Deploying the Right Capital for the Job

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IPAA Private Capital Conference – January 2015

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"My grandfather rode a camel, my father rode a camel, I drive a Mercedes, my son drives a Land Rover, his son will drive a Land Rover, but his son will ride a camel."

— attributed to **Sheikh Rashid bin Saeed Al Maktoum**, Emir of Dubai

Project Debt Overview

Project finance transactions allow borrowers to access greater amounts of capital than would normally be available for existing collateral, potentially resulting in outstanding economics

Project debt overview

- When does project debt make sense for a borrower?
  - Acceleration of drilling program (i.e. grow into a sale on a faster time table)
  - Development of lower priority assets with acceptable returns
  - Acquisition of assets significantly larger than internal funding sources can support
  - Utilize non-recourse structure to unlock additional capital or more favorable terms (i.e. greater advance rates, lower ultimate cost, etc)
  - Cheaper alternative to private equity structures
  - Cheaper alternative to traditional Farm-out structure

- What to expect:
  - Thorough technical evaluation by lender or 3rd party consultant
  - Capital usually deployed in stages
  - Performance based covenants and/or thresholds
  - Lender will look for primary repayment through cash flow sweep or amortization schedule
  - Shorter tenors, usually two to four years
  - Combination of current pay interest and equity kicker (e.g. warrants, overriding royalties, net profits interests, etc)
  - Hedging may be required as project develops

2^{nd} Lien Overview

2^{nd} lien loans allow companies to borrow against proved reserves that may not be given full credit in a borrowing base facility

2^{nd} lien loans overview

- When do 2^{nd} lien loans make sense for a borrower?
  - Refinance highly utilized borrowing base
  - Pay dividend to owners
  - Acquire acreage or other assets
  - Utilize additional leverage and provide alternative source of drilling and development capital
    - PE firms: grow portfolio beyond equity commitment, enhance returns to equity
    - PE sponsored management teams: utilize leverage to increase returns and hit incentive waterfall
  - Provide alternative to high yield market
    - Smaller size, fewer lenders in group, no public reporting required

- What to expect:
  - Fully funded up front
  - Tenor usually four years, primary repayment through refinancing or sale of company
  - Covenants to focus on asset coverage
    - Examples: Proved/PDP PV-10 to Total Debt, Total Debt to EBITDAX
  - Interest only, usually <u>no equity kickers</u>
  - Significant hedging may be required

Today's Environment - Lenders

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In response to the low commodity price environment, lenders have pulled back on advance amounts and have increased pricing

Project debt

- Focus is currently on cash flow and <u>economic</u> PUDs and PROBs
- Difficult to lend solely against undeveloped acreage
  - "Soft collateral" (i.e. not there when you need it most)
  - Leasehold expirations
  - Inclusion of PDP or "bailout" zones may improve story
- Unconventional oil deals difficult in the current environment
- New drilling must be economic unless sufficient PDP collateral exists
  - Lender will "toe in" to drilling program
- <u>Variety of price decks</u> used to evaluate both downside and upside cases
  - With equity kicker, lender is willing to take some price risk

2nd lien loans and rescue finance

- Like project finance, focus is currently on cash flow
- PDP collateral is of utmost importance
  - Generally looking for PDP PV-10 to Total Debt of 1.0 : 1.0
  - Willing look to PUDs as part of the collateral
- Use of proceeds does not necessarily need to be accretive if coverage exists
- Opportunities where borrowing bases over [75%] utilized
- Private equity sponsorship a plus
- Syndication through "club deals" still largely available
- Hedging likely will be a requirement
  - Lender unwilling to take price risk without exposure to upside

Acquisition/Project Finance Case Study (1 of 2)

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This case study will compare two different structures for an acquisition and development project finance transaction

Transaction assumptions

- $140 million purchase price
  - $146 million PDP PV-10
  - $27 million and $29 million PDNP and PUD PV-10
  - Oil weighted, conventional assets
- Commodity pricing
  - Oil: $50, $65, $70, $75, $75, $80 for 2015, 2016, 2017, 2018 and thereafter
  - Gas: $3.00, $3.25. $3.50, $4.00 for 2015, 2016, 2017 and thereafter
- Reserves:

