MINERALS & NON-OP REPORT

Plus Who's Who In Minerals Directory

A SUPPLEMENT TO

Oil and Gas Investor

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HARTENERGY

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MINERALS INVESTMENTS ARE GENERATING STEAM

I ran into a minerals executive the other day in Houston and asked him how he manages, given all the dollars chasing mineral deals these days and the many new entrants to the space. He laughed and said he is asked that particular question all the time. Luckily for him, sourcing and closing deals has not been a problem.

In fact, he said, the more dollars the better, because that has increased the minerals deal flow quite a bit in the past two years, opening up further opportunities for everyone who wants to invest in minerals. He also mentioned, as have many other sources, that consolidation is still needed.

In our second annual special report on minerals, we look at some of the transactions that made headlines, with an analysis of the Haymaker-Kimbell deal and the Continental-Franco Nevada deal.

Now it is up to minerals buyers to keep a clear line of sight on the time line for drilling, and to scout for fresh packages on the market in order to keep growing their business. We hope this directory aids those efforts.

—**LESLIE HAINES**, *Executive Editor-at-Large*

CONTENTS

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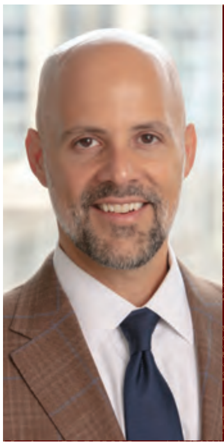
About The Cover

This photograph of a shale outcrop is overlain by an acreage map. The traditional minerals business has been revitalized by the rise of unconventional resource plays in the onshore U.S.

Shale image courtesy of Sigur/Shutterstock

PROFILE: TREGAN ENERGY PARTNERS

Dallas-based Tregan Energy Partners was formed as a minerals fund in early 2017. It began taking outside investments in June 2017. Elliot Karathanasis, CEO, spoke about the company's goals and strategy and methods of evaluating minerals.



> "At Tregan Energy, we pride ourselves on being good partners. We are transparent and we do what we say."
>
> —ELLIOT KARATHANASIS, *CEO, Tregan Energy Partners*

Q *How did Tregan Energy get started?*

A: It's actually quite an interesting story as to how we got into the business. Our chairman and founder, Trevor Pearlman, is a serial entrepreneur. After practicing law, he moved into telecommunications, where he saw an opportunity in the newly developing cell phone market. He launched a telecom tower company, Alamosa Holdings, which he took public and later sold to Sprint in 2005 for $3.5 billion. He then partnered with Starwood Hotels & Resorts to develop a 60-acre mixed-use site right outside of the Las Vegas Strip.

As he saw Las Vegas land prices skyrocket into bubble territory, he sold his entire interest in the project for a large profit, literally weeks before the financial crisis hit in 2007. After seeing the effects of the crisis, he decided to make more conservative investments, mostly in investment-grade triple-net real estate.

But Trevor was introduced to minerals while living in Texas looking for other conservative investment opportunities. He used his personal balance sheet to buy some minerals and he just could not believe how inefficient the market was. After a couple of years of doing this, Trevor approached me to start a minerals fund.

Q *Did you have a background in minerals investments?*

A: No, not at all. When Trevor first approached me about starting a minerals fund, I looked at him like he was crazy. Prior to working at Tregan, I was with Commonwealth Opportunity Capital, which is a $2 billion global macro-hedge fund based in Greenwich, Conn. But I had no background in minerals. After Trevor approached me, I spent a lot of time studying the market and decided there really was an incredible opportunity.

Q *What was the opportunity you saw thanks to the shale revolution?*

A: I looked at what it really meant; most people in finance knew something about U.S. shale. The U.S. oil supply almost doubling from 2011 to 2015 certainly catches your attention. But until you really study what these operators were able to achieve—the incredible increase in average EURs per well, the dramatic decline in well breakevens, turning the U.S. into a net exporter of natural gas—you don't truly understand just how momentous the shale revolution has been.

But then the question becomes how to play it. In late 2016, early 2017, Trevor and I were determined to break into the minerals space.

Q *What were your first steps toward meeting that goal?*

A: We decided that to fully take advantage of the fragmented nature of the minerals markets, we needed to have an edge in data analytics. This meant not only having access to newly available institutional-level data, but also hiring top talent. We made a major upfront investment in data. In terms of hiring, we wanted creative, talented people, but people who hadn't spent their whole careers in minerals.

We think we have a really top-notch team: We hired two of the top petroleum engineers from the University of Texas to run our engineering department. We hired someone with an MBA from Wharton with a hedge fund background to run our finance team. And we also hired strong back-office support staff. Today, we have 15 full-time employees.

For two years prior to starting the fund, Trevor and our current director of acquisitions, Zach Solomon, met with every landman, broker and player in the industry. Their time spent learning the business is paying off as we now have relationships all across the country, which we think is part of our competitive advantage.

Q *How are these relationships key in the minerals business?*

A: Mineral interests are so fragmented there are always deals to be made, but you have to know the right people to get the deal flow. At Tregan Energy, we pride ourselves on being good partners. We are transparent and we do what we say. If someone brings us a deal, we will respond quickly and tell them exactly how much we will pay, and why. I think that's somewhat unique in this industry, or at least that's what many of our partners tell us.

As newcomers to the space, our reputation is incredibly important to us. We try to deal with everyone fairly.

Q *What are some aspects of your deal process?*

A: Our whole process—both at the asset level and at the broader portfolio level—is backed by data and analytics. Now obviously, a lot of people can run cash flow models. That's why, when valuing PDP [proved developed producing] assets, you're usually going to get good deals through the strength of your relationships.

But on the non-producing side—drilled but uncompleted wells, drilling permits, acreage—we closely study operator intent, operator drilling inventory, basin pricing and timing scenarios, all in an effort to properly price assets. We purchase less than 5% of the deals we see, but our due diligence allows us to find attractive deals where others may not recognize the value.

Q *How do you stress-test your broader portfolio?*

A: At the portfolio level, although Tregan purchases many non-producing assets, we are also very yield-conscious.

TREVOR PEARLMAN
chairman and founder,
Tregan Energy Partners

Since the fund's inception, we have maintained high yields, although today, only 31% of our cost basis is in currently producing assets. Our engineers make monthly projection estimates for each asset we own and then our finance team calculates our projected portfolio monthly royalty revenue by factoring in asset-specific basin differentials and operator deductions.

We are constantly stress-testing our portfolio at different oil and gas price levels. We also keep close track of our basin exposure, asset mix exposure and asset life-cycle mix. Due to our analytics, we can immediately adjust our buying program and change our exposure to several factors, should market conditions change.

It really is a fun and interesting business. We think minerals are just getting started. ■

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FALCON MINERALS IS SET TO FLY

Big capital and big minerals unite to hatch a new $1 billion public company.

By Leslie Haines

The rapid pace of investing in the minerals sector continues as more privately-backed companies join the game and more institutional capital works its way in, and some significant mergers take place.

One of the latest deals has created a nearly $1 billion public company, Falcon Minerals Corp. It has 251,000 gross unit mineral acres in the core of the Eagle Ford Shale in Karnes, DeWitt and Gonzales counties, Texas.

"We own 1% of the revenue across that position—but it is in the highest-return area of the Eagle Ford in terms of production per thousand feet. That's where our position resides," Daniel Herz, president and CEO, said during Hart Energy's DUG Eagle Ford conference in September 2018.

The new entity he helms was born when Osprey Energy Acquisition Corp., a public special purpose acquisition company (SPAC) formed in 2017, acquired the assets of Royal Resources, a mineral entity formed in 2011 and owned by funds managed by private-equity giants Blackstone Energy Partners and Blackstone Capital Partners. Royal represented the sum total of Blackstone's mineral interests in the Eagle Ford Shale.

