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Portions of this report were underwritten by the participants.

# The Road To Capital

The road to capital is longer today, and it has more twists and turns, maybe a few detours, but you can still reach a destination. True, the upstream industry is in a holding pattern (that's putting it nicely); however, smart people with a good track record can continue to access capital and build upon a business idea, even within a climate of uncertainty and tepid commodity prices.

In July, we saw the latest example: WildFire Energy I LLC received a line of private equity exceeding \$1 billion from management and funds affiliated with Warburg Pincus and Kayne Anderson Private Energy Income Funds. WildFire is a Houston E&P startup led by CEO Anthony Bahr and president and COO Steve Habachy, both industry veterans most recently with WildHorse Energy, which was sold earlier this year to Chesapeake Energy Corp. for \$4 billion. WildFire will acquire cash-flowing, yet underdeveloped, assets in the Lower 48 onshore.

Some capital providers like to meet management teams with an idea, such as this one; others like to see teams with assets already identified to buy, if not in hand.

But because asset deals are so difficult to close these days, with a wide bid-ask spread, then providing capital for developing existing assets seems to be the more frequent choice. The old acquire-and-exploit business model so popular in the 1990s is back, but today, it's underpinned by more creative financing structures and more patient investors—and luckily, far better drilling and fracking technology.

Another difference: All the capital providers we spoke to mentioned how important it is to have, or to build, scale, rather than hope for a shorter-term strategy.

The biggest concerns for capital sources and management teams are directional: What are market dynamics telling us? How long does the bedeviling uncertainty last, and where are commodity prices and demand going in the next 24 months?

"There are assets being sold that are undermanaged and under-capitalized, and when you put an entrepreneurial team on it, the company will create value," said Hunter Carpenter, partner at Redbird Capital Partners LLC.

Cash is still king, said another source, and that means spending it carefully and returning it to investors in a timely manner.

E&Ps should not expect a strategic sale to be the way to create value now—rather, it's all about drilling within cash flow and operating wisely.

From one end of the industry to the other, people are looking at their options within evolving market conditions. They are investing patiently. They are constantly evaluating opportunities. They are extending additional capital to existing portfolio companies—or, merging some of their portfolio companies together to create scale and reduce G&A.

Just as it always has in the past, the industry will endure and rebound, and the players will figure out creative solutions that fit their every goal.

— **Leslie Haines**, Executive Editor-At-Large,  
*Oil and Gas Investor*



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A low-angle, black and white photograph showing the silhouette of an oil worker wearing a hard hat and safety harness, standing on a platform and working on a complex network of pipes and structural beams of an oil rig. The background is a clear, light-colored sky.

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## CAPITAL MARKET NEWS

In case you missed it, here is recent news from the capital markets.

### People to watch

**J.P. Morgan** announced that Jonathan (Jon) Ernst joined the Corporate Client Banking and Specialized Industries (CCBSI) business unit within commercial banking, as an executive director in the energy group. Based in Dallas, he will focus on the E&P sector across the bank's south region.

With over 15 years of banking experience, Ernst was recently a senior vice president on the energy investment banking team for Jefferies LLC, focused on M&A, debt and equity financings, joint ventures, restructurings and recapitalizations. Throughout his career, he has worked closely with private and public companies across the upstream, midstream, downstream, oilfield services and coal sectors. Ernst received a Bachelor's in Business Administration from Texas Christian University. Mike Lister, the head of CCBSI's Energy Group, said, "Jon's a great addition to the team, with deep industry expertise and knowledge of the local market that will be valuable in helping our clients meet their financial goals."

In July, **Simmons Energy**, a division of Piper Jaffray, said it named Spencer Rippstein, Andrew Schroeder and Sanjiv Shah as new co-heads of energy investment banking, effective immediately. Fred Charlton, current chairman, managing director and head of energy investment banking, will remain as chairman and managing director. In 2018, Shah was named a Forty Under 40 honoree by both the *Houston Business Journal* and *Oil and Gas Investor*.

In 2017 and 2018, the Simmons energy team closed more than 170 transactions. The latest one this year, which closed in May 2019, was the IPO of Rattler Midstream LP, which was co-managed by Simmons. It also advised Concho Resources Inc. in its recent JV with Solaris Water Midstream LLC in the northern Delaware Basin. In addition, Simmons co-managed the IPO of Brigham Minerals in April.

### S&P Global assessment

Energy prices have become increasingly volatile, and that volatility, along with increased leverage and liquidity pressures, has led to several recent defaults in the oil and gas sector among some speculative-grade companies—10 just since the start of 2019, S&P Global Ratings said. But are those companies complete anomalies? Probably not, concluded S&P in a recent report. "There may be yet more defaults, or even bankruptcies, to come among lower-rated oil and gas companies," S&P said.

### Capital review

In a remarkable turnaround, the second quarter of 2019 was the first three-month period on record when U.S. shale operators achieved positive cash flow from operations after accounting for capital expenditures, according to **Rystad Energy**.

The energy research and consultancy based in Norway studied the financial performance of 40 dedicated U.S. shale companies, focusing on cash

flow from operating activities (CFO). This is the cash that is available to expand the business (via capital expenditure, or capex), reduce debt or return to shareholders.

In the second quarter of 2019, 35% of operators in the peer group balanced their spending with operational cash flow, and they reported an accumulated \$110 million surplus in CFO versus capex.

"That is an industry first," said Rystad Energy senior analyst Alisa Lukash.

In the first half of 2019, U.S. E&P companies raised a record low \$4.8 billion, compared to an average semiannual issuance of \$16.4 billion since 2014. No pure U.S. shale operator has made a public offering since Magnolia Oil & Gas' initial public offering in 2017, according to a report by Rystad Energy.

"This leaves the industry with fewer options to boost capital guidance throughout the remainder of 2019, as operators had significantly frontloaded capital budgets this year, leaving 46% of guided capex for the second half of the year."

Rystad said it is important to note that the slowdown in spending doesn't directly translate into the elimination of production growth, as there is a natural lag between budgeted capital, fracking, completion and first oil.

**Enverus'** (formerly Drillinginfo) analysis of the second quarter pointed to different data, where it found the energy industry raised \$16.9 billion in aggregate funds via public equity and debt offerings. That total was down 36% from the same quarter a year ago, according to Drillinginfo's Q2 Capital Markets review.

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The firm's analyst, Andrew Dittmar, said, "In a particularly poor showing, the upstream and oilfield service sectors combined to raise only \$300 million from fresh equity and \$2.5 billion from bond issuances."

Upstream saw \$261 million in public equity raised in the second quarter, through a sole offering, the IPO of Brigham Minerals, and was down 75% year-over-year. It was the upstream sector's second-worst equity-raising quarter since 2010, the firm said.

### **Private equity news**

**WildFire Energy I LLC**, an exploration and production company in Houston, signed a line of equity arrangement exceeding \$1 billion from management and funds affiliated with **Warburg Pincus** and **Kayne Anderson Private Energy Income Funds**. WildFire is a new venture led by CEO Anthony Bahr and president and COO Steve Habachy, both long-time veterans of the oil and gas industry who were most recently executives at WildHorse before it was sold to Chesapeake Energy Corp. WildFire will focus on acquiring and developing onshore assets with significant existing production throughout the Lower 48.

**Kayne Anderson** also announced an equity commitment of \$100 million from Kayne Anderson Energy Fund VIII and the management team of newly formed E&P **Indianola Energy LLC**, which is led by Chapman Amend and Todd Bergamy. The new Houston-based company will acquire and develop assets in resource plays in "highly proven" areas, they said, and form partnerships with other producers to speed up development of their undeveloped acreage.

Amend was formerly an operations executive with El Paso E&P who also has led two private E&Ps, and Bergamy was formerly on the energy team at Kayne Anderson Energy Capital.

**Pegasus Resources LLC**, a mineral and royalty buyer in Fort Worth, secured an additional equity commitment of \$300 million from



**EnCap Investments**, bringing the total commitment to \$600 million. The focus is still the Midland and Delaware basins.

**Three Rivers Natural Resources Holdings IV LLC**, Austin, received an equity commitment of up to \$500 million from **Riverstone Holdings Inc.**, again with CEO Mike Wichterich targeting the Permian Basin. This is the partners' fourth such deal.

**Glendale Energy Ventures**, Houston, and **TPG Sixth Street Partners**, formed an oil and gas investment partnership with an initial \$500 million in capital commitments. They have already made a non-op investment in Oklahoma's Stack play to the tune of \$55 million. Glendale is a private oil and gas company that makes direct asset level investments in upstream oil and gas assets across the United States. It provides capital solutions to operators through joint ventures, non-operated joint development partnerships and non-operated acquisitions.

Two private equity firms, **Quantum Energy Partners** and **Post Oak Energy Capital** and other investors announced in April that they have a binding agreement to sell substantially all of the assets of Oryx Southern Delaware Holdings LLC and Oryx Delaware Holdings LLC (collectively, "Oryx") to funds managed by Stonepeak Infrastructure Partners, for a cash purchase price of approximately \$3.6 billion. Oryx is the largest privately held crude oil midstream system in the Permian Basin, and it is based in Midland. It is underpinned by acreage dedications from 20 operators, including Concho Resources and WPX Energy.

### **Worthy of recognition**

**Kayne Anderson Capital Advisors**, **Trilantic North America** and **TPG Growth Partners** were named to Inc. magazine's list known as the "Top 50 Founder-Friendly Private Equity Firms." All three are active in providing equity to upstream and/or midstream investments. ■





**\$1,500,000,000**

Senior Secured Revolving Credit Facility  
Joint Lead Arranger

July 2019



Texas Petroleum Investment Company

**\$550,000,000**

Senior Secured Credit Facility  
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**\$1,600,000,000**

Senior Revolving Credit Facility  
Joint Lead Arranger

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## INVESTMENT BANK OUTLOOK

# Investors And Bankers Want Returns, Not Growth

Out-of-favor independents may look good again as a contrarian mood emerges—  
but many considerations weigh on the sector.

By Gregory DL Morris

In mid-August, Sanchez Energy Corp. joined the still-small but now-growing list of upstream independents for whom the shale boom has gone bust. With the Chapter 11 bankruptcy filing, Sanchez joins a list of 2019 E&P bankruptcies that includes Legacy Reserves LP, Vanguard Natural Resources LLC, Arsenal Energy Holdings LLC and several others.

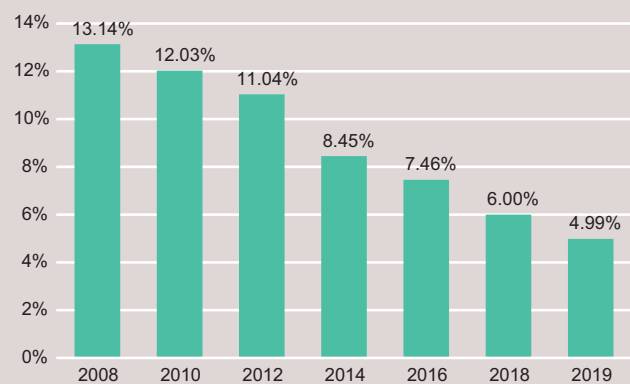
E&P companies have been under pressure by shareholders to focus on returns instead of growth. But the volatile nature of the oil business, which has seen oil prices rise post-downturn but nowhere near pre-downturn levels, has left

some companies—most of which are saddled with debt—struggling to stay afloat.

Investors, investment bankers and lenders have been down on the upstream for quite some time. In April, Hart Energy reported the somber mood at the usually convivial annual Oil & Gas Investment Symposium (OGIS) sponsored by the Independent Petroleum Association of America in New York. Investors did not seem eager to move. Of the overall conference one said, “I’m not really looking for anything in particular. I’m just trying to understand where the sector is now. I have not been paying it



## S&P 500 Energy Industry Weighting



Energy weighting continues to shrink within the S&P 500. Source: Seaport Global Securities LLC

much attention for the past few years.” Another investor said simply, “I have not been wowed.”

Producers seeking capital do have a few options remaining, even though public markets are largely closed to them. A few deals have been getting done but only for the highest quality assets that are immediately accretive to the acquirer. The mood remains dour, though a contrarian view is starting to coalesce. That is: The sector has been down so far for so long that it does not have much further to fall. The uptick in bankruptcies is taken as confirmation that capitulation is at hand. With broader markets teetering near the end of a 10-year bull run, the relative ratio of upside to downside favors the out-of-favor upstream segment.

Michael Bodino, managing director of investment banking at Seaport Global Securities LLC, based in Dallas, suggested that energy, specifically upstream independents, could have an opportunity when the market stalls. For that to materialize, he stressed that several factors, within the sector as well as without, have to break favorably.

“Upstream has been bouncing along historic low valuations,” Bodino said. “At present, it does not seem to be getting any worse, but neither is it getting much better yet. These days, I think of energy almost as a safe haven because it has hard assets that will retain value if the broader market cracks.”

To be sure, the sector remains out of favor, and for good reason, Bodino noted. Both upstream and services equities have been down, while the midstream has done well. There has simply been massive under-performance for years. After the E&P Index outperformed the S&P 500 by about 15 percentage points in 2009 and '10, both were about zero in 2012. E&P has underperformed the broader market in seven

of the eight most recent years, by an average of 24.5 percentage points. “Institutional investors simply cannot get into energy; they would get their heads ripped off,” said Bodino.