	Oil (Mbbls)	NGL (Mbbls)	Gas (MMcf)	Equiv. (Mboe)	Capex ($M)	PV 10 ($M)
PDP	7,908	0	9,329	9,462	$7,149	$146,333
PDNP	1,589	0	1,269	1,801	$7,378	$26,697
PUD	1,657	0	2,192	2,023	$24,826	$28,694
Total Proved	**11,154**	**0**	**12,790**	**13,286**	**$39,353**	**$201,725**

Structure I: interest only loan

- Senior secured first lien term loan (non-recourse)
- $120 million upfront towards acquisition, $32 million as needed for subsequent development opportunities
- $20 million equity contribution from management
- L+7.00% pricing
- No equity kicker
- 100% cash flow sweep
- 36 month term

Structure II: loan with equity kicker

- Senior secured first lien term loan (non-recourse)
- $132 million upfront towards acquisition, $32 million as needed for subsequent development opportunities
- $8 million equity contribution from management
- L+7.00% pricing
- 25% net profits interest
- 100% cash flow sweep
- 36 month term

Acquisition/Project Finance Case Study (2 of 2)

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Key takeaway: borrowers can achieve greater returns by taking a larger advance and giving up equity, as opposed to structuring for an interest only loan

Interest only loan transaction economics – no sale

	Lender	Borrower
Acquisition loan ($M)	$120,000	$0
Equity investment ($M)	$0	$20,000
Development loan ($M)	$32,000	$0
ROI	1.3x	5.0x
IRR	8.1%	14.6%

Interest only loan transaction economics – sale case[1]

	Lender	Borrower
ROI	1.2x	3.1x
IRR	8.0%	45.6%

Loan with equity kicker transaction economics – no sale

	Lender	Borrower
Acquisition loan ($M)	$132,000	$0
Equity investment ($M)	$0	$8,000
Development loan ($M)	$32,000	$0
ROI	1.5x	7.9x
IRR	10.1%	17.5%

Loan with equity kicker transaction economics – sale case[1]

	Lender	Borrower
ROI	1.3x	4.5x
IRR	10.9%	64.9%

1) Assumes a sale in 36 months at $50,000/BOEPD

2^{nd} Lien Financing Case Study

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Key takeaway: 2^{nd} lien financings can be a capital efficient way to finance development activity when borrowing bases may not have sufficient capacity

Situation overview

- Reserves:

	Oil (Mbbls)	NGL (Mbbls)	Gas (MMcf)	Equiv. (Mboe)	Capex ($M)	PV-10 ($M)
PDP	3,564	959	11,036	6,362	$0	$149,724
PDNP	1,254	617	4,109	2,557	$45,216	$24,727
PUD	4,244	1,248	14,079	7,838	$118,073	$60,903
Total Proved	**9,062**	**2,824**	**29,224**	**16,757**	**$163,289**	**$235,354**
Probable	7,766	2,160	24,172	13,954	$250,335	$74,877
Total 2P	16,828	4,983	53,396	30,711	$413,623	$310,230

- $100 million borrowing base
  - $84 million drawn
- Company equity 50% owned by individuals, 50% by institutions
  - $150 million of contributions to date
- Additional $30 million in capital needed to execute accelerated capital budget
- Financing options
  - Raise additional equity
  - Project finance facility
  - 2nd Lien financing

Comparison of alternatives

	Additional Equity Scenario	Project Finance Scenario	2^{nd} Lien Scenario
Incremental cost of capital	20% +	13% – 20%	7% - 12%
Dilution of Equity	Yes	Yes	No
Recourse to parent?	N/A	No	Yes
Loss of voting control	Potentially	No	No
Leverage existing PDP collateral?	N/A	Likely not	Yes
Nature of covenants	No	Performance based	Coverage based
Fully funded up front?	Potentially	No	Yes

