HERE'S THE MONEY:

CAPITAL FORMATION 2008

MAY 2008

A SUPPLEMENT TO

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HERE'S THE MONEY:

CAPITAL FORMATION 2008

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RIDING THE COMMODITY WAVE

What financial crisis? Executives heading up E&P, midstream and oil service firms need have little fear that the ongoing credit crunch on Wall Street will harm their capital-raising efforts in 2008. Yes, debt may be a little harder to come by, and for some, it may cost a few more basis points, but the oil and gas industry can access capital.

This is especially true if companies are involved in shale-gas plays or other so-called unconventional plays. At press time, for example, Range Resources Corp., which is a leader in the Barnett and Marcellus shales, increased its bank credit facility to $1 billion from $900 million—this after an oversubscription by its existing bank group and the addition of two more banks.

Carrizo Oil & Gas Inc., which is also active in the Barnett, and is leasing in other shale plays, closed a $75-million term B loan in January and a $135-million secondary equity offering in February.

Late last year, Chesapeake Energy Corp., the number-two driller in the Barnett and Fayetteville plays, and a huge leaseholder in the Marcellus, sold a $1.1-billion volumetric production payment to affiliates of UBS Securities and Deutsche Bank.

At the smaller, regional banking level, the same optimism holds true. Commercial bankers surveyed for this report reiterate that energy is still a favored industry.

Investors believe the same thing, especially as oil and gas prices on the Nymex continue to trend higher than ever before. Ironically, oil and gas are now seen as safe havens for investor dollars as the stock market and the dollar are buffeted by a wave of bad economic news.

That's one more reason why private equity available for E&P, service and midstream firms has increased dramatically in recent years. Experts estimate there is about $35 billion available for private equity investments today, well above the $20 billion tallied in the 2005-2006 cycle.

Since last year's Capital Formation report, NGP Midstream & Resources Fund I has arrived with a treasure chest of $1.4 billion.

EnCap Investments LP closed Energy Capital Fund VII LP with capital commitments of $2.5 billion for investing in upstream and midstream companies. This is its 13th fund and was oversubscribed.

Recently, Natural Gas Partners has closed a $4-billion fund for upstream.

TCW Energy Fund XIV closed with $2.6 billion to fund energy and energy-infrastructure projects with private equity and mezzanine deal structures. Several other such firms are known to be in the market now raising their next funds, which will close later in 2008.

All in all, 2008 is shaping up as a very active year.

—Leslie Haines, Editor-in-Chief

Previous Financing Articles

To assist in your capital-formation activities, refer to these articles published in Oil and Gas Investor *since last May's* Capital Formation *report.*

Three Roads to Capital. Meet Denham Capital Management, BPI Energy Partners LLC and Rivington Capital Advisors LLC. July 2007.

Dough to Grow. These midsize capital providers will finance microcaps: Stonehenge Capital Co. LLC, Allegiance Capital Corp. and Five States Energy Capital LLC. August 2007.

Banking Up. Three capital providers describe their recent deals. Capital One Southcoast, Citibank and Mizuho Corporate Bank. September 2007.

The Mezzanine Mall. Laminar Direct Capital LP, West Coast Opportunity Fund LLC and Petrobridge Investment Management LLC detail their recent mezzanine deals with E&P firms. November 2007.

Doors to Capital. Investment bankers and private-equity sources expected doors to all forms of capital to be open in 2008 for the energy industry. Lehman Brothers, Warburg Pincus, Citi, SB Energy and Banc of America Securities are interviewed. December 2007.

Lending Trends. Commercial capital availability is still good for energy. Bankers from Comerica Bank, Whitney National Bank and Compass Bank share their views and detail some recent transactions for E&P clients. January 2008.

Drilling Partnerships. The financing of drilling programs through public partnerships is discussed by HKP Financial, NGAS Resources Inc. and Reef Oil & Gas Partners LP. January 2008.

Start-up Money. Pine Brook Road Partners and Houston Energy Advisors find ample opportunity to provide private capital to E&P firms. February 2008. •

What's New

In the dynamic space of energy capital providers, people and companies are always on the move. Here's a look at some new names and faces in the past year.

