The Challenge: Private vs. Public Energy Markets

January 24, 2012

-- IPAA –

Private Capital Conference

Arthur L. Smith, CFA

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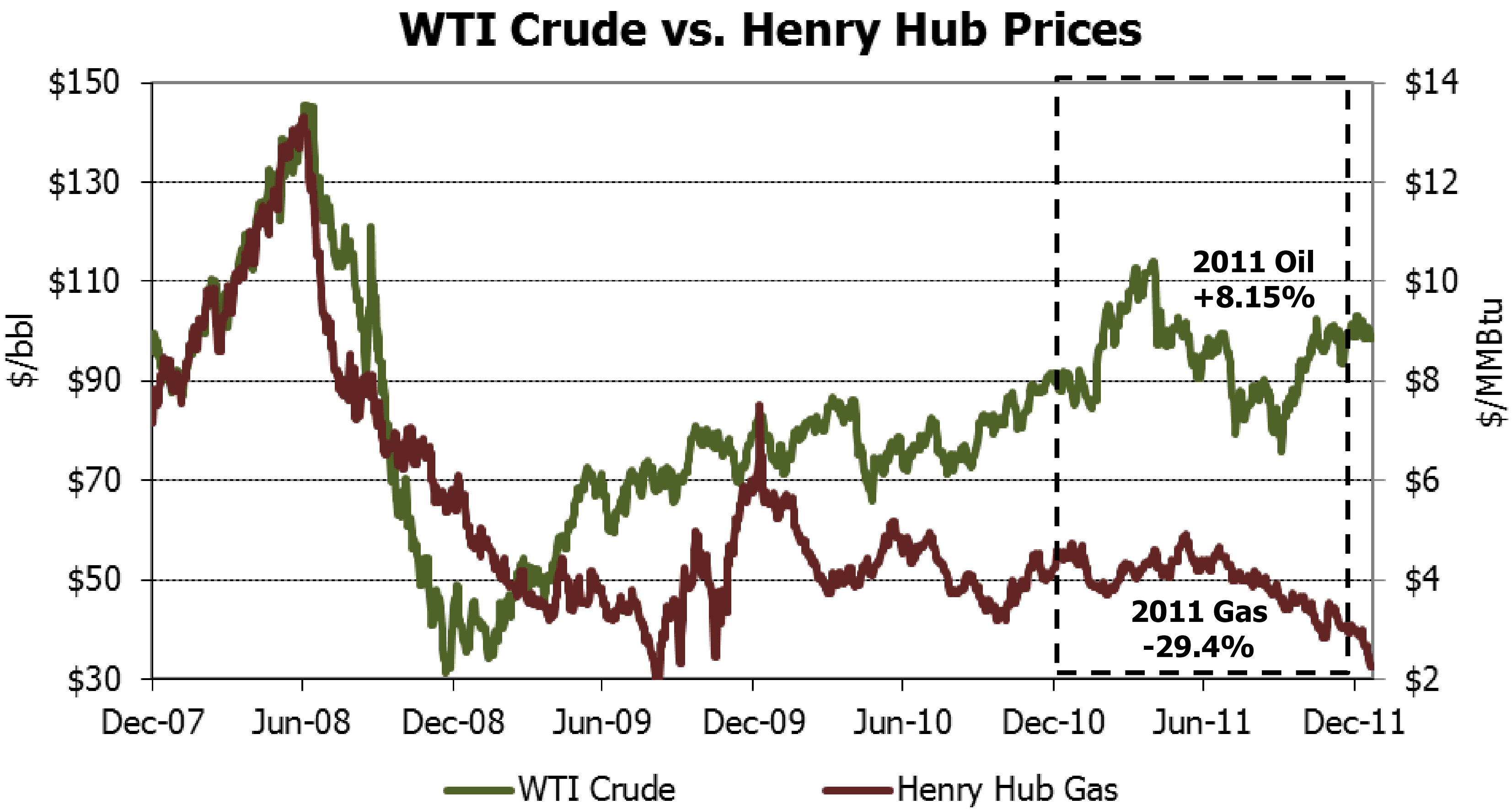
Topics

