's co-founder, CEO and chief investment officer, worked for both Goldman Sachs and Harvard Management Co. before starting Denham. Carl Tricoli, a Denham co-founder and co-president, heads Denham's natural resource efforts. Marye, a Denham partner, has been with the firm since 2006, joining from UBS Investment Bank.

Jordan Marye, Partner

"We feel like we have a deep bench and the right balance of capabilities," Marye says. "That means ours is a team that is well-suited to interact with management teams as they try to build a business at the strategic level, at the financial level, and also at the asset level. Typically, we think that the risks that are embedded in the companies we invest in are technical and execution oriented by nature. So if you don't have an appreciation for how the technical interacts with the financial, you can't appropriately strategize or price the embedded risk."

Denham invests primarily in upstream companies, with some investments in midstream projects that are owned or operated by the producers in Denham's portfolio. In almost all cases, Denham invests in start-up companies either as they build assets from scratch, or buy existing assets "and make them better," Marye says.

"When you start an oil and gas company, what you are trying to do is capture opportunity and then convert that opportunity through execution," he says. "So at the initial formation of that business, the first question is, 'Who is your team going to be?' And then, 'Where are you going to source the capital for your strategy?' Once you've captured that asset or potential asset, how are you going to convert it into something that's worth more than what you paid for it?

"What we do is partner with entrepreneurs and assist them in the full lifecycle of their efforts," Marye says. "We spend a lot of time helping them think through their teams and their strategy but then also roll up our sleeves alongside them in the marketplace to originate and capture the assets they seek. From there, we do everything we can to provide resources where the real work happens—execution—the day-to-day swinging of the hammer and building of these businesses into something more valuable than when they started."

Denham places a director on the boards of each of its portfolio companies, in each case a senior partner or other senior member of the Denham team. Regardless, Denham deal team members are available to the companies every day.

"We are not running these companies," Marye says. "What we are doing is providing talented entrepreneurs and their teams resources: capital certainly, but also market access, strategic thinking and hopefully an experienced point of view, having done this more than 25 times."

Denham's point of view

Tall City Exploration LLC is an example of how this works. The Midland-based company, formed in 2012, has a nine-member executive team that averages 30 years of experience in the business. It received a $200 million investment from Denham in 2012 to help it assemble an acreage position in the Permian Basin with hopes of drilling in 2013.

By November 2014, Tall City had sold 14,000 net acres of leasehold and 1,400 barrels of oil equivalent of production to an affiliate of Aubrey McClendon's American Energy Partners LP for $440 million. Tall City retained assets in Howard County, Texas, in the core of the Midland Basin. In a presentation to the ADAM-Houston Energy Network, Tall City said it "began the company with the end in mind" and "prepared for exit before [its] first acre was purchased."

In 2009, Denham invested in Houston's Alta Resources, its first entry in the Marcellus Shale play. The Denham investment allowed Alta to begin leasing, drilling and production on more than 20,000 acres in northeastern Pennsylvania. Denham's Tricoli called Alta "the right partner to take advantage of the cost-competitive production in the basin and its proximity to key gas markets." The next year, Alta sold 42,000 net acres in the Marcellus to Williams for $501 million.

There's no exit—yet—for Denver's Outrigger Energy, a midstream company that owns assets in the Permian and the Rockies. Denham invested in June 2014 alongside a private investor to provide Outrigger expansion capital, and the company has now implemented three major projects, Marye says.

"We are flexible in size," Marye says. "We can do a $50 million equity deal for the right team and opportunity, and we can do a $500 million equity deal for the right team and opportunity. We are flexible on timing and strategy. We are willing to do joint ventures. All of that is underpinned by the fact that we are equity investors who are focused on asset and intrinsic value creation, as opposed to simply timing the market or levering returns."

That also means investing for the long haul, rather than seeking quick exits. Denham has 10-year funds with extension options, "so we can be in things for a long time if need be," Marye says.

"We don't have any idea what the oil price is going to be tomorrow or what the gas price is going to be a year from now," Marye says. "What we're focused on is building businesses that are durable, regardless of the commodity price environment. What we find is that over time, that formula—good people who know what they're doing and good assets that have optionality embedded within them and that are low cost—over time, those things make money almost irrespective of the commodity price.

"We want to own the best houses on the best blocks and we want to build them or fix them up using the best carpenters. And that, to us, is a sustainable, cycle-agnostic way to invest." ■

> "It is a great time to be starting an E&P or midstream company. The market is going through a fundamental re-sorting and opportunity will be the result."
>
> *—Jordan Marye, Partner*


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CAPITAL OPTIONS CO 2015

EnCap's People Approach

People do drive success. And EnCap Investments L.P.'s portfolio companies, investors and investment staff are evidence of that, says Murphy Markham, managing partner.

In the energy-focused private equity firm's more than 27 years, it has invested in more than 225 start-up upstream and midstream management teams and, among the 166 investments realized, its portfolio companies have generated an average return of more than 40% for EnCap's investors and founders. Many successful realized investments have been led by repeat management teams. These portfolio companies are on their second, third or even fifth iteration of partnering and creating value with EnCap.

The investors themselves bring a demonstrated track record, Markham adds. In EnCap's most recent fund, the $6.5 billion Fund X raised this spring, 95% of the investors had invested in prior EnCap funds. "Fund X was well oversubscribed. It would have been 100% existing investors, but we carved out a small piece, 5%, to bring some additional, high quality fund managers into the fold."

EnCap's investment staff has vast experience. The firms founders— David Miller, Gary Petersen, Marty Phillips and Bob Zorich— all started their careers in energy finance together in the 1970s at Republic Bank energy lending group and formed EnCap in 1988.

The bench at EnCap is very deep. The four founding partners have an average of more than 40 years of experience. The three managing partners—Jason DeLorenzo, Murphy Markham and Doug Swanson—have an average of more than 25 years of experience, and the partners and managing directors also have an average of almost 20 years of experience.

"There isn't another energy-focused private equity firm that has as much continuity and experience. A lot of people running other energy funds have less experience than our non-founder partners. It goes back to people. People drive success."

Current market

In the current low commodity price market, EnCap-backed startup management teams are focusing on the acquire-and-exploit business model. "With the advent of shale, there was tremendous opportunity to create value from a low risk lease-and-drill model, and we have experienced great success with that strategy," Markham says.

"But today, in this low price environment, there are only a handful of plays that can be economically developed. But, where there is challenge, there is opportunity. I think we're going to divert more capital to an acquire-and-exploit strategy. As prices stay down, abundant opportunities will surface. With the capital markets being somewhat closed to energy companies, only private equity or cash flow can fund those opportunities."

EnCap has generated returns through the downturns of the 1980s, 1990s and 2000s. "When the market is strong, we're sellers. When it's down, we're buyers. We've had a disciplined approach toward investing. Today's market is a great market to buy into. There are limited opportunities, but we are actively pursuing them."

Repeaters

Among its portfolio company teams currently and historically, some 50% are repeaters. Among the balance, about 25% are known money-makers and the remaining 25% bring a sound business plan and unique technical competence that has been demonstrated in prior work experience.

Some of the new management teams will come from public E&Ps where they have found themselves with "golden handcuffs"— stock grants at, say, $50 a share and a five-year vesting period but currently valued at $30. "They would have to work for many more years to harvest that value. We consistently seek track record, technical competency and sound business plans," Markham says.

"EnCap's continuity and depth of experience is second to none in energy private-equity investing.

"We have a deep bench of experience and continuity both internally and externally—with our portfolio company investments and among our investors.

"People drive our success—the people within our management teams, the people who are our investors and the people on our investment staff." ■

ENCAP INVESTMENTS L.P.

www.encapinvestments.com

Energy Capital Solutions

For the past 14 years, Energy Capital Solutions, LLC ("ECS") has been a leading investment banking firm focused on private capital raising and M&A advisory assignments for mid-size public and private energy companies.

The current commodity price cycle coupled with unprecedented regulations has created a challenging environment for the oil and gas industry. Oilfield services clients have seen margins compressed and utilization drop precipitously. E&P companies, while benefiting from the reduced cost environment, are reducing capital expenditures in the face of marginal or non-economic returns.

Left to right: Russell Weinberg and Scott Trulock, Managing Directors, and David Malkowski, Director

Borrowing bases have been cut by traditional banks who are under scrutiny by federal regulators. ECS is ready to assist its clients to find capital to bridge the borrowing base gap and to help clients play offense in this environment.

Recently, ECS advised Basic Energy Services on its $250 million capital commitment from Quantum Energy Partners to help Basic take advantage of opportunities in this cycle, and advised a confidential client on a new $50 million reserve-based senior credit facility.