By Stephen Payne, Editor, *Oil and Gas Investor This Week*

E&P companies had plenty of opportunities to access capital in 2007, with private equity fueling plenty of start-ups and IPOs in the energy industry, as well as other sources providing plenty of funds for the healthy exploration and acquisition market. However, a robust capital market can mean feasting one day but trouble down the line, and can present challenges for the business plans of different organizations.

"For us it's a double-edged sword—the excess capital is clearly driving returns down on the acquisition side from my perspective," said Hallie A. Vanderhider, president and chief operating officer of Houston-based Black Stone Minerals Co. LP., in January as the year began.

"As a mineral owner, we want development capital to be available to the industry to facilitate drilling. Having said that, it is our overall view that there is too much capital in the space and for everyone who is principally growth through acquisitions, the market remains very difficult.

"Because of the abundance of capital and the relatively high commodity prices that have run for a long time creating an abundance of cash flow, it is difficult for sellers and buyers to agree on pricing. In addition, the flood of MLPs over the last one to two years has added both more capital and more competition at what I think are unrealistic prices."

S. Glynn Roberts, president of Houston-based Northstar GOM LLC, does not believe there is too much capital in his specific niche, the Gulf of Mexico.

"There is no flood of money into the Gulf of Mexico and that is evidenced by the fact that several quality asset packages ultimately did not exchange hands. At the end of the day, the sellers of those packages, who were hardly distressed sellers, made the decision to keep the assets rather than sell into a market that they deemed inadequate."

Chuck Perrin, president and chief executive of Tulsa.-based, privately held Rockford Energy Partners LLC, also thinks too much capital is floating around currently.

"I think that the private-equity providers have a tremendous challenge in finding enough seasoned veteran management teams to deploy capital to. Perhaps some money is falling into hands of management teams that don't spend money as prudently and their asset buying is raising up prices."

Perrin says the current market makes accessing capital easier for Rockford. He concludes, however, that there is too much capital chasing too few deals.

Following is a round-up of 2007 capital-provider news, from the *Oil and Gas Investor This Week* database.

CAPITAL PROVIDER NEWS

ArcLight Capital Partners LLC, Boston, closed **ArcLight Energy Partners Fund IV LP** with $2.1 billion in capital commitments. The closing came 15 months after ArcLight closed its $2.1-billion **ArcLight Energy Partners Fund III LP**, bringing the firm's total capital under management to more than $6.8 billion. ArcLight has invested $4.6 billion of its capital in 75 energy investments since the firm was founded in 2001.

Atlas America Inc., a Philadelphia E&P company, formed **Lightfoot Capital Partners LP** with $160 million. Partners in the fund include Chicago hedge fund Magnetar Capital, the global principal strategies group of Lehman Brothers, Goldman Sachs & Co. and a management team led by Vincent Cubbage, formerly managing director and sector head of master limited partnerships in investment banking for Banc of America Securities LLC. Lightfoot will focus on funding new infrastructure MLPs and existing MLPs in need of additional equity or structured debt. Atlas America will own, directly and indirectly, approximately 18% of **Lightfoot Capital Partners GP LLC**, the general partner of Lightfoot.

Avista Capital Partners, Houston, closed its inaugural $2-billion private-equity fund in June 2007 and has committed $1.4 billion in investments in 17 portfolio companies broadly diversified in the healthcare, media and energy industries. Its portfolio of energy companies includes Geokinetics, Frontier Drilling, Blake Offshore, Celtique Energie, Laramie Energy, Manti Exploration and Peregrine Oil and Gas.

BSI Energy Partners LLC, Ventura, California, raised its first private-equity fund, totaling $50 million, to invest in oil and gas producers in amounts of $1- to $10 million. Dustin Gaspari was formerly in energy banking with Union Bank of California. The firm also offers joint-venture partnership, direct investment in working interest, ORRI and NRI, and debt with equity participation.

BlackRock Energy Capital Ltd. changed its name to **BlueRock Energy Capital Ltd.** The Houston company provides $1- to $10 million to independents for development, acquisitions and monetizations through a non-recourse financial production payment via a limited-term overriding royalty. Cathy Sliva is a co-founder and principal.

