

# HOUSTON BUSINESS JOURNAL

## THE MONEY BEHIND THE SHALE

### How private money quietly funds Houston's energy boom

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Joseph Dee is eager to see more of his private equity firm move from Connecticut to Houston to help make more deals in the nation's busiest energy market.

Cadent Energy Partners LLC is one of many private equity firms moving parts of its operations to Houston and adding staff to cash in on Texas' thriving shale boom as it embarks on raising a fund that could easily approach \$500 million in investments.

"It's really driven by a view that the energy business is consolidating in Houston," Dee, Cadent's Houston-based principal, said about the decision for more employees of the firm to soon move from Stamford, Connecticut. "Private equity is just a larger player in all industries, and energy is certainly no exception."

Investments by private equity firms helped lead the ongoing shale boom, largely replacing the roles of banks and doing what venture capitalists did for the dot-com bubble. And most of it has occurred behind the scenes, say energy investors and analysts. Private equity deals in the energy space are now totaling close to \$30 billion annually.

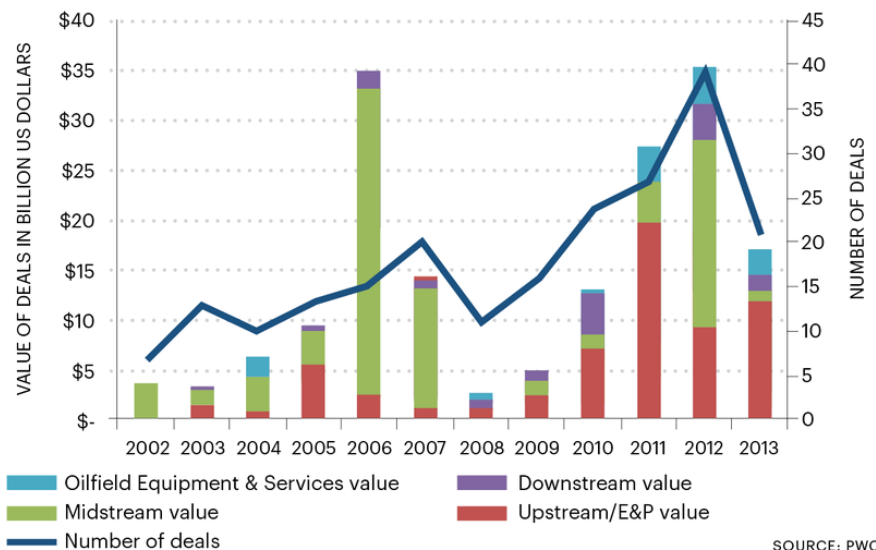
With massive capital needs for U.S. energy production and infrastructure, private equity continues to play a key role in North America's energy renaissance as investors, which range from individuals to pension funds to university endowments, all seek strong returns.

#### TIME FOR PE IN HOUSTON

As such, many private equity, or PE, firms like Cadent are moving more of their business to Houston, which has increasingly become the world's energy capital.

As Dee said, "Finding business deals (from contacts met) at soccer fields and church is a lot easier than having to get on the plane all the time."

PRIVATE EQUITY ENERGY INVESTMENTS BROKEN DOWN



SOURCE: PWC

*The oil and gas industry requires a tremendous amount of capital, and this need is expected to continue to grow. The shale revolution is projected to require more than \$5 trillion in investment over the next 20 years in the U.S. alone, according to a PricewaterhouseCoopers report, "The role of private equity in oil and gas." Much of that money is largely directed to the upstream and midstream sectors, which private equity has been moving in to capitalize on the demand for capital.*

Top PE firms like Boston-based Intervale Capital and Connecticut-based First Reserve Corp. also moved more of their teams to Houston. CSL Capital Management is switching its headquarters from Connecticut to Houston. Six-year-old Dallas- and Houston-based Turnbridge Capital LLC is planning to add more associates and staff to its two Texas teams after closing a new \$400 million investment fund.

"Now, that we've raised our fund, we're adding more people," said Turnbridge Partner Mitchell Cox. "We have a lot of neat opportunities around the shale space and (energy) infrastructure growth."

Turnbridge focuses on starting or funding mid-sized energy services companies and guiding their growth.

"The amount of capital invested on the

upstream side from PE is just huge, and it's going to stay huge," he said, noting that Turnbridge is well equipped to capitalize in midstream and downstream as well.

At CSL Capital, John Griggs opened the small Houston office three years ago as the managing director. He admits his firm "probably would not" exist if not for the shale boom.

