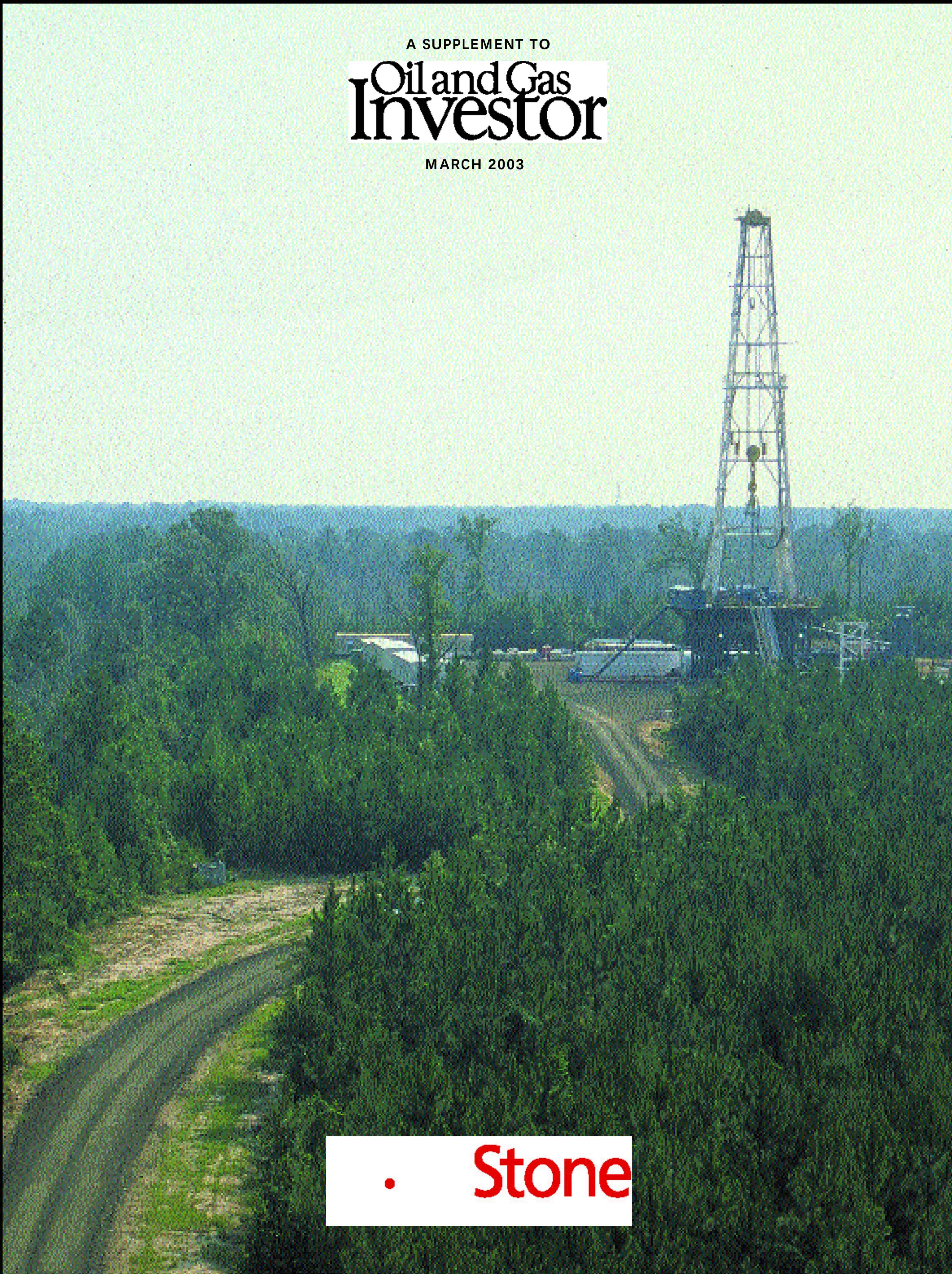
A SUPPLEMENT TO

Oil and Gas Investor

MARCH 2003



HART

Black Stone
MINERALS COMPANY, L.P.
MARCH 2003

A supplement to:

Oil and Gas Investor

Hart Publications,
Chemical Week Associates
4545 Post Oak Place, Suite 210
Houston, Texas 77027-3105
713-993-9320
Fax: 713-840-8585
www.OilandGasInvestor.com

LESLIE HAINES, **Editor**
Ext. 151, *lhaines@hartenergy.com*

NISSA DARBONNE,
Managing Editor
Ext. 165, *ndarbonne@chemweek.com*

Contributing Editor:
NICK SNOW

MARC CONLY, **Art Director**

CARLA CHESHIRE, **Graphic Artist**

ROBERT C. JARVIS, **Group Publisher,**
Ext. 130, *bjarvis@hartenergy.com*

BOB McGARR,
Regional Sales Manager
Ext. 144, *bmcgarr@hartenergy.com*

SHELLEY LAMB,
Regional Sales Manager
Ext. 118, *slamb@hartenergy.com*

Chemical Week Associates

RICHARD A. EICHLER, President,
Hart Publications

MARIO G. DI UBALDI, Executive VP,
ChemWeek Group

BILL RUTLEDGE,
Director of Conferences

MICHAEL D. KRAUS,
VP Manufacturing

KENNETH TURTORO,
VP & Circulation Director

STEPHEN J. SCHWARTZ, Group VP

LYN TATTUM, Group VP

RICHARD J. ZANETTI, Group VP

KEVIN F. HIGGINS, VP & CFO

MICHAEL SILBER, President & CEO

Since entering the oil and gas minerals business more than 100 years ago, Black Stone Minerals Co. LP and its predecessor companies have changed with the times as management identified new opportunities. Indeed, a proactive stance has enabled it to become one of the largest privately held fee mineral owners in the U.S.