Broadpoint Capital Inc., the broker-dealer subsidiary of New York City-based **First Albany Cos. Inc.**, was renamed **Broadpoint Securities Group Inc.**

Dahlman Rose & Co. LLC, New York, started an E&P and oilfield-services practice based in New Orleans. Stanley E. Ellington Jr. is managing director heading the new group. He was managing director, corporate finance, for Capital One Southcoast Inc., raising equity capital for various energy companies, and vice president and chief financial officer at Production Management Cos. Inc., a privately held oilfield-services company. Michael R. Uffman and Earl A. Stolz III have been named vice presidents, investment banking in the E&P group. Both were with Ellington at Capital One Southcoast.

Donovan Capital was formed by John W. Donovan Jr. in Houston, to provide energy investment capital and capital-markets advisory services. He was previously a vice president with energy private-equity provider Quantum Energy Partners, and a financial analyst in the investment-banking group at Credit Suisse First Boston.

EnCap Investments LP, Houston, closed **EnCap Energy Capital Fund VII LP** with total capital commitments of $2.5 billion. Participation was oversubscribed.

Energy Ventures of Stavanger, Norway, raised more than US$170 million in the first closing of its newest venture-capital fund, **Energy Ventures III**, which will invest in petroleum-related technology companies. The company opened branch offices in Aberdeen, Scotland, and in Houston.

Bob Schwartz heads its new Houston office. **Ferd** is strategic partner and the biggest investor in the fund. Energy Ventures' first fund, **Energy Ventures I**, was raised in 2002-2003 with committed capital of US$55 million.

Houlihan Lokey acquired energy M&A advisory boutique **Baxter Energy Partners LLC**, New York, for an undisclosed price. Baxter Energy has experience with majors, large-cap producers and downstream. The deal is to help grow Houlihan Lokey's energy platform. Scott Baxter has been named managing director, corporate finance, for Houlihan Lokey.

IEV Capital LLC, an investment bank in The Woodlands, Texas, formed a $1.83-billion fund to invest in on- and offshore drilling, green energy businesses and other industries. Ryan Sumstad is IEV Capital chief executive. He is founder, chairman and CEO of The Woodlands-based **IE Ventures Group of Cos.** In the past 11 years, IE Ventures has helped launch more than 50 start-ups in myriad industries.

Merrill Lynch Capital launched a loan shop to provide senior debt to energy companies and aims to develop a multibillion-dollar portfolio in the space. The unit's team consists largely of former Bank of America/Bank Boston and JP Morgan/Chase professionals who are credited with issuing more than $40 billion of senior debt in four years.

Parkman Whaling LLC in

Houston was formed by Jim Parkman and Graham Whaling as an energy investment-banking and M&A advisory firm. Parkman was a founder in 1989 of investment-banking and M&A advisory firm Petrie Parkman & Co., which was sold in 2006 to Merrill Lynch. Previously, he was with First Boston Corp. and the Federal Reserve Bank. Whaling was a founder of Houston-based, EnCap Investments LP-funded E&P company Laredo Energy. Previously, he was chairman of producer Michael Petroleum Corp., and chairman and chief executive of Monterey Resources.

Prospect Energy Corp., New York, changed its name to **Prospect Capital Corp.** to clarify that it is a capital provider and that its portfolio includes companies other than energy.

QEM Management LP, Houston, closed **Quantum Energy Partners IV LP**, a $1.32-billion private-equity fund dedicated to the energy industry. It's Quantum's fourth private-equity fund since 1998. Quantum targets investments in oil and gas, while also considering opportunities in the midstream, oilfield-service, coal, power, and alternative-energy sectors. The firm makes $25- to $150-million private-equity investments in the energy industry and has more than $3.2 billion under management.

Quintana Energy Partners LP closed with a $650-million private equity fund. The fund's Houston-based investment team is led by Corbin J. Robertson Jr., whose family founded Quintana Petroleum in the 1930s with Hugh Roy Cullen. Former U.S. Commerce Secretary Don Evans is also a fund manager. The investment team also includes Warren S. Hawkins, Brock E. Morris, Corbin J. Robertson III and William K. Robertson. The fund has already committed approximately $140 million to seven companies: Coldren Oil and Gas; Consolidated Oil Well Services; Cypress; Gulfstream Terminals and Marketing; Quintana WellPro; Stone Mountain Resources; and XL Prospect.