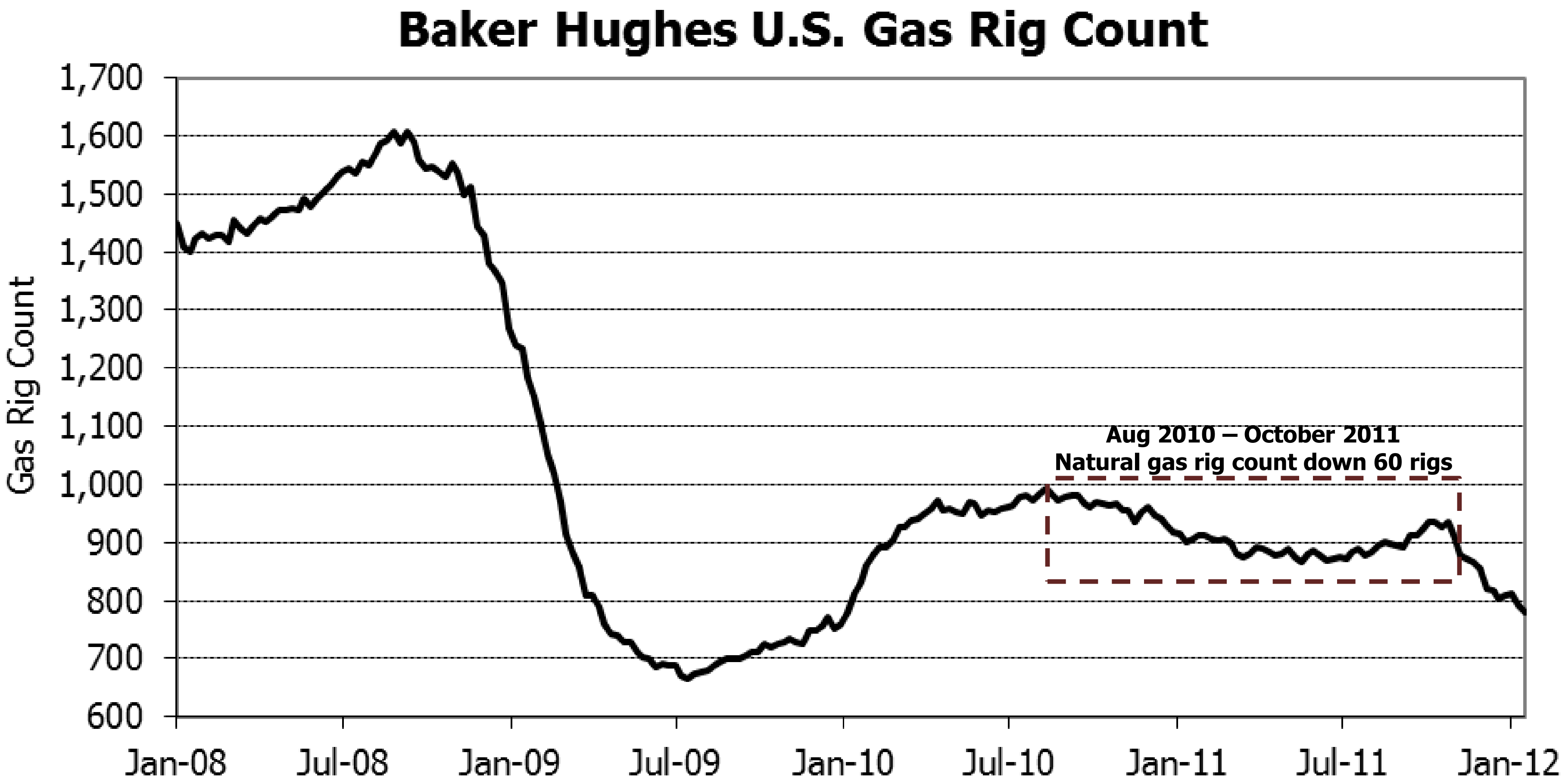

Bear Market 2011

I. Macro Review