The retreat from energy has become structural, Bodino explained. Over the past 10 years, the weighting of energy in the S&P 500 has shriveled from 13.14% to 4.99%, a decrease of almost two-thirds. Of the 10 major categories, it has lost the most shares [Chart 1].

## Potential for free cash

“This is a relative performance game,” said Bodino. “Money has been moving out because of the long run of underperformance. What seems to have been lost in the shuffle is the fact that enterprise values have not changed for many of these companies, even though many of them have doubled their cash flow. That is staggering. The market is not paying for growth but is rewarding companies for being capital independent. If companies can execute on the plans they detail in their presentations, this sector could be on course to generate 5% free cash next year.”

If they cannot execute, things could get even worse, precisely because the sector has few other sources of capital. “Private equity has recently had tremendous fundraising problems for upstream strategies,” said Bodino. “It’s hard

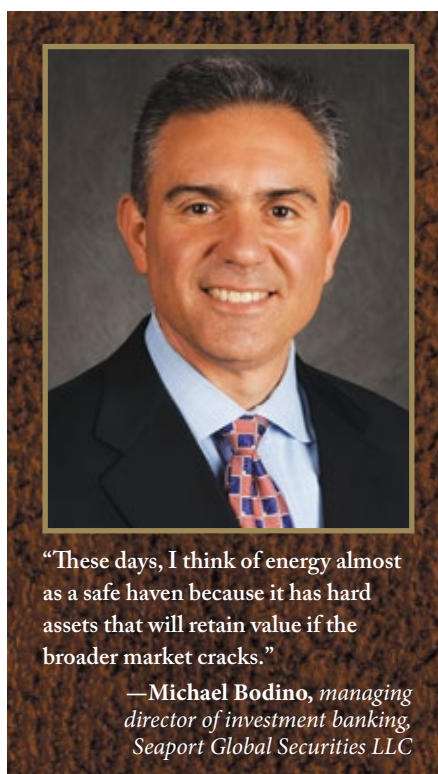
for them to convince investors of a valuation on paper when assets have been offered and not taken. That is a failed sale. PE is finding it necessary to keep assets longer and grow production.”

All of that is leading to an increase in combinations among stand-alone entities but also among portfolio operators. “There are three criteria to judge a combination today,” said Bodino. “Is it accretive to the acquirer, in terms of enterprise value to EBITDA; does it reduce leverage on the balance sheet; and does it add inventory that competes with other assets for capital?”

The last resort is still high-yield debt, even though the high is getting more so. “Over the past 10 years, high-yield rates have commonly had a 6 or 7 handle. Now that has moved to 9 or 10,” said Bodino [Chart 2]. “Investors and lenders are showing these days that they don’t want growth; they want capital, equity or return. Producers that can show yield and return cash to investors or lenders will be rewarded.”

Reflecting on the crude and gas differentials and the implications they have for independent producers, David Foley, senior managing director and chief executive officer at Blackstone Energy Partners LP, suggested that much of the current chill in public markets for new equity and debt fund raising by upstream companies may be warranted.

“Once producers demonstrate that they can exercise some self-discipline, funding all of their expenses, capital expenditures necessary to at least maintain production volumes,



make interest and tax payments, and oh a dividend would be nice, then generalist investors and public capital markets will reopen to the sector. But at present no one is willing to pay for more reserve booking and more drilling inventory.”

The market for publicly traded master limited partnerships (MLPs), which have been used to fund much of the midstream infrastructure in the U.S., has also been depressed, Foley noted. “With a dearth of capital inflows, private investors still find midstream a desirable area to deploy capital. There is a lot of appetite, some of it probably underestimating the risk and commodity price exposure of certain assets. High quality existing assets with revenues backed by long term-contracts probably should be valued at a more modest return target to reflect the stability of cash flow and lower risk,” said Foley.

### Another relative value game

An important driver for midstream investment is the compression of returns on fixed income and cash yielding assets anywhere else. “European sovereign debt has a negative interest rate,” said Foley. “U.S. Treasuries are paying about 2%. Compared to that, a 6% or 8% cash dividend plus growth on midstream assets looks pretty good, as long as they have staying power.”

“Once Blackstone Energy Partners and our management teams have borne the higher risk to develop, find long term revenue contracts and subsequently construct the pipelines, power generation facilities, etc., those assets are basically long-term investment grade bonds that can deliver reliable current cash dividends for many years into the future. Sovereign wealth funds and infrastructure funds are clamoring for assets with those characteristics.”

One way some companies have tried to strengthen their positions is to convert themselves from partnerships to traditional C-corporations. Christopher Sighinolfi, managing director for gas, utilities, midstream and refining at Jefferies, said his analysts “don’t find any meaningful difference. There is a greater appetite for traditional C-corp structures among institutional investors and offshore funds, but the well-capitalized operators can ride out the tide of active rather than passive administration. The prudent teams will adjust their balance sheets.”

Public capital has eschewed producers, especially unconventional operators, for several years now. It might seem that midstream companies would be insulated, but Sighinolfi suggested that the situation is not clear cut. “If an operator does not have a tether to export, that will be an issue for investors. The vertically integrated networks become more viable with more market options.”

Phil Lookadoo is fully aware of these current trends. He is a partner at Haynes & Boone LP with practice in energy

transactions, regulatory compliance in oil and gas, power and renewables, commodity trading and derivatives, mergers and acquisitions, as well as project finance and development.

For several years during and after the last down cycle in the upstream sector, Haynes & Boone released a quarterly synopsis and analysis of oil and

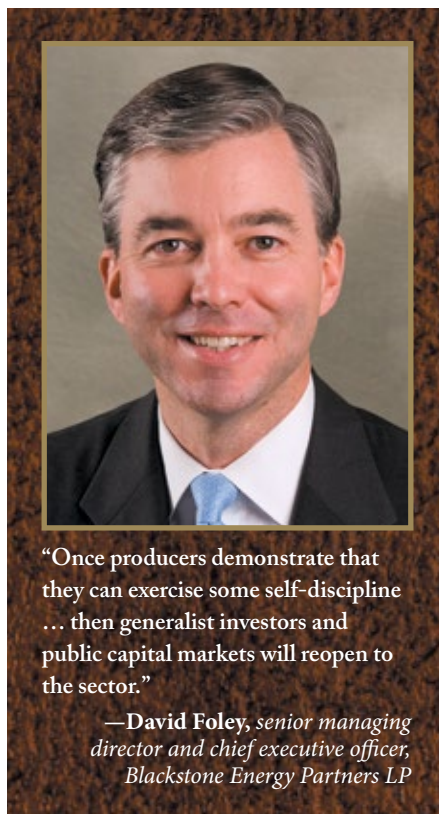
gas bankruptcies. That series has continued. Reflecting on persistent high production and low returns, Lookadoo noted, “a friend in the midstream called me recently asking if we have one [a report] for this year. Renewed interest in that report may be a sign of things to come.”

That growing concern throws a harsh light on the already limited capital options for producers. “The challenge for investors is where they think the future is for the oil and gas industry,” said Lookadoo. “What do they think the long-term plan is for producers?” The issues of economic and environmental sustainability and shareholder activism are important to investors, as is the lack of a coherent national energy policy. Those concerns definitely affect investor appetite for the sector.”

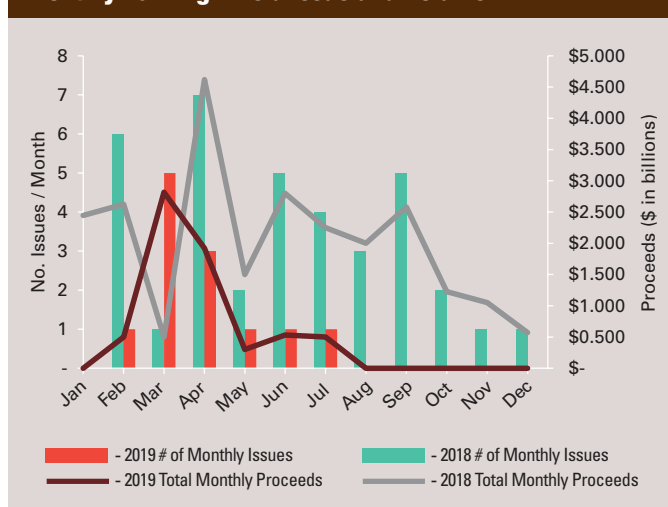
### Inherent value in existing infrastructure

Appetite for the resource is the key unknown. “I don’t have a crystal ball,” said Lookadoo, “but I do see

mobile sources of emissions—vehicles—moving to a mostly electric or at least hybrid fleet. But I do not see power generation moving to all renewables. A mostly electric vehicle fleet moves the issue of emissions control to larger stationary sources where emissions can be more



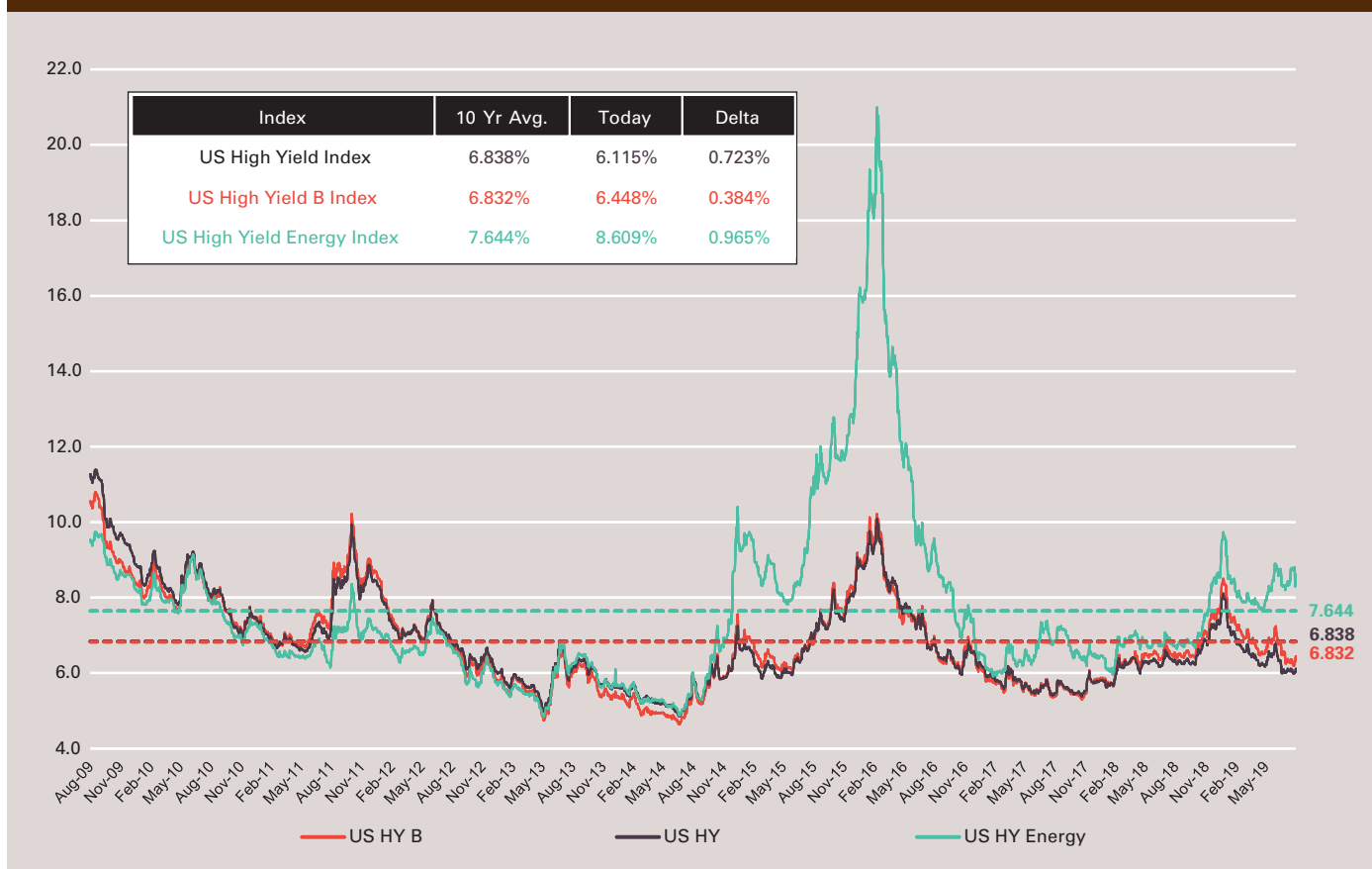
### Monthly E&P High Yield Issue and Volume



Monthly proceeds in decline. Source: FactSet, Bloomberg



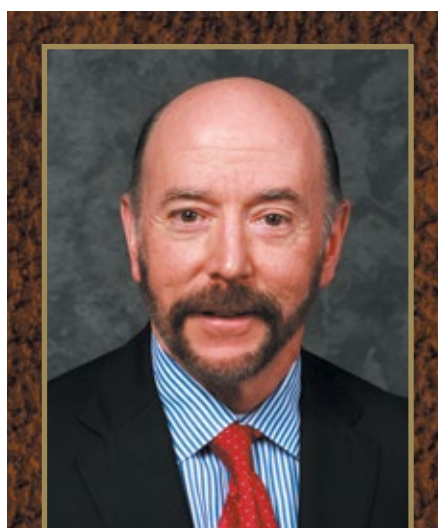
## Historical High Yield Performance



effectively and economically captured. Building carbon capture into power plant development will take climate risk and uncertainty concerns out of the equation.”