Private equity capital, mezzanine capital, and strategic sales are all tools to consider as the energy industry endures the current cycle. ECS' team of senior professionals have decades of experience helping management teams navigate both the capital markets and M&A opportunities. Let us help you create value for your stakeholders and maximize your alternatives. ■

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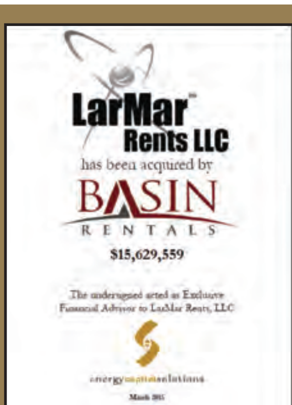

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Energy Spectrum Capital

Experience, stability and longevity are terms often used to describe Dallas-based Energy Spectrum Capital. Two of the founders, Tom Whitener and Leland White, began their working relationship in 1974 at InterFirst Bank. A third founder, Jim Benson, joined them there in 1984. In 1987, all three departed InterFirst for Reid Investments, a boutique energy investment bank where they generated the idea for the first Energy Spectrum fund. A fourth founding partner, Jim Spann, joined the team in 1995, and together they raised the firm's first fund (along with two other partners no longer with the firm). Energy Spectrum Partners LP was launched in 1996 with $140 million of committed capital from three pension funds. Since its founding, the firm has focused on providing lower middle market private equity for midstream companies. To date, the firm has raised seven midstream private equity funds totaling $3.5 billion.

"Our objective has always been to work with best-in-class management teams to build midstream businesses providing value-added services that are attractive to strategic buyers looking for quality assets with predictable cash flows," says Jim Benson, co-founder and managing partner. "When we began in 1995, we determined there were several different groups focused on E&P, but there was a lack of midstream private equity focused on acquisition and greenfield opportunities. That was our focus. There was a definite need for midstream private equity but limited availability, so we decided that was a good place to invest."

The Energy Spectrum team was well-positioned to meet the capital needs of the midstream space. Their time as energy bankers and financiers involved many midstream investment opportunities. "But investing in the midstream space has its own unique challenges and opportunities that differ from investing in the E&P space," says Tom Whitener, co-founder, president and managing partner.

"Challenges include a smaller, although still substantial, universe of potential deals when compared to upstream deals, and midstream opportunities are driven by the actions of oil and gas producers," Whitener says. Midstream companies exist to serve producer needs and rarely initiate new projects without signed producer contracts that provide the underpinnings to the projects and mitigate the risks.

Focusing on midstream also has some advantages. As midstream management teams search for a knowledgeable financial partner, they recognize the value of Energy Spectrum's focus on midstream and years of experience in that specialty. This kind of "pure play" proficiency improves the likelihood of creating strong partnerships with high-quality management teams, as well as the probability of consistently strong investment performance.

Energy Spectrum's top priority when looking at a potential investment is the people involved. "We believe the management team has the biggest impact on whether or not an investment is successful," says Ben Davis, partner. After nearly 20 years of investing in people, the team at Energy Spectrum

AZURE Midstream Company LLC	Frontier Midstream, LLC	Stonehenge Energy Resources LP	Tristate Midstream	Velocity Midstream Partners, LLC
President Chip Berthelot	**President** Dave Presley	**President** Patrick Redalen	**President** Glen Harrod	**President** Rick Wilkerson
partnership began in March 2005	partnership began in May 2003	partnership began in November 2007	partnership began in November 2007	partnership began in November 2008
Dallas, TX	**Tulsa, OK**	**Westminster, CO**	**Denton, TX**	**Tulsa, OK**

has a good idea of what makes a successful management team. Whitener believes there are three main aspects to a great team. "They must have a high level of technical expertise in building and operating midstream assets, they need to be good partners and view our relationship as a true partnership, and our philosophies on acquiring, managing, growing and exiting midstream businesses need to be strongly aligned," he says.

Energy Spectrum's values have earned repeat business from many of its management teams. Of the 14 teams it currently backs, six are teams the firm has funded previously, including two teams with whom the firm is partnering for the third time.

For example, Energy Spectrum's relationship with Frontier Energy Services ("Frontier") began in 2003, during the investment period of Energy Spectrum Partners II LP. Years later, after forming the third iteration of the company, Energy Spectrum and Frontier are currently partnered with Concho Resources Inc. to construct a new crude oil transportation system in southeast New Mexico called the Alpha Crude Connector (ACC). "The guys at Energy Spectrum have been great equity partners for us and have had success with our previous two iterations. There's a huge trust element in the partnership where they're not looking over our shoulders on a daily basis. They trust us and believe in our ability to go out and make these types of projects happen," said Dave Presley, president and CEO of Frontier.

Left to right: Mark Honeybone, Jim Spann, Leland White, Ben Davis, Jim Benson, Tom Whitener, Peter Augustini, Mike Mayon, Chandler Phillips. Not Pictured: Michael Mitchell

Energy Spectrum is now investing its seventh fund, Energy Spectrum Partners VII LP, which closed in November 2014 with $1.2 billion in total commitments. Concurrently, Energy Spectrum continues to support organic growth and acquisition opportunities for the established companies of Energy Spectrum Partners VI LP. Jim Spann, co-founder and partner, says the firm chooses to keep its funds near $1 billion for a reason.

"We want to be able to invest in smaller deals that have strong growth potential," says Spann. "We see attractive opportunities in the market and believe we can continue to invest with discipline in order to generate continued value for our limited partners. With a fund just over a billion dollars, we tend to keep our equity investment range from $50 million to $200 million, but we're willing to do a $5 million deal that has the potential to expand or a multi-hundred-million-dollar investment when we see the right opportunity." ■

Energy Trust Partners

Energy Trust Partners (ETP) raised its first upstream-focused energy private equity fund in 2002. The firm is affiliated by ownership with Energy Spectrum Capital in Dallas, but managed by a separate, dedicated team of energy professionals (see facing page). While Energy Spectrum invests purely in the midstream sector, ETP has and continues to be exclusively focused on lower middle market upstream operators. Since 2002, ETP has invested more than $1 billion through 29 investments across four funds.

Like most E&P private equity firms, ETP's objective is to realize substantial equity returns. It does it, however, by investing with smaller and more tightly focused management teams, having long histories of success in specific areas, than many of its larger private equity competitors today. ETP targets equity investments from $20 million to $50 million, with a few investments up to $75 million in size.

The key to ETP's success is to build niche positions with capable management teams. "We find the smaller opportunities often below the radar screen and grow them with the drill bit and opportunistic acquisitions of adjacent properties or interests," says Patrick Swearingen, one of the founding members of Energy Trust Partners.

"We are very focused on management teams that have knowledge in a particular basin, not a Permian team looking to move to the Bakken. Our investment track record emphasizes the importance of local knowledge in terms of understanding rock quality and sourcing opportunities."

Market transition

The upstream acquisition and divestiture market has transitioned from buyers seeking large undeveloped acreage positions in the early stages of a resource play a few years ago to today's emphasis on building assets for buyers seeking more profitable positions ready for developmental drilling.

"Our management teams pursue smaller, niche acreage positions of 2,000 to 20,000 acres in proven geological plays, which allows for shorter cycle times to de-risk an asset position. We are in the business of developing 'bolt-ons' for strategic buyers and portfolio companies backed by larger private equity," says John Clark, one of the partners of ETP.

Current strategy

"With the collapse in product prices, we feel the era of huge indiscriminant resource play investing is probably over," notes Leland White, a founding partner of ETP. "Today operators must high grade their acreage positions and tightly control costs to be profitable, and that may be the way of the future for a while."

In this environment, ETP believes its tight niche focus and smaller size can work to its advantage. As cases in point, the firm's Valpoint and Manzano teams have recently developed particularly attractive positions in which the drilling economics work even in today's price environment. The Valpoint assets,

Republic Energy	fivestones Energy	Manzano Energy Partners II	RYCA Energy, LLC	ValPoint Energy Partners, LLC
Focused on the development of natural gas assets in the Marcellus	Focused on the development of oil and gas assets in the Permian Basin	Focused on horizontal San Andres projects in the Permian Basin	Focused on conventional acquisition and exploitation opportunities in Texas and Louisiana	Focused on the development of oil and gas projects in the Midcontinent
President John Swanson	**President** Alan Peters	**President** Ken Barbe	**President** Larry Bates	**President** Doug Fisk
Dallas, TX	**Midland, TX**	**Roswell, NM**	**Winnfield, LA**	**Amarillo, TX**

Left to right: Stephanie Sullivan, Chris Sears, John Clark, Leland White, Patrick Swearingen, Alan Hsia and Damian Wells.

located in Western Oklahoma, were sold in September to a large public independent. The Manzano team is currently developing a sizable project in Yoakum County, Texas, targeting the San Andres Formation.