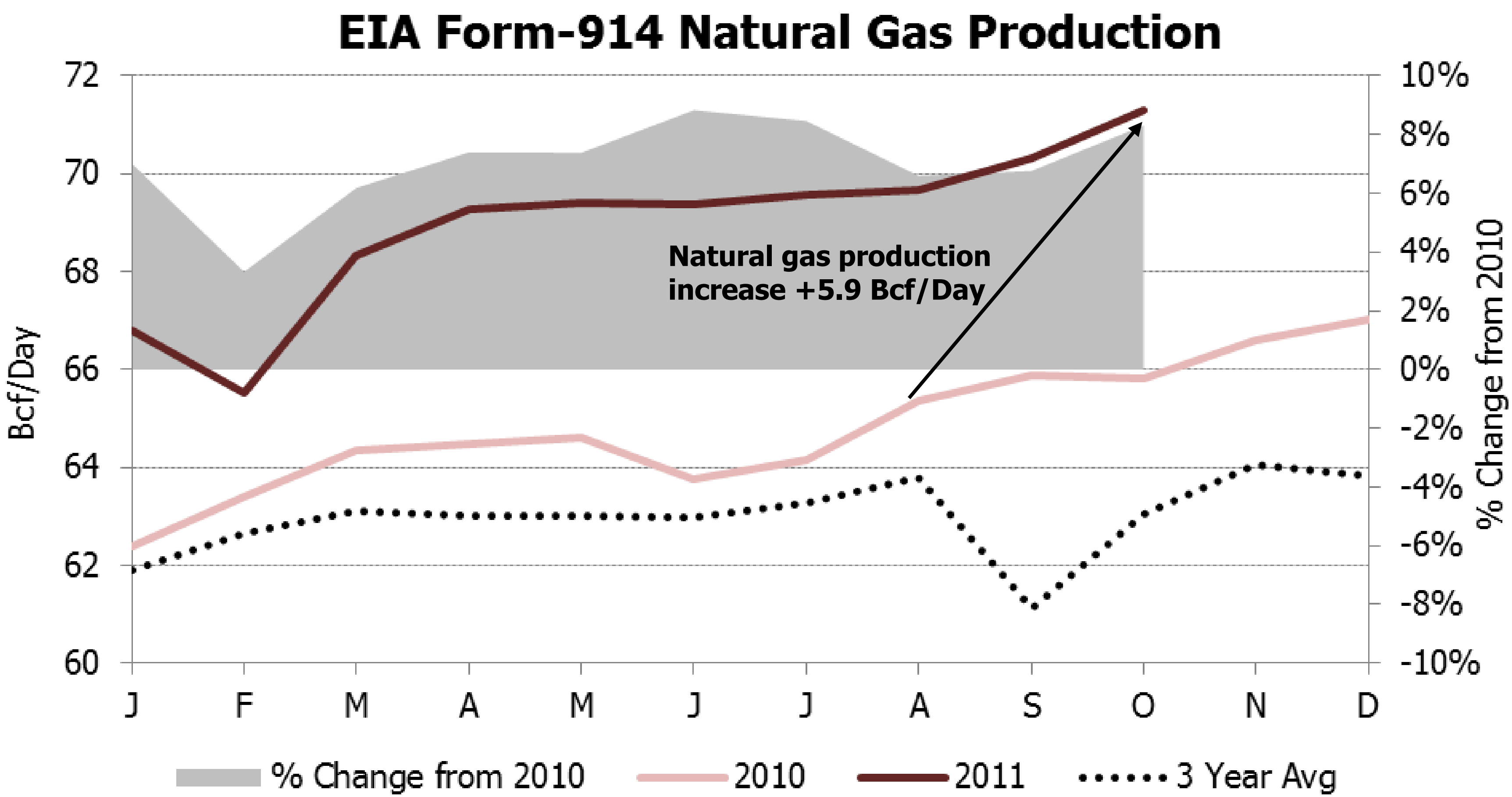
Why E & P companies need permanent capital