However the hydrocarbon consumption sector develops, Lookadoo expects that the controlling factors will be cost and utility. It is much more likely for existing infrastructure and supply chains to evolve than for whole new assets and systems to be funded and built. “For example, using liquid organic hydrogen carriers and hydrogen fuel cells for electric cars is a more efficient use of existing fuel distribution infrastructure and would reduce many of the international (political and economic) risks of relying entirely on batteries for electric vehicle fleets.”

“If the demand side materializes in those sorts of ways, that would give the E&P sector a shot in the arm,” said Lookadoo. “If long-term viability and thus value could be made more secure, then immediate concerns about immediate profitability become less.”



“The issues of economic and environmental sustainability and shareholder activism are important to investors, as is the lack of a coherent national energy policy. Those concerns definitely affect investor appetite for the sector.”

—Phil Lookadoo, partner,  
Haynes & Boone LP

In the near term, however, prices for oil and gas continue to be depressed and yet production continues to grow. “Even so, we do see real increases in demand for natural gas with a role in the global economy. As that grows, it seems reasonable to expect that pricing may become more stable.”

### Political uncertainty

Oil remains even more of a question mark, however. “Sovereign wealth funds, private equity and other institutional investors don’t know where the upstream sector is going long-term,” said Lookadoo. “We see the same thing in plastics. The export market seems to be the answer for everyone. If an investor does not know what the future looks like for an industry, a company or an asset, it is difficult to determine value. Certainly there is value in the upstream sector, and in export markets, but no one seems to know what it is or what it looks like.”

Ethan H. Bellamy, senior research analyst at Baird Equity Research

stressed factors outside the immediate industry. “What is missing from the discussion on gas supply is the political and regulatory uncertainty,” Bellamy said. “That is an increased concern regarding carbon. We are already well into the campaign ahead of the 2020 elections. Many of the candidates for the Democratic Party have advocated against hydrocarbons. One has suggested an outright ban on energy exports. Others have suggested eliminating further leasing on federal lands, including the Gulf of Mexico.” Most support some type of carbon tax. In contrast, the current administration has been a strident advocate for coal, leaving gas in the middle without a champion.

“The perverse reality for gas producers and investors,” Bellamy explained, “is that the best thing to hope for would be the victory of a moderate Democrat. That would be incredibly positive for gas prices because any limitations on leasing or development would increase the value of existing assets and operations.”

The range of possible outcomes depending on what happens in November 2020 is so varied that Bellamy cautioned, “Any forecast for gas prices beyond the third quarter of 2020 has got to have at least two different lines. There is a huge swing in eventualities. Some operations and companies will benefit greatly, others will be hurt.” Almost like the old sail-

ing charts with vast unexplored areas marked ominously, here be dragons.

In the long run, Bellamy sees the gas midstream, especially in the Permian, as an attractive place for investment. “There is no shortage of private equity capital for building the infrastructure to move that glut of Permian gas to the Gulf Coast,” he said. “Ultimately that will benefit LNG producers and buyers, LPG producers and buyers, and so forth. There are a lot of midstream opportunities.”

Keeping that larger perspective, Bellamy assessed that “we are in the midst of a massive world-wide realignment in hydrocarbons, especially gas, from demand pull to supply push.” That means both upstream and midstream operators must be aware of the shifting geopolitical sand. “You can know everything about your own industry, but if you don’t pay attention to global macro-economic issues, you can still get run over.”

Specifically, he cited the federal debt of \$22 trillion, as well as “ridiculously accommodative” monetary policy. “Easy money and loose regulation always create malinvestment. Excess capital has shredded margins in this business. But if the punch bowl is taken away, that would be good for existing assets and bad for anyone subscribing to the greater fool theory.” ■

A photograph of several oil pumpjacks (jackals) in an oil field, silhouetted against a bright, hazy sunset sky. The pumpjacks are in various stages of their pumping cycle.

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## DRILLCOS

# Sequel Energy: Act II

This GSO-backed specialist in funding DrillCo joint ventures has re-loaded with a further \$500 million. Here's how it fills a gap for E&Ps needing funding.

By Chris Sheehan, CFA

**Y**ou know funding for oil and gas is tight—really tight—when a multi-year low is made in the XOP (S&P Oil & Gas Exploration & Production ETF). The XOP's collapse in August plumbed depths last seen in February 2016, when West Texas Intermediate (WTI) crude sank to just over \$26/bbl. In the recent slump, activity in energy capital markets has dried up, leaving equity and high-yield sectors largely barren.

So where is an oasis to be found amidst the desert landscape of recent capital markets?

Although described broadly as backing “drilling joint ventures,” Sequel Energy Group LLC is focused primarily on what many call DrillCo joint ventures, an increasingly popular way to fill the gap between E&Ps and capital

sources. While relatively new, Sequel is well-heeled, having recently provided as much as \$500 million in funding to just three JV partners. In addition, with its financial partner, Sequel has the flexibility to offer complex, highly customized financing solutions.

Sequel Energy Group was formed in late 2016 with an initial capital commitment of over \$500 million from GSO Capital Partners LP. GSO is the global credit platform of the Blackstone Group Inc. Earlier this year, Sequel and GSO announced the formation of Sequel Energy Group II, backed by a further \$500 million, bringing combined capital committed to the Sequel platform to over \$1 billion.

The Sequel management team is led by a trio of industry veterans. Based in Greenwood Village, Colorado,



the three Sequel managing directors are Jeff Hemphill, Doug York and Dave Kornder.

All three members of the team have extensive industry experience. For example, York began his career with ARCO Oil and Gas. His later moves included a 10-year stretch with St. Mary Land & Exploration, where he eventually rose to COO. In 2006, he co-founded a privately-held E&P named Sequel Energy LLC, focused on acquiring and developing properties in Louisiana, Oklahoma and North Dakota.

After nearly 20 years in the E&P business, Hemphill joined York as a co-founder of Sequel Energy LLC, which developed a significant Bakken shale position in North Dakota. In 2013-2014, the company divested all its producing assets and leasehold.

Kornder has over 25 years of experience in the upstream sector. Prior to joining York and Hemphill in forming the next iteration of Sequel, he served as CEO of Cornerstone Natural Resources, a private equity (PE)-backed company with assets in the Williston Basin, and CFO of Patina Oil & Gas, a public company with assets focused primarily in the Denver-Julesburg (D-J) Basin.

"We're all operating guys. We've been in various E&P companies and in entrepreneurial companies but on the operating side for the vast majority of our careers," recalled York. "Dave Kornder had the relationship with GSO for many years. GSO wanted to build a drilling JV platform, and they realized early on that they needed a team to really execute their plans in the manner they wanted."

After working informally together on a couple of opportunities, according to York, the two parties came together to make a formal agreement. "We met the GSO guys and were super impressed by them," said York. "We formalized the partnership in November of 2016. They made a \$500 million commitment focused purely on drilling joint ventures or DrillCos."

Since late 2016, the Sequel management team has deployed its initial \$500 million in three deals. The smallest of the three was a \$75 million commitment, although it was later "upsized" with a second tranche of \$90 million to make a total of \$165 million. It involved "two iterations with the same company," a PE-backed producer located in the Permian Basin.



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—Doug York, managing director,  
Sequel Energy Group LLC

for certain projects, and that's changed. The banks want to see leverage levels at 2.0x debt-to-EBITDA or lower. There's this big gap between operators and capital providers right now."

The attributes of DrillCo financing may address some of the current issues facing producers, said York.

"DrillCos are fitting the needs of a lot of companies in that they are off balance sheet," he observed. "We take true working interests, so it's not debt," said Kornder. "Instead of running just one rig, companies can run two or three rigs—with us taking a working interest and financing it—so they can keep their teams in place and get to that inventory that may be 10 years out."

"At first, the terms of a DrillCo may appear expensive, if you view it purely as a financing vehicle," continued Kornder. "But if you view it more like the farm-outs that we did in earlier industry days, it's more 'down the middle,' because we're taking drilling risk right alongside the operator. You can't earn commercial bank-like returns and make this thing work."

With the recent deterioration in energy market conditions, Sequel is targeting an overall return in the "high-teens," up from the "mid-teens" prevailing 18 to 24 months ago, said York. "And for us to make these DrillCo JVs work, the program operating returns need to generate at least a 30%



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Sequel Energy Group LLC

internal rate of return at the current strip.”

But targeted returns are tied chiefly to the quality of the operator and the risk inherent in the rocks. “We might do something closer to mid-teens with a high quality operator and a more core area.”

Sequel noted that typical DrillCo structures focus on a carry, return hurdle and post-reversionary interest, with capital partners in many cases providing 90% to 100% of pre-reversion drilling and completion costs. In contrast, Sequel targets a 70% or lower working interest for itself. A non-reversionary structure has been used in three of its last four transactions.

Sequel has avoided so-called 90:10 deals (in which pre-reversion splits call for the capital provider to bear 90% of costs and the operator 10% of costs), because the parties’ interests are at risk of becoming “misaligned,” according to York. “We want to provide creative solutions for high quality operators in need of drilling capital that are not just ‘in the DrillCo box.’”

In terms of the asset characteristics it seeks, said Hemphill, Sequel wants a drilling joint venture to comprise “an area with a type curve in which we have a lot of confidence. And we need a big enough set of wells that we feel comfortable that, statistically, we’re going to hit that type curve on average. We’re not looking to prove up a different zone or a different spacing.”

Sequel typically targets an investment of \$100- to \$300 million, with an average well count with that size deal of 20 to 35 wells. The good news is that, as of mid-August, Sequel had dry powder to the tune of 100% of its second \$500-million commitment from GSO. While not on the horizon, with GSO as its sponsor, “we could do a \$500-million deal if it were the right deal,” commented York.

As a measure of its growth, Sequel’s net production has increased from zero in November 2016, to over 45,000 barrels of oil equivalent per day (boe/d) as of December 2018, noted York.

Interest in DrillCos is now more widespread, according to Hemphill, having grown from an initial circle of smid-caps and private operators to a broader group of large-caps and PE-backed E&Ps.

“I think people see the value in it,” he commented. “The public producers are sort of trapped in the need to generate free cash flow, and their financing options are extremely limited. At the other end of the spectrum are the private-equity



guys, where there are typically no exits now for their portfolio companies, and there’s very little M&A activity right now.”

As for the PE-backed producers, “we’re seeing a lot of demand currently from that group,” he added. “Their options are they can just sit on a declining asset, or they can bring in a JV partner to help fund the drilling program and grow their production and

EBITDA for an eventual exit. Many of those PE-backed teams were never set up with a capital commitment to operate programs for five years or more.”

In addition to the two tranches to a Permian producer, totaling \$165 million, mentioned earlier, Sequel has made capital commitments to two Utica E&Ps from its initial \$500 million from GSO. One of these was a \$200-million commitment to a “very large privately held company in Ohio.”

Another was made to Eclipse Resources Corp. of “close to \$300 million,” including cash recycled from its prolific wells.

Eclipse and Blue Mountain Resources Corp. merged in early 2019 to form Montage Resources Corp.

In looking at new opportunities, Sequel has not limited itself to deals in the Utica play and Permian Basin, said Hemphill. It has also reviewed transactions elsewhere: the Bakken, Denver-Julesburg, Eagle Ford and Midcontinent, for example.

Importantly, the financial flexibility provided by GSO has played a key role in allowing Sequel to take on what management says have been “some pretty complex transactions.” For example, one transaction included a significant acquisition component, requiring cash at closing, but also paved the way to signing a disproportionately larger DrillCo deal as part of a combined transaction.

The Sequel team is quick to praise the added creativity and flexibility it has with its GSO sponsor.

“GSO’s flexibility was a fantastic help in getting that deal negotiated and closed,” recalled Kornder. “GSO was

highly creative. The transaction was by no means a cookie-cutter deal.”

“We’ve coordinated very closely with GSO on an ongoing basis,” added Hemphill. “It’s almost like the lines blur between where we stop and they start, and vice versa. We’ve worked in lockstep with GSO.”

“Part of what makes our story unique is the relationship we have had with GSO that marries our skillset with their Street credibility and deal making skills,” said York. ■



“We’re seeing a lot of demand currently from that group [PE-backed producers]. ... They can bring in a JV partner to help fund the drilling program and grow their production and EBITDA for an eventual exit.”

—Jeff Hemphill, managing director,  
Sequel Energy Group LLC





## RECENT FINANCINGS

### EQUITY

Public and private deals \$20MM and above announced or closed February 2019 through July 2019.