This transaction created Falcon with a total enterprise value of about $894 million that is trading as "FLMN" on the NASDAQ stock exchange.

Falcon is led by Osprey's experienced management team of Jonathan Cohen, Edward Cohen and Herz. This group has taken six companies public in the past and closed on $23 billion of upstream and midstream acquisitions and divestitures. The Cohens previously headed Atlas Pipeline Partners LP, which they sold to Targa Resources in 2014 for $7.7 billion. They subsequently formed the SPAC that led to Falcon.

In this new deal, Blackstone retains a significant ownership stake of about 47% of Falcon's outstanding common stock.

Herz listed several of Falcon's advantages. "We are an independent, core-of-the-core company, with a modest $35 million of debt. We are a minerals business, so we're delighted not to be an operator—no capex is needed to participate in these wells," he said. "Our operating costs are only about $5 per barrel, simply for overhead. So, we're a lot less sensitive to commodity prices. We have less legal liability and no direct operating expense."

In 2018, Falcon's minerals generated about $100 million of free cash flow and Herz said he expects that sum to grow 15% to 20% in 2019 compared with 2018.

"When you hear about companies trying to grow production and create free cash flow—we're already there. And we don't have the plug and abandonment risk and other risks that go along with these wells. My strategy is that I just go to lunch and let the operators drill," Herz joked.

Not being the operator in this case is certainly not a problem, as some of the top-tier E&P companies in the business are drilling on Falcon's mineral acres. There are an estimated 3,000 undeveloped locations on its position, and the operators involved say the wells will yield internal rates of return of at least 100%.

PUBLIC MINERAL COMPANY SCOREBOARD

COMPANY	PRODUCTION (BOE/D)	ACRES	FOCUS
Black Stone Minerals	44,700	20 MM	64 basins
Viper Energy Partners	18,384	13,908	Permian
Kimbell Royalty Partners	4,612	11 MM	7 U.S. plays
Falcon Minerals Corp.	2,318 net	251,000*	Eagle Ford

*Gross acres Source: Oil and Gas Investor

FALCON MINERALS' OPERATORS

OPERATOR	ACTIVE EAGLE FORD RIGS	PERCENTAGE OF FALCON 2018 CASH FLOW
*BP	2	20%
*DVN	2	20%
COP	6	49%
EOG	11	20%
PXD	N/A	<1%

*BP and DVN will share rigs through the previous BHP-DVN joint venture. Source: Falcon Minerals Corp.

ConocoPhillips, the Devon-BP venture (formerly BHP) and EOG Resources Corp. represent 96% of the development capital being spent on Falcon's acreage and Falcon gets 1% of the resulting revenues. Conoco alone provides roughly half of Falcon's cash flow, and it announced recently it is moving one additional rig from the Permian to the Eagle Ford. Its estimated three-year compound annual growth rate in the Eagle Ford is about 25%.

"We are a free cash flow machine . . . and hopefully we'll grow it to something much bigger."

—DANIEL HERZ,
CEO and president,
Falcon Minerals Corp.

"EOG has said that the Eagle Ford Shale is their No. 1-return play in North America, and they are completing more wells in the Eagle Ford than anyone else, so we are the direct beneficiaries of that," Herz said. "The fact that BP recently bought out BHP's assets in the Eagle Ford is another factor that is going to be a big win for us."

The clear line of sight for development is critical to the minerals business. Falcon has about 1,500 producing wells in the play and as of September, another 189 or so were in the process of being permitted, drilled or completed, so Herz said there is about six months of visibility on production growth.

Because Falcon is new on the public's radar, it is not trading at a multiple similar to other public mineral companies. At press time it was trading at a 20% to 25% discount to where Viper Energy trades, but Herz said Viper and Falcon are similar in that Viper has a large undeveloped resource base in the Permian being drilled by prominent operators, and Falcon has a large resource base in the Eagle Ford being drilled by top operators.

Herz said the company plans to grow through acquisitions from top operators with "a clear line of sight to development," backed by the power of Blackstone. Plans are to grow the newly minted $1 billion company by multiples, maintain positive -and increasing -cash flow and all the while, preserve a conservative balance sheet, he added.

Herz said he admires how completion designs and innovations, such as EOR, have evolved and are being used by operators, like ConocoPhillips and EOG Resources, from which Falcon can reap the rewards.

"We're a free cash flow machine…and hopefully we'll grow it to something much bigger," Herz said. ■

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FINDING ROOM TO GROW

Kimbell Royalty's acquisition of Haymaker Minerals is one example of companies finding success in the minerals buying market. Here, we take a closer look.

By Daniel Murchison

The mineral and royalties space is unique as a way to invest in the oil and gas industry. Though vast and fragmented, and not at all a mature space where mergers tend to happen, this segment is rapidly attracting more investor attention and getting more sophisticated. A significant merger recently occurred that sheds some light on the possibilities.

Here, we compare and contrast the financial health of Kimbell Royalty Partners LP and Haymaker Minerals & Royalties LLC prior to and after Kimbell's acquisition of Haymaker and its subsidiary, Haymaker Resources LP.

The youngest of the 21 public partnerships, Kimbell Royalty Partners LP (KRP) went public in February 2017. The company's IPO opened at $18 per share, initially offering 5 million shares. Since going public, KRP's price struggled in its infancy and fell under $16 per share in mid-August 2017. However, 2018 has been much kinder due to the higher crude price; KRP's share price peaked at $23. About 70% of Kimbell's revenues are from oil and NGL.

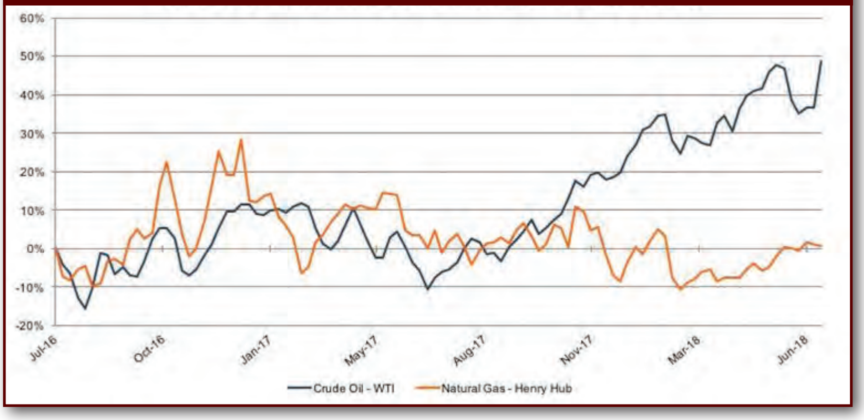
Acquisition overview

Prior to its acquisition of Haymaker Minerals & Royalties LLC and Haymaker Resources LP (collectively, Haymaker), Kimbell had nearly 5.7 million gross acres in nearly every major oil and gas basin across 20 states, primarily focused on the Permian Basin and in Oklahoma.

Kimbell solely invested in mineral and royalty interests with the largest portion of its production concentrated in the Permian Basin, where it had 1.75 million gross acres of mineral interests and about 200,000 acres of overriding royalty interests (ORRIs). Currently, KRP has 25 active drilling rigs on its acreage, and mineral interests and ORRIs on 50,000 wells. Kimbell's holdings in the Permian Basin alone account for 26% of its net royalty acres, 60% of its gross acreage and 60% of active wells on its total acreage.