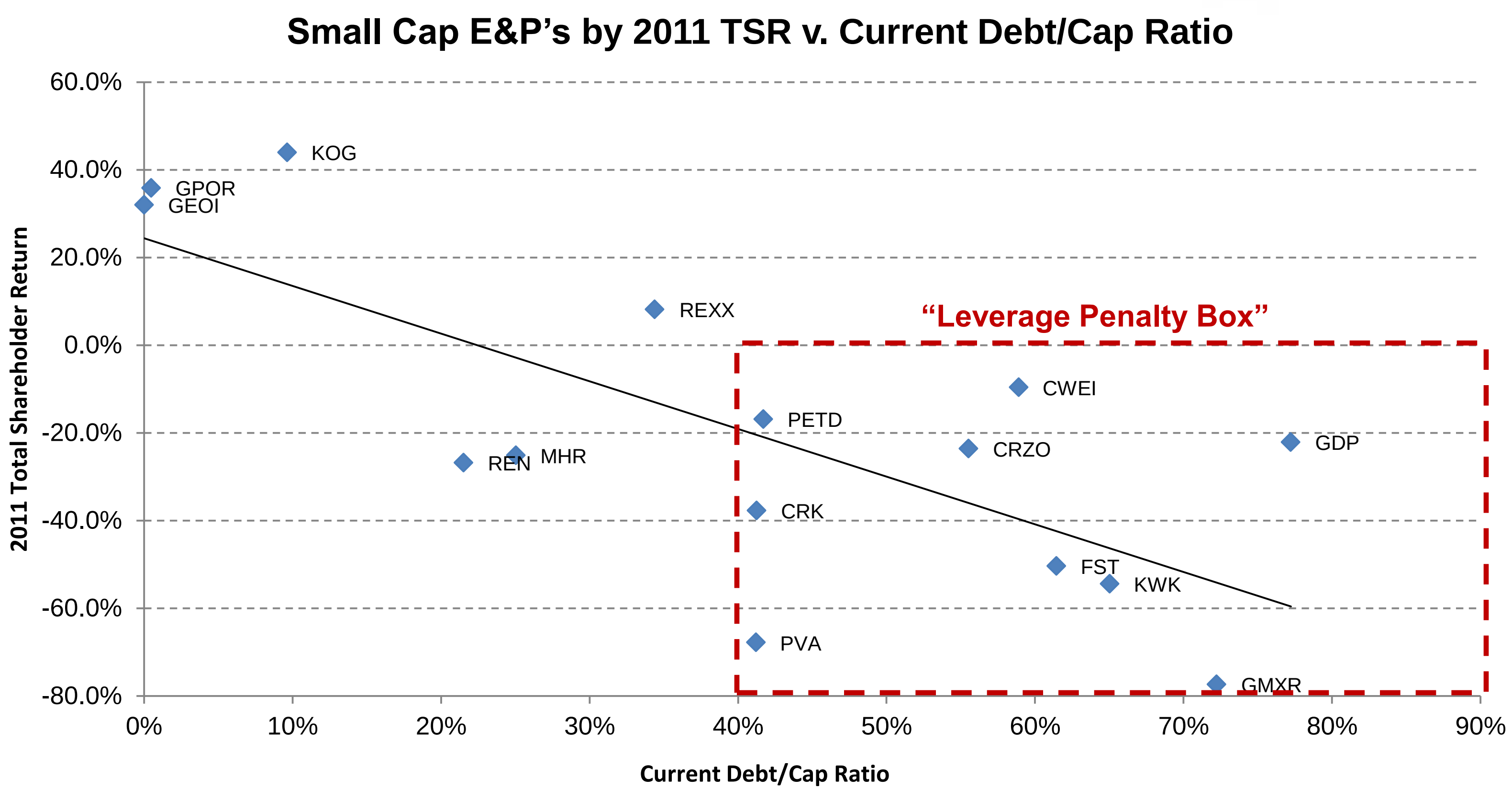
Only 770 Rigs to Go



Too Damn Much of a Good Thing



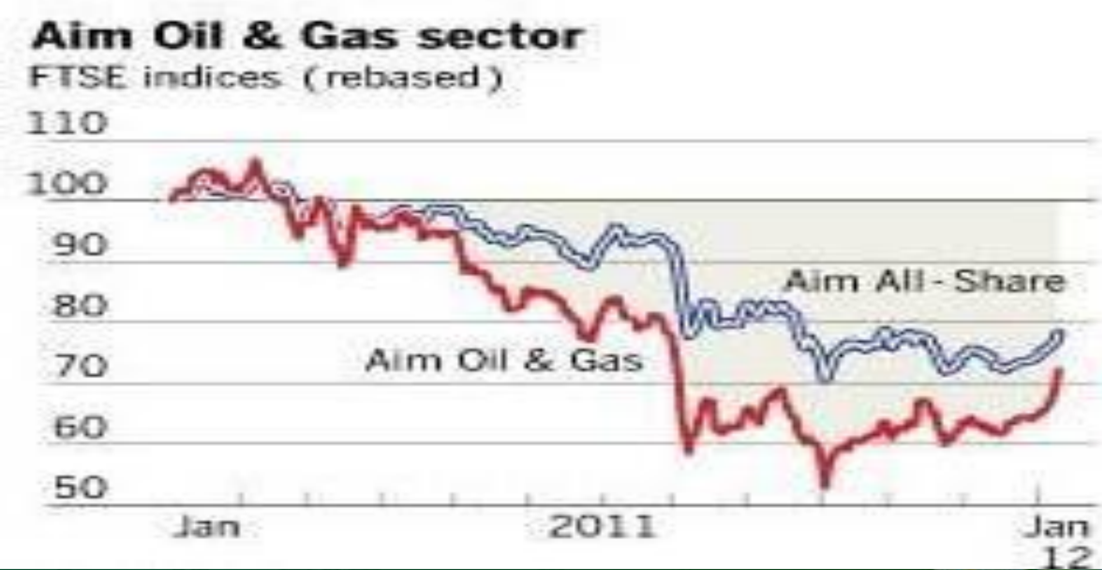
The Debt Penalty Box



➢ Debt metrics are an important factor of Small Cap E&P equity performance. Over the past year, no small cap E&P with a total debt to capital ratio of greater than 40% produced a positive total market return.


337

London AIM Suffers



II. Historical Perspective on E&P IPOs

Publicly-Traded Oils We Know and Love

Company	Public	Market Cap.	Headquarters
Occidental	1964	$80.6 Bil	Los Angeles
Anadarko	1986 [(a)]	$39.4	The Woodlands
Apache	1969	$36.4	Houston
EOG Resources	1999	$27.9	Houston
Devon Energy	1988	$25.7	Oklahoma City
Marathon	1962	$21.8	Houston
Hess	1962	$19.5	New York
Williams Companies	1957	$16.8	Tulsa
Chesapeake Energy	1993	$13.3	Oklahoma City
Noble Energy	1972	$17.0	Houston
Continental Resources	2007	$13.5	Enid

(a) Spinout from Panhandle Eastern

Publicly-Traded Oils We Know and Love

Company	Public	Market Cap.	Headquarters
Southwestern	1960s	$10.1 Bil.	Houston
Pioneer Natural Resources	1970s	$11.6	Irving
Concho Resources	2007	$10.4	Midland
Murphy Oil	1956	$11.4	El Dorado, AR
Range Resources	1998	$8.6	Fort Worth
Whiting Petroleum	2003	$6.0	Denver
EQT Corporation	1947	$7.3	Pittsburgh
Cabot Oil & Gas	1990	$6.9	Houston
Linn Energy	2006	$6.4	Houston
Ultra Petroleum	2001	$3.8	Houston

EQT Where energy meets innovation.