Company	Exchange/ Symbol	Amount (\$MM)	Comments
Occidental Petroleum Corp.	NYSE: OXY	10,000	Announced that, in connection with the financing of Occidental's proposal to acquire <b>Anadarko Petroleum Corp.</b> , <b>Berkshire Hathaway Inc.</b> has committed to invest a total of \$10 billion in Occidental.
WildFire Energy I LLC	N/A	1,000	Announced it had signed a line of equity arrangement exceeding \$1 billion from management, funds affiliated with <b>Warburg Pincus LLC</b> and the <b>Kayne Private Energy Income Funds</b> .
Rattler Midstream LP	NASDAQ: RTLRL	721.3	A subsidiary of <b>Diamondback Energy Inc.</b> announced that underwriters of its underwritten IPO of 38 million common units representing limited partnership interests in <b>Rattler</b> have exercised in full their option to purchase an additional 5.7 million common units at a price to the public of \$17.50.
Energy Transfer Operating LP	N/A	700	<b>Energy Transfer Operating LP</b> , a subsidiary of <b>Energy Transfer LP</b> , priced an underwritten public offering of 28 million of its 7.6% Series E fixed-to-floating rate cumulative redeemable perpetual preferred units at a price of \$25 each, resulting in total proceeds of \$700 million.
Blackstone Energy Partners LP	N/A	500	Funds managed by <b>Blackstone Energy Partners LP</b> have formed <b>Waterfield Midstream</b> , a full-cycle provider of water management services to provide solutions to producers in the Permian Basin. Waterfield has a \$500 million equity commitment to pursue greenfield development and acquisitions of water-related infrastructure.
California Resources Corp.	NYSE: CRC	320	<b>California Resources</b> and <b>Colony Capital Inc.</b> , through its energy investment management arm, <b>Colony HB2 Energy</b> , formed a strategic joint venture in which Colony has committed to fund \$320 million for the development of CRC's flagship Elk Hills Field in the San Joaquin Basin. Subject to the mutual agreement of the parties, the total investment may be increased to \$500 million.
Viper Energy Partners LP	NASDAQ: VNOM	304	Priced a public offering of 9.5 million common units representing limited partner interests at a price of \$32 each.
Clear Creek Midstream LLC	N/A	300	<b>Clear Creek Midstream LLC</b> announced an initial venture capital commitment of \$300 million from <b>EnCap Flatrock Midstream</b> .
Brigham Minerals Inc.	NYSE: MNRL	277.4	Announced that it priced an upsized IPO of 14.5 million shares of its Class A common stock at \$18 each. <b>Credit Suisse Securities (USA) LLC</b> and <b>Goldman Sachs &amp; Co. LLC</b> acted as lead book-running managers, and <b>Barclays Capital Inc.</b> , <b>RBC Capital Markets LLC</b> , <b>UBS Securities LLC</b> and <b>Wells Fargo Securities LLC</b> also acted as book-running managers for the offering.
New Fortress Energy LLC	NASDAQ: NFE	257.6	<b>New Fortress Energy LLC</b> announced the pricing of its IPO of 20,000,000 Class A shares representing limited liability company interests in <b>New Fortress</b> at \$14 each. <b>New Fortress</b> intends to contribute the net proceeds of the offering it receives to <b>New Fortress Intermediate LLC</b> , its subsidiary, in exchange for limited liability company units in NFI (NFI LLC Units).
Noble Midstream Partners LP	NYSE: NBLX	200	Secured a \$200 million equity commitment from <b>Global Infrastructure Partners Capital Solutions Fund</b> to fund capital contributions to <b>Dos Rios Crude Intermediate LLC</b> .
Tellurian Inc.	Nasdaq: TELL	200	<b>Tellurian Inc.</b> priced a private investment in a public equity offering with Total SA for about 19.9 million shares at \$10.06 each.
GasLog Partners LP	NYSE: GLOP	96.3	Completed public offering of 8.5% Series C Cumulative Redeemable Perpetual Fixed to Floating Rate Preference Units, raising gross proceeds of \$100 million and net proceeds of \$96.3 million.

Continued on next page



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Company	Exchange/ Symbol	Amount (\$MM)	Comments
Crescent Pass Energy LLC	N/A	75	<b>Talara Capital Management LLC</b> , a Houston-based private-equity firm investing in the North American upstream energy sector, is pleased to announce the formation of <b>Crescent Pass Energy LLC</b> supported by a \$75 million line of equity investment.
Seismos Inc.	N/A	11	Secured a \$10.5 million equity financing led by <b>Quantum Energy Partners</b> with follow-on participation from <b>Javelin Venture Partners</b> , <b>Osage University Partners</b> , <b>ATP fund</b> , <b>Hicks Oilfield</b> and other existing investors.
Canadian Natural Resources Ltd.	NYSE: CNQ	N/A	<b>Canadian Natural Resources Ltd.</b> announced in connection with its previously announced Normal Course Issuer Bid to purchase up to 61.4 million of its common shares. It entered into an Automatic Securities Purchase Plan (ASPP) with a designated broker.

## DEBT

*Public and private deals \$20MM and above announced or closed February 2019 through July 2019.*

Saudi Aramco	N/A	12,000	<b>Saudi Aramco</b> priced \$12 billion of bonds in an initial bond offering that was substantially oversubscribed.
GSO Capital Partners	N/A	4,500	<b>Blackstone's</b> credit platform announced the final closing of the <b>GSO Energy Select Opportunities Fund II</b> strategy at \$4.5 billion.
Energy Transfer Operating LP	NYSE: ETPD	4,000	Announced the offering of \$4 billion of senior notes in three tranches: \$750 million aggregate principal amount of 4.5% senior notes due 2024; \$1.5 billion aggregate principal amount of 5.25% senior notes due 2029; and \$1.75 billion aggregate principal amount of 6.25% senior notes due 2049.
Enterprise Products Partners	NYSE: EPD	2,500	Announced that its operating subsidiary, <b>Enterprise Products Operating LLC</b> , priced a public offering of \$2.5 billion aggregate principal amount of notes comprised of \$1.25 billion principal amount of senior notes due July 31, 2029, and \$1.25 billion principal amount of senior notes due Jan. 31, 2050.
Schlumberger Ltd.	NYSE: SLB	1,600	<b>Schlumberger</b> priced \$1.6 billion of senior notes in two tranches: \$750 million of 3.75% senior notes due 2024 at 99.792 to yield 3.795%; and \$850 million of 4.3% senior notes due 2029 at 99.932 to yield 4.309%.
Targa Resources Partners	NYSE: NGLS-A	1,500	<b>Targa Resources Partners</b> , a subsidiary of <b>Targa Resources</b> , priced \$1.5 billion of senior notes via two offerings: \$750 million of 6.5% senior notes due 2027 at par to yield 6.5%; and \$750 million of 6.875% senior notes due 2029 at par to yield 6.875%.
ONEOK Inc.	NYSE: OKE	1,250	Priced an offering to sell \$1.25 billion of senior notes consisting of \$700 million of 10-year senior notes at a coupon of 4.35% and \$550 million of 5.2% senior notes due 2048 through an add-on to its existing issue.
Apache Corp.	NYSE: APA	1,000	<b>Apache</b> is offering \$600 million aggregate principal amount of 4.25% notes due 2030 and \$400 million aggregate principal amount of 5.35% notes due 2049.
Enable Midstream Partners LP	NYSE: ENBL	1,000	<b>Enable Midstream Partners LP</b> has entered into a \$1 billion three-year unsecured term loan agreement.
Valero Energy Corp.	NYSE: VLO	1,000	Priced an offering of \$1 billion of 4% senior notes due 2029 at 99.233 to yield 4.094%.
USA Compression Partners LP	NYSE: USAC	750	Priced private placement to eligible purchasers and its wholly owned subsidiary, <b>USA Compression Finance Corp.</b> , of \$750 million in aggregate principal amount of 6.875% senior unsecured notes due 2027 at par.
Antero	NYSE: AM	650	Announced the pricing of the private placement by <b>Antero Midstream Partners LP</b> , an indirect wholly owned subsidiary of <b>Antero Midstream</b> , to eligible purchasers of \$650 million in aggregate principal amount of 5.75% senior unsecured notes due 2028 at par.
Antero Midstream Partners LP	NYSE: AM	650	Priced private placement to eligible purchasers of \$650 million in aggregate principal amount of 5.75% senior unsecured notes due 2027 at par.
Kosmos Energy Ltd.	NYSE: KOS	650	Priced an offering of 7.125% senior notes due 2026.
Crestwood Midstream Partners LP	NYSE: CEQP	600	A wholly owned subsidiary of <b>Crestwood Equity Partners LP</b> announced that it has priced \$600 million in aggregate principal amount of 5.625% unsecured senior notes due 2027 in a private offering, which was upsized from the originally proposed \$500 million offering.
DCP Midstream LP	NYSE: DCP	600	Announced that its wholly owned subsidiary, <b>DCP Midstream Operating LP</b> , priced an upsized offering of \$600 million aggregate principal amount of its 5.125% senior notes due 2029 at a price to the public of 100% of their face value.

Company	Exchange/ Symbol	Amount (\$MM)	Comments
Rockies Express Pipeline LLC	N/A	550	Priced \$550 million of 4.95% senior notes due 2020 at 99.826% to yield 4.969%. Proceeds will be used for general corporate purposes.
Transocean Ltd.	NYSE: RIG	525	Announced that <b>Transocean Sentry Ltd.</b> , a wholly owned indirect subsidiary of <b>Transocean</b> , has priced an offering of US\$525 million in aggregate principal amount of senior secured notes due 2023 to eligible purchasers. The notes will bear interest at the rate of 5.375% per annum.
Boardwalk Pipeline Partners LP	N/A	500	Announced that its wholly owned subsidiary, <b>Boardwalk Pipelines LP</b> , has priced a public offering of \$500 million aggregate principal amount of 4.8% senior notes due 2029.
Centennial Resource Development	NASDAQ: CDEV	500	Subsidiary <b>Centennial Resource Production LLC</b> priced its previously announced private offering of senior unsecured notes due 2027. The 2027 notes, priced at 99.235% of principal amount, will mature on April 1, 2027, and will pay interest at an annual rate of 6.875%.
Cimarex Energy Co.	NYSE: XEC	500	Priced an offering of \$500 million aggregate principal amount of senior unsecured notes due 2029, which will carry an interest rate of 4.375%. The notes were sold to the public at 99.862% for a yield to maturity of 4.392%.
CNX Resources Corp.	NYSE: CNX	500	Priced \$500 million of its 7.25% senior notes due 2027. The notes will be guaranteed by all of <b>CNX's</b> wholly owned domestic restricted subsidiaries that guarantee its revolving credit facility.
EnLink Midstream LLC	NYSE: ENLC	500	Priced an offering of \$500 million principal amount of 5.375% senior notes due 2029 at a price to the public of 100% of their face value.
Magellan Midstream Partners LP	NYSE: MMP	500	<b>Magellan Midstream Partners</b> priced \$500 million of 4.85% senior notes due 2049 at 99.371 to yield 4.890%.
Moss Creek Resources Holdings Inc.	N/A	500	A wholly owned subsidiary of <b>Surge Energy US Holdings Co.</b> announced that it has priced \$500 million aggregate principal amount of its 10.5% senior unsecured notes due 2027 in a private offering. The notes will be guaranteed by each of the company's two subsidiaries, <b>Moss Creek Resources LLC</b> and <b>Surge Operating LLC</b> .
NuStar Energy LP	NYSE: NS	500	<b>NuStar Logistics LP</b> , a wholly owned operating subsidiary of NuStar Energy LP, announced that it has priced \$500 million aggregate principal amount of 6% senior notes due June 1, 2026.
Sequel Energy Group LLC	N/A	500	Funds managed by <b>GSO Capital Partners LP</b> , the credit platform of <b>Blackstone</b> , and the founding partners of <b>Sequel Energy Group</b> formed <b>Sequel Energy Group II LLC</b> with initial capital commitment in excess of \$500 million.
Sunoco LP	NYSE: SUN	500	Announced a private offering of senior notes due 2027 in an aggregate principal amount of \$500 million. <b>Sunoco Finance Corp.</b> , a wholly owned direct subsidiary of <b>Sunoco</b> , will serve as co-issuer of the notes.
NGL Energy Partners LP	NYSE: NGL	450	<b>NGL Energy Partners LP</b> and its wholly owned subsidiary, <b>NGL Energy Finance Corp.</b> , priced a private offering of \$450 million aggregate principal amount of 7.5% senior notes due 2026. Interest on the notes will accrue at a rate of 7.5% per annum. The maturity date of the notes is April 15, 2026.
DCP Midstream	NYSE: DCP	325	<b>DCP Midstream</b> priced an add-on \$325 million offering of 5.375% senior notes due 2025 at 100.75 to yield 5.230%.
Nine Point Energy LLC	N/A	320	Announced its entry into a \$320 million term loan facility with <b>AB Private Credit Investors LLC</b> as administrative agent and lead-arranger.
Gran Tierra Energy Inc.	NYSE American: GTE	300	<b>Gran Tierra Energy Inc.</b> completed its previously announced offering of \$300 million aggregate principal amount of 7.75% senior notes due 2027 in a private placement to qualified institutional buyers in the United States.
Teekay Corp.	NYSE: TK	250	Announced the closing of its previously announced offering of \$250 million in aggregate principal amount of 9.25% senior secured notes due November 2022.
Transocean Poseidon Ltd.	NYSE: RIG	50	<b>Transocean Poseidon Ltd.</b> , a wholly owned indirect subsidiary of <b>Transocean</b> , has priced an offering of US\$550 million in aggregate principal amount of senior secured notes. The notes will bear interest at the rate of 6.875% per annum and will be callable after Feb. 1, 2022.
Chesapeake Energy Corp.	CHK		Announced the commencement of private offers of new 8% senior notes due 2026 to be issued in exchange for certain outstanding senior unsecured notes. The exchange offers are not subject to a minimum or maximum amount.





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## VOICES FROM THE MARKET

# Despite Uncertain Times, Investment Firms Still Seek Opportunities

In these short discussions, hear what five firms have to say  
about strategy, outlook and their latest deals.