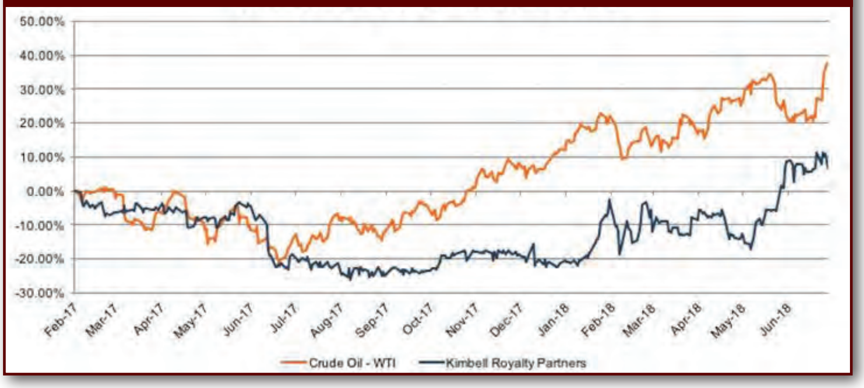
In comparison, Haymaker had roughly 5.4 million gross acres and roughly 43,000 net royalty acres primarily focused in the Midcontinent. It had royalty interests in

CRUDE OIL AND NATURAL GAS PERFORMANCE (LAST 2 YEARS)



The underperformance of natural gas prices is due to the surge in production of shale gas since 2006 and the more recent rise of natural gas production as a result of increased oil production. *Source: Kimbell Royalty Partners LP*

KRP SHARE PRICE vs. CRUDE OIL PRICE



Of the MLPs/C corps, Kimbell has the highest dividend yield at 7.63%, with Dorchester, Black Stone and Viper at 6.23%, 6.76% and 6.02%, respectively. *Source: Capital IQ*

33,800 wells and 51 drilling rigs, more than double the amount Kimbell had.

Kimbell acquired Haymaker for $404 million with $210 million of cash and 10 million newly issued common units going to Haymaker's sponsors. The acquired company's private equity sponsors are KKR & Co. LP and Kayne Anderson Capital Advisors LP. Alongside the acquisition, Kimbell converted its tax status from an MLP to a C corp, believing this will provide access to a much broader base of investors and a more "liquid and attractive currency."

Kayne Anderson and KKR's willingness to take the newly issued shares, which will account for roughly 37% of Kimbell's outstanding common units, shows the potential for investment growth that is achievable for Kimbell but not necessarily for Haymaker. Kimbell estimates the acquisition will not only be accretive due to the quality of the assets, but will be highly scalable and reduce general and administrative (G&A) costs on a per barrels of oil equivalent (boe) basis.

After the acquisition, Kimbell will have more than 11 million gross acres spanning 28 states, with 38,000 of its 84,000 wells in the Permian Basin. As of April 27, Kimbell's 73 rigs accounted for 7% of the total rigs in the U.S.

To calculate price per acre, Haymaker's 42,759 net royalty acres must be converted to the industry standard one-eighth conversion, since Kimbell uses a non-standard method of calculating net royalty acres. The conversion, which assumes eight royalty acres for every mineral acre, results with Kimbell acquiring 342,072 net royalty acres for $404 million. This results in an implied price of $1,181 per net royalty acre. At the time of the transaction, Kimbell's market capitalization was about $327 million with an 8.7% yield. Post-transaction, KRP's free cash flow yield rose to 12%, implying a 15% yield for Haymaker prior to the transaction.

Much of Haymaker's acreage, an even oil and gas split, is congruent to Kimbell's existing acreage. Haymaker's acres enhance the company's position in the Permian and Midcontinent and also increase its exposure in the Marcellus and Utica shales. After the transaction, Kimbell's production will be about two-thirds liquids and one-third gas. Pro-forma G&A expense can decrease by as much as 50% to $3.22/boe. This decrease is due to the increased scalability of Kimbell after the transaction.

The transaction is also projected to increase the net production per unit by 56%. The company estimates the increased production and the cost reductions alone could lead to a 20% increase in distributable cash flow per unit.

Public-private disconnects

Why would two companies with relatively comparable assets have such drastically different yields? Is it due to the fact that Kimbell is publicly traded while Haymaker is private? Perhaps the solution lies in the differences between public and private mineral market share sizes.

Kimbell estimates that the total mineral buying market is close to $500 billion, excluding ORRIs. Public companies only make up 2.5% of the total market with a combined enterprise value of roughly $12.3 billion. The two largest publics, Black Stone Minerals and Viper Energy Partners, make up a combined $8.3 billion of that total value. While the public minerals market is only made up of a handful of companies giving public investors a limited number of investment options, the private minerals market is highly fragmented.

Small mineral aggregators can operate with more attention to acreage details. These aggregators have the ability to negotiate directly with the landowners and handpick the acreage of their choosing. As a result, they expect higher

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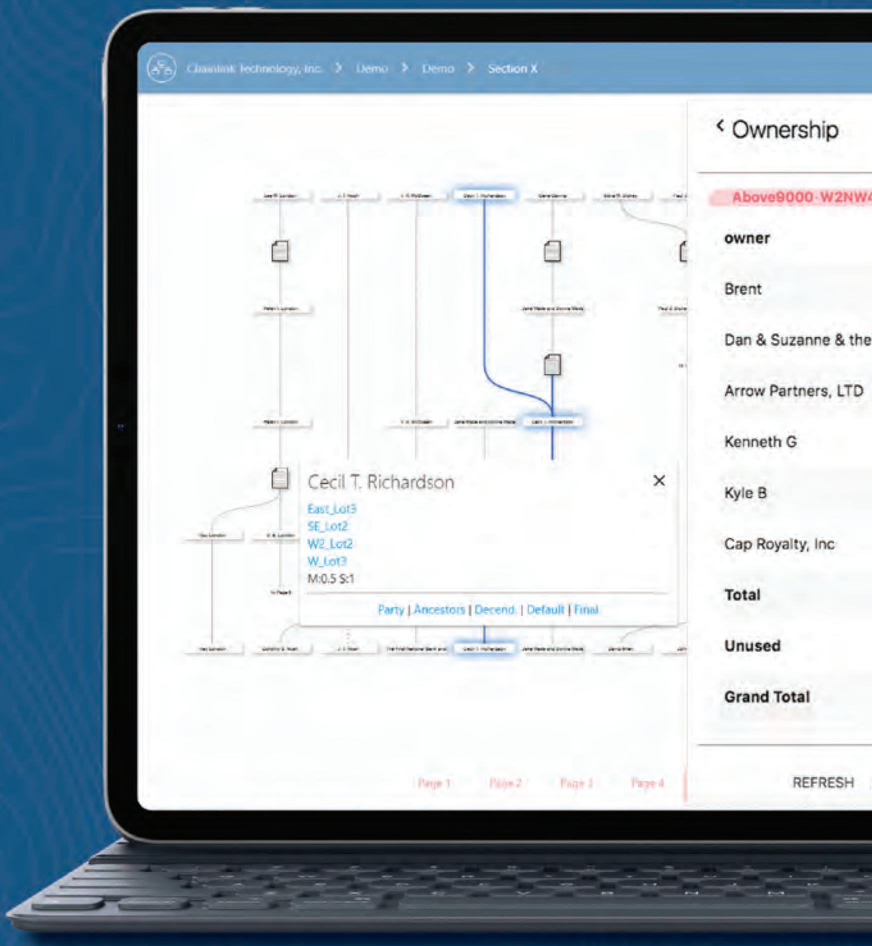

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SUMMARY POINTS

Category	Gross Acres(1)	Net Royalty Acres(1)	Well Count(1)	Rig Count(2)
Kimbell	5.7 MM	71,276	50,464	25
Haymaker	5.4 MM	42,759	33,800	51
Total	11.1 MM	114,035	84,264	73

Source: Kimbell Royalty Partners
(1)Acreage numbers include mineral interests and overriding royalty interests.
(2)Based on DrillingInfo rig count as of 4/25/2018 via Kimbell. Three rigs overlap between Kimbell and Haymaker.