PIONEER NATURAL RESOURCES

MURPHY OIL CORPORATION

CONCHO

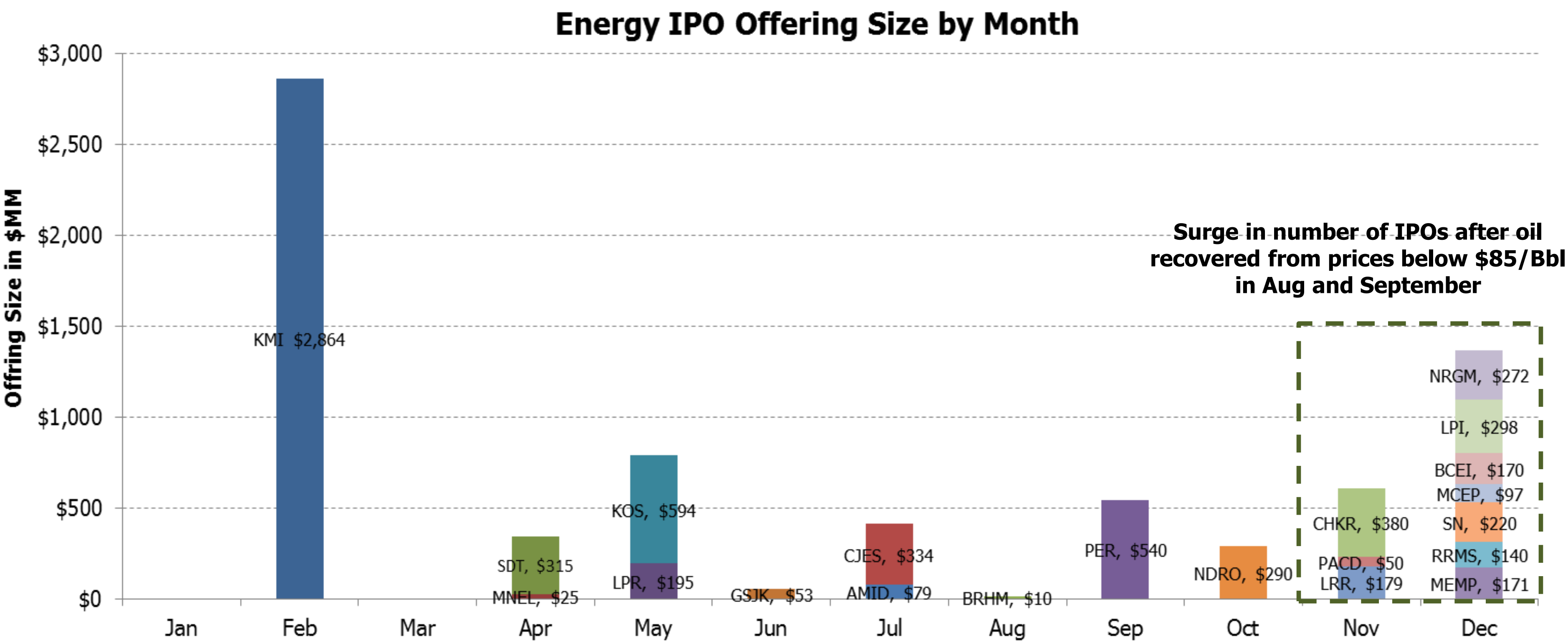
TDA Expertise: Getting a Closer Look at Energy Assets