By Ellen Chang

### Redbird Capital Partners LLC

**Focus:** A New York and Dallas-based private equity firm, Redbird focuses on investing in energy and energy services companies and also provides long-term capital for communications infrastructure, business and financial services, sports, leisure and hospitality, industrial services and media and entertainment companies. Redbird tends to invest \$75-

to \$200 million in companies with an existing management team over a longer period of time. The firm was founded by Goldman Sachs alum Gerry Cardinale.

**Latest deals:** Redbird made its latest investment this May in FireBird Energy, an independent Texas-based oil and gas company that operates and develops crude oil and natural gas producing assets in the western Midland Basin.





"There are assets that are being sold that are undermanaged and undercapitalized, and when you put an entrepreneurial team on it, the company will create value."

—Hunter Carpenter, partner,  
Redbird Capital Partners LLC

The FireBird team is comprised of former RSP Permian team members and other industry veterans. The deal terms were undisclosed.

**Strategy:** The firm's strategy is to focus on partnering with management teams to help them acquire assets where upside can be achieved with technological advances, according to Hunter Carpenter, a partner at Redbird.

"Approximately a quarter of RedBird's activities are energy related, and we offer entrepreneurs longer-term capital," he said. "We like backing teams where there is a line of sight on a deal with assets already identified."

The firm plans to extend additional capital this year to its existing portfolio companies to "actively grow our positions," he added.

Since 2015, the firm has held steadfast to its strategy of building a company and scaling it, instead of the shorter-term strategy of drilling two wells and selling the acreage, he said.

**Market outlook:** While the economic conditions for the remainder of 2019 and heading into 2020 remain murky, Redbird plans to deal with any uncertainties by continuing to work with its partners on its "very aggressive hedging programs" and "always" analyzing commodity prices, execution and its pacing of capital, Carpenter explained.

"Our biggest concern is how the uncertainty in the market emanating from trade concerns will impact demand over the next 18 to 24 months."

Many opportunities still exist as majors and independents reallocate and reprioritize capital, driving them to divest quality assets, he noted.

"It's a good time to be a buyer," he said. "There are assets that are being sold that are undermanaged and undercapitalized, and when you put an entrepreneurial team on it, the company will create value."

### Carnelian Energy Capital Management

**Focus:** An energy investment firm based in Houston, Carnelian has approximately \$1.8 billion of cumulative equity commitments. The firm focuses on lower-to-middle market equity investments in the North American upstream, midstream and oilfield services sectors in partnership with management teams, said Preston Powell, a managing director of Carnelian.

Carnelian typically focuses on investments requiring less than \$100 million of equity, although the firm has the ability to "expand meaningfully for the right opportunities," he added.

**Latest deals:** Founded in 2015, Carnelian's inaugural \$400 million fund closed in 2015, and its \$600 million second fund closed in 2017.

It closed its most recent fund, Fund III, at its hard cap of \$775 million in June 2019. The firm specializes in partnering with next generation, entrepreneurial owner-managers, and with concentrated portfolios of eight to 10 investments per fund, Carnelian "is able to provide differentiated focus and attention to each portfolio company," Powell said.

The firm recently partnered with Selenite Energy Partners, an Oklahoma City-based company that was formed to capitalize on the current environment by pursuing middle market special situation transactions in the North American energy space.

"The company has a solid combination of financial and technical acumen that provides it the flexibility to be opportunistic in its approach," he said.

**Strategy:** The firm's primary investment structures include pre-asset equity line of credit commitments as well as growth equity investments in companies with existing assets. Carnelian's recent successful exits include Percussion Petroleum LLC, Bison Oil and Gas and OneEnergy Partners among others.

**Market outlook:** The energy market continues to undergo many changes, Powell said, noting that the energy market gyrations we are observing are akin to a pendulum.

Prior to 2018, companies were living large.

"A lot of rigs were running, drilling in excess of cash flow, company and asset valuations were high based largely on inflated location counts and sizable acquisitions were executed often with disregard to the actual strategic fit to the story," he said.

In 2018 and 2019, the pendulum has swung the other direction and too far.

"Investors want companies to primarily drill within cash flow regardless of the economics of their inventory. Large acquisitions are frowned upon regardless of the price paid or the strategic benefit, and public companies are trading at historically low multiples," he said.



"While many operators are on the sidelines, we see the current state of the markets as an attractive opportunity to deploy capital and build great companies with great assets."

—Preston Powell,  
managing director, Carnelian  
Capital Management

The pendulum will end up somewhere between the extremes of the past and the current environment, Powell said. Companies are currently and can continue making smart acquisitions at reasonable prices and can drill wells that are highly economic within or even conservatively in excess of cash flow.

“As investors see prudent behavior play out, we expect the energy space to receive more mind share from Wall Street,” he said. “In the meantime, while many operators are on the sidelines, we see the current state of the markets as an attractive opportunity to deploy capital and build great companies with great assets.”

The energy market could turn around in the future.

“Setting aside the traditional supply and demand factors that affect commodity prices, we believe that generalist capital should and will eventually return to the public energy equity and debt markets to take advantage of the rare combination of top tier assets that provide both a dividend and attractive growth, all at very attractive, multi-year low entry multiples,” Powell said. “Once capital flows into the system, shares and bonds will trade up and give companies additional confidence to drill and acquire quality complementary assets at accretive prices.”

Environmental, social and governance has emerged as an increasingly frequent topic of conversation whereby investors expect and deserve thoughtful and thorough programs to systematically monitor and enhance ESG best practices throughout the portfolio.

“As it relates to the broader fundraising environment, we found our investors were largely excited about the opportunity to acquire assets given the current market backdrop,” he said.

### Talara Capital Management LLC

**Focus:** Founded in 2010 and based in Houston, Talara provides equity capital to the upstream oil and gas industry’s middle market companies.

**Strategy:** Talara looks to deploy about \$400 million of capital over the next few years for upstream oil and gas assets in the U.S., said David Zusman, co-founder and managing partner. The firm, alongside management teams, has not only bought controlling interests in assets it intends to develop but also has led restructurings, joint ventures and farm-outs.

“Our focus right now is on the Gulf Coast since the assets in the region have fast cash payback periods,” Zusman said. “We’re buying assets that pay back within three years.”

In early 2019, the firm closed its most recent fund. The firm typically focuses on assets or structured transactions that require about \$100 million in equity to fund both the initial acquisition as well as a multi-year development program.

**Latest deals:** Talara’s largest transaction was the \$130 million it committed to the restructuring and development of Caza Oil & Gas Inc., a formerly distressed oil producer in the Permian Basin with top tier shale assets in New Mexico. During the past couple of years, Caza has seen tenfold growth in production volumes and is now largely being funded out of internal cash flows. It has also recently been acquiring conventional production and development opportunities along the Gulf Coast in Texas and Louisiana.

In January, Talara provided a \$75 million equity commitment to Crescent Pass Energy LLC, a Spring, Texas-based company that is focused on acquiring producing assets in East Texas and Louisiana. Crescent Pass is also developing about 7,500 acres in the liquids-rich Cotton Valley trend.

**Market outlook:** The A&D market has changed dramatically in the past year, Zusman said. A trend has emerged as commodity prices have weakened. Talara has seen more motivated sellers place assets on the market, particularly smaller companies.

“Companies need to be able to self-monetize through their own manufacturing-like development programs and return cash to shareholders,” he said.



“We and our companies should not be dependent on a strategic sale of a company to create value. Cash flow is king.”

—David Zusman, co-founder and managing partner, Talara Capital Management LLC

In the Permian Basin, private equity firms and other buyers can purchase smaller acreage blocks for \$5,000 to \$15,000 an acre that are worth \$50,000 to \$100,000 once they are developed, he noted.

“You need very good rock, a strong technical team that knows the manufacturing process and enough capital to get economies of scale.”

Companies can succeed “with the right capital partner and a strong balance sheet with multi-year production hedges,” he stated.

Zusman stands by one motto consistently: “We and our companies should not be dependent on a strategic sale of a company to create value. Cash flow is king.”

With stagnant oil prices in the \$50 range and both the capital markets and A&D markets entering a transition phase, Zusman said the “market is increasingly coming to us.”

A stalemate A&D market could continue for a while, but recently the market has seen “more motivated sellers and groups looking to bridge valuation gaps with structured transactions,” he said. “Either way, we’re very patient investors at Talara. There is no rush. We only need to do one or two great deals a year.”

The largest opportunity remains in overlooked conventional oil assets. There will be more divestitures of assets from larger players looking to right-size their development, more restructurings, more bankruptcies, more joint ventures and creatively structured preferreds, Zusman said.

### Pearl Energy Investments

**Focus:** A Dallas-based energy investment firm, Pearl has \$1.2 billion of committed capital under management. The firm’s Fund II closed at \$600 million in July 2017.

Pearl focuses on partnering with management teams to invest in the lower-to-middle market North American upstream, midstream and oilfield services sectors and typically invests \$25 million to \$100 million of equity capital.





**Latest deals:** In July, the firm backed Streamline Innovations Inc., a San Antonio-based technology provider specializing in hydrogen sulfide treatment for natural gas and water, with a \$24 million commitment. Streamline's technology removes hydrogen sulfide from natural gas, produced water and wastewater. Founded in 2015, Streamline deploys advanced technologies for water and gas treating and related processes to help oil and gas, utilities, industrial, and municipal customers, both domestically and internationally.



In March, Pearl made a \$150 million commitment to Red Wolf Natural Resources, a newly formed upstream exploration and production company based in Oklahoma City. Red Wolf will pursue upstream development and acquisition opportunities focused in the Midcontinent region as well as several Rockies basins.

**Market outlook:** Pearl said funding more startups is a possibility. "We will continue to evaluate opportunities to partner with new management teams pursuing differentiated business plans," said Stewart Coleman, managing director.

For an E&P start-up opportunity, the firm prefers to partner with management teams and does not require an asset in hand in order to make an initial investment, he said. Pearl plans to extend additional capital to its current portfolio companies.

"We view the current market as an attractive opportunity to deploy capital alongside great teams," said Coleman.

The firm's strategy is to build companies around assets that provide long-term value creation opportunities with "optionality in evolving market conditions," he said.

While economic conditions for 2019 and 2020 are unknown, Pearl said it continues to scout potential deals.

"While subdued equity markets are creating exit uncertainty in the marketplace, we are committed to investing

patiently and are constantly evaluating opportunities to return capital to our investors," Coleman said.

### CSG Investments Inc.

**Focus:** A global buy-and-hold institution headquartered in Dallas, CSG is an affiliate of Beal Bank and Beal Bank USA, which have total assets of \$7 billion as of June 30. CSG focuses on transactions ranging from \$50 million to \$600 million and does not plan on funding any startups in 2019, said Hans Hubbard, a managing director of CSG.

"CSG's transactions generally require substantial durable, tangible collateral, and we prefer E&P opportunities with existing production already in place," he said.

The company is open to extending additional capital to existing borrowers only within the context of existing facilities or for a new facility, depending on the circumstances, Hubbard said.

The typical hold period for CSG is three to five years. "We're generally prepared for the longer end of that range," Hubbard said.

**Latest deals:** In May 2019, CSG originated a \$250 million senior secured term loan with full funding provided by Beal Bank to U.S. Well Services LLC, a Houston-based electric hydraulic fracturing services and technology company. The capital will give the company an opportunity to fund its growth initiatives to capitalize on the growing market demand for electric-powered fracturing services.



**Market outlook:** The energy sector still has various opportunities available, according to Hubbard. "Within the energy sector, the biggest opportunity is simply being available with capital and flexible, customized solutions tailored to meet borrower needs," he said. ■

EIV CAPITAL LLC

# Deals Can Be Found In Out-Of-Favor, Non-Core Areas



“A lack of a requirement for broader platforms puts the focus on building and maintaining quality assets and focusing on the customer. EIV’s institutional relationships give teams the confidence in capital support as projects and customer needs grow.”

—Patti Melcher, co-founder and managing director, EIV Capital LLC

Headquartered in Houston, EIV Capital LLC is an energy private equity firm focused on providing growth equity to small and mid-cap North American energy companies. Founded in 2009, the firm has approximately \$1 billion in assets under management across three funds and co-investment vehicles.

## Experienced, entrepreneurial team sets itself apart

The firm’s investment team consists of individuals with a diverse set of energy-focused backgrounds, including commercial, construction, entrepreneurial, financial and operational.

“Based upon our team’s deep assortment of energy industry experience, EIV seeks to quickly

understand the business, capital and leadership requirements necessary for a potential partner to achieve long-term growth and profitability,” said Patti Melcher, co-founder and managing partner of EIV.

EIV’s partners have started their own businesses and understand the passion and determination required to drive success in a growing enterprise. The entrepreneurial backgrounds of EIV’s senior members provide incremental experience to its portfolio as each company works through the typical challenges that often accompany growth. By concentrating its investment focus, limiting the number of investments per fund and fostering an environment of open communication, EIV believes its operationally-focused team can help

each portfolio company achieve its full potential.

## Focus on building customer-focused, operationally-sound businesses

EIV primarily provides growth equity capital and invests the majority of its capital in traditional midstream businesses, such as transportation, logistics and processing, but it also will pursue opportunities throughout the entire energy value chain, including oil field service and equipment, renewable/sustainable, upstream and downstream sectors.

“EIV believes its thorough understanding of the multi-facets of a business plan required to develop and build a successful energy business allows it to partner with high-



quality, ethical entrepreneurs focused on building businesses with solid operating fundamentals and long-term customer relationships,” said David Finan, partner at EIV Capital.