Kimbell's holdings in the Permian Basin alone account for 26% of its net royalty acres, 60% of its gross acreage, and 60% of active wells on its total acreage. *Source: Kimbell Royalty Partners LP*

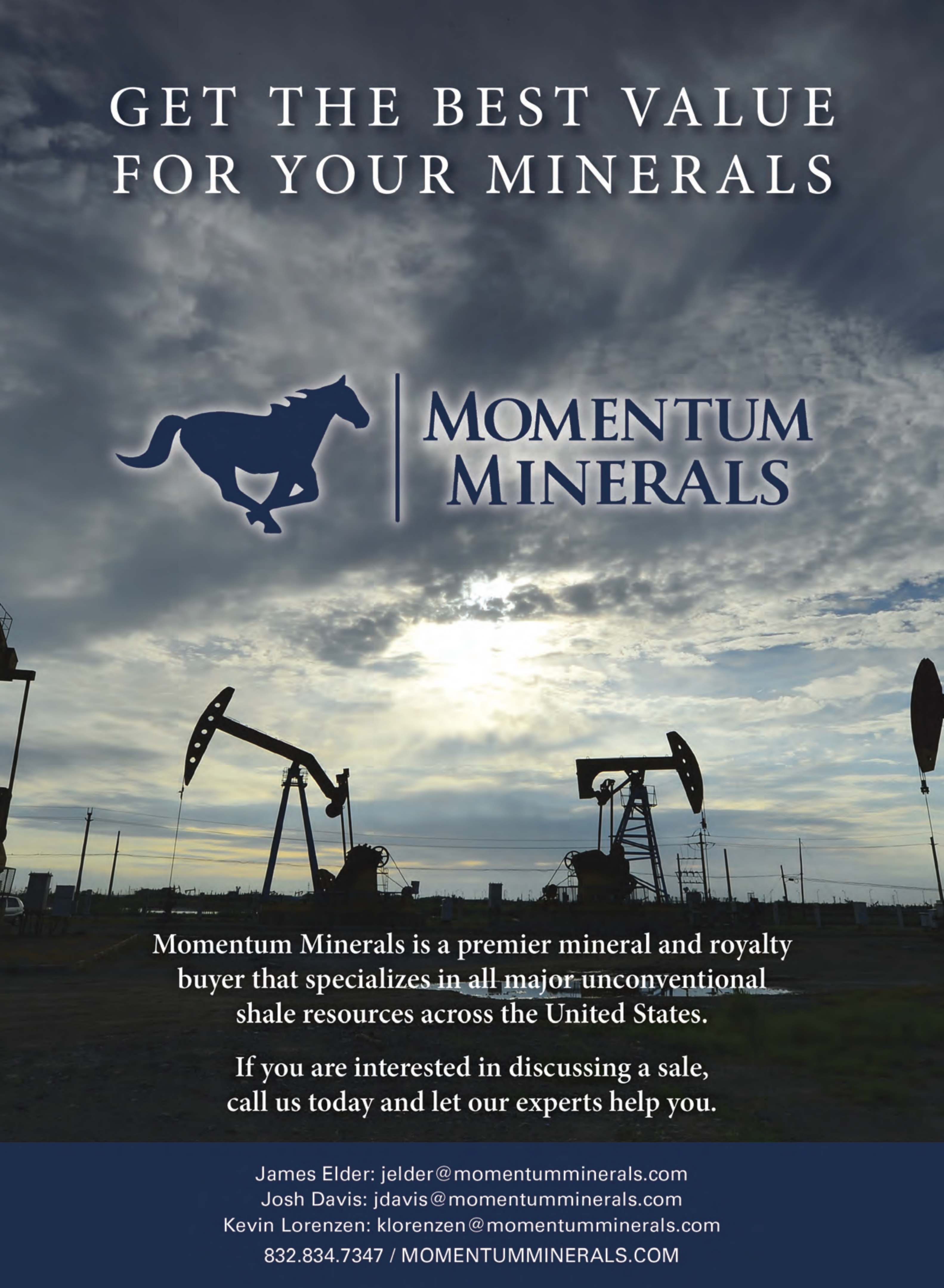
yields than the public companies. While these yields are higher, the acreage is typically much more focused on certain areas. Combined with their small size, these investments are inherently riskier than a larger, more diverse pool of assets, such as those held by public royalty trusts.

Kimbell's acquisition of Haymaker demonstrates the disconnection between the public and private markets and the discounts at which private limited partnerships (LPs) are valued. It seems that private royalty LPs do not have the same access to capital as the public MLPs or C corps. This lack of access is potentially why KRP and Haymaker have distinctly different yields, 8.7% and 15%, respectively, and why KRP was able to successfully negotiate such a highly accretive deal. Private-equity investors and backers seem to recognize this.

Haymaker's sponsors, KKR and Kayne Anderson, most likely saw the potential behind the accretive mix of the two companies, which is why they were willing to accept roughly 50% of the purchase price in Kimbell shares. Kimbell was public and its transition to a corporation opened up a broad array of inexpensive capital. This capital makes it easier for Kimbell to grow through acquisitions and continue to increase its returns and shareholder value.

Public investors are seeking opportunities to invest in mineral plays; however, many of them only have the opportunity to do so through public companies. Following the rise of crude oil prices, the increased demand from public investors has driven up the prices of the royalty trusts and MLPs and, in turn, lowered the yields. More and more investors, including institutional investors, are looking toward the mineral market to find investment growth. The emerging field of mineral aggregators has the potential to provide this growth through accretive acquisitions, as well as steady dividend payments, that public investors crave.

This article was co-researched with the energy group at Mercer Capital, which provides valuation and cash flow analyses regarding royalty interests. ■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HAYMAKER SHARES MINERALS AND ROYALTIES JOURNEY IN SONG

It's rare to hear such pop hits as Adele's "Hello" or Bruno Mars' "That's What I Like" at an oil and gas conference.

But Haymaker Minerals & Royalties II co-founder and CEO Karl Brensike's playlist of Grammy Award winners for Best Song seemed to accurately depict the mood of the oil and gas industry over the last five years while chronicling moves taken by Haymaker.

Since the sale of Haymaker Minerals & Royalties and Haymaker Resources LP to Kimbell Royalty Partners LP closed in July, Haymaker II (HMKR) has already made 89 acquisitions, Brensike told attendees of Hart Energy's recent A&D Strategies and Opportunities Conference & Workshop in Dallas.

"When you look at the final scorecard for what we did in Haymaker I and the combined HMKR entity we invested about $260 million worth of equity, made 420 acquisitions for $355 million, divested $630 million while cash flowing about $91 million in the process," Brensike said. "We're really proud of this accomplishment—especially over this period of time" considered one of the worst commodities market downturns in the industry's history.

The activity came amid increased interest in mineral holdings in the oil and gas industry as buyers look to add value from resources in areas such as the Permian, Eagle Ford and Midcontinent shale plays.

Before being acquired by Kimbell, Haymaker grew its public royalty portfolio to about 5 million gross acres, covering 26 states and more than 500 counties. More than 900 operators were producing a combined average of about 5,500 barrels of oil equivalent per day from more than 35,000 wells, according to Brensike. The company, one of the largest mineral companies in the U.S. at the time, had cash flow of about $40 million in 2017.

That year, Brensike recalled Adele winning a Grammy for Best Song. "Our big 'hello' moment in 2017 was when Kimbell Royalty Partners went public in the first quarter. It was the first energy IPO in a couple of years," he said before speaking of Haymaker's logic behind going public. "We knew we were going to be a yield vehicle.

