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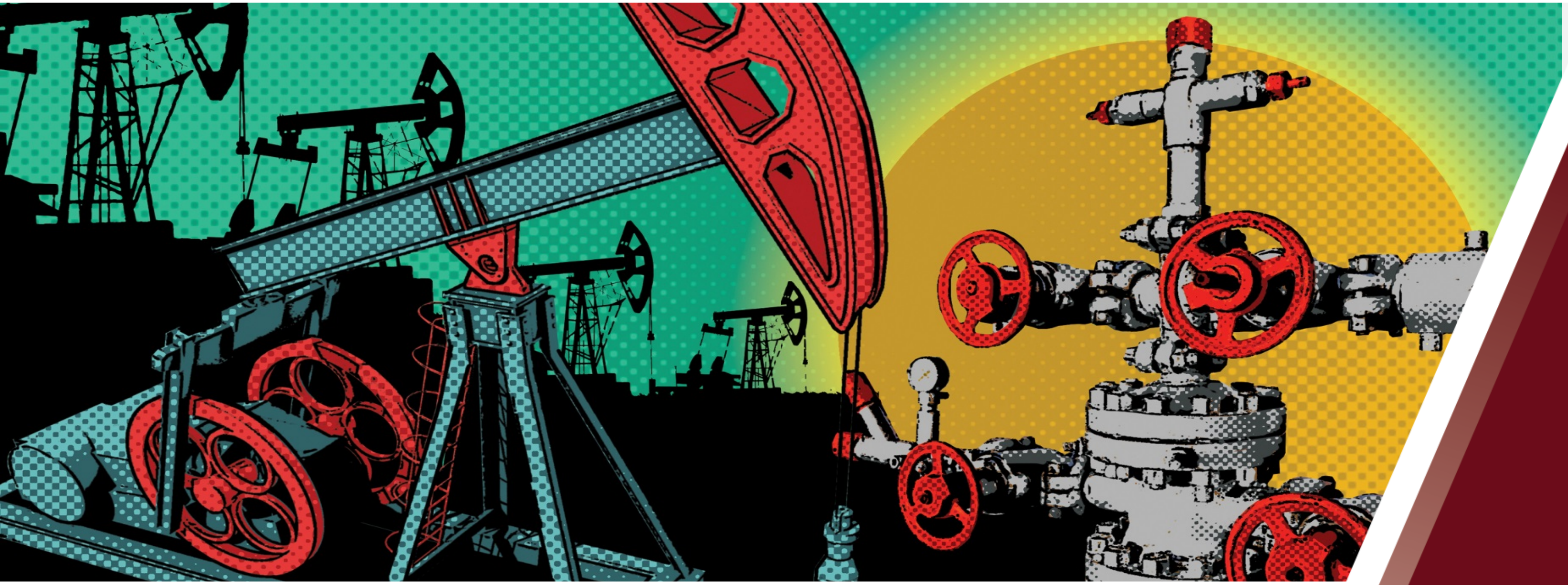

Non-Traditional Financing Sources

IPAA Private Capital Conference
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Austin Elam, Partner

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Parties and Structures

Review of select non-traditional financing structures and sources

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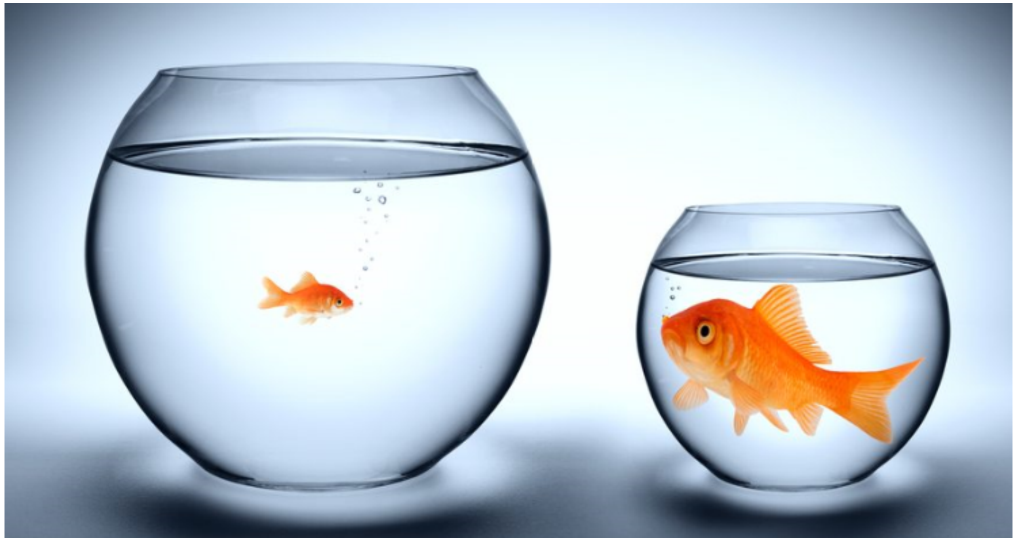
Know your Counterparty (and Audience)