"The shales have changed the game dramatically here in the U.S.," Griggs said. "Some of the things that we're seeing now, many years into it, frankly, is that it's so much less about finding oil and gas than it is about developing oil and gas."

#### PE CHANGED THE GAME

Bruce Ross, the managing partner of



# The Money Behind the Shale

Houston-based private equity firm OFS Energy Fund, has helped buy dozens of energy companies in over a decade or so.

In doing so, private equity has largely replaced the role of banks in the energy space, he said.

“Private equity was not a big business 20 years ago,” Ross said. “But, in today’s environment, banks are more cautious. Banks aren’t there. It’s really created quite an opportunity for private equity. It’s just a great time to be in the business. We’ve had a lot of fun in it going back to about 2004.”

Houston-based Post Oak Energy Capital LP Managing Director Frost Cochran said private equity “really backed the initial forays into the shale plays” and “keeps pushing the edge of technology.”

While the late George Mitchell – who founded The Woodlands – is rightfully the “father of fracking” with Houston-based Mitchell Energy & Development Corp., Cochran said private equity money helped drive the energy boom with adventurous investments and deals in unconventional production.

“Private equity was the catalyst – the capital that allowed it to happen – and I think PE will be on the leading edge for years to come,” Cochran said. “Like venture capitalists were with the tech companies, PE was the catalyst with energy.”

Energy independents like Houston-based Linn Energy LLC (Nasdaq: LINE) and Oklahoma City-based SandRidge En-

ergy (NYSE: SE) – both companies that Post Oak previously invested with – have done a lot, but major public companies have largely been followers in the shale boom, Cochran said, buying up assets that were first discovered by others.

“I think it was natural that private equity ended up leading the application of unconventional technology and the energy revolution,” Cochran said.

“There’s not many public companies that are rewarded for experimenting with technology in unconventional ways,” he added, noting that shareholders want returns and often lack patience. “In private equity, we don’t think in three- to six-month increments. We think in three to five years.”

As such, private equity firms have “insight” and advantages in terms of seeing investment trends early, Cochran said, like how to deploy capital to best invest in oil-field services, logistics and energy infrastructure.

## PE TRENDS EVOLVING WITH MORE PLAYERS

Houston-based Denham Capital Management LP Partner Jordan Marye said PE firms like his are continually thinking long term. A lot of oil and gas production positions held now by the major independent energy companies were originally developed by PE-backed companies and flipped for a profit.

Now, rather than selling, Marye said

## THE DEALS

*Want to see how busy private equity firms are in the energy sector? Just take a look at a snapshot of deals in August.*

- ▶ Houston-based private equity firm EnerVest Ltd. acquired Houston-based HighMount Exploration & Production LLC. Terms were not disclosed.
- ▶ Houston-based Dynegy Inc. (NYSE: DYN) bought power plant assets for \$3.45 billion from Energy Capital Partners, a New Jersey- and Houston-based private equity firm.
- ▶ Houston-based private equity firm Quantum Energy Partners spent \$17 million for land to partner with Houston-based ZaZa Energy Corp. (Nasdaq: ZAZA) on East Texas acreage. Quantum also made a \$450 million commitment to partner with Fort Worth-based Tug Hill Inc. in the Marcellus Shale.
- ▶ Boston- and Houston-based Intervale Capital private equity firm bought Houston-based oilfield services company Recapture Solutions LLC from its Houston holding company, Triten Corp. Terms were not disclosed.
- ▶ Black Energy Partners, an affiliate of New York private equity group Blackstone (NYSE: BX), created Dallas-based Vine Oil & Gas LP to buy Haynesville Shale assets from Houston-based Shell Oil Co. for \$1.2 billion.
- ▶ Private equity firms like New York-based Warburg Pincus LLC, BlackRock Private Equity Partners and more pumped nearly \$1.3 billion into Dallas- and Houston-based offshore startup Venari Resources LLC, which has quickly become one of the most aggressive deepwater Gulf of Mexico explorers.
- ▶ Houston-based TNT Crane & Rigging Inc., which is owned by Greenwich, Connecticut-based private equity firm First Reserve bought Alberta, Canada-based Stampede Crane & Rigging Ltd., British Columbia-based Eagle West Truck & Crane Inc. and certain assets of J&B Trucking. Terms were not disclosed.
- ▶ Warburg Pincus invested \$600 million to form Houston-based terminals and storage business Zenith Energy.