But Black Stone is not resting on its laurels. The Houston company co-sponsors an annual mineral management conference and a technical conference. It spends anywhere from $3- to $5 million annually for working-interest participation in some of the wells drilled on its vast holdings. The company develops its own geologic concepts and actively courts industry partners and ideas as well. And it is now raising institutional funds to propel it through the next growth stage.

"We believe in turning over our mineral acreage inventory," says president Tom Carter.

Today Black Stone is looking to expand its already-generous mineral holdings into plays with longer-life reserves, attract more proactive drilling activity on those acres, and encourage prospect generation on those assets. The transformation had its seed in late 1998, when Black Stone management began to implement a more aggressive business plan designed to transform the company into a proactive lessor and operator. Black Stone has spent nearly $160 million during the past four years, increasing its mineral ownership to more than 5 million acres in 40 states. It now boasts interests in more than 10,000 wells throughout the major oil and gas plays of the U.S.

More recently, the company branched out again, having raised a $150-million fund from institutional investors to acquire mineral interests in even larger packages. We hope you find the Black Stone story presented here to be intriguing, and that it suggests opportunities and ideas to you.

—Leslie Haines

CONTENTS

ABOUT THE COVER: Photo by Mieko Mahi.

Black Stone
MINERALS COMPANY, L.P.

Providing Opportunities to E&P Companies, Mineral Owners and Investors

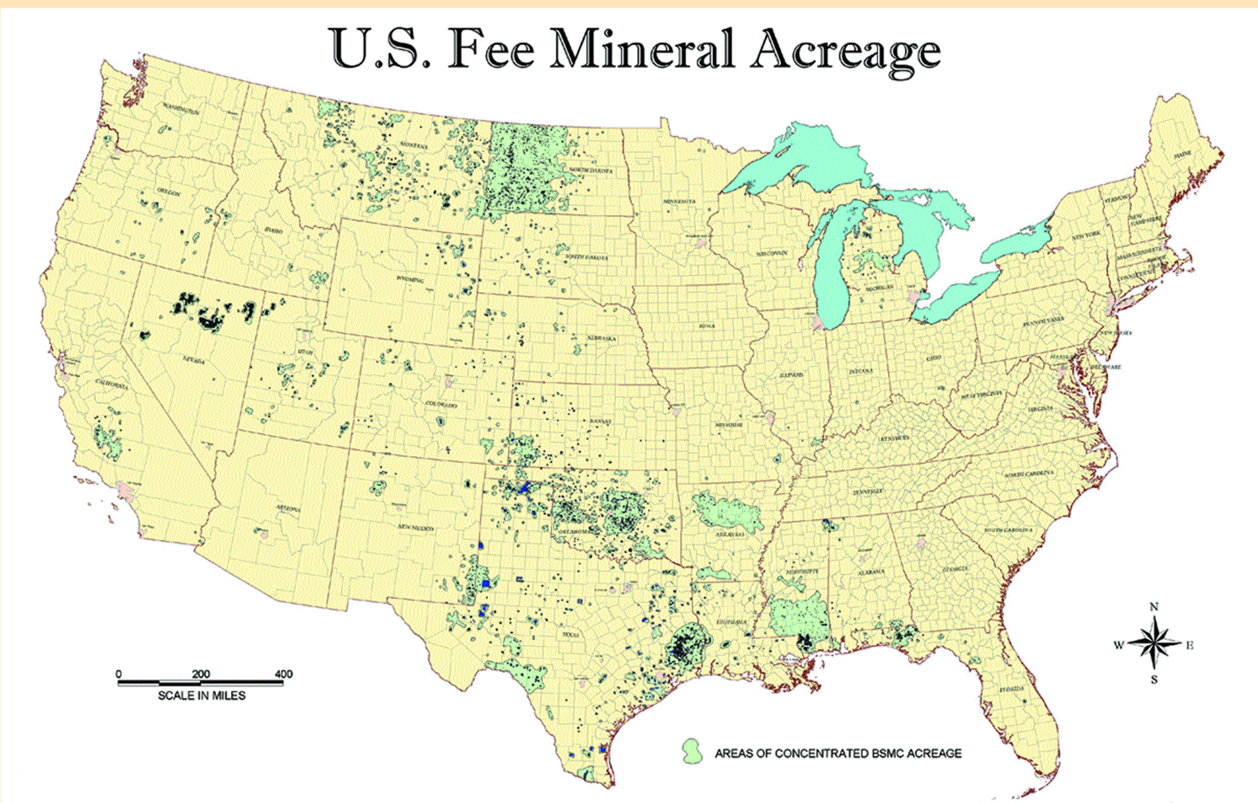
Oil and gas exploration companies are searching for attractive, drillable prospects. Mineral and royalty property owners may desire to sell or diversify their holdings. Investors seek alternative investments with current income and potential for asset appreciation in an uncertain market. Black Stone Minerals Co. LP can provide each of them opportunities.

For exploration companies, Black Stone's position as one of the nation's single largest private mineral owners affords these companies an extensive acreage inventory to generate prospects within the major U.S. oil and gas basins. Its steady, methodical aggregation of mineral acreage and producer-friendly attitude mean exploration and production companies can spend less time negotiating with several mineral holders, secure a lease on fair terms and spend more time looking for oil and gas.

For mineral and royalty owners, Black Stone strives to negotiate a fair purchase price and quickly close a sale. Since 1999, the company has closed seven large acquisitions of mineral properties with producing royalty totaling approximately $160 million, from large corporations to family-held entities. If you are reevaluating your ownership of minerals, Black Stone is always ready to negotiate a fair deal and customize the deal structure.

For accredited investors, Black Stone offers an often-attractive investment alternative to other, more traditional energy investments. Black Stone's new mineral and royalty fund provides a significant current yield and potential for appreciation through third-party E&P company investment within the mineral base. Black Stone's cash distribution yield has exceeded most public energy investment vehicles. More importantly, new acquisitions and activity within its vast mineral base have caused its distributions to climb more than tenfold since 1992.