Stonehenge Growth Capital, the principal investment group of **Stonehenge Capital Co. LLC**, raised a $200-million, junior-debt investment fund, bringing its total assets under management to $735 million. **Stonehenge Growth Capital Fund** targets privately held, lower middle-market businesses with a variety of debt structures of up to $20 million per transaction for working capital, buyouts, recapitalizations and acquisitions. SGC partners include David Kocen, Andrew Aye and Nemesio J. Viso. SGC invests in many industries, including the energy-services sector. Offices are in Baton Rouge, Denver, Dallas, Tampa and New York.

Tudor, Pickering & Co. Securities Inc. was renamed **Tudor, Pickering, Holt & Co. Securities Inc.** with the arrival of Maynard Holt as co-president, leading the Houston-based firm's upstream advisory business. Holt was a managing director at Goldman, Sachs & Co. in its energy, power and natural resources practice, where he worked with Tudor Pickering co-founder Bobby Tudor. David Cunningham was named managing director, investment banking, where he will lead the firm in the oilfield-services sector. Ward Polzin joined to launch the firm in property-marketing.

Wayzata Investment Partners was formed by Michael V. Strain in Houston. It runs a hedge fund and is raising money for its first private-equity fund, both focused on energy. He was formerly with Strain Consultants of Houston and managed investment funds for Cargill Corp. in Minneapolis.

PEOPLE NEWS

BMO Capital Markets, Toronto and Chicago, the investment- and corporate-banking arm of **BMO Financial Group,** named Tod Benton managing director and head of the energy and power group in Houston, consisting of more than 35 professionals. Scott Humphrey was named executive managing director and head of U.S. M&A in Chicago.

BNP Paribas named Ian H. Fay managing director and head of the energy and natural resources, Americas, team within corporate finance.

Valerie Gibbs joined **Bank of Scotland**'s loan-production office in Houston as senior vice president. The 26-year-old Houston office has been active primarily in oil and gas upstream, midstream and downstream transactions. Loan sizes are $20 million and up. Prior to joining Bank of Scotland, Gibbs was with Bank of Texas, Amegy Bank and Wells Fargo.

C.K. Cooper & Co., Irvine, California, opened a branch office in New York City, headed by senior research analyst Michael Cohen.

Dahlman Rose & Co. LLC named Kevin Mack managing director of investment banking, focusing on maritime and offshore services. He was chief executive and head of U.S. corporate finance for Danske Markets Inc.

Hallie H. Kim joined **EnCap Investments LP** in its Houston office as a managing director, overseeing investor relations and fund-raising. Prior to joining EnCap, Kim was with Pantheon Ventures Inc. in San Francisco.

GE Capital's Robert D. Franson joined Dublin, Ireland-based **Bank of Ireland** as vice president, North American global project-finance team. Franson will be based in Stamford. At GE Capital, he was vice president, energy financial-services group.

Houlihan Lokey named Richard J. Mandery a director in the global energy group. Mandery was a director at Barclays Capital and has experience in investment banking with the natural resources groups at JPMorgan and Banc of America Securities.

Trond Rokholt was named managing director for New York-based **Jefferies Finance LLC**, a direct lending company. He was head of the U.S. loan syndication group at Fortis Capital, focusing on energy transactions, head of energy investment banking at BancBoston and managing director in the natural resources group at ING.

Lazard Ltd., New York, named Bruce Bilger chairman and head of global energy for its financial business and will co-head its Southwestern U.S. investment-banking region.

Townes Pressler joined **Lime Rock Partners**' investment team as a managing director in the Houston office. He was co-founder of Peregrine Oil & Gas.

NGP Energy Technology Partners LP named Jason E. Hicks principal. He was vice president and has experience at Citigroup in M&A and leveraged finance.

