The Challenge: Private vs. Public Energy Markets

January 24, 2012

-- IPAA --
Private Capital Conference

Arthur L. Smith, CFA
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Topics

I. Macro Review
II. Historical Perspective of E&P IPOs
III. Top 10 Reasons for an IPO
IV. The Benefits of Staying Private
V. Alternatives – ATMs & Bought Deals
VI. Final Thoughts
I. Macro Review
Why E & P companies need permanent capital

WTI Crude vs. Henry Hub Prices

2011 Oil +8.15%
2011 Gas -29.4%
Only 770 Rigs to Go

Baker Hughes U.S. Gas Rig Count

Aug 2010 – October 2011
Natural gas rig count down 60 rigs
Natural gas production increase +5.9 Bcf/Day
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.
London AIM Suffers

Funds raised on Aim
Oil & Gas sector further issues (£bn)

- 2008: 0.7
- 2009: 1.1
- 2010: 1.9
- 2011: 1.0

Aim Oil & Gas sector
FTSE indices (rebased)

- Aim All-Share
- Aim Oil & Gas
II. Historical Perspective on E&P IPOs
<table>
<thead>
<tr>
<th>Company</th>
<th>Public</th>
<th>Market Cap.</th>
<th>Headquarters</th>
</tr>
</thead>
<tbody>
<tr>
<td>Occidental</td>
<td>1964</td>
<td>$80.6 Bil</td>
<td>Los Angeles</td>
</tr>
<tr>
<td>Anadarko</td>
<td>1986 (a)</td>
<td>$39.4</td>
<td>The Woodlands</td>
</tr>
<tr>
<td>Apache</td>
<td>1969</td>
<td>$36.4</td>
<td>Houston</td>
</tr>
<tr>
<td>EOG Resources</td>
<td>1999</td>
<td>$27.9</td>
<td>Houston</td>
</tr>
<tr>
<td>Devon Energy</td>
<td>1988</td>
<td>$25.7</td>
<td>Oklahoma City</td>
</tr>
<tr>
<td>Marathon</td>
<td>1962</td>
<td>$21.8</td>
<td>Houston</td>
</tr>
<tr>
<td>Hess</td>
<td>1962</td>
<td>$19.5</td>
<td>New York</td>
</tr>
<tr>
<td>Williams Companies</td>
<td>1957</td>
<td>$16.8</td>
<td>Tulsa</td>
</tr>
<tr>
<td>Chesapeake Energy</td>
<td>1993</td>
<td>$13.3</td>
<td>Oklahoma City</td>
</tr>
<tr>
<td>Noble Energy</td>
<td>1972</td>
<td>$17.0</td>
<td>Houston</td>
</tr>
<tr>
<td>Continental Resources</td>
<td>2007</td>
<td>$13.5</td>
<td>Enid</td>
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(a) Spinout from Panhandle Eastern
## Publicly-Traded Oils We Know and Love

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<tr>
<td>Southwestern</td>
<td>1960s</td>
<td>$10.1 Bil.</td>
<td>Houston</td>
</tr>
<tr>
<td>Pioneer Natural Resources</td>
<td>1970s</td>
<td>$11.6</td>
<td>Irving</td>
</tr>
<tr>
<td>Concho Resources</td>
<td>2007</td>
<td>$10.4</td>
<td>Midland</td>
</tr>
<tr>
<td>Murphy Oil</td>
<td>1956</td>
<td>$11.4</td>
<td>El Dorado, AR</td>
</tr>
<tr>
<td>Range Resources</td>
<td>1998</td>
<td>$8.6</td>
<td>Fort Worth</td>
</tr>
<tr>
<td>Whiting Petroleum</td>
<td>2003</td>
<td>$6.0</td>
<td>Denver</td>
</tr>
<tr>
<td>EQT Corporation</td>
<td>1947</td>
<td>$7.3</td>
<td>Pittsburgh</td>
</tr>
<tr>
<td>Cabot Oil &amp; Gas</td>
<td>1990</td>
<td>$6.9</td>
<td>Houston</td>
</tr>
<tr>
<td>Linn Energy</td>
<td>2006</td>
<td>$6.4</td>
<td>Houston</td>
</tr>
<tr>
<td>Ultra Petroleum</td>
<td>2001</td>
<td>$3.8</td>
<td>Houston</td>
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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%
Surge in number of IPOs after oil recovered from prices below $85/Bbl in Aug and September

IPO Window Opens and Closes in 2011

Energy IPO Offering Size by Month

Offering Size in $MM

Surge in number of IPOs after oil recovered from prices below $85/Bbl in Aug and September
IPO fees vs. $MM Go Big or Pay the Price

Energy IPO Offering Size vs. % Fees
III. Top Ten Reasons for an IPO
10. Access permanent capital for growth.
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.
5. Appease private equity sponsors who need to mark to market for their investors.
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
You have to work too hard being public; Not enough time for fishing!
III) Remaining Private has Benefits

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- You make more money being private – just ask Aubrey
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• A lot less of your time is spent with lawyers and investment bankers
• 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!
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 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.
“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
Positive proof of global warming.
OXYMORONS
TDA Favorites

Great Depression

TOXIC ASSETS!

Marital Bliss

Tight Slacks

Synthetic Natural Gas

Miliary Intelligence