Black Stone, from the perspective of a mineral manager and owner, has a far different approach and strategy than traditional E&P companies. Please contact us, whether your interest is to generate new prospects, monetize mineral and royalty property or consider the merits of investing with us.



Black Stone Minerals Co. LP holds more than 5 million gross acres throughout the western two-thirds of the U.S. Most of this fee mineral acreage is in solid oil and gas producing regions, with abundant future potential.

Black Stone Minerals Co. LP, 1001 Fannin, Suite 2020, Houston, Texas 77002 713-658-0647 Fax: 713-658-0943 *www.bsmc.cc*

A Proud History

From timber to oil and gas minerals, Black Stone Minerals Co. LP has managed natural resources for more than 100 years.

In February, Grey Wolf Drilling Inc. Rig No. 91 was drilling the 22,000-foot Anadarko Petroleum Co. Black Stone Minerals A-249 No. 1, a Deep Woodbine wildcat in Polk County, Texas.

The story of Black Stone Minerals Co. LP is rich in history and details its evolution from a timber business to an oil and gas mineral and exploration company. It begins in 1876 when Black Stone's earliest predecessor, W.T. Carter & Bro. (WTC), was formed to acquire land, grow and harvest southern pine timber and to manufacture lumber.

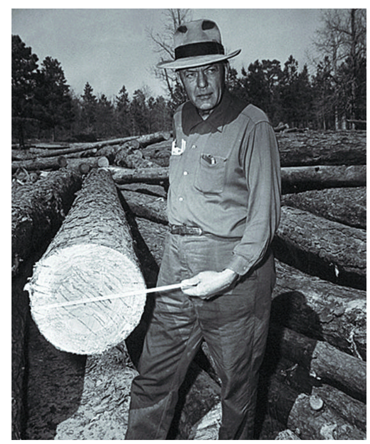
"In many respects, our affinity for real estate and owning property started more than a century ago, when W.T. Carter began building a lumber business in the Upper Gulf Coast of Texas after the Civil War. WTC acquired land strictly for the purpose of harvesting trees and making lumber," says Thomas L. Carter Jr., president of Black Stone.

WTC was one of the longest surviving ongoing partnerships in Texas. From 1876 to 1968, it was one of the largest timber and lumber companies in the Lone Star State, with large timber holdings, associated sawmills and infrastructure concentrated in Polk, Tyler and Angelina counties. In 1968, WTC sold most of its surface holdings and its lumber operations to a predecessor of Champion International Inc. After the sale, its principal business became the leasing of its retained mineral interests in approximately 200,000 acres. "The opportunities we saw were related to our unleased mineral position," Carter says.

In the late 1980s, WTC sought to increase its leasing activity and develop its large, concentrated mineral position. At that time, WTC had not seen significant leasing activity or experienced the benefit of any large discovery on its mineral properties. To foster development of its minerals, WTC invested in projects developed by Black Stone Holdings Partnership (BSHP). BSHP was an active exploration prospect generator and operator in the Upper Gulf Coast with a focus on the WTC mineral areas.

WTC leased a substantial block of acreage to BSHP in Polk County, Texas, and this acreage appeared at that time to be no different than any other lease of mineral property. After drilling a couple of marginal Deep Woodbine Formation discovery wells, BSHP stepped out and drilled the Carter No. 6 in the early 1990s. This discovery led to development of the Double A Wells Field, the largest deep Woodbine natural gas field in Texas, with estimated recoverable reserves in excess of 500 billion cubic feet of gas equivalent.

"During 1990-1996, we were actively developing the field, which included the construction of a gathering system and processing plant," explains J. Mark Connally, vice president of asset management. In late 1996, BSHP sold its working interest to Comstock Resources of Frisco, Texas.



N.B. Weatherford, superintendent on logging operations north of Camden, Texas, during W.T. Carter & Bro.'s early years of lumber operations.

BLACK STONE TIMELINE

	1876-Current	1992	1999
Acquisition / Seller	W. T. Carter & Bro.	Santa Fe Energy (Kirby Minerals)	Four- S
Purchase Price (000s)	-	$23,000	$5,600
Approximate Gross Fee Mineral Acres	200,000	558,000	45,000
Property Location	SE TX	SE TX and SW LA	S. TX
Total Cumulative Gross Acres	200,000	758,000	803,000

In 1998, Thomas L. Carter Jr., president and founder, rolled up four partnerships to form Black Stone Minerals Co. LP. and implemented a new strategy.

However, WTC retained its significant royalty position in Double A Wells Field, which today remains a large field in the portfolio.

While the field was being developed, BSHP and WTC formed Black Stone Minerals (BSM) in 1992 to further expand ownership of fee minerals. In June 1992, BSM bought producing and nonproducing oil and gas fee mineral properties and nonproducing royalty interests in Texas and Louisiana from Santa Fe Energy Resources and two associated entities for $23.2 million. Its mineral acreage represented the fee mineral assets of the old Kirby Lumber Co., which included approximately 558,000 gross acres across East Texas and southwest Louisiana.

"Like many railroads, the Atcheson, Topeka & Santa Fe Railroad had established an energy arm that took over its mineral rights. In 1989, the railroad spun the energy company off to the public. Three years later, Santa Fe Energy decided that the asset didn't fit its increasingly international portfolio," Carter recalls.

The acquisition more than tripled BSM's Gulf Coast holdings to approximately 758,000 gross acres. "Through WTC's participation in projects with BSHP, we changed from a passive landowner to developing geologic concepts around our properties, to bring industry players in and increase our reserves and revenues," Carter says. "We had been fortunate enough to discover or participate in significant new fields that were statistical exceptions. Our cash flow and reserves shot up dramatically. Yet, while we were enjoying the increased distributions, we wondered what we would do for an encore.