Current environment

Alan Hsia, a founding partner of ETP, says, "While we believe the industry environment will remain challenged, with lower current oil and natural gas prices through most of 2016, this downcycle will lead to significant investment opportunities for our management teams."

By way of example, Hsia cites ETP's most recent investment in Ryca Energy. "Ryca is a re-up of one of our Fund II investments, Voyager Energy, which achieved significant success through a low-risk acquire and exploit strategy on conventional properties in south-central Louisiana," says Hsia. "We're excited to be doing it again with the Ryca team in this current environment."

Fivestones Energy is a Midland-based team seeking similar opportunities in the Permian Basin. Its management team is comprised of four principals with deep expertise and prior investment success in the basin. Both Ryca and Fivestones are targeting acquisitions in the $10 million to $30 million range.

With capital available for only one or two more investments in Fund IV, ETP expects to begin a fund-raise in 2016 for ETP V. ■


HP

Five States Energy Capital LLC

Despite the recent downturn in commodity prices, Five States' strategy remains on course with our 30-year legacy as a capital provider to the energy industry. Independents have done an admirable job in this price environment of streamlining and optimizing their operations in order to preserve value. At Five States, we endeavor to partner with independent upstream and midstream operators to acquire and develop long-life assets. Our investment philosophy allows us to structure custom financing solutions to fit most situations.

In the current pricing environment we are expanding on our core strategy of acquiring long-life, conventional PDP reserves—both gas and crude oil. As hedges fall off and liquids and condensate prices remain weak, we have seen many upstream programs begin to offload producing gas assets in order to pay down debt and continue development programs. While natural gas prices are currently depressed, we believe the relatively lower price volatility will encourage an increase in gas-heavy PDP transactions.

As value investors, we do not try to time the market or predict commodity prices. Rather, we rely on our core fundamental analysis and risk assessment of each deal to direct our selection process.

Five States has the capacity to enter into upstream oil and gas transactions primarily through two structures: as a working interest partner or as a mezzanine lender. In both instances, property-level production economics drive a significant portion of our internal decision process.

Five States employs a careful selection process refined by our decades of experience in production acquisition and development, as well as midstream and service company development and operations. Our goal is to help our clients develop and maximize the same type of properties we both want to own. Discipline and diligence in our project assessment have proven valuable to both our investors and our clients in the past and remain central to our continued success today.

Jim Gibbs,
Chairman of the Board

Arthur Budge Jr.,
President and CEO

Midstream investments remain a core focus despite declining production growth. Because much of the production growth in the last five years occurred in basins with undeveloped takeaway infrastructure, we anticipate the continued need for gathering lines and processing facilities. Five States has historically entered greenfield midstream projects as an equity participant, although we have the capacity to offer construction debt as part of the financing package. We are also interested in participating in the acquisition or expansion funding of existing midstream and service operations.

Five States celebrated its 30th anniversary this year. Throughout our history, we have always targeted high-quality projects focused on strong and sustainable assets with proven operating partners. We are a traditional project financier in that we are chiefly interested in the value of an existing asset in combination with strong personnel in place to manage it.

Five States is always looking for strong assets backed by reputable and trustworthy management teams. Our current fund is currently seeking onshore domestic upstream and midstream financing opportunities between \$5 million and \$100 million with a sweet spot between \$15 million and \$50 million. ■

FIVE STATES® ENERGY CAPITAL, LLC

www.fivestates.com

GSO Capital Partners

Is it possible to make $15 billion in energy loans and still fly under the radar? Larry Tharp of GSO Capital Partners, the credit arm of investment giant Blackstone Group, thinks it may be so.

"GSO is part of the strong franchise that is Blackstone, and GSO has great breadth and depth in the market," he says. "But in the small-cap upstream market, it's been my experience that GSO is not as well known. We've put about $15 billion to work in the energy space over the last 10 years. We are not new entrants to the sector. We have quite a successful track record, and as a result of that track record we are active in the market today at a time when capital has pulled back in the upstream space."

GSO currently has access to $9.6 billion of dedicated energy capital. "We find ourselves very well-positioned as credit investors in a segment that we understand well as energy experts, with the fundamental belief that the energy market is cyclical and that today is a great time to be putting money to work," Tharp says.

Tharp joined GSO in early 2013 leading its technical evaluation team and bringing three decades of energy and financial experience from firms including EIG Global Energy Partners, NGP Capital Resources, and Compass Bank. He's a petroleum engineer and registered professional engineer in the state of Texas. He's part of a group of 20 energy specialists at GSO, divided evenly between the Houston and New York offices.

Leading the effort is the head of GSO Capital Partners' Energy Practice, Dwight Scott, a senior managing director of GSO. Scott joined GSO at its inception a decade ago, having formerly served as chief financial officer of El Paso Corp. and as a managing director of Donaldson Lufkin & Jenrette. Robert Horn, another senior managing director of GSO, recently moved from New York to Houston "as a reflection of our continued focus in this sector," Tharp says. GSO's high pace of energy activity has driven an expansion of its Houston presence, and new, larger downtown office space to accommodate its growing staff.

GSO's strength, Tharp says, is a dedicated group of professionals who have the experience and knowledge to structure complex financings and a wide variety of funds to place those investments. "When we feel like we need to be highly secured we can be toward the top of the capital structure. We can be the only debt or the most senior debt. Or, if we feel like that there's coverage and upside, we can drop down and take a more equity-like position."

He can point to several recent investments to illustrate GSO's flexibility:

In February, GSO purchased half of $250 million in senior unsecured notes and $50 million equity issuance from Austin's Jones Energy. The company used the proceeds to repay borrowings under its revolving credit facility, solidifying its capital structure and allowing it "to execute on our long-term growth plan while providing us with the flexibility to take advantage of any opportunities that may arise," said Jonny Jones, the company's founder, chairman and CEO.

Larry Tharp, Principal and Chief Engineer

Dwight Scott, Senior Managing Director and Head of GSO Capital Partners' Energy Practice

Rob Horn, Senior Managing Director

Says GSO's Tharp: "We are continuing to find attractive opportunities providing additional liquidity for companies."

In July, GSO entered into an agreement with Houston's Linn Energy to provide up to $500 million over five years to support Linn's drilling program. Subject to adjustments, GSO will fund 100% of the costs associated with new wells drilled under the agreement and will receive a working interest in the wells. GSO's working interest is reduced after it hits a specified rate of return.

The deal gives Linn "a new source of capital that will allow us to develop assets without increasing capital intensity, enhance our long-term ability to live within cash flow and provide cashless dropdowns of stable production over time," said Mark E. Ellis, Linn's chairman, president and CEO.

"This is definitely a theme of one type of deal that we're looking at right now, which would be called drilling joint ventures," Tharp said. "Those are very attractive to a number of different companies today as companies are trying to limit the capital budget, be disciplined as their investors want them to be, yet still find a way to keep drilling wells that make sense today."

In August, GSO entered into a joint venture with Woodlands-based GeoSouthern Haynesville LP to acquire Encana's Haynesville Shale assets (112,000 net acres and 300 operated wells) for $850 million. GSO is taking a preferred equity position in the venture, Tharp says, that's "structured equity keeping the company lightly levered. Unlike a typical private equity deal, this structure leaves more operational control and flexibility with the company. By providing preferred equity alongside common equity from an exceptional sponsor, we allow the company plenty of time to address even a prolonged downturn."

Keeping the interests of the portfolio companies in mind is a common theme in GSO's investing. In January 2010, GSO bought $125 million in convertible preferred units of Dallas-based Crosstex Energy LP and Crosstex Energy Inc. It followed that up by investing, in October 2012, an additional $91 million in common equity in XTXI (GP). Crosstex subsequently merged with Devon's spinoff of midstream assets to form Enlink.

"It's one of our biggest successes," says Tharp. "In the 2009 downturn, Crosstex had a tough experience and had to cut its distribution to investors. We made a preferred investment that we ended up supporting down the road after the initial investment. It was highly successful because they had an excellent management team and their business did come back. Because of how we structured the deal, they were able to weather the storm, and today they have been merged into Devon Energy's midstream business and are now called Enlink.

"The funds we are investing could go into a variety of different themes, but we see the main themes being providing liquidity: capital infusions for companies that are looking to term out some debt, fund growth or development capital or needing additional capital in one form or another. It could also be drilling joint ventures, and it could be for acquisitions and joint ventures like we did with GeoSouthern."