Natural Gas Partners, Irving, Texas-based private-equity firm, named Christopher D. Ray managing director. He was a principal and remains general counsel. Raymond G. Edgar and Thomas J.N. Verhagen were named principals. Edgar was a head of underwriting and portfolio manager for GE Energy Financial Services. Verhagen was director of commercial operations of the Western region for Oceaneering International Inc. Ray Davis was named venture partner. He was co-chairman and co-chief executive of Energy Transfer Partners LP, an NGP portfolio company.

Plexus Capital, Denver, named David Christofferson partner. He was chief financial officer for Venoco Inc., Denver, and involved in the company's IPO.

Quantum Energy Partners, Houston, named David L. Bole managing director. He was president of SouthView Energy LP, a Quantum portfolio company. Bole was a managing director of asset marketer Randall & Dewey (now Jefferies Randall & Dewey) from 1996 to 2005.

Riverstone Holdings LLC, New York**,** named John Browne managing director and managing partner of **Riverstone Europe** in London. He was chief executive of BP Plc. Riverstone named Elizabeth K. Weymouth managing director in New York. She was managing director and head of investment business in the U.S. Northeast for JPMorgan Private Bank. John J. Moon was named managing director. He was a managing director at New York-based Metalmark Capital LLC**.** Greg Myers, managing director, is Moon's successor at Metalmark. •

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BRADEN EXPLORATION, LLC

BRADEN EXPLORATION

$50,000,000

Senior Secured Credit Facility

Arranger and Investor

June 2007

The IPR Group of Companies

IPR EXPLORATION, INC.

$100,000,000

Senior Secured Credit Facility

Arranger and Investor

August 2007

MILAGRO EXPLORATION

$1,350,000,000

Senior/Second Lien Credit Facility Equity

Arranger and Investor

November 2007

Reveille RESOURCES

$50,000,000

Senior Secured Credit Facility

Arranger and Investor

November 2007

RAM ENERGY RESOURCES, INC.

$500,000,000

Senior Secured Credit Facility

Arranger and Investor

November 2007

MIDSTREAM ENERGY SERVICES, LLC

$50,000,000

Senior Advancing Credit Facility

Arranger and Investor

February 2008

Funding Offshore E&P

E&P companies focused on offshore assets find many ways to fund their activities.

By Ellen Chang, Contributing Editor

E&P firms that focus on offshore drilling and production are finding various methods to finance acquisitions or accelerate their drilling programs. Commercial banks and private equity providers are not adverse to taking an interest in Gulf of Mexico exploration and development, even though the assets underlying such companies differ greatly from onshore assets as far as reserve life goes.

Callon Petroleum Co., Northstar GOM LLC, Cobalt International Energy LP and Dynamic Offshore Resources LLC are examples of E&P companies that have employed various strategies to fund their offshore programs. Each predicts an increase in drilling in 2008 as oil and gas demand increases and commodity prices remain healthy.

MONETIZING A JEWEL

In February 2008, Callon Petroleum Co., of Natchez, Mississippi, took a somewhat creative route to gaining enough capital to finally develop its 100%-owned Entrada Field in Garden Banks Block 782, in 4,650 feet of water. The field was found in 2000 by BP and Callon after drilling two discovery wells and seven delineation wells.


Glynn Roberts, president, Northstar GOM

Since then, Callon had acquired the rest of the field it had not owned, and sought more capital to bring it to production. It needed to drill two development wells that will be produced as subsea tie backs to the Magnolia Field tension leg platform nearby.

On April 8, the same day CEO and chairman Fred Callon rang the bell at the New York Stock Exchange, Callon closed on its deal to accomplish this by bringing in a new 50% partner from Japan.

At closing, CIECO Energy (U.S.) Ltd., a subsidiary of Tokyo-based Itochu Corp., paid Callon $155 million and reimbursed Callon $12.6 million for 50% of Entrada capital expenditures incurred prior to the closing date. In addition, CIECO agreed to fund half of a $40-million future contingent payment owed by Callon to BP Exploration and Production Co., the former majority interest owner of the field.

As part of the transaction, CIECO has also agreed to provide a loan to Callon for $150 million of field development costs through initial production. Callon will retain a 50% working interest and continue to operate the field. Merrill Lynch & Co. advised Callon on the transaction.

Fred Callon said at the time the deal was inked, "The agreement provides for a fully funded development plan…and represents the final major step in achieving initial production from the Entrada Field in the first quarter of 2009."