The Energy IPO Class of 2011

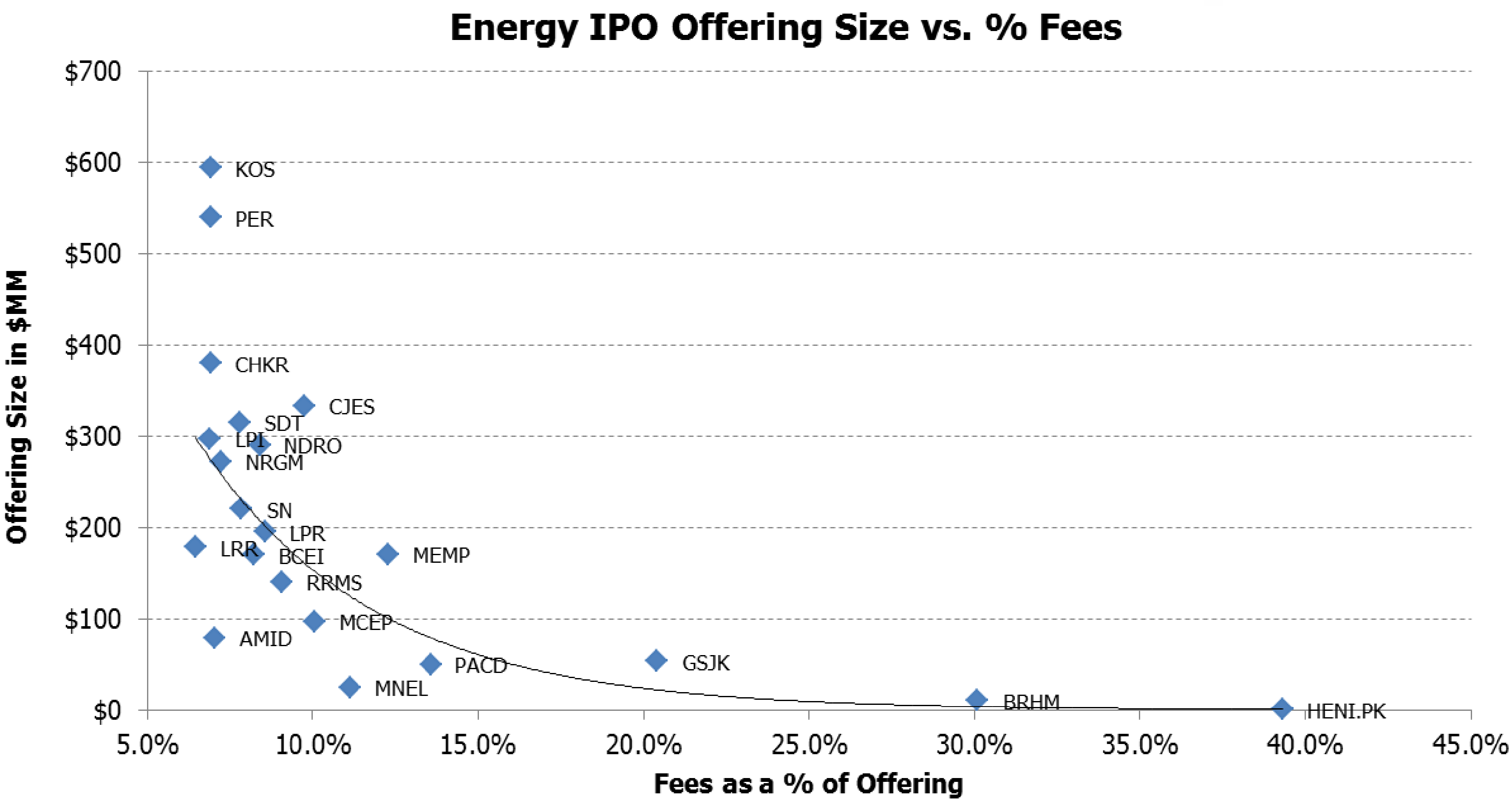
- Largest: Kinder Morgan (KMI: $2,864MM)
- Smallest: Brenham Oil & Gas (BRHM: $10.3MM)

- **E&P.** Laredo (LPI: $297.5MM) , Sanchez (SN: $220MM) , Bonanza Creek (BCEI: $170MM),
  - Enduro Resource (NDRO: $290.4MM); Lone Pine Resources (LPR: $195MM); Kosmos Energy (KOS: $594MM)
- **Royalty Trusts**. Sandridge Permian (PER: $540MM) , Sandridge Mississippian (SDT: $315MM),
  - Granite Wash Trust (CHKR:$380)
- **MLPs**: Inergy Midstream (NRGM: $252MM); RoseRock Midstream (RRMS: $140MM);
  - Memorial Production Partners (MEMP: $171MM); LRR Energy (LRE: $178.8MM); American Midstream (AMID : $78.8MM)
- **OIL Service**: Pacific Drilling (PACD:$49.5MM); C&J Energy Services (CJES: $335.5MM);Compression Partners (GSJK: $53.4MM)
- **Alternative Energy**: Mission New Energy (MNEL: $25.1MM)
  - Friction costs Lowest. 6 percent. Highest. 28 percent. Median 7%

IPO Window Opens and Closes in 2011



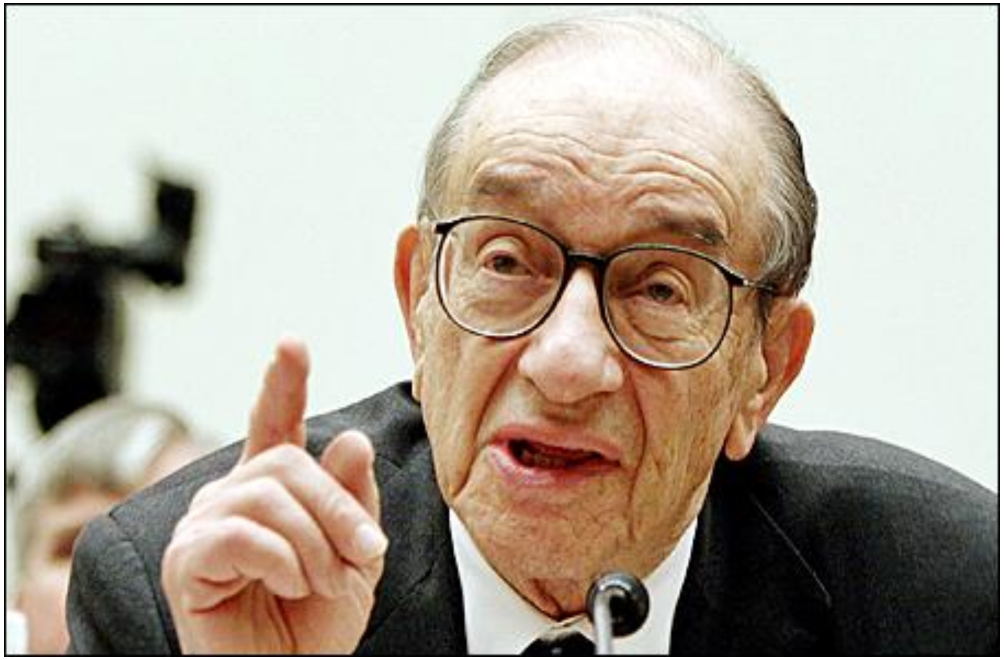
IPO fees vs. $MM Go Big or Pay the Price