Predictions for the future of oil prices are all over the map. Many are pessimistic, but others say this downturn may not last as long as many expect. "We are investing in a cyclical commodity, and we don't have a crystal ball to tell us what's going to happen—and by the way, neither does anybody else." Tharp says. "We're not taking a specific view. We are looking forward, and what most companies are looking for is liquidity, an ability to make it through the down cycle. We are most focused on asset value and liquidity. We are trying to provide as much runway as possible for companies to make it through the down cycle."

"We believe that the regulated banks are going to be under continuing pressure to reduce borrowing bases, and that will take away from companies' liquidity," Tharp says. "We are entertaining lots of calls to help provide some of that liquidity back at a very senior part of the capital structure.

"The other thing we believe is that there will be a great opportunity to acquire assets in the down cycle. The floodgates have not opened yet on that. We also think there will likely be a further round of divestitures and consolidations in the industry."

GSO will be there for all of it, Tharp says. "We have an ability to custom-craft a solution, and we think of ourselves as a long term partner with deep industry knowledge. Lots of firms talk about that, but because we have different sources of capital, we really do have the ability to put a wide range of capital structures into our portfolio, and we have done this through numerous cycles. That's the single biggest thing that I see that's different about us." ■

GulfStar Group

Alan Blackburn of GulfStar Group used to work in investment banking for a major Wall Street firm, where clients focused on the price of the firm's services, where junior staff members were called in to do most of the work on deals, where investment bankers were more salespeople than advisors.

"That's not how it works here," he says of Houston-based GulfStar, which is celebrating a quarter-century of representing private companies in sales transactions, accessing capital and recapitalizations, having closed more than 630 deals since 1990. Its client base is primarily entrepreneurs and families who own "middle market" companies between $25 million and $350 million in enterprise value. Most of these private business owners have never sold a company before and don't know what their alternatives are.

"We know what choices they may have in front of them, who their buyers might be, and all the steps involved in navigating the sale process," says Blackburn, a managing director and a nine-year veteran of the company. "So it's a very granular, hands-on, high advisory-content process. It sounds trite, but we do become serious trusted advisors to our clients because they need our help."

Alan Blackburn,
Managing Director

Kent Kahle,
Managing Director

Bryan Frederickson,
Managing Director

Eric Swanson,
Managing Director

True to its roots

GulfStar traces its roots to Rotan Mosle Financial, a Houston firm acquired by Paine Webber in 1983. A number of its bankers stayed on until most of the management decisions moved to New York and the focus shifted away from the middle market.

"We didn't really want to be just a new business calling operation, so we formed GulfStar, primarily to do everything we had done at Rotan, other than public offerings," says Managing Director Kent Kahle, one of GulfStar's founders. The 630-plus deals in the last 25 years make GulfStar the most active middle market firm in the Southwest and one of the most active firms in the United States, Kahle says. Energy and infrastructure deals represent about half the company's business.

"Over the years we've done a large number of transactions, and success breeds success," Kahle says. "We get almost all of our transactions from word-of-mouth referrals. We don't do a lot of what I call direct marketing, and we certainly don't do cold calls or send out letters to prospective sellers. We pride ourselves on successfully completing transactions and basically exceeding our client expectations, and that's worked well for us over the years."

One of the things that differentiates GulfStar from its competitors, he says, "… is that we provide a realistic view of potential value when we initially meet with a client and analyze their business. We have either been in the range that we provided, or above that range, in more than 90% of the transactions that we've completed over the last five years.

"A lot of our clients are first-time sellers, and it's very important that they understand the process, so we really educate them on what's going to happen throughout the process, as well as deliver on what we say we're going to do."

Over GulfStar's long history, most of its work has been for oilfield products, services and equipment companies. However, Eric Swanson, a former Morgan Stanley banker, joined GulfStar this year as a managing director to build the firm's expertise in the E&P sector. He'll also collaborate with Managing Director Bryan Frederickson on restructuring and distressed-company transactions, which are expected to pick up going into 2016.

"This go-round, a lot of new money has been raised with the objective of buying troubled loans or putting 'rescue capital' into companies," Frederickson says. "By paying down debt and pushing the existing equity holders deeper into the capital structure, the company remains more or less intact. New money can earn a good yield on the investment, and the existing investors at least live to fight another day."

This fall, many E&P companies' reserve-based lending facilities are expected to be reduced by commercial banks in response to lower oil prices and property values. "That's really when you're going to see companies pursuing alternative sources of capital," Swanson says.

On selling assets and timing

"One of the least attractive alternatives for many producers is selling assets now, after the dramatic fall in commodity prices, at what could be the bottom of the commodity cycle. Many assets are not economic at current prices and will be challenging to sell for attractive valuations," Swanson says. "That's why many companies are exploring securing alternative sources of private capital. This is where private equity and other non-bank sources of capital are stepping in to provide new capital, which may potentially replace existing credit facilities."

Swanson says it's difficult to see a rebound in oil prices before late 2016 or 2017. The amount of capital poised to buy assets in the energy sector makes it crucial for companies with high debt levels to assess the timing implications of what they have to gain by waiting for commodity prices to improve while existing assets decline.

"Right now, there is a general acceptance in the market that there's not going to be a quick recovery," he says. "It is to the producers' benefit to be as proactive as possible in securing and preserving capital.

"One of the first things producers did when oil prices dropped was to lay down rigs, so for many private operators, production is dropping like a rock. The oil price has fallen in half, but the longer producers wait, the further down the decline curve of existing production they are," he says.

"So if you're considering selling an asset to raise capital and deleverage, you're potentially hurting yourself by waiting because you're going to have less production to sell. When the economics don't support putting rigs back to work to increase production, and you're not getting paid for upside in a sales process, time is not on your side."

Swanson says there's extreme interest in the market in buying assets, and by people who want to put money to work in the energy space. "A number of assets in the Permian Basin have been purchased by private equity backed companies. You'd rather do something while the pool of capital is largely intact and fully available. If you wait a year or more, much of the available capital could have been deployed. If oil prices have not recovered, they will have made their investments before you decide to sell in desperation."

It's important to note, however, that the pessimism in the energy marketplace today doesn't apply to all its participants. Blackburn notes that a number of GulfStar's clients don't have a lot of debt, "and most of them have the ability to wait this out."

"So to many of our clients our advice was, 'Let's just put this on hold until we have a better market.' There's no reason for them to sell at a discounted valuation unless they have to. We haven't tried to force deals into the market that made no sense and that were not in the interests of our clients to try to get the deals done." ■

GULFSTAR GROUP
INVESTMENT BANKERS
www.gulfstargroup.com

Kayne Anderson Energy Funds

Kayne Anderson Capital Advisors is a leading alternative investment manager with more than $25 billion in assets under management, including over $20 billion invested in energy with over 50 investments professionals dedicated to the energy sector. Through Kayne Anderson Energy Funds, the firm has raised more than $4.3 billion of committed capital dedicated to energy private equity investments in primarily high-growth upstream and midstream oil and gas companies.

In August Kayne made a $100 million equity commitment to Monadnock Resources, a new operator led by Matt Gentry, president and CEO, that will consider opportunities throughout select North American basins with an initial focus on the Permian Basin.

Just the month before Kayne made a $150 million equity commitment to another newly formed operator, Amistad Energy Partners. Amistad is led by Bryant Chapman, president and CEO, formerly of BP, and will focus on the Midcontinent, Permian Basin and East Texas regions.

Chuck Yates, co-managing partner of Kayne Anderson Energy Funds, discussed the current lay of the land in the upstream independent sector and how private equity sees the market.

Mike Heinz, Managing Partner

Chuck Yates, Managing Partner

Q What are you hearing from the limited partners who invest with you? Are they eager or anxious these days?

At the end of last year, there was a pretty even split between three mindsets. Roughly a third of our LPs were maintaining course, making their typical allocations to energy; a third were saying that energy has been temporarily hit so it was time to "back up the truck" and overweight sector exposure in anticipation for a long-term recovery; and a third were highly concerned that existing energy investments were down and wanted to watch the market before making further energy allocations.

In contrast, today about three-quarters of our LPs are viewing the current situation as a phenomenal time to invest in upstream E&P companies. The remaining quarter are divided between those who plan to hold steady through what is expected to be a choppy period and those who plan to reduce sector exposure. But the overall sentiment today is much more bullish than it was at the end of last year.

Q Analysts used to speak of a crisis premium built into the price of the commodity, given the geopolitical uncertainties in most producing regions—the aboveground risk. But with the shale bonanza and the rise of a manufacturing mentality, that crisis premium seems to have reversed at least at present, to a discount.

