

# Experienced Management Teams With New Firms And Capital Help Operators Chart Growth

By Richard Mason  
Special Correspondent

Capital. It makes the upstream energy world go round.

And high levels of activity and strong commodity prices are attracting record amounts of investment capital to the oil and gas sector. By one estimate, the volume of private capital available to oil and gas firms has grown 20-fold in the past decade. But capital needs expertise to be invested successfully. That is why a host of firms led by principals with decades of domestic and international experience are hanging out shingles to provide the operational expertise to deploy outside investment capital creatively to the benefit of investors, operators and the general public by producing more oil and gas for an energy-hungry market.

The trend weaves together all the right stuff—the right capital, the right projects, the right people and the right strategies—into a formula for success, but the management team is the all-important bridge that connects all these elements to opportunity. There are plenty of new companies in the capital markets serving oil and gas, but often as not, the executives and managers running those firms have extensive upstream pedigrees, and their names are already very familiar in oil and gas circles.



Consider the case of Merrill Lynch Petrie Divestiture Advisors, a new company with an instantly recognizable name. For years, Petrie Parkman & Co. was regarded as a premier boutique banker with an extensive portfolio of oil and gas industry relationships—particularly in the Rockies, which has become front and center in the unconventional natural gas renaissance that is revitalizing the onshore market. Merrill Lynch, of course, had long been a giant name in financial services.

Last October, soon after its filing of an initial public offering, Petrie Parkman & Co. agreed to merge with Merrill Lynch, recalls Mike Bock, a Merrill Lynch managing director and formerly a shareholder in Petrie Parkman & Co.

“There were two main factors that really drove the merger,” Bock explains. “First, Merrill Lynch was a good cultural fit for us, and the company appreciated the way we did business and wanted to keep that approach in place. Second, we were really good with equity but we did not have a presence anywhere else in the capital structure. We did not have debt distribution capabilities, and we were not really effective with convertibles. Merrill Lynch brought a host of resources—public and private—and a lot of very specific knowledge in the convertible, preferred and convertible debt universe. It has hedging capabilities for clients and reserve-based lending. From a banker’s perspective, you can bring all kinds of resources to a business relationship. That is what won us over in the end.”

Bock began working for Petrie Parkman & Co. in the early 1990s and recalls the firm’s first private capital placement in 1992. That initial placement subsequently developed into a sizeable business, with Petrie specializing in private and public capital equity financing. By early 2006, Bock says Petrie Parkman & Co.’s principals were as optimistic about the future of oil and gas as any time in their careers, and were seeking a way to capitalize on very strong energy tailwinds.

The IPO presented an opportunity to gain public market value for the firm. But no sooner was the IPO put in motion, Bock states, then the company received an unsolicited offer from Merrill Lynch. “The timing may have seemed a little odd after having just launched the IPO process, but it was the right time and Merrill Lynch was the right partner for a merger,” he remarks. “Importantly, all of the investment

bankers at Petrie Parkman & Co. remained employed with Merrill Lynch after the merger.”

### New Players, New Money

Bock says there were four basic choices for private capital in the 1990s, including stalwarts like Encap Investments, NGP Energy Capital Management, Yorktown Energy Partners or First Reserve Corp., and the combined investment pool of private equity did not quite reach \$1 billion. But all that has changed, he points out.

“The last few years have seen the growth of large direct energy investment funds, some totaling several billion dollars, which are often fully subscribed in a matter of months,” he comments.

A list of some of the major players in direct energy investment today include

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dozen players, and maybe you get six of them to take a hard look at a deal, and you wound up with two or three term sheets—if you were lucky,” Bock recalls. “Today, you get a dozen term sheets. It has gotten very competitive, which I think is indicative of how much more capital is out there.”

Commodity prices have helped, but results make the difference for investors, Bock explains. He cites examples like Lime Rock Partners, which began direct energy investment in the late 1990s with a \$100 million fund and more than doubled it. The company found the second fund much easier to raise, and more than doubled investor’s money once again. That type of performance generated interest in energy as a suitable destination for large pools of investment dollars.



Yorktown Partners Group, Quantum Energy Partners, Goldman Sachs, Riverstone Energy, Lime Rock Partners, and the combined investment pool now exceeds \$20 billion, Bock goes on. For the independent oil and gas sector, private equity represents as much as 15 percent of the available capital market.

Even hedge funds have entered direct investment in oil and gas deals, he points out, which is an unusual development considering that hedge fund participants traditionally prefer the liquidity associated with public equity markets. Bock adds that the potential capital available through hedge funds is more than 10 times that of the private direct investment firms.

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“I would say that half, or maybe a little more than half, of the results stem from commodity prices, but the rest is just good management,” Bock explains. “Another trend is that a lot of good public company managers are now going to the private capital markets. They realize that capital is plentiful, and they can get good deals and good compensation where they are awarded for performance,” he says, citing examples of public companies such as Bill Barrett Corp. that have successfully raised capital in the private equity markets.

“You have more money available and strong commodity prices, but you also have high-quality management teams in place,” Bock says, noting that many of those management teams create compa-



nies that become acquisition targets for larger firms. Again, results matter. The original management team will have investment money lined up the very day they close the merger.

### Investment Pendulum

What interests the direct energy investment funds? It is a pendulum that swings back and forth in strategy between acquire-and-exploit and growth through the drill bit, Bock responds. "The traditional play, and the way many investment funds all played it, is to invest in an acquisition and exploitation company," he explains. "They invest in management teams that can go out and acquire in a given area, build production, and then sell. That was the way to generate equity value."