"There were some areas where we could get better value if we carved out some assets," he said. "We did have some really high-value acreage that didn't have a lot of cash flow associated with it. So much private equity …was looking to buy that acreage."

Also that year, Haymaker II, which was launched a year earlier, made 244 acquisitions. But "a lot of people don't know we actually sold almost $150 million worth of assets in 2017," proving the portfolio turned out to be "hugely diverse" and attractive to Kimbell.

"When we looked at their assets and our assets, we really liked what we saw. There were a lot of synergies. We would have this incredibly diverse asset base where 95% of the rigs in the country were going to be in a county where one of the two of us owned interest," Brensike said. "We loved the production mix of liquids and gas and thought for any investor to come into a company like this, you could give them complete exposure to the entire U.S. energy complex, which we thought would be a very compelling thing for investors."

The situation was far better than in 2016 when the price for a barrel of oil dipped as low as $26. "It was a real interesting time for Ed Sheeran to come into my life," Brensike said, to laughter from the audience.

He spoke of how the lyrics of Sheeran's "Thinking Out Loud" nailed the industry's mode—its legs weren't quite working as well and it wasn't standing as tall as in 2013 when it was "young" and "setting the world on fire," having become good at hydraulic fracturing—a nod to Fun's "We Are Young."

In 2013, Haymaker received funding from Kayne Anderson, made two acquisitions and invested $725,000 in capital.

This grew in 2014 to 342 acquisitions and $210 million invested as grassroots buying took hold with the Viper IPO and Cornerstone acquisition. That year Lorde's "Royals" was the Best Song, but Brensike pointed out that the song was really not about being royals but rather never being royals. "Boy, did we feel like that at the end of 2014," he said, recalling the beginning of the market downturn.

The following year wasn't much better, he added, noting how Haymaker streamlined its management systems and divested $17 million in assets but invested in the Permian's core. Haymaker's acquisitions that year totaled 55 and Best Song was Sam Smith's "Stay With Me," something the company—and others—wanted investors to do.

But Brensike, whose entertaining presentation kept the audience in good spirits thinking about those depressing years, recalled a coded message in Sheeran's "Thinking Out Loud." Sheeran actually sang: "I will be loving you 'til we're 70." Brensike heard: "I'll be loving you 'til oil's 70."

"When you get a coded message from a redheaded Irish leprechaun, you don't question it. You just get to work and you go and buy a big minerals package. So that's what we did," Brensike said, sparking more laughter from the audience.

With oil prices up from historic lows, things have been looking up for Haymaker and others in the industry. "So we like 2018," Brensike said after playing a bit of Mars' "That's What I Like."

Haymaker II has since made 350 acquisitions in the Permian, Stack, Scoop, Merge and Bakken, Brensike said. The package includes 110,000 gross acres with 133 producing horizontal wells and 131 horizontal locations permitted or awaiting completion.

"There are millions of mineral owners and I really believe that if you're looking to buy a mineral or sell a mineral there's somebody willing to transact at your price," he said. "You just need to be able to find them." ■

—Velda Addison


A Better Future is Just Below the Surface

OneMap has become one of the premier, direct mineral buyers in the Permian Basin.

Since its first deals in 2012, OneMap has become one of the premier, direct mineral buyers in the Permian Basin. "It's been a really exciting journey," said Mackie Cannon, CEO of OneMap. "We have strategically invested in our team as well as the data and technology needed to conduct a large volume of small, direct-to-owner deals in a highly targeted geographic area. Our disciplined approach to acquisition and aggregation has generated value for our investors and provided timely liquidity to sellers."

Partnering with key institutional and family office investors, OneMap has acquired more than 17,000 net royalty acres in the core of the Permian since early 2017 and deal flow continues to build. "We have cemented our reputation as a high integrity minerals buyer that communicates openly with sellers and closes in a timely fashion," commented David Sims, CFO. "As competition has increased in recent years, our name recognition amongst sellers is proving to be very valuable."

Experienced Team

A key part of OneMap's success is the team that handles all acquisitions from start to finish. In total, OneMap has a staff of 30 that close 30 to 50 acquisitions per month.

"If you think about the core functions required to execute this strategy at scale, you need expertise in engineering, geology, mapping, land, accounting, finance and data analytics," explains Mr. Cannon. "Not only do we drive efficiency by building this expertise within the walls of OneMap, but we create better alignment with our investors since we don't outsource critical technical evaluations. It's a real differentiator."

Forward Momentum

OneMap continues to see significant opportunity aggregating minerals in the Permian. With more than $300 million raised within the last two years and a growing pipeline of potential transactions, the group is well positioned for continued success. "It's easy to underestimate just how big the addressable market is within the Permian," commented Andrew Davis, Vice President of Capital and Strategy. "We estimate there are likely $60 billion of privately held minerals within our focus area, indicating substantial acquisition potential in the coming years. We look forward to seizing this opportunity along with our capital partners." ■

"Our disciplined approach to acquisition and aggregation has generated value for our investors and provided timely liquidity to sellers."

—MACKIE CANNON,
CEO of OneMap

MINERALS INVESTING COMES TO THE FORE

Recent deals challenge long-held assumptions that minerals are uncompetitive and non-scalable as minerals investing emerges after decades in the background.

By Gregory DL Morris

In early August 2018, Continental Resources Inc. and Franco-Nevada Corp., a precious metals royalties firm, formed a joint venture (JV) to acquire hydrocarbon mineral rights in Oklahoma's Scoop and Stack plays. Franco-Nevada will contribute about $220 million for the acquisition of existing mineral rights owned by a Continental subsidiary. Franco-Nevada committed, subject to satisfaction of agreed-upon development thresholds, to spend up to $100 million per year over the next three years to acquire additional mineral rights. The existing mineral rights and others to be acquired later will be jointly held through the new company.

Revenues are expected to build as Continental ramps up development of its leasehold position. Franco-Nevada, based in Toronto, intends to fund its investment from cash on hand, partial use of its credit facilities and its projected future growing free cash flows. This new relationship will add to Franco-Nevada's existing interests in the Scoop and Stack.

"In most cases people buy mineral rights blind, not knowing when, if ever, they will be developed," said Jason O'Connell, the vice president of oil and gas for Franco-Nevada. "The idea here is to buy the mineral rights for sections where Continental plans to develop. Sure, in offering to acquire those rights we tip our hand a little and possibly pay more than the market price, but there is still a compelling value arbitrage that can be achieved."

The terms of the transaction are complex, but essentially Franco-Nevada will pay 80% of the cost for the mineral rights being acquired, and then revenues are split 50:50 with Continental if the latter meets certain production targets.

"The transaction is hugely attractive to Continental," O'Connell said. "They provide the information and they manage the program. We provide the bulk of the investment, and they get half the revenue," which for Continental is actually reduced outlay. Franco-Nevada is not new to energy, but has focused on gold royalties. In March 2015

"We are not looking for profits in three to four years, but in 10, 20, 30 years. That is in contrast to the short-term investment objectives of private equity."

—JASON O'CONNELL, *vice president of oil and gas, Franco-Nevada Corp.*

at the bottom of the recent oil price decline, the company decided to increase its exposure to hydrocarbons.

"We are long-term investors," O'Connell said. "We are not looking for profits in three to four years, but in 10, 20, 30 years. That is in contrast to the short-term investment objectives of private equity." He also recognized Continental as a producer with experience in mineral rights. "They are already set up with the ability within the company to understand the complexities of mineral ownership. Most producers trying to replicate the idea would have to start from scratch. What they wanted was a strategic partner with long-term capital. That is us."

History as a guide

There is a long history of operators buying minerals associated with their development, said Frost Cochran, managing director, Post Oak Capital. "Exxon and Chevron are two prime examples dating back to the 1940s and 1950s. They would often buy the mineral rights and sometimes even the surface, especially Exxon. I don't know of any operators, majors or independents that make a deliberate strategy of buying mineral rights for their own development, at least not in the last few years. But there definitely is a history of that."