The overarching macro issue, I believe, is that there is just so much inventory in North America and worldwide. You just don't have much of those what-if scenarios currently. You could have a situation where half a million barrels of supply goes offline temporarily, yet because there is so much inventory it tends to mute a crisis mentality.

Q How do investment options look today?

Thanks to a shift in public market sentiment, public E&P investors have shifted focus from production growth in favor of capital preservation and efficiency. This shift will further limit public E&P companies' ability to invest in new projects or noncore areas. Moreover, public E&P companies have already spent 60% to 70% of their 2015 budgets in the first half of the year,

An Adventure Exploration Partners operated pumping unit in Glasscock County, Texas.

which will force companies to tighten their capital spending trajectories during the back half of the year. We believe well-capitalized private companies are uniquely advantaged in their ability to provide both funding and technical expertise to under-exploited asset bases stranded within larger companies.

Fall 2015 and spring 2016 borrowing base redeterminations are also expected to provide additional capital constraints—or worse—for many over-leveraged E&P companies which face difficult liquidity situations. According to equity research analyst projections, the average leverage profile of public E&P companies with enterprise values between $1 billion and $7.5 billion is more than 3x Debt/EBITDA, and more than 4x Debt/EBITDA for companies between $500 million and $1 billion of enterprise value. We believe the amount of leverage within the E&P sector will create opportunities to invest in or acquire assets that otherwise would not be available in a higher price environment. We view the distress that may result from the volatility in the oil price environment as a potential opportunity.

Q You personally, and Kayne have been through several cycles in the industry. How does the current situation compare to previous low-price periods?

The last oil price downturn in 2008-09 was relatively short in duration compared to today. Producers also had optionality in new shale plays and were under limited pressure from banks. The banks were more concerned about their own survival at the time than in telling their borrowers how to run their operations. All of those conditions are different now.

Today especially, you see new mandates and increased scrutiny from the lenders. Due to commodity price volatility and new regulations, the banks are now under increased pressure to both view the world and interact with their borrowers differently. Today, there is less reserve-based lending (focused on cash flow), more covenants and broader definitions of what is considered debt. In spring redeterminations earlier this year, there were still not a lot of directives from lenders. But it seems likely that this fall and next spring new regulations will force banks to be a lot tougher on their borrowers.

Q How would that work?

For example, a producer that had $100 million in EBITDA, $200 million in high-yield debt, and a completely undrawn borrowing base of $200 million would have historically been viewed to have a leverage profile of 2x (high-yield debt divided by EBITDA). But in the current environment, it's expected that the banks will include additional credit analysis in the upcoming borrowing base reviews that measures total committed debt to EBITDA. Therefore in this example, the same company would have a sensitized 4x levered ratio due to the inclusion of the borrowing base in the calculation, despite it being currently undrawn. As a 4x leverage ratio is on the edge of acceptability for most banks, introducing new sensitivities such as this into the bank's analysis will ultimately limit the banks' ability to provide liquidity to its borrowers.

Q So if bank lending and public debt are tighter, what about public equity?

In the first quarter of 2015, a ton of capital was raised through the public equity markets. Given the continued liquidity constraints, more public equity will be needed over the next few quarters. However, two factors make this a good time for upstream private equity. One is that the market's mandate for public companies has changed. The other is the near-term outlook for hedging. The message from Wall Street is very different today than it was 18 months ago. At that time the mandate was production growth, every quarter. That has flipped. Now the mandate is capital discipline, clean balance sheets, and liquidity. Public markets took growth at any cost off the table.

On the risk-management front, hedges with $100 oil are starting to roll off the books and will continue to do so through this year. Though there will continue to be public equity issuances, the market may be more judicious for issuers this time around and, regardless, many companies will need to monetize assets.

Q In short, with public markets, borrowing, and many producers being less hedged in future years, does private equity come to the fore?

Yes, but that is not to say private equity has been neglected to this point. We have consistently seen strong deal flow, especially with middle-market deals. We have actually invested almost a quarter of our Energy Fund VI since November 2014. As public companies face further liquidity constraints, we expect to see even more deal flow.

Q If deal flow and dollar volume are higher, are there lots of new faces on the other side of the table?

Absolutely, many companies that would not entertain a conversation last year are now willing to not only discuss a potential transaction, but actually transact.

Q So what opportunities are you seeing out there these days?

For example, if an operating company has several plays but is capital constrained, the company will focus on the highest returning, proven assets that are core to the company's portfolio. These assets are most likely not for sale, however, the company inevitably has legacy properties or less delineated assets from transactions and growth over the years. These earlier stage plays may have significant potential, however, the company cannot focus the necessary human and financial capital to develop the play into a core asset. Instead of allowing the leases to expire, the company is motivated to monetize the potential, often at a significant discount to transactions 18 months ago.

Firms with both the in-house engineering and management team expertise needed to tackle early-stage technical and geological concepts are well suited to capitalize on these opportunities.

Q How is that?

It is a tremendous competitive advantage to have world-class engineers on an investment team. The ability to recognize an engineering solution in the portfolio, such as a new fracturing technique, and translate that learning to another company is a significant benefit to operating teams. The time and cost savings helps to maximize the value of the investment. ■

LegacyTexas

A banking partner with the resources to deliver.

As a trusted financial partner to the energy industry for more than 30 years, LegacyTexas understands the challenges that come with the territory in this dynamic, unpredictable business. So we know how to move fast when opportunities demand a quick decision, and we're ready to deliver with the funding you need.

Chris Parada,
Managing Director,
Head of Energy Finance

LegacyTexas Energy Finance At A Glance

Commitments of $5 Million to $40 Million
Syndicated Credit Facilities
Upstream Operations
Transportation and Gathering
Reserve-based Development Financing
Property Acquisition Financing

Our story

Based in Plano, Texas, we are one of the largest community banks in the region and a subsidiary of publicly traded LegacyTexas Financial Group Inc. (NASDAQ: LTXB). With approximately $6.5 billion in assets, our financial strength means you'll have even greater access to capital when you need it.

We serve both public and private oil and natural gas producers, transmission and gathering companies and gas processors here in Texas and across the U.S. We provide debt capital to finance oil and natural gas reserve-based development, oil and natural gas property acquisitions, corporate mergers/consolidations, recapitalizations and energy infrastructure assets.

Our focus

LegacyTexas focuses on privately held and private-equity-sponsored companies. As a financial partner with extensive industry knowledge, we can offer added value to your debt financing by collaborating with you on other parts of the capital structure, commodity risk management strategy or M&A ideas. Our experience, combined with strong support from and direct access to our executive management team, allows us to understand each unique situation and provide highly responsive, realistic and tailored solutions to meet your specific needs.

With an emphasis on relationship banking, LegacyTexas also offers specialized business lending, depository, treasury management and private wealth management services for our energy clients.

Our commitments

While our target commitment levels range from $5 million to $40 million, we have the ability to arrange and syndicate facilities up to $200 million. With an estimated $500 million in total reserve-based commitments and $50 million in total midstream commitments across 38 clients, our energy portfolio has doubled in the last 18 months.

Our team

Chris Parada is managing director and head of energy finance at LegacyTexas. He and lenders Alison White and David Carter are ready to help you explore opportunities that will deliver results. ■

For more information, contact Chris Parada at Chris.Parada@LegacyTexas.com or 214.217.7084.

Lime Rock Partners

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

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

With that, Lime Rock Partners was formed, with an initial strategy that remains the same today: invest in global E&P and oilfield services, with a focus on backing quality management teams with differentiated growth strategies. The firm's Fund I was fully capitalized in 1998 at $100 million. Lime Rock Partners is currently investing Fund VII. Total funds raised are nearly $6 billion.

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

"Technology," he says, "has opened U.S. investment opportunities in E&P and service that weren't available even five years ago."

As the price of drilling wells has changed, so has the firm's investment size. Today, the smallest E&P commitment Lime Rock will consider is $50 million.

One of the advantages of Lime Rock's broad focus on E&P and service, in multiple regions, for its portfolio companies is the lack of competition they experience from other Lime Rock-backed portfolio companies. The firm never backs two companies in the same area. "If we have a company addressing a play in New Mexico, that will be the only portfolio company we will back involved in that play," Farber says. "We find that results in a much closer relationship with management teams. They never have to worry we have another company looking at the same assets because we don't have more than one company playing in the same sandbox."

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

—Jonathan Farber

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

Lime Rock also seeks to deploy patience in its investments, which typically run three to five years but have been much longer. It has been invested for nearly nine years in CrownRock, a joint venture operating company with Midland-based CrownQuest and now a major leaseholder and producer in the Northern Midland Basin.