The firm typically commits between \$20- to \$100 million per investment, teaming up with entrepreneurs in existing businesses or on new platforms. EIV has the ability to provide commitments of \$200 million or more and has done so when its partners identified larger projects with appropriate risk-adjusted returns.

“EIV’s strategy is focused on supporting teams as they build and operate good businesses as opposed to having an emphasis on capital deployment. This allows us to pursue niche opportunities and support our partners as their businesses grow into stable, profitable enterprises with steady cash flows that are attractive to potential acquirers,” said Jenny Gottschalk, partner at EIV Capital.

### Diverse portfolio across the energy value chain

Since the firm first focuses on people and a nimble investment strategy, EIV started a midstream engineering company at the bottom of the last cycle. The company now has 400 employees and four offices. EIV also provided funding for one of the first oilfield water midstream business platforms well before outsourced oilfield water infrastructure was a hot topic, invested in a renewable natural gas and compressed natural gas fueling business, and funded multiple traditional midstream gathering and processing businesses spanning from East Texas to West Virginia.

■ **Fullstream Energy**—EIV partnered with the management of Fullstream to develop, acquire and operate midstream infrastructure focused on providing oil and natural gas gathering solutions to hydrocarbon



“This environment presents opportunities for both first-time and serial entrepreneurs to identify inefficient or underutilized assets and work with capital providers, such as EIV, to enhance midstream operations, improve customer service and drive returns.”

—David Finan, partner,  
EIV Capital LLC

producers in the Marcellus and Utica shale basins in 2016.

“When Fullstream identified its anchor project, EIV extended its relationship with Fullstream by increasing its total commitment to \$180 million in support of the company’s Marcellus greenfield pipeline and compression project in West Virginia,” Melcher said. “EIV worked alongside management as the commercial and capital scope of the project shifted, ultimately providing flexible equity support to assure success of the project and provide incremental capital to expand the project’s scope.”

■ **H<sub>2</sub>O Midstream**—In 2016, EIV identified the oilfield water sector as primed for growth, professionalization and cost savings and partnered with H<sub>2</sub>O

Midstream. H<sub>2</sub>O Midstream acquired Encana’s produced water infrastructure in Howard County, Texas, as its initial asset.

“Since closing the deal, H<sub>2</sub>O has expanded both its customer relationships to include seven contracted producers today and its operating asset base by substantially increasing its gathering footprint and disposal capacity, including the acquisition of a produced water gathering, disposal and recycling system from a neighboring producer,” Finan said.

The company also developed the first commercial truckless produced water hub in Texas. As the water midstream market was maturing, EIV increased its commitment in support of H<sub>2</sub>O Midstream’s growth. In 2019, H<sub>2</sub>O was also named as University Land’s preferred water service provider across the Southern Delaware, an area of increased commercial activity for the company.

### ■ **AMP Americas**—AMP Americas

I was a renewable energy company focused on producing renewable natural gas from dairy waste and owning/operating compressed natural gas fueling stations. In mid-2019, AMP Americas sold its existing businesses. EIV has partnered with the same management team to form AMP Americas II to develop similar renewable natural gas production projects as it developed and operated in AMP Americas I.

### ■ **Bayou Midstream**—EIV partnered with management of Bayou Midstream to develop, acquire and operate crude oil, natural gas and/or oilfield water midstream infrastructure focused in the Powder River Basin and Bakken Shale.

“Bayou completed construction of its first asset, a crude oil gathering

system in the Bakken Shale, in mid-2019. EIV looks forward to continuing to support the company as it seeks to grow both organically around its initial asset and in other parts of the Rockies region,” said Greg Davis, partner at EIV Capital.

■ **Summit Terminaling**—EIV partnered with management of Summit Terminaling to focus on developing, owning and operating terminal projects in underserved areas throughout the United States, such as inland waterways.

“EIV has personal relationships with the Summit team, having utilized their expertise to develop assets previously as well as evaluating opportunities alongside the Summit team,” said Gottschalk. “With the changing dynamics of the energy industry, EIV and Summit believe opportunities exist to own critical pieces of terminal infrastructure to eliminate bottlenecks throughout both the United States and the hydrocarbon value chain.”

■ **Woodland Midstream**—Woodland initially partnered with EIV in mid-2015 and successfully built an organic business focused on providing gathering and processing services primarily for new horizontal Cotton Valley and Haynesville drilling activity in East Texas.

“Management and EIV’s patient approach to shifting producer dynamics in 2016 and early 2017 positioned the company to be well-situated to provide greenfield solutions for producers to access the optimal downstream market pricing for their commodities,” Davis said. “In the fourth quarter of 2018, EIV and Woodland sold its existing asset and partnered to form Woodland Midstream II to pursue similar projects throughout Texas and Oklahoma.”

■ **EcoVapor Recovery Systems**—EIV has also partnered with EcoVapor to provide differentiated tank battery vapor recovery systems utilizing patented equipment (“ZerO<sub>2</sub>” standalone oxygen removal units) that reduce emissions and flaring in the oilfield. These ZerO<sub>2</sub> units have rapid paybacks for operators, due to incremental revenues from both oil and gas sales, and improve the environmental and safety profile of wellsites while reliably meeting pipeline corrosion specifications. EcoVapor’s equipment is in use on over 100 locations in all major oil producing basins in the U.S.

#### Opportunities exist due to current market dynamics

EIV believes the public market’s focus on free cash flow generation and profitability is opening the door for private capital to find opportunities in out-of-favor, non-core or off-the-beaten path areas. Additionally, EIV believes opportunities exist in core areas for customer-focus driven management teams to partner with producers and create a win-win for both parties.

“This environment presents opportunities for both first-time and serial entrepreneurs to identify inefficient or

underutilized assets and work with capital providers, such as EIV, to enhance midstream operations, improve customer service and drive returns,” Finan said. “These opportunities exist and can be profitable regardless of size, market cycle or geography.”

As unconventional basins mature, EIV is spending more time with entrepreneurs seeking to provide small scale services (under \$100 million projects) to producers that recently consolidated large positions.

“EIV is happy working with teams and producers with line of sight to self-contained projects,” Melcher said. “A lack of a requirement for broader platforms puts the focus on building and maintaining quality assets and focusing on the customer. EIV’s institutional relationships give teams the confidence in capital support as projects and customer needs grow.” ■



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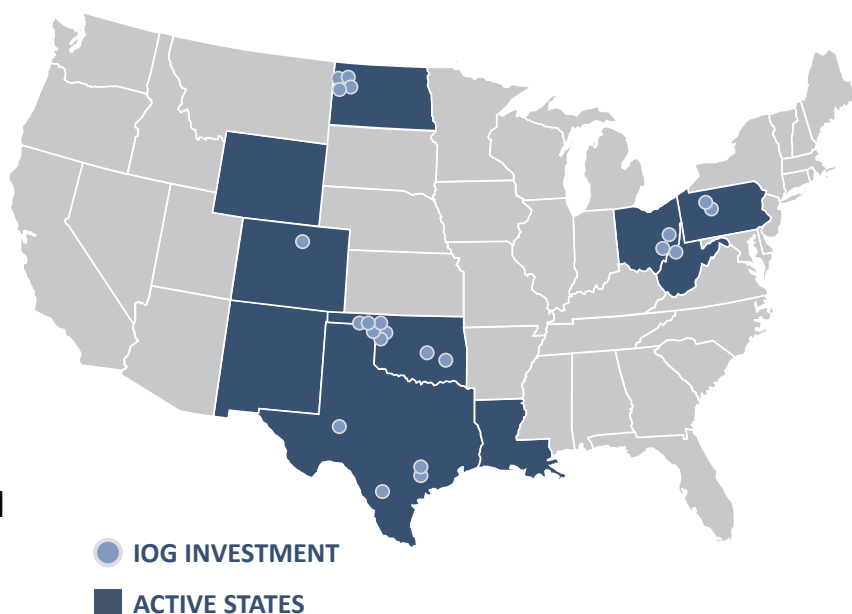
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## IOG CAPITAL LP

# Seasoned Upstream Investors



“New players seem to come and go, ready to add additional complexity to the latest bespoke structure. We have found that our simplicity and experience resonate with the best operators.”

—Charlie Shufeldt, managing director, IOG Capital LP

**I**OG Capital LP is a Dallas-based investment firm focused on direct investment in conventional and unconventional oil and gas assets. It targets an investment range of \$25- to \$150 million, and through the execution of more than 25 asset-level joint ventures and acquisitions, IOG has established a footprint across all major U.S. basins.

## Collaboration is key

More than a source of capital, IOG brings a deep understanding and appreciation of the technical and commercial components that result in successful partnerships. “Just as well performance varies, we understand that no two projects are the same and work with our partners to provide the right solution, designed for everyone’s success. We tell our operators we want our deal with them to be the best deal they’ve ever done. That’s the tone we set from the start,” said Marc Rowland, senior managing director at IOG. The firm has also expanded from development focused DrillCos and

AFE purchases to joint acquisitions and sell downs of production.

IOG collaborates with and encourages the sharing of ideas between its partners in varied ways. It recently hosted its 3rd Annual Operator Forum. “We invite current and prospective operating partners to participate in a moderated discussion on technology, innovation and challenges we all face as an industry. The unfiltered opportunity to see how peers are tackling the same challenges in other basins is highly valued and, unfortunately, very rare today,” said Tommy Woolley, managing director. Illustrating one successful outcome of this year’s forum, Woolley said that an operator shared results of testing three different frack interference mitigation techniques, which allowed another operator to arrive at the optimal solution more efficiently ahead of its first pad.

## New deals and opportunities

The “DrillCo” is a term coined to describe an asset-level drilling deal with a reversionary interest. Over

the last five years, the DrillCo has evolved to more closely resemble a credit product with complex rules governing all imagined scenarios, in an effort to reallocate investor risk back to the operator. While the cost of capital may seem attractive, the lack of control, administrative burden and all-in costs of these arrangements can be off-putting, at best. In contrast, IOG prefers more simplicity and transparency in the structure of its deals and provides the flexibility operators require in this business.

The IOG team sees that the market is constantly changing. “New players seem to come and go, ready to add additional complexity to the latest bespoke structure. We have found that our simplicity and experience resonate with the best operators, and we’re proud of our track record of closing deals and the repeated business we see. The world of operators with the right asset, track record, scale and cultural fit is currently very small. It’s our job to find these opportunities and match them with the right solution for



"Just as well performance varies, we understand that no two projects are the same and work with our partners to provide the right solution, designed for everyone's success."

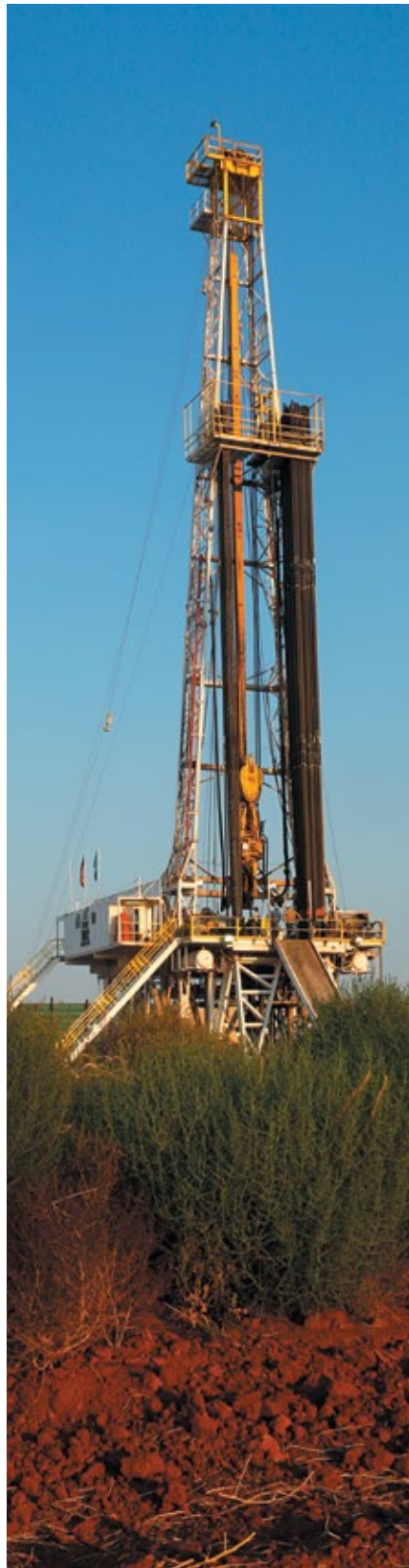
—Marc Rowland, senior managing director, IOG Capital LP

both sides," said managing director Charlie Shufeldt.

In the present challenging drilling environment, the firm is considering other upstream strategies. "Historically, we have been associated with development capital projects. Now, we see opportunity in producing assets, and we are prepared to make several large acquisitions of non-operated PDPs over the next 12 months," said Shufeldt.

### Working with the publics

With public capital markets effectively closed for most E&P companies, IOG spends more time with publics seeking alternative capital solutions. Inbound interest from large independents occurs regularly for the firm. "Another theme we're seeing is companies offloading their non-operated exposure. Their unpredictable nature has always been difficult to manage for publics, and with unprecedented scrutiny around capital discipline,



"The unfiltered opportunity to see how peers are tackling the same challenges in other basins is highly valued and, unfortunately, very rare today."