If anything, there is a trend in the other direction, especially for the publicly traded companies. Several sources noted the demand by public investors for cash flow. Owning large mineral holdings means tying down considerable capital, antithetical to a free-cash model. If a minerals purchase were necessary or came with a deal as part of the package, such a position would not be disdained, but at least for the big public operators, mineral rights have not been a part of the strategy.

"As a private operator, starting in the 1990s we would try to accumulate minerals," Cochran said. "It was not a specific strategy, more of a side line. As a private-equity shop, if associated minerals fell into the lap of our portfolio operating companies, we would keep those when we sold the operation. It was just picking up breadcrumbs. Strategic buyers placed little or no value on mineral rights, so we would retain them as we made our exits from portfolio companies. Mineral rights are severable so we would retain ours in the fund."

Post Oak is hardly alone, as most of the big Houston- and Dallas-based energy private-equity houses invest in mineral rights. EnCap Investments is considered the largest in that segment, but Quantum Energy Partners, Kayne Anderson, NGP Energy Capital Management and Lime Rock Resources participate, some alongside operating companies and some as discrete and dedicated strategy.

About five or six years ago Post Oak portfolio companies began reporting they could buy minerals as inexpensively as they could lease them. "In many areas, owners had not seen royalties in a long time," Cochran said. "That gave us the idea to offer to buy mineral rights first, before making a lease offer."

Five years ago, Post Oak created its first dedicated minerals investment, Saxet Minerals. Post Oak is now on its third iteration with Saxet. "In our last two funds, about 20% of the capital was dedicated to minerals," Cochran said. "We make cash distributions on a quarterly basis from these investments. Ultimately, we are going to have to decide whether to sell those or roll them into something long-term. Our fund investors have been clear with us that they prefer us not to sell mineral rights."

That preference reflects an investor base that differentiates Post Oak: "Our limited partners consist almost entirely of tax-exempt U.S.-domiciled endowments, foundations and pension plans," Cochran added. "Being perpetual institutions, they plan on a multi-decade basis. That is atypical of private-equity funds. Many other funds consist of a mix of sovereign wealth funds, family offices, fund-of-funds, as well as tax-exempt investors that have their own limits for durations."

Post Oak funds technically run for 10 years plus a two-year extension, but in practice can be rolled into a perpetual vehicle, be distributed in-kind, or extended indefinitely.

"In our last two funds, about 20% of the capital was dedicated to minerals."

—FROST COCHRAN, *managing director of Post Oak Capital*

Busting mineral myths

The Hefner family has been involved in minerals investing for more than a century. And still, Robert Hefner V, president and CEO of Oklahoma City-based Hefner Energy Holdings LLC, said that as he grew up in the industry, conventional wisdom held that minerals were unable to compete with operated or non-operated working interest, and were not scalable.

"I never bothered to question those two assertions until about 2013, when I invested in some minerals in the Scoop at $100 [per barrel] oil. I noticed, even as oil prices collapsed to $40, my mineral investments were generating strong returns. Since the former was disproven, I then questioned the latter assumption that minerals were not scalable.

"I started investing more in minerals and found that minerals are very scalable. Both of the two common beliefs about minerals were wrong," Hefner said.

Given his love of history, Hefner has a theory as to why minerals suddenly seem to be on everyone's mind in the last few years. "You always hesitate to say, 'This time it's different,' but there are things about this cycle that were not present in previous industry cycles, notably horizontal drilling and hydraulic fracturing. The shale bonanza has meant massive capital programs, hundreds of millions [of dollars] for a single unit. That has significantly increased the velocity of the cash flow and the nature of capex. Minerals investing is a capex story."

"Minerals investing is a capex story."

—ROBERT HEFNER V, *president and CEO, Hefner Energy Holdings LLC*

Having whetted his appetite busting myths about minerals, Hefner would like to dispense with one other, that investors could run out of things to buy. "There is a $10 billion unfunded market out there in Oklahoma. For all the work that has already been done—LongPoint, Brigham, Saxet, Expro and others—there has been $2 billion spent out of a potential for $12 billion or $13 billion," he said.

The minerals segment remains "highly inefficient and highly fragmented. So we say, yes, it's good that more people are investing in minerals; the segment is still under-funded," he said.

Exit strategies are a complex issue for minerals investors, Hefner noted. "Today, conditions are not favorable. The IPO market does not appear conducive and Wall Street has demonstrated a clear lack of understanding of the space, as evidenced by Kimbell Royalty Partners and Viper Minerals trading under the same metrics when they are very different companies with very different assets. We have a lot of work to do in educating the public markets."

While many are currently dealing with those headaches, Hefner believes more yield-based investors will follow Franco-Nevada into the space and large pension funds will follow the major pension fund, Canada Pension Plan Investment Board, into the space to create more favorable conditions for exit in the future.

"Ultimately, mineral investments are the most flexible investments I've experienced. You don't have to wait for an exit to make investor multiples —you can cash-flow multiples without an exit and wait to exit when market conditions are favorable," Hefner said.

Accelerating into the mainstream

Having said that exits are not necessary, Hefner added that his firm has taken some material steps to broaden its options. "One thing we are doing differently is using proprietary technology to mark-to-market our assets in real time. We have spent two years to develop the intellectual property. I cannot say for certain, but we may be the first to do that."

Hefner believes this technology will help accelerate the integration of minerals investing into the mainstream, and hopes that others will do likewise. He is circumspect, however, about how. Two other trends he sees are also helping to broaden the appeal.

Noting the joint venture between Continental Resources and Franco-Nevada, Hefner said he expects more yield investors will be attracted to the segment. "In foreign markets, people are starting to wake to the idea that minerals investing could really change the game," he added.

For all the growth and new interest, minerals investing is not frictionless. "I see a bit of a dilemma brewing between working interest and minerals interest. Royalty interest owners do not care about well economics, except that wells are economic enough for operators to keep drilling. Mineral owners want shorter laterals to maximize recovery of hydrocarbons. From the operators' perspective, they want longer laterals to gain better well economics. So the different interests compete a little."

In recent years, a growing appetite for mineral investments has changed the market significantly, according to Matt Meagher, president of brokerage Meagher Energy Advisors. "The competition is heavier than ever. Private equity has shown up, as has family money and even some [IPOs]."

Meagher has 1.5 million gross acres and 400,000 net acres in 33 states currently on the market. "Those assets include conventional and unconventional oil and gas resources. About the only thing we avoid is coalbed methane. We have brokered numerous successful mineral transactions, most notably in the Powder River, Williston, [Denver-Julesburg] and Permian basins, as well as the

"Minerals are easy to manage. There is not a lot of operational complexity, making mineral investments an appealing option for diversification, especially for private-equity entities and wealthy families."

—MATT MEAGHER,
president, Meagher Energy Advisors

Scoop and Stack areas of the Anadarko Basin. We have also had a few misses, but not too many."

There are certainly advantages to the increased attention on minerals. According to Meagher, "There is a lot more data available to substantiate an investment thesis. Also, minerals are easy to manage. There is not a lot of operational complexity, making mineral investments an appealing option for diversification, especially for private-equity entities and wealthy families."

Control and cost of capital

Still, Meagher cautioned investors to remain aware that cost of capital is an important factor. "Mineral owners have no control over what gets drilled and when, so you need a very low cost of capital. Even if a parcel is developed, it may be limited to just a few wells so that the acreage is [HBP]. It is not always going to be a pad program with multiple wells."