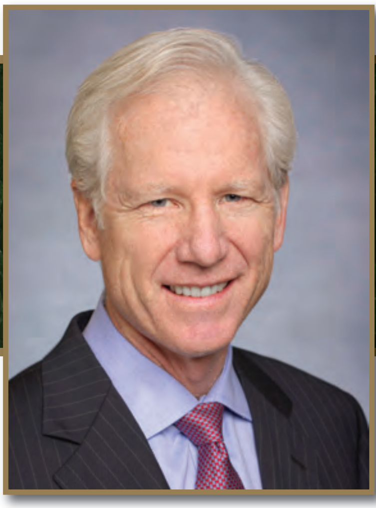
When Lime Rock is investing a fund, it focuses on management teams that bring a strong knowledge of a play. This was exemplified with the firm's 2015 investment with Endurance Resources to expand into the Texas portion of the Delaware Basin. With Lime Rock's initial $100 million commitment, Endurance has already drilled several successful Bone Spring wells and expanded its leasehold position. ■

LIME ROCK PARTNERS

www.lrpartners.com

NGP Energy Capital Management

NGP Energy Capital Management remains a preferred private equity firm for both management teams and investors in the energy sector. The firm just completed a closing of its 11th fund—the largest in NGP's 27-year history—solidifying the firm's status as one of the most important, and effective, private equity franchises focused on energy.



> "We are talking with larger companies about restructurings, including equity infusions as well as large-scale asset development."
> —*Robert Edwards*

NGP started in 1988 when Ken Hersh, co-founder and CEO of what was soon to become NGP, approached legendary money manager Richard Rainwater with an investment thesis based on deregulation of the natural gas industry. Rainwater, Hersh and fellow co-founder David Albin launched their first fund with $100 million.

Fast forward 27 years later, to early 2015 with NGP closing on its 11th fund, bringing in total committed capital of approximately $5.3 billion, or 53 times the amount of the first fund. "Fund XI marked our biggest capital raise ever and pushed total capital raised since inception to $16.5 billion," says Robert Edwards, a managing director in NGP's Houston Office.

Refreshing the talent pool

The investing model that NGP pioneered hasn't changed in 27 years. While the energy industry is known for being cyclical, NGP has made its reputation by investing through the cycles with its philosophy of backing great management teams, who have the expertise to acquire assets and improve fundamental performance.

The strategy works. NGP has built a premier investment franchise in the natural resources sector, closing more than 282 transactions with more than $45 billion of total equity value. What's more impressive is NGP's ability to nurture and support serial entrepreneurs, with a vision of building great companies. NGP has had a hand in building some of the industry's great public companies, such as Energy Transfer, Pioneer, Rice Energy and Memorial Resource Development. But as Edwards explains, "equally impressive is our track record of sponsoring the many, smaller private companies that are on their third or fourth iteration with us of building highly valued, focused, growth companies."

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

NGP's recent success of bringing portfolio companies into the public markets has created an opportunity for bringing in more new management teams. Patrick McWilliams, also a managing director in NGP's Houston office says, "Going public is not the only exit strategy our companies pursue, but for some it is the best way to maximize value. Seven of our portfolio companies have accessed the public markets though IPOs in the past 24 months, which means those teams are gone for the foreseeable future. This success has created an opportunity to refresh the talent pool, and find new owner-managers with great ideas to back."

Another characteristic of the new fund is youth. Backing younger teams with exceptional technical capability is one of the objectives of NGP's new fund, NGP XI. "We are willing to target oil and gas executive teams at an earlier age than most of our competitors," says Edwards. "In fact, NGP has backed more than a dozen CEOs under 35 years old, and several of these portfolio company CEOs are women."

Over the last five years, NGP implemented a "Leaders Under 40 Program" to specifically target executives earlier in their career who can take senior roles in new oil and gas companies. "The focus on the individual and the merit of his or her idea is the core of any investment we make. 'Leaders Under 40' isn't about excluding people over that age, it is simply a recognition that over the last 10 years, our industry has grown dramatically, and created a new wave of talent. We invest in talent and good ideas regardless of an entrepreneur's age," says McWilliams.

> "We invest in talent and good ideas regardless of an entrepreneur's age."
>
> —*Patrick McWilliams*

In fact, the firm continues to fund people of all ages who have good ideas. So far, out of Fund XI, NGP has provided commitments to 18 teams in 2015, ranging from $35 million to $500 million.

The great rotation

As NGP sees it, the current cycle is precipitating a major rotation of assets from mid- and large-sized independent E&P companies that will be forced to rationalize their portfolios to shore up balance sheets and focus on core operations.

"After a lull earlier this year in A&D activity caused by commodity price volatility, we are starting to see the early signs of major portfolio prioritization and rationalization," says Edwards. "It doesn't make sense for large operators to sit on acreage and PUD locations that they will have no financial ability to develop."

Edwards predicts, "The opportunity for deeply capable technical teams to partner with financially sophisticated and experienced capital providers such as NGP will be as great over the next 18 months as we have ever seen in our industry."

Experienced energy investors and oil executives know instinctively that commodity cycles present an increase in the velocity of new opportunities. "The owner-managers NGP backs are a diverse group," McWilliams notes. "We are looking for teams with a specific, demonstrable edge based on technology, relationships or experience in a particular area or in a specific play. Today, we are looking at teams, confident in their abilities and looking to build something special with focus and conviction."

NGP has also responded to the increased variety of opportunities coming its way. As deal flow has increased, so has the firm's ability to evaluate those deals quickly and be more creative with the ones it backs. Over the past several years, NGP has allocated much of its capital to resource development opportunities, but the current price environment has generated more interest in existing producing assets. McWilliams explains, "We can be buyers of production, as long as these assets have been acquired by a team that knows how to execute. Increasing margins through cost control while enhancing reserves with the drillbit and other operational efficiencies is where value will be created."

Industry stress and financial creativity

Reduced cash flow resulting from prevailing commodity prices and more conservative bank lending practices are beginning to create a capital shortage. "Increasingly, we are finding companies with compelling asset profiles that are capital-constrained," remarks McWilliams.

The longer the cycle persists, then the fewer options exist for accessing liquidity. McWilliams adds, "Debt markets are stressed, given the broader regulatory challenges lenders face, and the window is closing on more structured debt alternatives, given heightened levels of cash flow leverage and the expectation of reserve write-downs."

NGP has a broad set of options to employ and customize when partnering with teams. "We can build a creative capital strategy that is appropriate for the individual company and would consider various forms of investments including common, preferred, joint ventures or other similar alternatives," says McWilliams. "We have strategies for investments with public companies to allow them to develop and grow, as well as fresh capital for new teams pursuing acquire-and-exploit strategies."

In addition to having a wide array of tools in its capital options tool box, NGP seeks to invest in more than just upstream E&P opportunities. McWilliams comments, "We expect to deploy about 80% of our capital in upstream opportunities, with the rest allocated between midstream and services."

Bigger fund, greater flexibility

NGP continues to pursue its traditional business model of backing entrepreneurs, but with $5.3 billion of freshly committed capital under management, the firm is able to be flexible and support larger companies with attractive opportunities.

"We're excited about the opportunity to do what we have always done, make initial investments of $35 million to $100 million. This is our core business," Edwards emphasizes. "But with $5.3 billion, we can do more and supplement our traditional acquire-and-exploit business with larger transactions with transformational potential. We are talking with larger companies about restructurings, including equity infusions as well as large-scale asset development."

Enhancing the capabilities of NGP is its relationship with The Carlyle Group, one of the world's largest money managers, with an estimated $193 billion of assets under management.

"NGP's relationship with The Carlyle Group is strong," explains Edwards. "Combined with the ability of our Limited Partners to co-invest alongside NGP, the Carlyle relationship enables us to tap capabilities for carve-outs and more sophisticated financial and transformational transactions. There really is no upper limit to what we can do, which expands our scope into a broader market."

Full circle

Today's energy industry environment is reminiscent of that in 1988 when NGP Energy Capital Management got its start. Depressed commodity prices, expectation of a cyclical upturn and volatile geopolitics drove the headlines, a time not much different than today.

NGP's approach has not changed much since then either. The firm's philosophy of backing skilled, bold and visionary entrepreneurs has served it and its portfolio company management teams exceptionally well through at least three major market cycles.