Macquarie Group:
Committed to the Energy Sector

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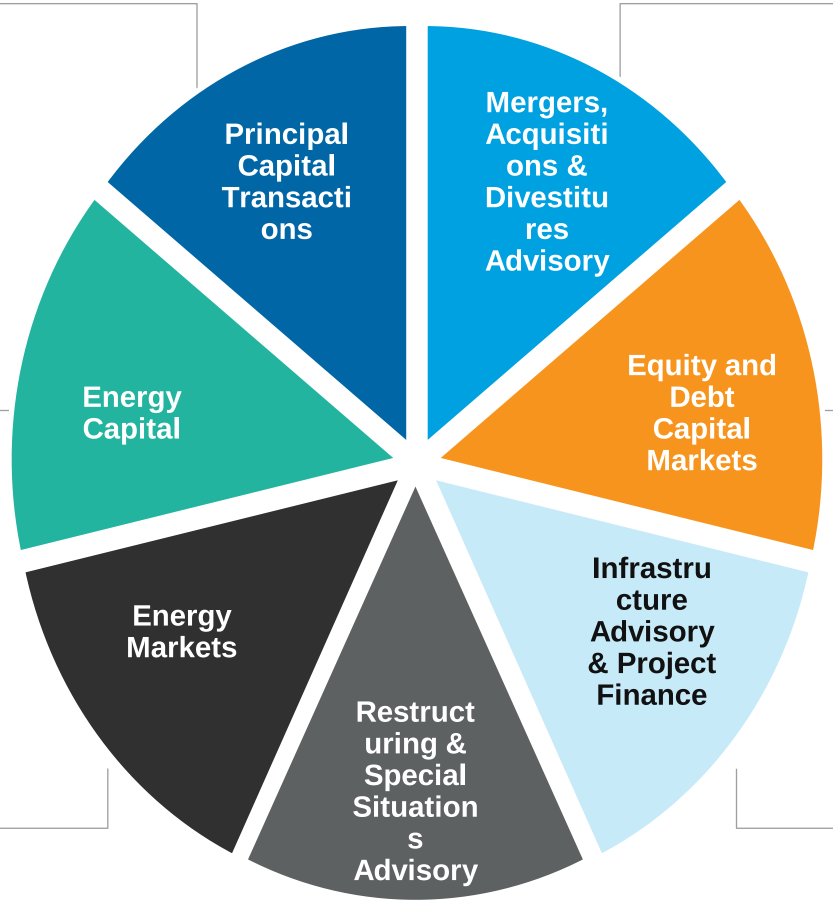
300+ people in Houston focused on the Energy sector

Over $1.1Bn invested to support clients in the U.S.

Over $4.5Bn(2) in capital deployed to 150+ E&P companies in past 13 years

Largest non-producing gas trader in the U.S.
9.7 Bcf(4) of physical gas traded each day



$55 Bn(1) in Energy related M&A and A&D transactions since 2008

239 energy companies covered by 37 equity analysts in 24(3) countries

Almost $3.0Bn AUM invested in 13 (5) energy assets globally

"Metals and Energy Capital" and "Energy Markets" are part of Fixed Income, Currencies and Commodities (FICC) which is part of Macquarie Bank Limited. Principal Transactions, Mergers, Acquisitions & Divestitures, and Capital Markets are all part of "Macquarie Capital"

Notes:
(1) Mergerrmarket as of September 15, 2014; universe includes transactions with target E&P assets located in North America, South America and Asia Pacific; includes transactions of Tristone Capital acquired by Macquarie in 2009; (2) Macquarie Energy Capital Document, as of December 2014; (3) As of December 2014; (4) Natural Gas Intelligence Press Inc for 3Q 2014; (5) As of September 30, 2014

Energy Capital Overview

World leader in natural resource investments: 150+ deals and $4.5b+ funded in last 13 years

Energy Capital provides a wide array of debt and equity capital for the upstream oil and gas industry

- Structured and project finance ("Mezzanine")
- Subordinated debt
- Convertible debt
- Non-conforming senior debt
- Conforming senior debt
- Volumetric production payments ("VPPs")
- Alternative JV development capital
- Public and private equity capital
- International lending and equity investment capability

Debt deal size: $20-$150m / Equity Hold: $5-$25m