Many investors have also encountered problems managing their expectations, Meagher added. "Someone will see that mineral rights sold for $60,000 per acre in Lea County, N.M., and expect to see similar numbers everywhere. It simply doesn't work that way due to the diversity of the geology from one basin to another, among other factors."

Meagher has a theory on why the appetite for mineral investments has grown so rapidly. "When the industry fell on tough times at the end of 2014, a lot of people lost their jobs. Many of them tried to buy minerals just to flip them. The result of all that was more people with industry expertise and time on their hands looking up mineral records. Suddenly, there were more packages on the market. It worked well enough to pay the bills until the recovery."

Technology also played a part. "It used to be you had to drive to the courthouse and dig through the records. Now almost anyone can pull up the records online," Meagher said.

With the increase in transaction volumes, it was not long before bigger money started to enter the picture. "Now that the big money is in, I am not so sure it is going to stop. For private equity, the strategy would be their normal M.O. of amalgamating assets and trying to sell up to a public company," Meagher said. Given the size of the Permian Basin, Meagher believes that it will continue to see mineral investments for many years to come as "other smaller basins may run out of appealing assets to buy."

Another trend that Meagher identified is operators "getting ahead of their own drillbits by buying minerals rather than leasing them. The challenge for operators, however, is that most are working in only one or a few basins," making some of the larger multistate mineral packages less appealing, considering their concentrated needs. ■

SELECTED MINERALS INVESTMENT OPTIONS BY OWNERSHIP TYPE

Company	Commitment ($MM)	Ownership type
A	$2,000	Endowment
B	$1,000	Private Equity
C	$632	Pension
D	$300	Private Equity
E	$300	Private Equity
F	$300	Private Equity
G	$254	Private Equity
H	$200	Family
I	$100+	Private Equity
J	$100	Private Equity
K	$100	Private Equity
L	$58	Private Equity
M	$11	Family
Total $5.300+		

Source: Falcon Minerals Corp.

THE NON-OP MODEL IS IN THE DRIVER'S SEAT

The non-op business model is no longer just a passive vehicle. Here, three non-op companies' stories exemplify clever funding strategies in a market still recovering from the downturn.

By Tyler Jones

Capital availability has changed for all players in the oil and gas value chain over the last several years, with investors demanding more discipline and capital markets being less open than they were in the past. This new environment encourages finding creative solutions for funding operations; one solution is non-operated companies' strategies to allocating capital. Non-operators (non-ops), however, have traditionally been viewed as passive investment vehicles.

Non-op companies such as Northern Oil & Gas Inc., Panhandle Oil & Gas Inc. and Pivotal Petroleum Partners LP have benefited from this greater emphasis on capital discipline and the associated deal flow. The non-op model is no longer just a passive investment vehicle. Their detailed understanding of plays and their approach to capital allocation offers investors strong internal rates of return (IRRs) with less asset-level risk than their operating partners face.

Goldilocks in the Bakken

While the Permian Basin has received a great deal of attention in recent years thanks to its strong economics, non-op companies such as Northern Oil & Gas have found an opportunity to grow substantially, both organically and through acquisitions this year, in the heart of the Bakken oil play in North Dakota. The Denver-based company recently completed three acquisitions, nearly doubling its production year-over-year to 33,250 barrels of oil equivalent per day (boe/d) by the fourth quarter of 2018, and it thus increased its core future drilling inventory to nearly 400 net locations.

"Capital flowing towards the Permian and other basins has helped us on the acquisition front," said Brandon Elliott, Northern Oil & Gas CEO. With much of the market's attention focused elsewhere, Northern has been able to approach deals with a competitiveness and degree of insight few others can match.

"Odds are, we've participated in 20% to 25% of the wells on an acreage package already," Elliott said. "We have participated in more than 4,000 gross wells to-date. That gives us an advantage when we analyze future wells and when we evaluate acquisitions."

With its knowledge of the Bakken, its decision to put capital toward acquisitions, and facing few competitors of scale in the basin, Northern is able to uniquely position itself to bid on acreage it understands well, according to Elliott.

"When we set about repositioning the company, we took on some debt structures that required us to grow into our balance sheet, and acquisitions played a big part of our

success at that. The acquisitions we have completed give us a unique combination of growing free cash flow and future drilling locations while deleveraging the company. That's a difficult combination to execute upon," he said.

From fourth-quarter 2017 to second-quarter 2018, Northern's market capitalization increased to $1.6 billion from $56.6 million, while debt was reduced to less than $850 million from $1 billion.

Its three major acquisitions were paid for with a combination of cash and stock, which has increased shares outstanding, but per-share metrics are expected to improve markedly, with earnings per share projected to have increased nearly 100% in the fourth quarter of 2018 from the second quarter, giving full effect to the closing of its three transactions.

BRANDON ELLIOTT
CEO, Northern Oil & Gas Inc.

"Equity investors have been excited to get involved in the recapitalization of Northern," Elliott said. "People appreciate that we have always had a very good business model, but we didn't have the capital structure to execute on our strategy previously. With this recapitalization, we think we can generate strong economic returns with free cash flow that we can allocate as appropriate. While our organic growth alone this year has been stellar, it is really just the residual effect of our returns-based philosophy, and not growth for growth's sake."

That capital will go to work wherever the company feels it will generate the best IRRs, Elliott added. How expensive or inexpensive a well might be is unimportant as long as the production generates the appropriate returns.

With advancements such as pad development and new completion designs, the company continues to find growth opportunities. With working interest and associated data from more than 4,000 wells in the Bakken, Northern's team feels that it knows the basin just as well as, if not better, than anyone.

"Because pads require a high capital commitment, we've been able to pick up incremental gains where minority interest owners are not able to commit that kind of capital and might be forced into non-consenting if they don't sell down their interest." This, along with the company's legacy position and recent acquisitions, is helping to make Northern the dominant Bakken non-op company, Elliott said.

"We are proud of what we've accomplished so far, but there's more to do." There's more appreciation from investors for a company that can consolidate working interests in this basin. And now we have the balance sheet to continue to grow, using disciplined capital allocation over the next 12 to 24 months."

The non-op model with added sizzle

While Northern remains laser-focused on the Bakken and Three Forks plays in North Dakota, other companies, such as Panhandle Oil & Gas, are taking a more diversified approach by participating in plays across the country. The company holds interests in the Eagle Ford, Permian Basin, Scoop/Stack and Bakken, among other plays. It hopes to maximize value through selective participation in the most attractive projects across this portfolio.

"The diversity of our assets distinguishes us," said Panhandle president and CEO Paul Blanchard. "We can allocate capital to plays as we see fit."

The company has made several acquisitions it thinks will pay off down the road, such as Bakken acreage and Scoop/Stack assets outside the hottest areas of these plays. "We're looking for contrarian acquisitions," Blanchard added. "We are able to capture value where we see long-term opportunity."