The industry will always be capital intensive, and having a strong capital partner with expertise in deal structuring, legal and corporate development is essential to achieving success through the cycles. Edwards and McWilliams are confident NGP can play a meaningful role in allocating capital to the best opportunities and extending the legacy that NGP's founders helped create. ■

ORIX Energy Capital

ORIX USA is built on a strong foundation. We hold approximately $6 billion of assets and manage an additional $29 billion, approximately. Our established financial stability and access to deep resources stems from our parent company—ORIX Corporation. Based in Tokyo, ORIX Corporation is an international financial services company with operations in 36 countries and regions worldwide. ORIX Corporation is listed on the Tokyo (8591) and New York Stock Exchanges (IX).

ORIX USA and our family of companies offer investment capital and asset management services to portfolio companies in the corporate, real estate, municipal finance and energy sectors. Our product offerings include: middle-market lending and private equity; venture capital; real estate, municipal and infrastructure finance; fund investments and alternative strategies; structured products; healthcare debt and equity solutions; and energy debt and equity solutions. Drawing on this broad range of expertise, we deliver customized and flexible solutions across a wide variety of industries, including the energy sector.

Focused on forward-thinking financial solutions, ORIX USA looks to not only meet our portfolio companies' immediate financial needs, but also to serve as a long-term partner, working with them through their business growth and changing market dynamics.

ORIX Energy Capital represents the best of both worlds: a partnership between a sophisticated global financial company with a balance sheet that backs it up, and an experienced oil and gas team in Dallas with 50 years of oil and gas experience, technical know-how and a laser focus on client service in the middle-market energy space.

Q What does ORIX Energy Capital provide?

We provide commercial financing solutions to the upstream, midstream and oilfield services sectors. We also work closely with the ORIX Municipal and Infrastructure team on power and infrastructure opportunities. Our investments typically range from $10 million to $50 million for secured debt, and from $5 million to $50 million in mezzanine capital. We can also provide equity—either with a debt product or as a stand-alone solution—of as much as $15 million.

We are completely focused on capital solutions for the smaller, middle-market energy space—an area that is overlooked by many of our competitors. By providing customized capital solutions using both debt and equity, we can provide our clients excellent attention and help them access capital that fits the needs and parameters associated with the middle market.

Q What sort of deal structures are available?

We like to focus on capital structure efficiency, so our deal structures depend on the client's specific situation, which makes us very flexible. We can offer senior stretch and unitranche deals, as well as second-lien and last-out loans. We can also provide mezzanine debt and preferred and common equity.

> "We are building a long-term business for ORIX USA that will provide valuable capital solutions no matter where we are in a cycle."
>
> —*Mark Tharp*

Q How do you approach a deal?

We meet with the management team to come up with thoughtful solutions. We prepare customized analysis of each deal opportunity based on the company's assets, specific location, the contracts involved and so on. We partner with proven managers who need capital to fund internal growth or bolt-on acquisitions; drill out their PUDs; or recapitalize their balance sheets, such as after a bank redetermination.

We're able to respond quickly and close in a timely manner because we report directly to the investment committee right here in Dallas. ORIX has a large balance sheet that stands behind us and since this is internally-sourced capital, we can close quickly.

ORIX USA is in a unique position because we can be more creative and flexible than traditional bank lenders. In addition, our investment perspective is longer than most funds. Lastly, we serve companies looking for capital below $50 million, which we believe to be an underserved market where our capital and expertise is well suited.

Q What are some of your return drivers?

In general, for secured debt structures, we use a Libor-based coupon and an override. For mezzanine capital structures, we seek a cash return or PIK coupon, warrants or a net profits interest. With an equity co-investment, we base our decisions on an initial entry valuation that shows cash flow and revenue growth, with the view of an eventual sale or an equity dividend. But we are long-term investors.

Q Who are the key players on your team?

Our team is led by Managing Director Josh Mayfield, a 16-year veteran of ORIX USA, who was recently responsible for ORIX's Alternative Investments business. Managing directors Jay Mitchell and Mark Tharp, along with Director Alicia Summers, round out an experienced technical and sourcing team. Mark has a track record that includes more than 50 transactions in excess of $10 billion in total value. Jay and Alicia were colleagues at Netherland, Sewell earlier in their careers for 15 years. All of us have been involved in oil and gas finance, engineering and transactions for several years.

Standing, Jay Mitchell and Alicia Summers. Seated, left to right, Josh Mayfield and Mark Tharp.

Q What is your view of the industry during the downturn, and for the future?

We are building a long-term business for ORIX USA that will provide valuable capital solutions no matter where we are in a cycle. We are keenly aware of the current sector correction and believe now is a great time to start a team with oil in the $40s and gas below $3. ORIX USA is not a fund with third-party capital that has to be invested in a certain time frame, so we don't have the usual time pressures to invest and get out in three to five years—we can take a longer view of the business.

Today we see more tailwinds than headwinds and, being new, we don't have any upside-down loans on the books that we have to work out. We are providing long-term, permanent capital to a sector that has significant long-term capital needs. The challenge in the current upstream environment is finding companies that can service the debt they have and survive. We see ourselves helping them by providing capital that helps them bridge the gap and navigate the trenches.

We're stretch; we're mezzanine. But even if we can't get there with those structures, making an equity investment is an option to help clients get through the refinancing period and out to the other side. Challenging situations certainly do call for greater creativity in this current market downturn, so we believe in flexibility of deal structure—in the covenant or payment terms, for example. These are areas where ORIX Energy Capital can partner and provide value-added counsel and capital. ■

ORIX

www.orix.com

Pearl Energy Investments

Pearl Energy Investments, based in Dallas, is a new energy private equity firm focused on investing in the small- to mid-cap North American upstream, midstream and services sectors. Pearl was founded in July and closed its inaugural fund—Pearl Energy Investments LP—at a hard cap of $500 million on September 30. With the first fund closed, the Pearl team is excited about the current investment environment and is fully focused on creating partnerships with best-in-class management teams.

"Pearl believes the small- to mid-cap space has an outsized number of investment opportunities with asymmetric risk-return profiles."

—Billy Quinn, Founder and Managing Partner

Pearl's two partners have more than 50 years of combined experience in the oil and gas industry, bringing together a broad combination of investment, operational and commercial expertise as well as an extensive network within the industry.

Billy Quinn, founder and managing partner of Pearl, is a former co-managing partner of Natural Gas Partners with more than 20 years of energy private equity experience. Quinn has been investing in the upstream, midstream and services sectors of the oil and gas industry and has played a critical role in finding, executing, monitoring, and exiting numerous investments throughout his career.

Chris Aulds, also a partner of Pearl, built his career as a successful, private equity backed midstream entrepreneur with more than 30 years of operational and commercial experience in the industry. Chris has a history of successfully partnering, founding, building and managing energy businesses, including Crosstex Energy Services and TEAK Midstream.

Both Quinn and Aulds have long track records of building, managing and investing in the energy industry. They have built Pearl's investment team to similarly possess a combination of investment, finance, engineering and operational experience to inspire collaborative and well-rounded investment decisions.

What is Pearl's investment philosophy?

BQ: First and foremost, Pearl invests in management teams who are critical to a company's ultimate success. Pearl believes in achieving superior risk-adjusted returns by partnering with best-in-class management teams that employ attractive risk-reward business models and focus on small- to mid-cap investment opportunities in upstream, midstream and services sectors in North America.

Pearl focuses on investments requiring between $25 million and $75 million of equity capital. Pearl believes the small- to mid-cap space has an outsized number of investment opportunities with asymmetric risk-return profiles.

Pearl expects to deploy 70% to 80% of its capital in the upstream sector, with an emphasis on acquisition and exploitation and selective investment in development drilling strategies. Pearl also expects to invest 20% to 30% of its capital in the midstream sector, with an emphasis on contracted cash flows and selectively pursuing development and acquisition opportunities.

How does Pearl work with its management teams? What value does Pearl bring to the table?

CA: Pearl prides itself on being a great partner. The Pearl team has a successful history of not only investing in, but also founding and building companies across the oil and gas value chain. Our combination of investment, operational and commercial expertise coupled with deep industry relationships enables Pearl to add meaningful value to portfolio companies in addition to providing capital.

Through over 20 years of private equity experience, Billy has had the opportunity to work with many different management teams and has served on numerous public and private energy company boards to help found, build and guide companies to successful exits.

BQ: Having started his career as a production engineer in the mid-1980s, Chris has since built two very successful midstream companies with private equity backing, co-founding TEAK Midstream in October 2009 and being part of the management team that founded Crosstex Energy Services in 1996. While at TEAK, the company grew from a start-up with no assets in late 2009 to a billion-dollar enterprise at the time of its sale in May 2013. That experience allows Chris to understand management teams' perspective, having served as a successful management team member himself.