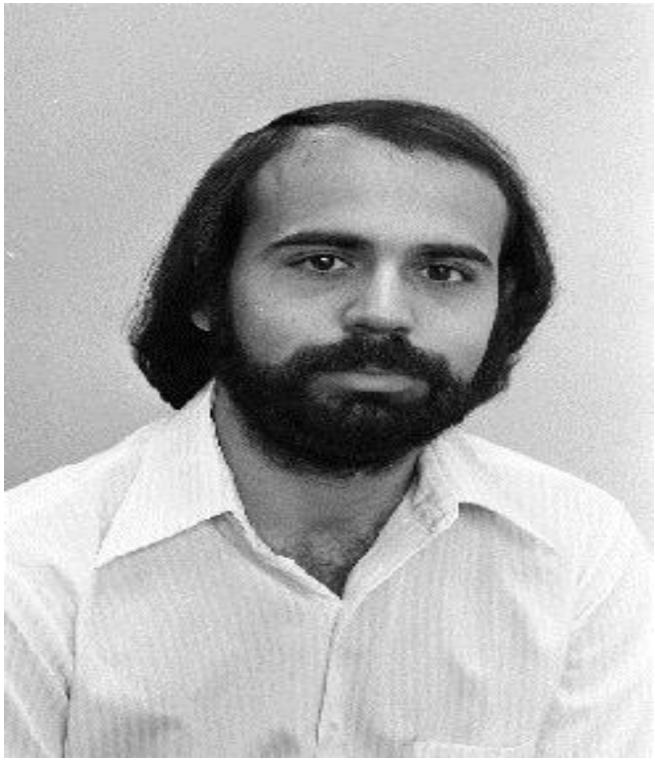


III. Top Ten Reasons for an IPO

10. Access permanent capital for growth.

9. Strong balance sheet provides flexibility and limits muscle of bank group.





8. Valuation: Reality check and "free appraisal."

Back in 2005, this place
was worth $850,000.

7. Liquidity event for existing shareholders and welcome exit for early investors.

6. Intelligent opportunity to diversify assets of executives and principals.

TripleDouble Advisors, LLC

5. Appease private equity sponsors who need to mark to market for their investors.

4. **Provide welcome and profitable work for friends in accounting, legal, investment banking & brokerage fields. "Feed the starving children of struggling Goldman Sachs execs."**

3. The glamour of travel and rewards of the "Road Show."

2. You get to show your PowerPoint skills to:

Adoring Wall Street Analysts?

1. The closing dinner celebration with 20 oz. steaks, fine wine, Cuban cigars, Louis Tres cognac and Lucite deal paperweights.

IV. Benefits of Staying Private

III) Remaining Private has Benefits

- You have to work too hard being public;
  Not enough time for fishing!

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- A lot less of your time is spent with lawyers and investment bankers

Private Equity Sales Pitch

- -Access to capital used to be the driver for going public. Given the number and size of PE funds it no longer a significant issue until companies get quite large.
- -PE deals can be done faster with less “friction” expense.
- Fewer reporting and administrative burdens therefore more productive and efficient organizations.
- -Lower G&A load.
- -Lack of public reporting and oversight makes for more nimble companies that are better able to respond to opportunity.
- -It’s more than just money; Good advice, experience and strategic thinking should come with the PE package.
- -Results in a bottom-line oriented board focused on creating value for all the shareholders with aligned interests.
- -Allocation of Management equity throughout the organization is less complicated and more flexible.

IV. Alternatives – ATMs & Mergers

- A) Reverse merger into existing public "shell" company, e.g. Southern Bay into Georesources, Inc. RAM/Halcon by Floyd Wilson

  Less costly (>50%) but difficult, time consuming and high mortality rate

  B) At-The-Market (ATM) Offerings -- MLV, BofA, Cantor Fitzgerald and Wells Fargo promise attractive ATM issuance costs of 2%-3%.

  C) Stock merger with comparably valued public company.