"The tendency would have been to gravitate back toward the mean by drilling dry holes. We decided instead to emphasize acquiring mineral properties with producing royalty that have a lower risk profile."

A string of acquisitions

In late 1998, four partnerships—WTC, BSHP, BSM and Randall Interests—were merged to form Black Stone Minerals Co. LP. This combination allowed for ownership of a new, larger entity.

Upon the merger, Black Stone implemented a new, long-range plan that emphasized diversifying its mineral holdings away from the Upper Gulf Coast by acquiring mineral holdings in other areas that have longer-life reserves. "We planned primarily to acquire much longer life properties than the typical Gulf Coast properties, where we had our first positions," Carter says.

Black Stone's expenditure of nearly $160 million during four years has expanded its fee mineral ownership from 758,000 gross acres in two states in 1999 to approximately 5 million in 40 states, with interests in more than 10,000 wells.

Black Stone's first acquisition under the plan came in 1999 when it acquired the mineral assets of Four S Minerals Ltd. for $5.6 million in cash and partnership units. This transaction eventually added producing royalty and 45,000 gross acres, predominantly in South Texas, and minor interests in other states.

That same year, it bought Southern Mineral Corp.'s mineral and producing royalty assets for $6 million, adding more than 245,000 gross acres in southern Mississippi as well as approximately 275,000 gross acres in various Texas and New Mexico counties. Two months later, Black Stone stepped up and acquired mineral rights and producing royalty in July 1999 for $32 million from Prize Resources. Prize had acquired a large package, primarily of working interests, from Pioneer Natural Resources Co. Upon closing the purchase from Pioneer, Prize simultaneously sold Black Stone most of the mineral and royalty portion of the package. The Prize chain of title also included assets from Santa Fe Energy Resources, Mesa Operating Co., Bridge Oil Co. and Parker & Parsley Producing Co.

Also in 1999, Castleton Management Inc., a Dallas-based investment partnership, formed Prince Minerals Ltd. to acquire producing and nonproducing oil and gas royalty and mineral interests. Its biggest purchase was Wiser Oil Co.'s producing and nonproducing royalty and mineral properties that the independent oil and

1999	1999	2000	2000	2001	2002	Total
Southern Min.	Prize (Pioneer)	Kempner	Prince	Cortez (Home Stake)	Ocean	
$6,000	$32,000	$2,500	$28,000	$24,000	$61,000	$182,100
520,000	1,500,000	54,000	620,000	696,000	940,000	5,133,000
Miss. and TX and NM	30 States	TX	20 States	20 States	20 States	40 States
1,323,000	2,823,000	2,877,000	3,497,000	4,193,000	5,133,000	5,133,000

gas producer had acquired during several decades. These assets were in 26 states from South Texas and the Gulf Coast through the Midcontinent and the Permian Basin, up to the Rocky Mountains and the Williston Basin.

Black Stone's December 2000 acquisition of Prince Minerals' mineral and producing royalty properties for $28 million added new mineral acreage positions in Colorado, Montana, Wyoming, North Dakota and Utah to its portfolio, as well as increasing its presence in Texas, Oklahoma, Louisiana, Mississippi, New Mexico and Arkansas. The purchase expanded Black Stone's mineral holdings by 620,000 gross acres.

About the same time as the Prince acquisition, Kempner Minerals LP contributed its approximately 54,000 gross acres of mineral assets in Texas to Black Stone in exchange for a partnership interest valued at $2.5 million.

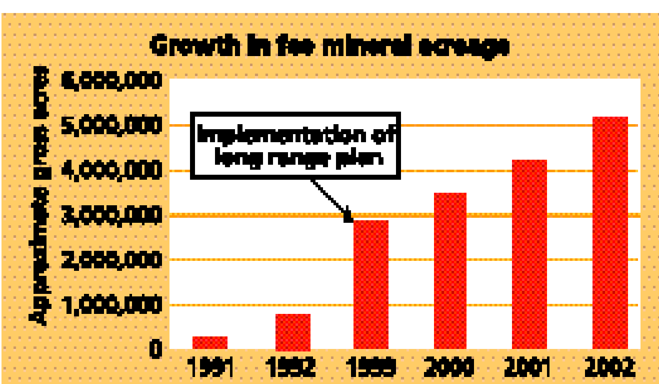
The partnership's largest 2001 purchase was its acquisition of most of Home-Stake Oil & Gas Co.'s mineral assets from Cortez Oil and Gas Co. for $24 million, which had acquired the Oklahoma independent a year earlier. The acquisition added approximately 696,000 gross acres across 17 states with ownership concentration in the Permian Basin and Oklahoma.

By the end of 2001, Black Stone was well on its way to executing its long-term plan, having acquired six packages, increasing its royalty ownership from interest in 200 wells to 7,000 wells, all for an aggregate purchase price of nearly $100 million. The newly acquired properties are in longer-life basins and expose Black Stone to new plays with more consistent reserve replacement.

"We had approximately a threefold increase in reserves and took our reserve half-life from approximately two years to six," says Hugh Idstein, chief financial officer. "The implementation of the long-range plan allowed us to stabilize the production base and cash flow distribution while still exposing us to the upside surprise factor from large new discoveries. Also, with a diversified, longer life reserve base, we were able to significantly increase our borrowing capacity to fund acquisitions."

Recent transactions

Black Stone has grown to be a large mineral management company with interests across the country. "Through the addition of staff and upgrades of our data-information system, we are able to manage a significant income stream coming from a large number of purchases," says Idstein.



"When we acquire a property, the files are often incomplete as to organization and were never put into any type of electronic format by the prior owners," adds Richard D. Eicher, vice president of land administration. "Our land administration group has developed a procedure to set up an acquired property in our system, including electronic mapping. This system allows us to easily access all of our interests, whether royalty or minerals."

Al W. Erxleben, vice president of exploration, (left) and Michael M. Ellis, vice president of land management.