—Tommy Woolley, managing director, IOG Capital LP

trading out of these opportunities can be a wise solution," said Shufeldt. IOG prefers high working interest, discrete proposals typically associated with pad drilling and has recently closed two deals representing over \$45 million. Both deals were structured with simple reversionary working interest after payout.

With significant dry powder available, IOG is well-positioned to transact at the asset-level and expects continued success in this capital constrained environment, Shufeldt said. ■



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## LIME ROCK PARTNERS

# Lime Rock Works To Thread The Market's Needle



“The shale revolution has been the great disruptive event in our careers, for good and ill. But that disruption is not over. This creates an opportunity for our portfolio companies to come up with new, unforeseen strategies to capture value and achieve growth.”

—Jonathan Farber, co-founder and managing director, Lime Rock Partners

“There is no question that as we enter the mature stage of the shale revolution, and a difficult time for energy equity investors, all oil and gas private equity firms must return to the first principles of energy PE,” said Jonathan Farber, co-founder and managing director of Lime Rock Partners. Now 21 years old, Lime Rock closed on nearly \$700 million for its eighth fund and an affiliated co-investment vehicle last year.

“The questions any teams seeking capital from us have to ask themselves are, ‘what necessary role do we play in today’s shale economy?’ and ‘why is private capital actually needed?’”

Farber continued to explain that all investment strategies must start with an inescapable fact: The public E&P sector is aggressively shifting its business model to be a generator of free cash—for dividends, share buybacks

and debt paydown—rather than a consumer of private or public capital. While some E&P operators with good acreage and a healthy outlook will continue to present investment opportunities for equity providers in the near term, “those will be the exception rather than the rule.”

J McLane, chief investment officer of Lime Rock, added, “Given these changes in the environment, we are looking for companies that have a differentiated ability to access value or growth in the lowest-breakeven cost, lowest risk and highest growth shales.” Almost three-quarters of Lime Rock’s recent capital has been deployed in either minerals acquisition vehicles or oilfield service companies with specific strategies to grow market share and profits even in a stagnant overall oilfield service market.

One of Lime Rock’s minerals-focused portfolio companies, San Jacinto Minerals II, recently sourced and participated in a \$300 million acquisition of an overriding royalty interest from Range Resources alongside Lime Rock Resources, Lime Rock’s other strategy focused on acquiring and directly operating producing oil and gas properties in the United States.

McLane said, “We are being highly selective in adding any new platform companies in either minerals or oilfield services. Our two minerals platforms, San Jacinto and CrownRock Minerals, are already active in the Permian, Marcellus and D-J, and we as a rule don’t back companies in direct competition. And any oilfield service company that gains our interest will have to make the case as to why and how it can maintain healthy margins





“We are looking for companies that have a differentiated ability to access value or growth in the lowest-breakeven cost, lowest risk and highest growth shales.”

—J. McLane, chief investment officer, Lime Rock Partners

and gain market share, with defensible and sustainable service delivery or technological differentiation.”

Jeffrey Scofield, a managing director on the Lime Rock team, discussed the team’s approach to working interest E&P: “Like any investor, we’d always prefer to have both the highest quality assets and operatorship under our portfolio companies’ control. But the realities of today’s market, with so much of the best acreage already held and being intensively developed by large public companies, means that we will have to make choices.”

Scofield noted that Lime Rock has backed Wayfinder Resources, a non-op strategy focused on the Midcontinent, with the explicit choice to forgo operatorship to access better rock.

“The conventional wisdom that ‘lease and drill is dead forever’ may overstate the matter,” Scofield said. At some point, public companies will have to add inventory. However,

threading that needle will be difficult for new teams, as there has to be a clear ability both to access new acreage that will eventually be interesting to public companies and to hold that acreage for an indefinite period with a potentially rocky commodity price backdrop.”

Farber added, “Providing growth capital to new companies is only one part of our strategy at Lime Rock, and we weigh that strategy versus other options, such as holding assets or pursuing acquisitions in the Lime Rock Resources funds.”

McLane explained that, last year, Lime Rock raised \$740 million in new capital as part of a \$1.9 billion “acquisition fund” process to swap out limited partners in the fund that holds CrownRock, its largest current holding and the largest private equity-backed company in the Permian Basin. He added that CrownRock has continued to increase production and EBITDA and is benefiting from the slowdown in competitor activity in the Permian.

The Lime Rock Resources funds have also been active acquiring properties, with recently publicly



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—Jeffrey Scofield, managing director, Lime Rock Partners

announced acquisitions (in addition to the Range Resources override) including an acquisition of SWOOP properties from BP and Barnett Shale properties from ConocoPhillips.

“The shale revolution has been the great disruptive event in our careers, for good and ill,” concluded Farber. “But that disruption is not over. This creates an opportunity for our portfolio companies to come up with new, unforeseen strategies to capture value and achieve growth. We are constantly impressed by the ingenuity of the entrepreneurs in our business and look forward to working with existing and new teams.” ■



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NORTH HUDSON RESOURCE PARTNERS LP

# Creative Investing In A Shifting Market



“We believe our targeted investment size, coupled with the current market, allows us to capitalize on smaller opportunities that are often overlooked. Our strategy of starting small and building up businesses to scale is critical in the current commodity price environment.”

—Mark Bisso, managing partner, North Hudson Resource Partners LP

North Hudson strives to avoid the “one-size-fits-all” business model and seeks to continuously adapt to market conditions to optimize its investments. “We believe flexibility in structure and approach and execution at the portfolio company is critical, particularly in today’s market,” said Mark Bisso, managing partner of North Hudson Resource Partners LP, addressing how North Hudson remains successful in a period when investors are reluctant to deploy additional capital in the oil and gas sector.

Many private equity firms have found it hard to exit their legacy investments and return capital to investors, but North Hudson believes it has found opportunity where others are challenged.

Formed in 2018, North Hudson is a Houston-based private equity firm focused on middle-market private equity investments in the North

American upstream and midstream sectors. North Hudson primarily looks to make investments ranging from \$50 million to \$150 million, and the firm is on track to fund its fourth portfolio company in the fourth quarter of 2019.

Bisso considers this equity range to be a sweet spot that allows the firm flexibility to “go down market and acquire smaller transactions where we generally find compelling risk/reward propositions given the limited competition with executable capital,” he said. “We’ve found investments in the middle-market compelling as it has allowed us to not only find deep value propositions on the front end but also provides more flexibility for monetization.”

For example, North Hudson’s most substantial investment, TNM Resources, has acquired over 5,000 acres in the “core of the core” Delaware Basin through over 250 transactions

under the leadership of Aaron Davis, TNM’s CEO and president.

“We like the flexibility to be able to go down market and do the half a million, \$2 million, \$6 million deals—if you’re too big, this transaction size becomes impractical. Some of our best transactions to date have included deals that fly below the radar for larger players.”

TNM has made several opportunistic divestitures this year, underpinning the ability to monetize assets regardless of market conditions.

“There’s still a market for our assets. If you’re a big fund that’s spent \$300 million on acreage and another \$200 million on drilling, you’re likely waiting for a public exit; essentially, you’re stuck.”

North Hudson is actively pursuing opportunities in markets that many investors have overlooked, Bisso said. This kind of thinking has led



to the firm's formation of Split Rock Resources LLC, led by CEO and president Jake Bailey. Split Rock is focused on acquiring nonoperated wellbore interests in the D-J Basin. Specifically, the company offers operators holding nonoperated interests an option to sell out of their position to help manage or optimize third party drilling. This allows companies to keep their dollars focused on their primary business, which is their operated positions.

Split Rock generally acquires wellbore interests before or just after a well is spud.

"We can choose our partner and have a clear line of sight into where and when we deploy capital. This strategy seeks to remove many of the variables associated with traditional oil and gas investing and minimizes working capital."

The firm's third portfolio company, Winright Resources LLC, led by president Jason Cribbs, staked its claim in the western Anadarko Basin, an area that Bisso sees as underappreciated. The company acquired legacy assets from a large public operator exiting the basin in December 2017.

"You have a lot of neglected assets with a great deal of upside," Bisso explained. "There's a reason large companies are exiting, but there is still a real opportunity here. There are numerous proven benches to tackle, many of which remain very economic but are sub-scale for larger operators."

North Hudson believes it is well-positioned to handle the ebbs and flows in the oil and gas industry as the firm has significant experience optimizing investments across various commodity price environments. "There are oil and gas deals that remain attractive in the current environment. However, new investments require a high level of scrutiny before capital can be deployed," said Bisso. On the flip side, "sellers place meaningful premiums simply in working



with a trusted and credible buyer which leaves us well positioned."

He believes the lower to middle deal market is still open for business, even for exits, but North Hudson's portfolio companies are not built with a near-term sale necessary for attractive returns on investment. Instead, they are designed to grow organically and ultimately generate yield after the acquisition phase.

"We're finally starting to see the dam break. Companies are accepting the current environment and are looking to divest what many consider marquee assets formally," Bisso explained. "These assets are generally underpinned with PDP value and an appropriate value allocation for the upside."

"We build value. We seek to build the production base, create incremental value through the drill bit and leverage our platform for bolt-on acquisitions," Bisso said.

North Hudson believes that a certain scale is required to attract and retain top-tier management teams and to avoid situations where a company's balance sheet dictates its development plans. The firm recognizes that sub-scale commitments can create challenges.

"We believe our targeted investment size, coupled with the current market, allows us to capitalize on smaller opportunities that are often overlooked. Our strategy of starting small and building up businesses to scale is critical in the current commod-

ity price environment," Bisso said.

In keeping with the firm's overall strategy, North Hudson generally works with experienced management teams that don't have existing obligations and are specialists in their area of focus. Having a single area of concentration allows management teams the time they need to focus on building their companies.

"One of the things we believe that we've been successful in doing is finding the first-time teams that are already playing varsity but just haven't built that independent track record."

Before committing to a new platform, North Hudson commonly requires an asset at close or a clear and transactable pipeline to an asset, explained Bisso, even if just a small proof of concept purchase. "We believe this model helps us de-risk the potential partnership and helps assure that we're synced up on how we approach risk and the future strategy of the business, and it also helps us manage overhead."

North Hudson's portfolio has seen activity increase dramatically in 2019. The firm expects its portfolio companies to participate in over 300 gross horizontal wells across its positions in the Delaware, D-J and Anadarko basins during 2019. Likewise, North Hudson plans to remain active with acquisitions in these regions as well.

As the oil and gas industry continues to evolve, North Hudson not only recognizes the present challenges but also sees an emerging array of investment opportunities. "We are excited to have the proper platforms and capital to act in this market," said Bisso. ■



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## PEARL ENERGY INVESTMENTS

# Pearl Is In The Business of Partnership



“We are in the business of partnering with entrepreneurial management teams that have complementary backgrounds and share a capitalistic mindset.”

—Billy Quinn, managing partner, Pearl Energy Investments

Pearl Energy Investments is a Dallas-based energy investment firm with \$1.2 billion of committed capital under management. Founded in 2015 by Billy Quinn and Chris Aulds, the firm closed on its first fund in September 2015 and its second fund in July 2017—both at their hard caps. Pearl focuses on partnering with management teams to invest in the lower-to-middle market North American upstream, midstream and oilfield services sectors. The firm typically targets opportunities requiring \$25- to \$100 million of equity capital.

When asked about Pearl’s investment strategy, Quinn’s response centered on partnership. “First and foremost, we are in the business of partnering with entrepreneurial management teams that have complementary backgrounds and share a capitalistic mindset. We look for teams with clearly demonstrated technical and commercial competitive advantages stemming from

proprietary relationships and local market knowledge.”

Pearl targets lower-to-middle market investment opportunities and avoids “stacking” teams geographically, which mitigates competition among portfolio companies. “We have the luxury of being selective with our teams, and we purposefully size our funds and equity commitments to allow us to exclusively pursue the highest conviction investments in each basin,” said managing director Stewart Coleman. “Pearl will likely invest in only eight to 12 companies per fund, and we do not require an asset in hand in order to make an initial investment, keeping with our philosophy of ‘management team first.’”

“One aspect that differentiates Pearl is our ability to move quickly and support our portfolio company partners with follow-on capital,” said Coleman. This nimble decision making, coupled with the firm’s breadth of diverse and knowledgeable investment personnel, positions Pearl as a partner of choice for management teams.

“We believe in a collaborative approach with our portfolio companies. We understand what’s important to each management team, provide open lines of communication and maintain transparency throughout the partnership. Our investment, operational and commercial expertise combined with deep industry relationships enables Pearl to add meaningful value to portfolio companies,” said Steven Cobb, vice president at Pearl.