- Major obstacles to successful stock for stock transactions are Valuation & "Social Issues“ --
  - Agreement on which Chef will man the new kitchen
  - Much less " transaction friction " but can backfire badly if unsuccessful.
  - Name of surviving company. *BP Amoco; Chevron Texaco; Total Fina Elf.*
  - Executive leadership pecking order and elimination of redundancies
  - Composition of board of directors

Requires very delicate negotiations and
clear communication of objectives and merger benefits

V. Additional Thoughts

- There are times where public valuation metrics encourage IPOs. The arbitrage can be seductive! “Feed the ducks”, “Take a cookie.”
- Significant access to cheap permanent capital for mega projects is done most efficiently through the public markets.
- You get “marked to market” every NYSE business day -- Can feel good when “Street Sentiment” is bullish.
- And, Vice Versa. Don’t think your presentation will change the mindset of a 22 year old from the Wharton School!
- Proxy Statements let your friends, enemies and those seeking beneficial funding to know your annual income, benefits, bonus and perquisites. Ask Mitt Romney!

PostScript: Art Smith's Philosophies Successful E&P Firms I Have Known

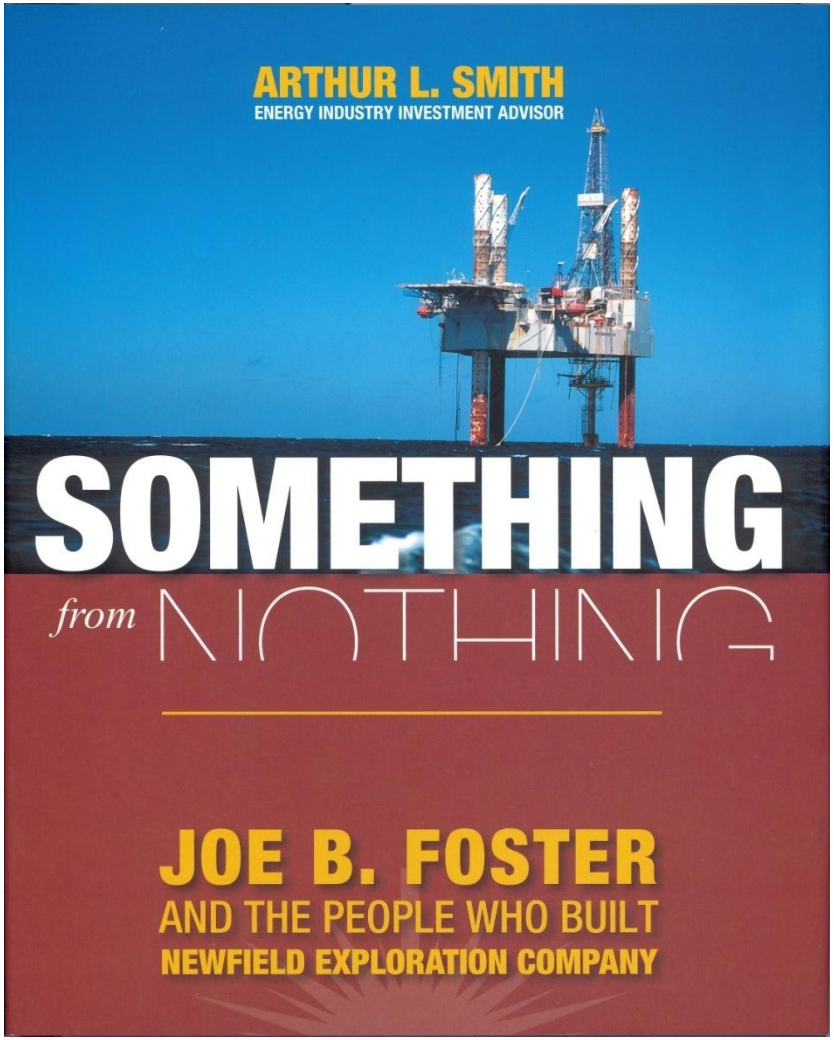
The Essential Ingredient: A great executive team with well articulated shared goals & strategy

- A strong and diverse Board of Directors. All members of the board should be independent (except CEO and/or non executive chairman); Essential components of board are accounting, business experience, financial capability and all free from conflicts of interest and "cronyism"
- Beware having too many lawyers on the board, litigators are particularly disruptive.
- Beware RESUME Boards -- you need some youth who will challenge status quo and have fire in their belly.
- Establish mandatory board retirement at 70 or ……….
- Populate board with strong chairmen of compensation, conflicts and audit committees. Rotate service among committees.
- Engage in an annual strategic board review with ex post analysis of prior year performance against plan.
- Find out where the buck stops.
- Yellow flags should not go unheeded.; you want executives who make money and not excuses .
- Strong role for lead director who delivers tough issues to CEO directly ;
- Lead director t needs to be prepared to rise to occasion and take charge in a time of crisis – Fire Drill?
- Get to know all top executives and CEOs leadership list.
- Attend analyst presentations.
- Tour facilities whenever possible
- Ask tough questions and don't tolerate evasive or wishy-washy answers
- Voluntarily resign when -- you are the obstacle to progress! CEO should hold the trump hand. Leave graciously.

The Newfield and Joe Foster Story

"Exploration – Wildcatting – is a lot more risky than the statisticians tell us it is. Even with all the new exotic technology, the probability of success we assume for a wildcat is nearly always too high."

Joe B. Foster



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