During this growth phase, Black Stone had internally funded acquisitions through reinvestment of cash flow and modest leverage. To access deeper capital pools to pursue larger transactions and achieve more diversity across basin areas, Black Stone formed Black Stone Acquisitions Partners I LP (BSAP I) in 2002. The new investors include Black Stone, a large university, endowments, foundations and individuals. The initial capital commitments are $106 million.

Black Stone closed its first purchase in its new fund when it bought producing royalty properties in Texas, Oklahoma, Louisiana and other states from Ocean Energy Inc. for $61 million. The purchase included royalty and overriding royalty interests in approximately 3,000 wells and interests in mineral acreage across more than 20 states.

Black Stone's expenditure of nearly $160 million during four years has expanded its fee mineral ownership from 758,000 gross acres in two states in 1999 to approximately 5 million gross acres in 40 states, with interests in more than 10,000 wells. This makes Black Stone one of the nation's largest privately held fee mineral owners, with minerals located in high-impact basins including the Upper Gulf Coast, South Texas and Anadarko. More active exploration plays within its mineral base include resources from deep-gas drilling in the Upper Gulf Coast and South Texas, tight-gas development in the Texas Panhandle and western Oklahoma regions, coalbed methane and deep gas in the Rockies and the Williston Basin, and oil and gas in California's major basins.

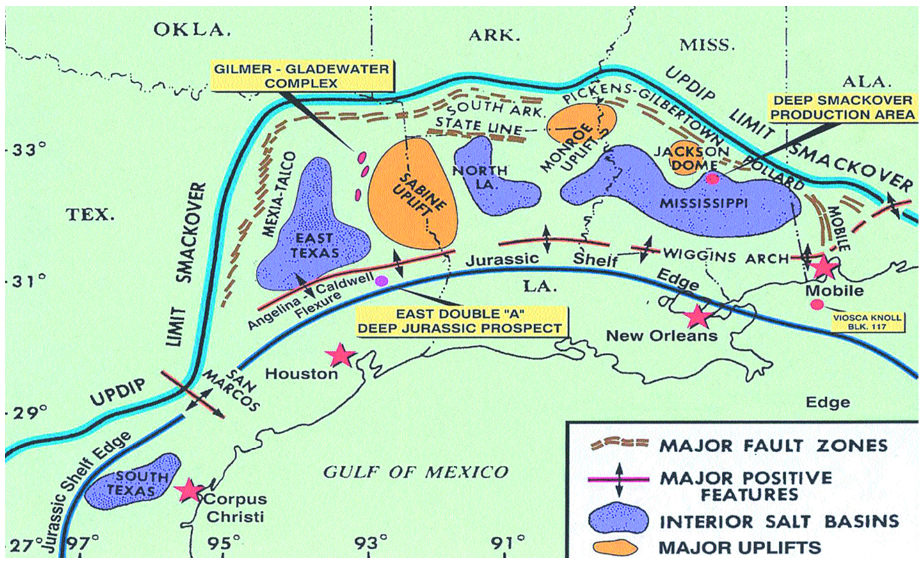
Black Stone continues to actively seek fee mineral acquisitions from privately held and publicly traded companies, family partnerships, trusts and other large mineral and royalty owners. With its new institutional equity fund, BSAP I, Black Stone has the capital base to fund acquisitions of the largest mineral properties. ■

A Creative Focus

Black Stone's evolution from passive to active management emphasizes flexibility in lease negotiation. It also generates some of its own prospects.

Because it is an active mineral owner, Black Stone Minerals Co. LP's growth has been rapid yet carefully structured. Its land-management team has a unique viewpoint on mineral management which allows prospective lessees to close trades more easily than with typical mineral owners, including large companies and individuals.

"We believe in turning over our mineral acreage inventory. The more acreage that is leased, the more subsurface data that is gathered on it, the more wells are drilled and the greater the opportunity that more oil and gas will be produced," says Tom Carter, Black Stone president. "We recognize that there are a lot of geologists and geophysicists out there generating prospects on and around our minerals. We just don't always know who they are and they are not on our payroll. However, when they identify a prospect and contact us, we want to make a deal with them."



Depositional setting for the Gulf Coast during Jurassic times. Black Stone is drilling a 21,000-foot wildcat well during 2003 to test Late Jurassic carbonate reservoirs on a salt platform northeast of Houston. If successful, this well could initiate a significant deep gas play across the Gulf Coast. Black Stone fee mineral acreage will be well positioned within this play. (Map courtesy of Wayne Ahr, 1981.)

But it is Black Stone's in-house exploration team that further enhances "active mineral management." This team not only helps generate new activity in its areas of larger mineral ownership, but also will sometimes join with lessees to drill prospects as both a working interest and mineral owner.

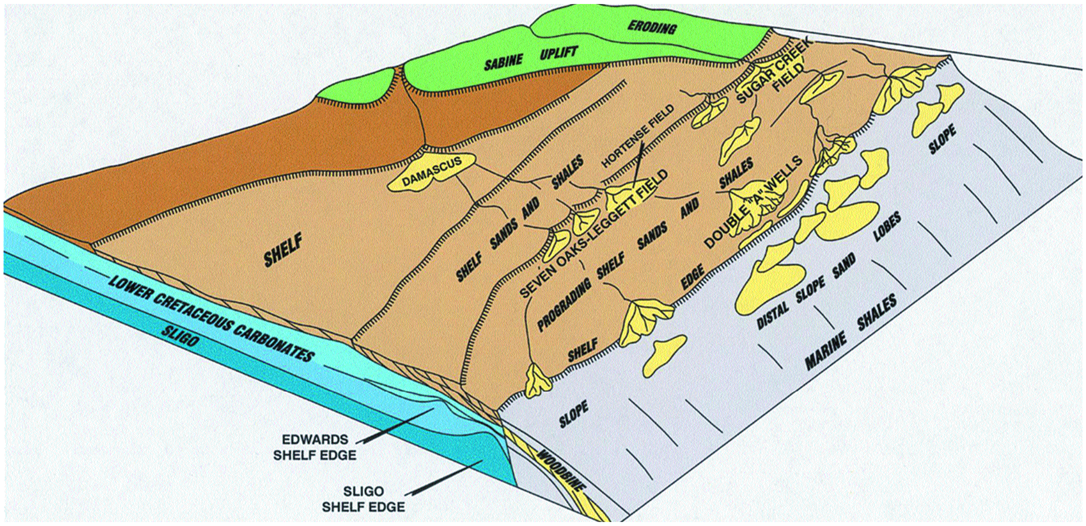
"Our incentive with any prospective lessee is to work with them to give both parties an opportunity to close a fair trade," says Michael M. Ellis, vice president for land management. Exploration companies appreciate Black Stone's flexibility. "We work with them on our lease form. We encourage their comments. While some mineral owners will not budge from their ironclad lease form, we will negotiate. We're not locked into set provisions, terms, bonus considerations or royalty percentages. If an operator's terms are reasonable, we'll move forward."