The Pearl team's complementary areas of expertise, perspectives and networks allow Pearl to work successfully with management teams and add value in all stages of portfolio companies' development. Chris and I plan to work directly with every company in the Pearl portfolio and look forward to working with all of the management teams.

"The current commodity price environment has established an attractive entry point in the industry."

—Chris Aulds, Partner

What excites Pearl about the current commodity price environment?

CA: Pearl believes the current commodity price environment has established an attractive entry point in the industry, whether for a new private equity firm like Pearl or for a start-up energy company. Pearl's strategy, however, does not change at its core. Pearl's focus is partnering with the best management teams and building companies with prudent risk-reward business plans.

The Pearl team sees great opportunities in the acquisition and divestiture market for both the upstream and midstream sectors, as healthy companies focus capital plans on developing core acreage, and distressed assets emerge from borrowing base redeterminations, over-levered balance sheets and public equity and debt markets tightening. Pearl also sees significant opportunities in midstream development, as producers focus on maximizing margins and have less capital available for midstream infrastructure.

This can be especially true in the small- to mid-cap space, where an abundance of underexploited assets, less competition and more deals transact on a proprietary, non-marketed basis.

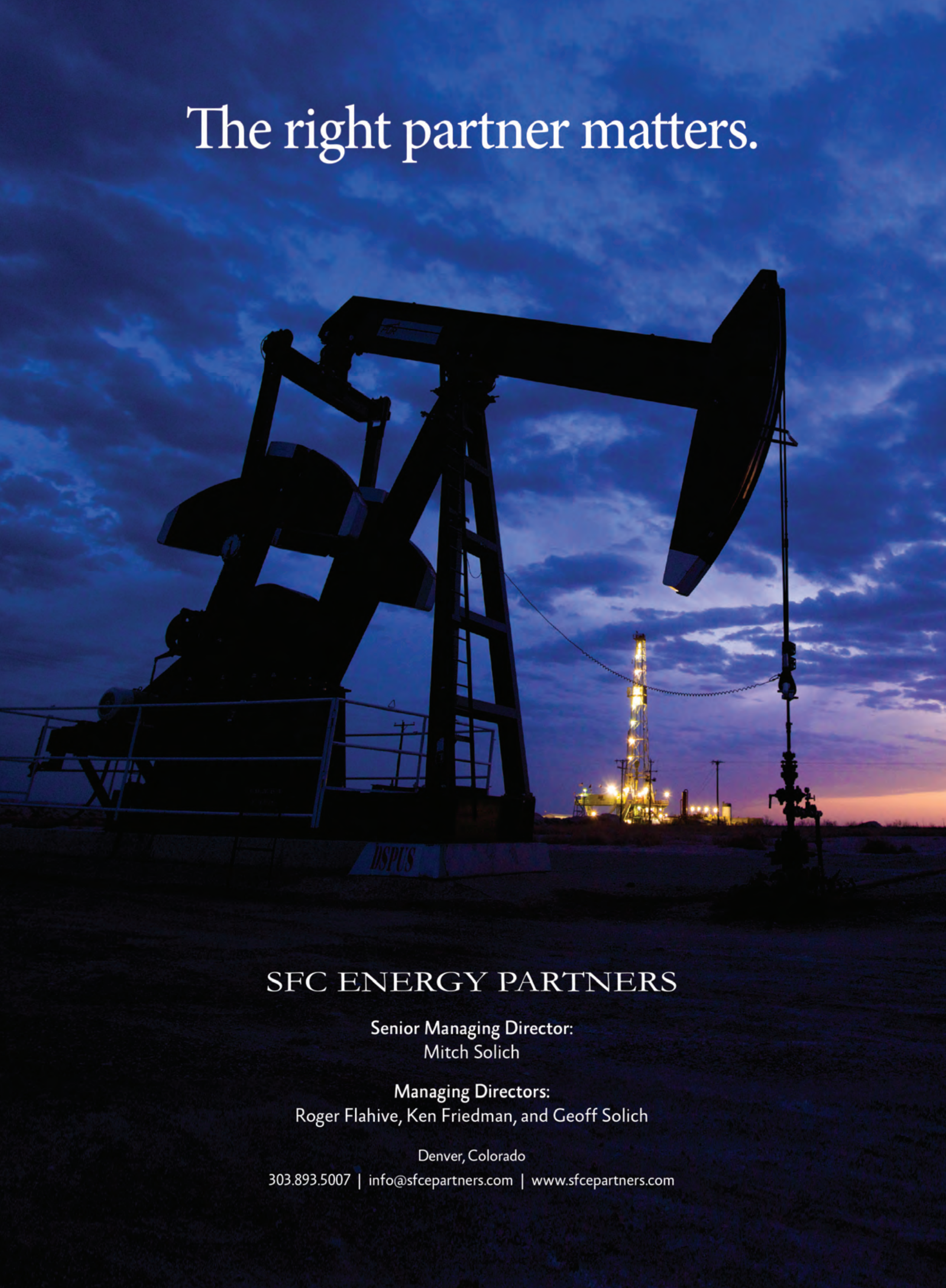
Equally as important, many skilled and motivated entrepreneurs and management teams are looking to start companies and create value.

Pearl is a brand-new firm, have you made any investments?

BQ: Yes. Pearl has completed one transaction with Wild Wind Petroleum, a Calgary-based management team focused on upstream opportunities in the Western Canadian Sedimentary Basin. The team comprises two E&P executives who have created and exited multiple successful companies, worked the Western Canadian Sedimentary Basin their entire careers, and demonstrated a competitive advantage from a technical and deal-flow perspective. I have worked extensively with this team over the creation and exit of multiple ventures. ■

PEARL ENERGY INVESTMENTS

www.pearl-energy.com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SFC Energy Partners

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

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

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

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

SFC initiated fundraising for its first fund in 2006, which closed in March 2007 at $415 million. That initial fund is now fully committed, and the firm is in the process of committing its second fund, which closed at $596.9 million, giving the firm more than $1 billion under management. SFC currently has 15 portfolio companies, and the partners expect fundraising for their third fund to begin in 2016.

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

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

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

Technical acumen

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

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

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

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

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

SFC ENERGY PARTNERS

www.sfcepartners.com

BY THE NUMBERS

$14.8 billion

Schlumberger's Agreement to Acquire Cameron

$6.5 billion

Raised by EnCap Energy Capital Fund X

$70 billion

Royal Dutch Shell Deal to Acquire BG Group

$38 billion

Energy Transfer Partners' Long Pursuit of Williams Ends in Deal

$5.325 billion

Raised by NGP Natural Resources XI

$34.6 billion

Halliburton to Buy Baker Hughes by Dec. 2015

$5.575 billion

Raised by ArcLight Energy Partners Fund VI

C$3.3 billion

Ontario Teachers' Pension Plan Buys Oil and Gas Royalty Firm Heritage Royalty

$4.45 billion

Raised by Quantum Energy Partners VI


QUANTUM ENERGY PARTNERS
Investing Our Energy and Our Capital™
A lot of people talk partnerships. We live it.
To us, it's not just private equity; it's personal equity.
WIL VANLOH - QUANTUM ENERGY PARTNERS
At Quantum, our belief in true partnerships has defined how we have built the firm and how we invest our time and capital. We're personally invested in our partners' success, and maintain a smaller portfolio of companies to deliver opportunities and deal flows without putting them in competition. More supportive, responsive and accessible, we are energy entrepreneurs and investors, not asset managers, who are focused on building great businesses with great people. It's how we approach every partnership, and how we live every day.
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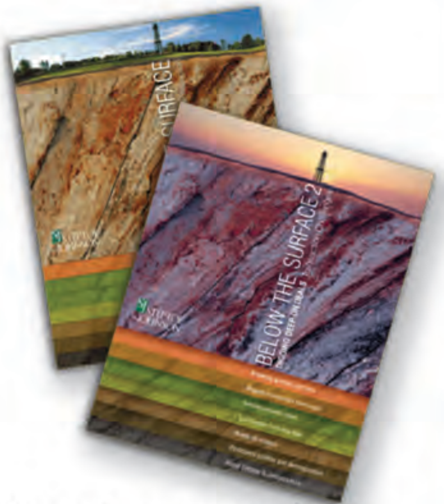

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Managed divestiture of more than 2 million mineral acres in a single transaction

Extensive experience in private placement and private equity financing

325 attorneys firmwide with more than 200 devoted to the energy industry

More than 100 years experience in Energy Law

Top-ranked in Energy Law by *Chambers USA, The Best Lawyers in America*®, and AV rated by Martindale-Hubbell

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