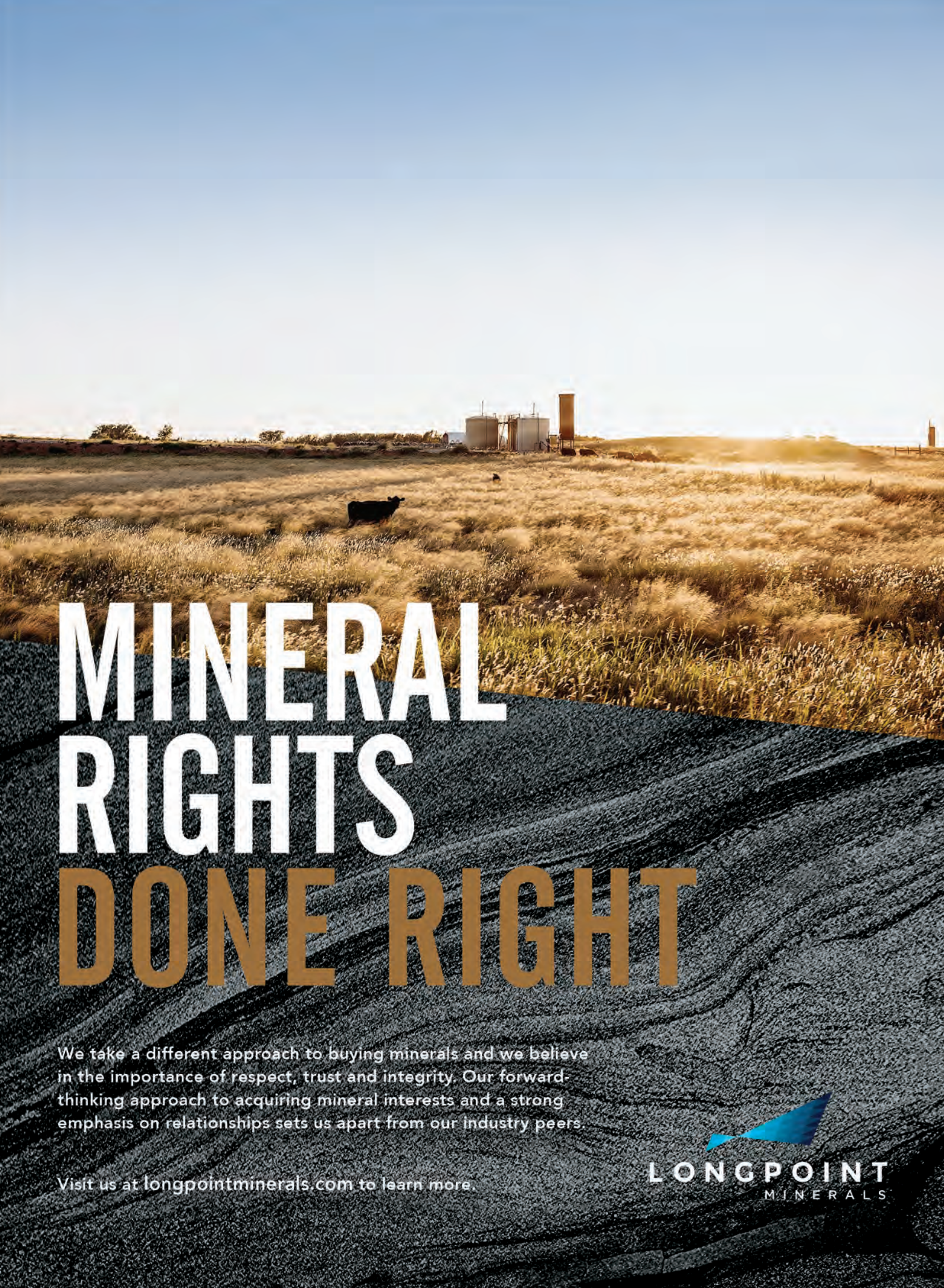
The major differentiator for Panhandle is not only its diverse assets, however, but its strategy of acquiring the mineral interests associated with assets in addition to working interest in wells. This unique strategy started in 1926 when Panhandle offered one share in the Panhandle Cooperative Royalty Association to homesteaders in Oklahoma in exchange for one-quarter of their mineral rights.

"In any given well, we're always going to have a competitive advantage with more cash flow and much higher return profiles, because we get that non-cost bearing royalty interest in addition to the working interest, and if we don't participate with a working interest we still receive the royalty," Blanchard added.

Because of the wealth of assets and knowledge the company holds, Panhandle is able to identify overvalued minerals in its portfolio, or assets with limited optionality. By divesting itself of such assets, the company is able to further maximize its operations. In 2018, the company reported selling 462 marginal wells, thus reducing lease operating expense 9.6% with just a 1.8% reduction in cash flow.

"We are making continuous refinements, but I think this model has merits in perpetuity," Blanchard said.

Panhandle sports an impressive record, too, paying a quarterly dividend for the last 50 years. Blanchard often remarks that the company maintains a long-term outlook and is constantly driving toward strong returns while mitigating risk. For 2018, that strategy prompted Panhandle to put the majority of its capital to work in the Eagle Ford, and it expects the trend to continue into the future.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"On the acreage we own, the Eagle Ford is very low-risk. It has been successfully drilled on the limits of our acreage, and so what remains is very low-risk in-fill drilling. That, along with the improvement in oil prices, makes the rates of return some of the best we see in the company," Blanchard said. Adding to improving commodity prices, Panhandle's operating partner in the play plans a continuous drilling program, and Panhandle holds a 16% working interest in the projects, compared with a typical 5%, making the impact several times greater for the non-op company.

PAUL BLANCHARD
CEO and president, Panhandle Oil & Gas Inc.

Opportunities for win-wins

Market sentiment shifted during the 2015 commodity price downturn, creating new opportunities in the non-operated space. Equity has become more difficult to raise in today's environment with eight IPOs totaling $1.3 billion in value year-to-date through October 2018, compared with 16 IPOs with total deal value of $4.8 billion for the same period in 2013. Follow-on offerings have similarly slowed, with $4.6 billion in additional capital raises year-to-date compared with $15.9 billion for the same period in 2013.

EDWARD HERRING
Co-founder and managing partner, Tailwater Capital LLC

Investors are demanding that companies return capital to shareholders and spend within cash flow, a significant departure from the growth-driven mindset that pervaded markets prior to the downturn. This has, in turn, reduced access to capital for companies throughout the supply chain.

Tailwater Capital LLC co-founder and managing partner Edward Herring said, "The need for companies to live within cash flow has discouraged operators from buying assets that are not cash-flow positive. As such, private-equity-backed companies need additional capital to develop their assets and may not be capitalized for it."

Tailwater, an energy private-equity firm, holds non-operated interests across the Lower 48 through Pivotal Petroleum Partners, which it founded in 2013. Pivotal gives Tailwater insight into the upstream side of the business, offering the firm a greater depth of knowledge with which to guide its strategy of debottlenecking resource plays.

Earlier this year, Northern Oil & Gas acquired 4,100 boe/d of production from Pivotal for cash and stock, but Pivotal continues on.

"Following the 2015 correction, access to debt and equity capital is dramatically constrained for public companies. Previously, companies may not have needed private-equity money; today, they are much more interested in working with us," Herring said.

"More than $1 trillion of upstream capital has been put to work since 2005, and what we're seeing now is, there is a need for more infrastructure to support the associated growth. With our non-op interest and our midstream investments, we're able to provide those infrastructure solutions and capital to the upstream sector."

Reaching that point took time and an evolution of Pivotal's model, Herring added. "The largest risk factor when we initially looked at starting a non-op was the perception that they were passive. Even when you had good assets, there was a sense that you did not control the pace of development."

To address that concern, Pivotal went through several iterations of its business model. When the 2015 downturn hit, Pivotal was able to partner with operators who had good rock but lacked the capital to fund their operated and non-operated development programs. By providing them capital for their non-operated development programs, Pivotal created line-of-sight on future development, and that model has continued changing to allow for even more control.

"Today, we are looking at many joint ventures, including programmatic drilling joint ventures or 'DrillCos,'" Herring said. "We carve out acreage, we build a plan around it and we provide capital to develop it. This allows operators to get their acreage into development and to live within cash flow." By following this model, Pivotal can support operators rather than create competition by leasing up nearby acreage. "We are being creative and providing solutions for our partners in this more capital-constrained environment."

By taking an approach that allows its partners to further their exploration goals, Pivotal can steer future development in a way that is beneficial to it and the operator in the well. "We look to have conversations with operators as partners and not just as financial participants. We rely heavily on creating partnerships where all parties can win," Herring added. ■

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