The process begins when an exploration company has identified a prospect and approaches Black Stone with a *bona fide* inquiry. The land management staff prepares an overview as to how its acreage is involved. The prospective lessee might make an offer that Black Stone accepts and an agreement is reached quickly. If the offer is less than what Black Stone considers the going market rate, the staff tries to negotiate an agreement so that both parties win.

With fewer 3-D seismic surveys being shot today, mergers of large companies and less emphasis on onshore exploration, Black Stone continues to be more flexible, often making unusual, creative and innovative proposals.

"At one time, almost every lease along the Gulf Coast bore a quarter royalty. We still grant leases on that basis, but only in certain areas," Ellis says. "If it's in an area on the fringe or our acreage hasn't been explored recently, the first well may bear a lower royalty percentage and on subsequent wells, a percentage that is higher than the first well on the lease. Today, most leases have at least one well drilled on them. That wasn't the case 10 or 15 years ago, when companies did not rely as much on 3-D and speculated more often by leasing large blocks of acreage within a trend or around a discovery."

Because Black Stone holds diverse mineral holdings across the United States, the land-management group receives inquiries from companies large and small, from all over the country. "Our group deals with companies such as ExxonMobil on down to the smallest independents," Ellis says. "During the last 10 years, the majors and large independents haven't come in and announced plans to lease thousands of acres. What we're seeing now is interest in smaller lease blocks that both large and small producers consider prospective."



Depositional model for the Late Cretaceous Upper Woodbine sands in Southeast Texas. The 550-billion-cubic-foot Double A Wells gas field was discovered by Black Stone in 1985. The trend continues to yield significant drilling opportunities. Black Stone holds more than 700,000 fee mineral acres in this highly prospective region.

One way Black Stone keeps up with oil and gas prices and supply and demand forecasts, regulatory issues and other mineral ownership issues is through its participation in and the sponsoring of an annual mineral-management conference. Mineral owners from many states attend to hear experts who speak on a variety of subjects relating to mineral ownership. "It's important to stay abreast of what's going on, to understand political issues and regulations in various states and other issues that affect mineral ownership. You have to do that. If you don't, you're going to lose," Ellis says.

In Oklahoma, for instance, leasehold interest owners and mineral owners may have to contend with forced pooling. "We find that when an operator offers combinations of lease bonuses and royalty interest, we determine what we have received in the area. Because we've taken the risk of buying properties, a lease bonus is one way we recoup some of our investment. That's one of the reasons why we usually do not accept a trade with no bonus. We'd rather seek a trade with bonus money and a royalty that we can live with.

Al W. Erxleben, vice president of exploration, (left) and Paul Sacco, senior staff geologist.

"During the last 10 years, we have leased a million gross acres," Ellis points out. "Today, we will close at least 100 lease and option trades annually. In the early and mid-1990s, we averaged only 35 deals per year. Our activity has tripled primarily as a result of the acquisition of mineral packages. If someone approaches us with a lease offer, we respond. If the deal is not consummated, it is because the lessee changed his mind or their funding fell through, not because of Black Stone's lack of effort in accommodating the lessee."

Prospect generation

To generate additional interest in its fee mineral position, Black Stone has its own exploration group, a reflection of its more proactive mineral-management philosophy. As a result, Black Stone may participate as a working interest owner in some prospects, which can assist in leasing a block of minerals and getting a prospect sold. "We believe in turning over inventory and sometimes we participate in order to get a well drilled," says Tom Carter, Black Stone president.

"We typically spend \$3 million to \$5 million per year for working-interest participation in wells on or near our larger fee minerals areas," says Al W. Erxleben, vice president of exploration. "Despite a small exploration staff, we are able to generate prospects and ideas using our workstations and our rather extensive 3-D database. Although we take both large and small prospects to the companies that work the same plays, we typically participate only in the larger prospects," he adds.

"The prospects we participate in are not always immediately on our acreage, but if they result in a discovery, they can affect leasing activity on our nearby minerals."

Black Stone has hosted a technical conference known as the Woodbine Summit, which attracted oil and gas companies ranging from majors to small independents. "We try to create an environment that encourages exploration on our minerals," Erxleben observes. "Our task is to be cooperative. We spend 30% to 40% of our time meeting with other companies that are prospecting in and around our acreage and can provide insight into their prospects and play concepts."

Says Carter: "The oil and gas business, by its very nature, is proprietary. Most companies horde information and data because the business is competitive. Technical expertise is how they separate themselves and obtain competitive advantages. As a mineral owner, however, we want as many of the upstream companies coming in and exploring our properties as possible."

From left to right, Black Stone Minerals' Paul Sacco, senior staff geologist; J. Mark Connally, vice president of asset management; Marshall M. Eubank, vice president of business development; Thomas L. Carter Jr., president; Michael M. Ellis, vice president of land management; Al W. Erxleben, vice president of exploration; and Hugh J. Idstein, vice president and CFO. (Not pictured, Richard D. Eicher, vice president of land administration, and John F. Robinson, land manager.)