However, escalating acquisition costs in recent years caused those funds to shift investment strategies to companies that are good at building acreage positions and drilling prospects. But Bock says that appears to be changing yet again.

"I would say the drilling approach is maturing now because service costs are getting high. I see people going back to an acquisitions strategy. In fact, our two last private placements were for acquisitions. Two years ago you could not get anybody interested in acquisitions. It seems the drilling approach has matured, from a market perspective, and the acquisition approach is coming back," he goes on.

Energy financing also continues to evolve. Bock says he expects to see a return of master limited partnerships (MLPs) for publicly held companies as well as publicly traded limited liability corporations (LLCs). MLPs are a vehicle that fit well with investor demand for low-decline, yield-oriented asset plays, such as in the Appalachian or Williston basins.

"I don't know how MLPs are going to play out," Bock says. "It is really too soon to tell. It has been a long time since there have been a lot of oil and gas MLPs, and it did not work very well 20 years ago, but this is a little different cycle and MLPs are an appropriate vehicle. That is one nascent trend I see."

A second trend stems from the enormous size of recent investment funds, which must put billions of dollars to work. Some of these funds have raised as much as \$8 billion in investor capital. "With funds of that size, it does not work to invest in startups or private companies

because they are generally not big enough," Bock says. "So the funds have to look at taking public companies private, with Kinder Morgan being a great example of that. I bet we see more of that, with more existing public companies taken private."

### Investing Institutional Funds

Post Oak Capital Partners Inc. is a new startup that seeks to transform senior management's broad energy industry experience into direct energy investment for institutional investors, according to



Chief Executive Officer Frost Cochran. The firm was established last year and formed alliances with a number of institutional investors, including Chicago-based Magnetar Capital Partners LLC, a multistrategy fund.

To date, Cochran says Post Oak has funded three deals, including a private placement to deleverage the balance sheet of Linn Energy LLC, SandRidge Energy Inc., and a follow-on investment in Linn Energy for a property acquisition in the Texas Panhandle. Post Oak also has two equity and two debt investments pending.

The company's partners have experience as officers, directors or senior management with majors, oil service companies, and corporate and administrative law firms, says Cochran, who holds an undergraduate degree from the University of Mississippi and an M.B.A. from the University of Texas. He formerly served as president and CEO of Capital C Energy, the holding company for Belden & Blake Corp. prior to its 2005 sale to Enervest Management Partners Ltd. Before that, Cochran was managing direc-

tor at Torch Energy Advisors, and he got his start in the pipeline and power business working for Enron and companies that were predecessors to Dynergy.

After selling Capital C Partners, Cochran says he invested in Signal Hill Power, a power generation plant acquired through the bankruptcy of Mirant. He formed Post Oak with partners Clem Wetmore, Philip Davidson, and Rob Walls, all of who have experience working with institutional investors in direct energy investment.

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### FROST COCHRAN

CEO  
Post Oak Capital Partners Inc.

ital, that capital needs expertise to understand the actual physical assets and operations and strategy of the companies we invest in," Cochran comments. "We really need to understand what a company is trying to accomplish with its strategy and with its operations, and to do that in a very short time to facilitate strategic consolidation or incremental property acquisition opportunities."

Post Oak employs its own engineers and a geologist to look at deals, which range from \$20 million to \$200 million. "We are not constrained by size because we are a fundless investor," Cochran explains. "All of our capital comes from co-investment relationships and we have deployed more than \$200 million in capital in our first six months of existence. We hope to do a multiple of that in 2007."

### Network Of Relationships

The company relies on a network of industry relationships to find deals, which can come through partners, the management of companies the partners



previously worked with, or third-party engineers, law firms, accountants and bankers, he says.

“These are all relationship folks who have either lent to us before or invested in our activities, or with whom we have been operating partners,” Cochran states. “It has all walked in through the door or come in through a friend of a friend, and I think that is how it is likely to be for us.”

The partners retain a traditional view of the industry, according to Cochran. “We believe oil and gas is a cyclical business. It always has been and always will be; it is simply a matter of degree. It is possible, although we have not fully bought into it, that commodity prices have found floors at higher levels than in the past, but if the industry overbuilds or overdrills, there may be another com-

modity price collapse,” he says. “If Wall Street makes it hard on the industry to raise capital and develop resources, then commodity prices will most definitely go much higher.”

Cochran sees the main challenge facing the energy industry—and investors—as people. “One thing that is clearly recognized now that was probably underappreciated over the past two decades is how scarce human resources are in this industry,” he says. “If you are going to be a successful investor in this business, you have to have access to human resources. As industry guys, those are the things we are most keenly focused on. We have seen some wonderful assets that did not have the human resources to execute, so we passed on those investments. And we have seen some great management teams that we are willing to back because

there are enough asset opportunities out there for them to find and exploit. Human resources are much more precious than the commodity itself. Without it, you cannot produce the commodity.”

Cochran says the energy industry has substantial capital needs on the horizon. “There are a lot of big funds on the private side that have been raised, but there has been a tremendous flight of capital on the public side,” he observes. “When we see some of these large multibillion-dollar funds, not all of that capital will be exclusively deployed in oil and gas basins. It is also raised for midstream power, infrastructure and mining, so there may not be quite as much capital out there as everyone thinks.” □