## THE TOP PLAYERS

While national rankings are tough to come by, experts list these firms as some of the top private equity players in energy.

**APOLLO GLOBAL MANAGEMENT:** New York

**THE BLACKSTONE GROUP:** New York

**CARLYLE GROUP:** Washington, D.C.

**ENCAP INVESTMENTS:** Houston

**ENERGY SPECTRUM:** Dallas

**FIRST RESERVE CORP.:** Greenwich, Connecticut

**KOHLBERG KRAVIS ROBERTS:** New York

**NGP ENERGY CAPITAL MANAGEMENT:** Dallas

**QUANTUM ENERGY PARTNERS:** Houston

**RIVERSTONE HOLDINGS:** New York

**TPG CAPITAL:** Fort Worth

**WARBURG PINCUS:** New York

more private equity firms are further fostering their companies and taking them public.

Houston-based Memorial Resource Development LP (NYSE: MRD) launched its initial public offering with its financial sponsor firm, Dallas-based NGP Energy Capital Management, while Midland-based Diamondback Energy Inc. (Nasdaq: FANG) was taken public with the aid of Connecticut-based Wexford Capital LP.

"They're all big companies that are all private equity-backed," Marye said. "Three or four years ago, they would have sold them to Chesapeake (Energy Corp. based in Oklahoma) or something like that, and now they're taking them public."

As longtime Houston oil and gas guys, Bruce Ross and Frost Cochran have mixed feelings about the flood of investments coming into the energy sector from East Coast firms that traditionally have not had strong energy portfolios.

"We're energy guys doing private equity, not Connecticut guys out of equity doing energy," Ross said, noting that it is easy to make bad investments if you choose the wrong people to do the exploration and production. "It's like having a great horse but a bad jockey."

"They may not know anything about it, but they all feel they need an energy investment in their portfolio," Cochran added about some northern firms. "They used to specifically exclude it from their strategies. It used to be out of favor, and now it's in."

But some major New York PE firms, like Warburg Pincus LLC, have long histories of investing in Houston energy.

Warburg Pincus has thrived by focusing on people and investing in the right management teams, said Managing Director In Seong Hwang, as opposed to just throwing money into the energy space.

For example, Warburg Pincus early on backed and controlled Denver-based Antero Resources Corp., which was a big player for a while in Texas' Barnett Shale. Last year, Warburg Pincus took the company public in a massive \$1.57 billion IPO.

"That was a pure startup from 2003," Hwang said.

His firm continues to invest in other facets of the energy boom, such as the recent \$600 million to start Houston-based Zenith Energy as a terminal business, because the transportation, storage and exporting of oil and other liquids is on the rise.

In the shale boom, the focus now is on oil with natural gas prices running much lower. As such, Big Oil and major independents have bought up a lot of the top oil-producing assets. So private equity strategies are shifting.

"There's a lot of private equity taking the long investment in natural gas assets," Cochran said. "They're not rewarded for it now, ... but clearly natural gas is an important part of America's energy future."

"A lot of public companies are selling their gas assets, and PE is buying them up," he added.

### LOOKING GLOBALLY

In a sign that American private equity is looking to take the energy boom global, private equity players in Houston have formed what is being dubbed Mexico's first independent oil and gas exploration and production company.

Houston-based EnCap Investments LP and New York-based Riverstone Holdings LLC, which has a major Houston presence, are both investing \$225 million in the formation of Mexico City-based Sierra Oil & Gas S de RL de CV.

Likewise, New York-based private equity firm Blackstone Energy Partners and

Washington, D.C.-based Carlyle Group LP have new multibillion-dollar partnerships with Nigeria-based Dangote Industries to build up Africa's energy infrastructure.

Griggs said CSL Capital also has an eye on the rest of the world.

"It will take a lot longer, and there will be areas where it works and areas where it won't," Griggs said. "A lot of this depends on the geology, and so much more depends on the politics and the populace of these foreign countries. But we have made and we will continue to evaluate investments that we see basically replicating some of these successes that we've seen domestically in select international markets both onshore and offshore."

There is a strong possibility that private equity will want to help "export the shale revolution out of the U.S.," although it has not occurred yet, said Bobby Tudor, chairman and CEO of Houston-based Tudor, Pickering, Holt & Co.

For instance, Argentina has some of the world's best shale, he said.

Regardless, Tudor said, private equity firms will make their moves without garnering a lot of public attention.

"I think that's the way they like it," Tudor said. "They should get credit. They've been very integral in the growth of the shale production. They were quick to it."