Several large independents are among the producers exploring the prolific Woodbine and other formations in the Upper Gulf Coast of Texas, while a number of large and small companies are at work across Black Stone's mineral holdings in other basins. Occasionally, a project that smaller producers initiate on Black Stone's holdings attracts a larger E&P partner. "We have also worked with a smaller company to get a well drilled on a prospect over which they shot a 3-D survey in the Deep Woodbine Play in Polk County. They, along with our help, sold a portion of that well to a large independent, which is very interested in the Deep Woodbine. The large independent is now shooting an 80- to 85-square-mile 3-D survey that could ultimately lead to drilling deep wells between 18,000 and 20,000 feet to test those prospects," continues Erxleben.

"A fun part of this job is that we never do the same thing two days in a row. Even though a lot of our exploratory activity is in Texas and Mississippi, we often talk with companies about various plays, geology and basins associated with our acreage all over the U.S.," Erxleben observes.

"We recognize that there are a lot of geologists and geophysicists generating prospects on and around our minerals. We just don't always know who they are and they are not on our payroll. However, when they identify a prospect and contact us, we want to make a deal."

—Tom Carter,
Black Stone Minerals Co.

"Most geologists are assigned to a specific trend or basin for two or three years. Our exploration group must know something about geology and trend activity across the U.S. For example, we now have a project under way on approximately 951,000 acres in the Williston Basin that came through several acquisitions. It's an area that we want to learn more about in order to increase industry interest."

Flexibility and innovation

Black Stone's innovative uses of seismic data are another characteristic that sets it apart from a typical mineral owner. "Our acreage concentration in the Upper Gulf Coast allows us to acquire seismic data through our lease negotiations," says Dick Eicher, Black Stone vice president of land administration. "We are now collecting data on our newly acquired minerals in the Midcontinent and other areas to utilize in the future to increase activity in those areas," adds Eicher.

The approach fits Black Stone's strategy of initiating third-party exploration activity without maintaining a large in-house exploration team. "We welcome exploration companies that are looking for prospects. This includes conducting 3-D surveys upon us as part of their studies of our areas. In some cases, they're proprietary surveys. In others, they're speculative," explains Al Erxleben, vice president of exploration.

For example, Black Stone has been recently working with an independent on a new 3-D survey under way over a large block of its minerals in South Texas. "It's a 160-square-mile 3-D survey that touches the Mexican border. We think we might have prospects along our side of the Rio Grande River," Erxleben says.

Negotiated options, leases and permits provide Black Stone the right to obtain the geophysical data. "These agreements specifically state at what point we are entitled to use the information," says Mike Ellis, Black Stone vice president of land management. "When you have a mineral position like ours, a lessee may conduct a proprietary seismic survey, review the survey results and determine it no longer wishes to pursue exploratory efforts of the areas. The data is of no further use to them when they're finished, but we're able to use the data to promote and develop our minerals." ■

More Arrows In The Quiver

Through its new fund, Black Stone's investors have expanded its capital base for acquisitions.

Black Stone Acquisitions Partners I (BSAP I), formed in late 2002 with institutional and individual investors, is a significant departure from Black Stone Minerals Co. LP's usual funding strategy and capital structure. Forming this fund provided Black Stone with new capital sources, a deep pool of equity capital and long-term institutional relationships. All of Black Stone's future mineral and royalty acquisitions will be purchased by BSAP I and planned follow-on funds.

From 1999 through 2001, Black Stone used internally generated funds and modest leverage to complete six acquisitions totaling $100 million. This expanded its mineral position, which allowed it to diversify away from the Gulf Coast and maintain cash flow. While the strategy was successful, Black Stone desired to pursue larger transactions and to further diversify its ownership over a larger number of properties, so it entered the alternative investment market in March 2002 with BSAP I, its first private equity fund.

"Through these partnerships, we hope to raise $300 million or more during the next five years. That will complete the cycle of our 10-year plan," says Tom Carter, Black Stone president.

In November 2002, BSAP I had a first closing of $106.3 million in commitments as part of a $150-million fund. A $61-million purchase from Ocean Energy Inc. was the fund's first transaction. Investors include an affiliate of Black Stone as the general partner, Black Stone as a limited partner and a number of new limited partners that include a major university and several foundations, trusts and individuals.

Once again, Black Stone broke away from the crowd with a different approach. "We are significant participants, both as limited partner and general partner, for a significant piece of the capital instead of the general partner's usual 1% to 5%. With the fund, both Black Stone and the new investors can achieve diversification—take pieces of several deals, rather than 100% of one large deal—and thereby spread exposure and risk," says Marshall M. Eubank, vice president of business development.

"Also, transactions in the $100- to $200-million range may come up that historically would be a stretch given our conservative capital structure. Finding a third-party partner to bid with you on short notice is very difficult. With the new investor base, we now have the ability to pursue very large mineral transactions by ourselves," adds Eubank.

Market conditions

Earlier during the stock-market boom, Black Stone had contemplated accessing capital from alternative investment sources, but thought it would be difficult to compete against the Internet, telecom and other technology investment opportunities, which had returns in excess of 30%. Furthermore, the upstream sector of the energy business had underperformed the S&P 500 on a long-term basis.

"Three years ago, it would have been virtually impossible to raise a new energy fund. Communications and information technology stocks were climbing 30% a year. Oil and gas investments with 10% to 20% rates of return potential looked rather stodgy," Carter recalls.

The collapse of the technology sector, coupled with the recent stability of the upstream sector, actually helped Black Stone find an audience with many investors who were rethinking their portfolio strategy. "When we embarked on this first fund, I spoke with several people who were involved in the investment industry. Each one of them cautioned me that it would take us 18 months to 2.5 years to put the first fund together. In fact, we were able to put together a fund in nine months," says Carter. "I think that says a lot about the product we are buying and managing."