- Aligning the deal and the capital provider
  - Decision making layers
  - Experience in industry (or, where were they in 2014?)
  - Reputation and Reputational risk



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Unitranche and Development Loans

- Traditional mechanism to finance significant drilling when other credit is unavailable (e.g., insufficient Borrowing Base capacity)
  - Can also be applied to acquisition finance and stressed RBLs
- Unitranche and Overadvance facilities
  - 1 + 1 = 3
  - Requires material PDP properties
  - Blended rates or distinct "conforming" and "over-advance/development" tranches
- Development Loans
  - Generally useful if there are insufficient PDP reserves to generate a material Borrowing Base number
  - Equity kickers vary widely
    - Penny-warrants
    - Net Profits Interests – Term or Perpetual
    - Convertible Royalty Interest
  - AMI protections and limitations

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The "DrillCo"

- The need for (off balance sheet) capital remains a constant
- Many credit facilities allow farmout and development agreements as express permitted dispositions
- Enter the DrillCo – a drilling joint venture between a Producer and a Capital Provider
  - Not a company or jointly-owned entity – a "financial" farmout agreement
  - Capital Provider agrees to fund Producer's drilling of wells in exchange for negotiated "Before Payout" and "After Payout" returns and interests
- Providers historically have included insurance companies and firms of all sizes, from small family office to global funds

	Producer	Capital Provider
Drilling/Development Costs	20%	80%
Payout Hurdle	13% IRR	
Before Payout Working Interest in Wells	40%	60%
After Payout Working Interest in Wells	90%	10%

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The Structural DrillCo "Deal"

- Scalable based upon size of drilling program (from 8 well up to 48+ wells)
- Can work in tandem with existing credit facilities, without Intercreditor
- In some cases, simplified off-ramps as opposed to equity based transactions
- **Producer** receives:
  - Access to capital to finance drilling of an agreed well program
  - (Likely) no additional debt on the balance sheet
  - The upside and full ownership of all in-fill and adjacent drilling locations outside of the program
  - Borrowing Base uplift from DrillCo program wells once PDP (up to the Producer's retained working interest in each well)
- **Capital Provider** receives:
  - Firm obligation by Producer to drill agreed well program
  - Right to a return on invested dollars (BPO) *plus* a perpetual APO "tail" working interest in each program well
  - Direct non-operated working interest in each funded well, carved out of the Producer's estate in the event of a bankruptcy, with some strings attached

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ORRIs, VPPs and NPIs

- Royalty Interests
  - **ORI**: interest in production free of production expenses
  - **VPP** (“Term ORI”): interest in limited fixed quantity, free of production expense
  - **NPI**: share of production burdened by certain expenses
- Analogous to DrillCo transactions with important exception for capital providers:

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  - No direct personal liability
    - Little to no environmental exposure or exposure to royalty owners
    - No plugging obligations
    - Worst case is a $0 check for a month (or months)
- Frequently structured as “term” interests, that revert back to the producer upon satisfaction of a payout or other threshold
- Might require approval by the producer’s bank group(s)

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The Structural "Deal" for Royalty Interests

- Scalable based upon percentage of production or size of burdened acreage
- **Producer** receives:
  - Access to capital, sometimes to finance drilling of an agreed well program
  - (Likely) no additional debt on the balance sheet
  - ~~The upside and full ownership of all in-fill and adjacent drilling locations outside of the program~~ Full operational control and sole consent/non-consent election rights
  - Borrowing Base uplift from program wells once PDP (up to the Producer's retained working interest and net revenue interest in each well)
- **Capital Provider** receives:
  - Firm obligation by Producer to drill agreed well program, but frequently PDP
  - Right to a return on invested dollars (BPO) ~~*plus* a perpetual APO "tail" working interest in each program well~~
  - Direct ~~non-operated working~~ interest in ~~each funded well~~ acreage, *potentially* carved out of the Producer's estate in the event of a bankruptcy,
  - Limited liability to third parties and lessened operational risks
  - UBTI and tax considerations

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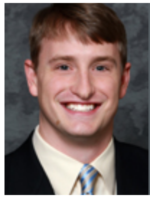
CONTACT INFORMATION



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