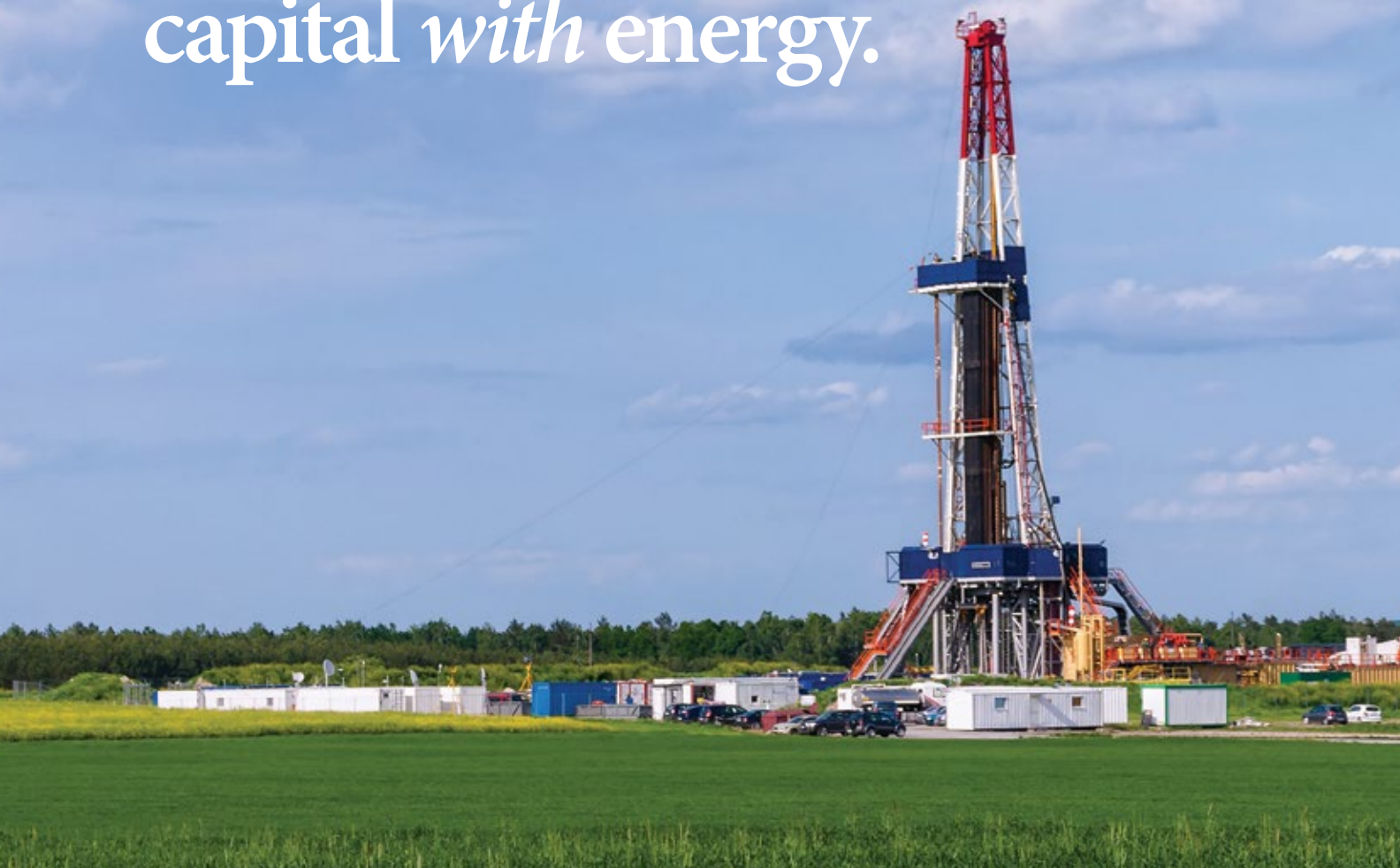
Across its funds, Pearl is currently partnered with 16 portfolio companies, 12 of which are upstream-focused commitments. “With substantial dry powder, we remain opportunistic, looking to partner with high-quality management teams pursuing compelling business plans,” said Aulds. ■

**PEARL**  
ENERGY INVESTMENTS

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PEARL  
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# BUILDING BLOCKS OF A STRONGER OIL & GAS INDUSTRY

<b>UNDISCLOSED</b>  <b>AETHON</b> ASSET DIVESTITURE Financial Advisor	<b>\$950 MILLION</b>  <b>EARTHSTONE</b> Energy Inc. HAS AGREED TO ACQUIRE  <b>SABALO</b> Fairness Opinion	<b>\$66 MILLION</b>  <b>HESSE</b> <b>ENERGY SERVICES</b> FOLLOW-ON OFFERING Co-Manager	<b>UNDISCLOSED</b>  <b>ROSEWOOD</b> <b>RESOURCES</b> JOINT VENTURE TRANSACTION Financial Advisor	<b>\$750 MILLION</b>  <b>Matador</b> <b>RESOURCES COMPANY</b> SENIOR UNSECURED NOTES Co-Manager												
<b>\$28 MILLION</b>  <b>VIKING</b> <b>MINERALS</b> ASSET DIVESTITURE Financial Advisor	<b>\$100 MILLION</b>  <b>LILIS</b> <b>ENERGY</b> CONVERTIBLE PREFERRED STOCK Placement Agent	<b>UNDISCLOSED</b>  <b>PEARL</b> <b>ENERGY INVESTMENTS</b> BUSINESS COMBINATION OF PORTFOLIO COMPANIES Valuation Analysis	<b>\$322 MILLION</b>  <b>SRC ENERGY</b> FOLLOW-ON OFFERING Co-Manager	<b>\$350 MILLION</b>  <b>VIPER</b> <b>ENERGY PARTNERS</b> FOLLOW-ON OFFERING Co-Manager												
<b>\$22 MILLION</b>  <b>Thunder Basin</b> <b>Resources</b> PRIVATE PLACEMENT OF EQUITY Placement Agent	<b>UNDISCLOSED</b>  <b>PETROFLOW</b> <b>ENERGY</b> ASSET DIVESTITURE Financial Advisor	<b>UNDISCLOSED</b> <b>BEELINE</b> <b>COLORADO, LLC</b> HAS DIVESTED ITS COLORADO MIDSTREAM ASSETS Financial Advisor	<b>UNDISCLOSED</b>  <b>ENTRADA EXPLORATION</b> HAS DIVESTED ITS COLORADO UPSTREAM ASSETS Financial Advisor	<b>UNDISCLOSED</b> <b>EAGLE FORD MINERALS</b> <b>PLATFORM</b> PRIVATE PLACEMENT OF EQUITY Financial Advisor												
<b>ENERGY GROUP KEY STATISTICS</b>  <b>\$46.9 Billion</b> Aggregate Transaction Volume since 2009  <b>\$293 Million</b> Average Transaction Size  <b>159</b> Transactions Closed since 2009			<b>ENERGY GROUP AGGREGATE TRANSACTION VOLUME</b> \$ in billions  <table><tr><th>Year</th><th>Aggregate Transaction Volume (\$ in billions)</th></tr><tr><td>2010</td><td>\$1.9</td></tr><tr><td>2012</td><td>\$7.5</td></tr><tr><td>2014</td><td>\$30.8</td></tr><tr><td>2016</td><td>\$38.1</td></tr><tr><td>2019</td><td>\$46.6</td></tr></table>		Year	Aggregate Transaction Volume (\$ in billions)	2010	\$1.9	2012	\$7.5	2014	\$30.8	2016	\$38.1	2019	\$46.6
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## STEPHENS INC.

# Navigating A New Private Equity Environment



“Upstream private equity funds are more likely to underwrite live deals with potential teams in conjunction with funding an acquisition to ensure that there is a fit, as blank check private equity commitments continue to get more rare.”

—Keith Behrens, managing director and energy group head, Stephens Inc.

There is a paradigm shift occurring in upstream private equity, according to Keith Behrens, managing director and energy group head at Stephens Inc.

The strategy of acquiring acreage, drilling a few wells to prove it up and then flipping it to a public E&P is no longer a viable option, as public E&Ps no longer get credit from investors for vast inventories and acreage. Consequently, there is a paucity of buyers for these types of deals, he said.

“Most upstream private equity firms are looking for PDP deals with upside, or deals in which 50% to 75% of the value is derived from PDP, and the rest of the deal value is attributable to line-of-sight upside,” Behrens said. Upstream private equity is high-grading both its assets and human capital, as investors attempt to part ways with lesser acreage (largely unsuccessfully) and are consolidating assets under

certain teams (the so-called “smashco”) while severing relationships with other teams in order to reduce G&A burden.

There is concern amongst energy private equity funds’ limited partners about the lack of capital returned in the past few years. Now, upstream PE firms struggle to find buyers for some of their portfolio companies, particularly those that employ or have employed a lease-and-flip strategy. Upstream private equity has been affected tremendously by the mood of public energy investors. During shale’s recent period of growth, upstream private equity was able to feed acreage deals to inventory-hungry public companies that were still being rewarded for acquiring decades of drilling inventory.

With the focus in U.S. upstream shifting from production and drilling inventory growth to positive cash flow, dividends and return on and of

capital, U.S. upstream private equity is modifying what types of teams it backs, what sort of strategies it employs, and its exit and hold period expectations.

## Approaches to debt

On the private debt side, and as access to the public debt markets becomes more challenging for those with less than ideal balance sheets, dividend recapitalization and unitranche debt deals have become more attractive.

Unitranche debt, through its combination of both junior and senior debt into one facility with one set of documents, allows borrowers to use facility proceeds for organic growth, acquisitions or for a one-time dividend. “Due to increased commodity price volatility and other U.S. upstream headwinds, unitranche debt is an attractive option for E&Ps that are running out of room in their current bank facilities or are facing



covenant issues with bank lenders,” he said.

Direct lenders are still active in U.S. upstream and are taking market share by providing flexible and creative products such as unitranche debt, and borrowers are generally willing to pay a pricing premium in exchange for additional leverage and covenant flexibility, including less restrictive dividend limitations and acquisition baskets.

The drilling joint venture or “DrillCo” structure remains a viable option for E&Ps seeking off balance sheet financing, with more generalist private equity investors offering this product, though structuring has become a little less advantageous for the operating partner, with capital providers now being wary of E&Ps using the product to finance the development of fringy acreage.

### Bright spots

Upstream private equity investors are still putting capital to work, despite fundraising presenting a bit of a challenge, and are focusing on fostering relationships with teams that have had success building oil and gas companies that can be successful in

the long term and excel operationally. Teams are instructed to focus on free cash flow generation, operational excellence and building a viable long term investment vehicle, while largely eschewing aggressive development and capital expenditures.

“Most upstream private equity funds expect their teams to buy assets right, while taking advantage of the plethora of attractively-priced PDP assets on the market, and then to develop opportunistically, remaining aware that an exit in three years might not be a realistic expectation.”

Minerals and royalties continue to be a bright spot in this challenging environment, with private equity investors cautiously adding exposure to what they view as a highly fractured market that is in its very early stages. Upstream private equity investors are increasingly demanding analytical and technological expertise from their minerals and royalties teams.

“Upstream private equity funds are more likely to underwrite live deals with potential teams in conjunction with funding an acquisition to ensure that there is a fit, as blank check private equity commitments continue to get more rare,” said Behrens. “When

looking at deals, private equity-backed teams are unlikely to overpay, choosing instead to focus on relative value, high quality PDP and low-hanging-fruit upside.” Upstream private equity is looking more closely at the “PDP aggregator” strategy to determine if it meshes with its view of the future of the business and returns and exit expectations, he added.

After years of deploying multiple teams to certain basins and watching them compete over resources, private equity funds are reducing their exposure to the expenses associated with having so many teams concentrated in limited geographic areas.

“Well-capitalized private equity investors are positioned to take advantage of the large amount of attractively valued assets on the market while partnering with teams that are capable of building successful oil and gas companies.” ■

Stephens

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TAILWATER CAPITAL LLC

# Looking For New Value In A Capital-Parched Market



“At Tailwater, we are focused on conservatively capitalizing our companies to ensure they are well-positioned for the long-term, in any market environment.”

—Edward Herring, co-founder and managing partner, Tailwater Capital LLC

Tailwater Capital LLC, a Dallas-based energy private equity firm founded in 2013 by managing partners Jason Downie and Edward Herring, has proved that it can offer solutions to energy entrepreneurs in all market environments.

“At Tailwater, we are focused on conservatively capitalizing our companies to ensure they are well-positioned for the long-term, in any market environment,” Herring said. “This has made us a partner of choice for management teams and has helped us to create value and minimize risk across our portfolio.”

One of the firm’s most representative investments continues to be Goodnight Midstream LLC, a leading produced water infrastructure company that Tailwater originally partnered with in 2016 through an equity investment of \$80 million. Since its initial investment, the firm has helped the operator to scale in both the Bakken and the Permian and to expand its

Eagle Ford footprint. Herring noted that Tailwater “remains very constructive about the core growth prospects in that platform.”

And with \$3.2 billion in managed, committed capital, Tailwater stays busy elsewhere, too. The firm recently exited another of its midstream portfolio companies, Petro Waste Environmental LP, and continues to grow Silver Creek Midstream, a Powder River Basin operator that is now “one of [Tailwater’s] largest platform companies and has been very active over the last 12 months,” said Herring.

In the capital-parched upstream sector, Tailwater invests as a non-op working interest partner with a \$1- to \$100 million investment range, which offers distinct opportunities for strategic growth, Herring said.

“We are seeing that the capital variability of non-op positions concerns boards of directors,” he said. “Over the last 18 to 24 months, Tailwater has partnered with a number of counterparties to help effectively get in front of non-op related capital opportunities

that otherwise these public companies don’t have the capital to participate in.”

Tailwater’s flexibility is an advantage. “We’ve got a really differentiated value proposition to boards of directors of E&P companies,” Herring said. “We’re not competitive with them on the leasing front, and we’re not competitive with them on the control operator front. But we can solve non-op problems, just as we can solve midstream problems.”

Having executed more than 100 energy transactions in the midstream and upstream sectors representing over \$19 billion in transaction value, Tailwater continues to explore opportunities with new management teams and has active investments in 14 portfolio companies. ■



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