Along with market timing, Black Stone's track record attracted investors. A combination of well-timed acquisitions and several large discoveries had allowed the company to enjoy nice returns. Furthermore, its annual distribution to investors had increased more than tenfold since 1992.

"From all indications, there appears to be a fair amount of additional capital, from our existing and new partners, so that we could raise a new fund in the near future, as acquisitions become available," Carter says. "That is an expression of the marketplace. Endowments, foundations, universities, etc. are looking for alternative investment classes with a property base, while producing significant cash-on-cash yields. As long as the yield curve for interest rates stays low, we'll look attractive."

The new fund offers not only current income but also an ability to maintain asset value through reserve maintenance, and growth through third-party development activities within the mineral base. BSAP I offers a low-risk asset class with a competitive current yield. This yield compares favorably to those of publicly traded entities such as master limited partnerships, oil and gas royalty trusts, and real estate investment trusts.

Marshall M. Eubank, vice president of business development.

Black Stone's new fund and planned future funds are significantly different than traditional upstream-oriented funds such as funds with direct ownership in public upstream companies, funds that invest in start-up E&P companies or funds that purchase working interests. All of these other funds make investments that require a significant portion of the cash flow stream to be redirected into exploration, development or acquisitions. Black Stone's fund differs in that it will distribute all current cash flow since ongoing capital expenditures are not required. Its fund also has a much longer holding period, given the perpetual nature of minerals.

Hugh J. Idstein, vice president and chief financial officer.

The fund owns a real property interest in producing royalty properties that have a meaningful current cash flow component. The cash flow from current royalty production provides investors an immediate return on their investment and a yield, yet the fund's ownership of a large undeveloped mineral acreage component makes it interesting.

"The upside in our fund comes from leasing acreage to oil and gas companies for new development, which leads to bonus and rental income," says Hugh J. Idstein, vice president and chief financial officer. "Upon successful development, we receive royalty revenues from the new production." This alternative approach effectively allows an investor to be exposed to some of the benefits of a large discovery through mineral ownership, but without having to take the risk or invest the capital to participate in the discovery, which is funded by the third-party lessees.

Essentially, Black Stone aims to provide investors the best aspects of each end of the exploration and production business. Global producers have diverse reserves, but face a recurring challenge of making sufficient discoveries to offset declining production. At the other extreme, a producer with a $200-million market capitalization and a drilling budget of $15- to $20 million might be very effective one year and equally ineffective the next.

"We emulate the bigger company without having its capital structure. We have interests in many basins and many plays," Carter says. "Yet because we are purchasing minerals, we don't have to spend capital on drilling. We can distribute significant cash to our partners because we have the significant exposure without the associated E&P drilling and development costs.

"We would have loved to have been in the mineral acquisition business 50 to 75 years earlier than we were. But we think the next 25 or 50 years will be a good time to own oil and gas reserves onshore in the United States." ■

The Future: More Acquisitions

With its new capital base, Black Stone will seek to close acquisitions from a variety of mineral owners. Large independents, majors, utilities and other corporations will continue to reevaluate their ownership of onshore oil and gas properties, which will include mineral assets.

"During the last 15 years, larger upstream corporations have divested many of their marginal or noncore, onshore working-interest properties. Yet many of these companies have retained their large fee mineral positions," says Marshall Eubank, vice president of business development. "To the extent they continue to evolve and are no longer active in certain areas, minerals may not be considered core to their business. We believe more and more of these companies will consider divesting their minerals, as a result."

"There are three or four primary sources," adds Tom Carter, president. "Timber, paper or other land companies are looking to streamline their asset base and sell noncore assets, such as underlying minerals. Mid- to large-cap E&P companies are looking for a price per barrel of oil equivalent (BOE) that's significantly higher than what their stocks trade for. Families with large land holdings have become more diverse and individual members have different needs. We have done swaps where families get a smaller piece of a larger pie, and professional management."

For large corporations, Black Stone can offer benefits to such owners of large royalty production and mineral acreage. Its offer price will reflect not only the existing production stream but also a portion of the future expectations in the mineral acreage with potential development activity. This translates into a premium to the present value and an attractive BOE multiple.

The seller can redeploy proceeds realized by the divestiture of fee minerals and royalty to core areas and higher-return projects. A sale will also provide other benefits including realignment of human resources. "In certain cases where a seller wants to retain some core mineral holdings, we may offer rights of refusal to the seller to maintain certain leasing rights in a property that is sold," notes Eubank. "Our flexibility to consider a tie-back to attractive areas (even on our own acreage) can make a difference in winning or losing a deal."

For families and individuals, Black Stone offers a way to monetize mineral acreage and associated royalty production. While most sales are simply structured as a cash purchase, Black Stone may offer the seller the option to exchange the properties for a partnership interest. "If the owner does not want to fully exit the mineral business, we have traded them partnership interests for their mineral and royalty property," notes Carter. "This alternative to a cash sale allows them to be indirectly involved in the business, own a smaller piece of a much larger property base and often provides them tax advantages."


There are 5 million reasons
to explore on our land.
With over 5 million gross fee mineral acres, located in most of the U.S. onshore basins, Black Stone offers a wealth of opportunities for oil and gas exploration teams. From our perspective as a large mineral owner and manager, we recognize that your success is our success. Our producer-friendly attitude means you can spend less time securing leases and spend more time looking for oil and gas. Since 1999, Black Stone has spent over $160 million adding to its extensive mineral position. In the future, we will continue increasing our mineral position and in turn, make it available to industry.
Please contact us, whether your interest is to generate prospects, review our acreage holdings, lease our property or sell your fee mineral interests and royalty properties.
Black Stone Minerals Company, L.P.
1001Fannin, Suite 2020 • Houston, Texas 77002
713.658.0647 • www.bsmc.cc
Stone