Independent engineers have estimated Entrada's net proved reserves at 17.5 million barrels of crude oil and 87.1 billion cubic feet of natural gas.

OFFSHORE A&D

Northstar GOM is a 13-year-old, private Houston company focused on growing its offshore asset base through a strategy of low-risk drilling and strategic acquisitions, says Glynn Roberts, president. The company's target for 2008 is to produce 60- to 70 billion cubic feet equivalent daily and to increase its reserve size by 20% after production runoff.

To that end, Northstar is currently taking a look at two different acquisitions of assets with a total value of about $200- to $300 million.

"We are also starting to take larger pieces of deals, but we still are not likely to drill very many projects with a 100% working interest," he says.

Northstar has sampled a menu of capital-raising options. It is backed by a private equity infusion from Natural Gas Partners, and also currently has a senior debt facility of $100 million led by BNP Paribas. The company's bankers also include Comerica Bank and Capital One.

The company's earlier structure included mezzanine financing but that changed in March 2006 when the company joined with NGP and arranged the original senior facility with BNP Paribas. "Northstar and our equity sponsor, NGP, determined in early 2006, directly following hurricanes Katrina and Rita, that it was an attractive time to recapitalize and pursue growth in the Gulf," Roberts says.

Today, the company's average deal size is about $50 million, although last year, Northstar acquired additional interest in one field for a smaller, undisclosed amount. In 2008, Northstar plans to do deals in the $50- to $150-million range.

"If the deal is priced right and is a great fit, then we will definitely do it," Roberts says.

Roberts says additional equity is available from Natural Gas Partners for the right transaction. Regardless of whether the company seeks additional growth from transactions, his strategy is to keep the company's debt equal to one year or less of cash flow.

"We are mindful of not taking too much in debt and will always attempt to maintain a very healthy balance sheet with proper hedging in place," he says. "We would typically fund any acquisitions with a combination of debt and equity. The majority of our drilling is funded by internal reinvestment of cash flow, and our borrowing base."


Matt McCarroll, chief executive and co-founder, Dynamic Offshore Resources

DEALS OUT OF THE GATE

A new Houston-based offshore player, Dynamic Offshore Resources, has already been active in the A&D space since it received a $500-million private equity commitment from Riverstone Holdings and management in January 2008. In March, the company closed its first purchase, a 75% interest in SPN Resources LLC for $165 million. SPN was the oil and gas subsidiary of Superior Energy Services Inc., which will retain an effective 25% interest in the oil and gas unit.

In the deal, Dynamic and an affiliate, Moreno Group Holdings LLC, purchased approximately 180 producing wells with current net daily production of approximately 11,000 barrels of oil equivalent per day. The package includes interests in 31 offshore blocks covering approximately 100,000 net acres.

More than 90% of the proved reserve value and current production volumes from the properties come from six operated fields. Current proved reserves exceed 13.5 million barrels of oil equivalent and these volumes are more than 95% developed.

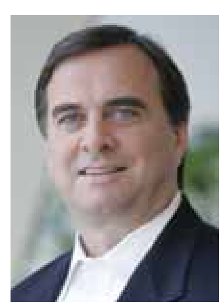
Dynamic Offshore Resources has also entered into a turnkey abandonment contract with Superior Energy Services whereby the latter will provide all well abandonment and platform decommissioning services at fixed prices once the SPN fields are depleted and ready for abandonment.

"Our purchase of the controlling interest in SPN Resources provides the platform to implement our strategy of investing heavily in the Gulf of Mexico shelf," says Matt McCarroll, chief executive and co-founder of Dynamic Offshore Resources. "We believe this is a very opportunistic time for a well-capitalized new company in the Gulf of Mexico."

While Gulf of Mexico assets are sometimes viewed by other producers as out-of-favor or neglected, he says the assets are viable and can generate plenty of growth opportunities.

"We just see an opportunity where public or large independent companies are exiting the shelf," he says. "There are more sellers than buyers. There are many opportunities to buy. Reserve calculations can be very subjective, but we think even at these high product prices, we can assemble a portfolio of properties with growth."

The company could also use some of its capital to fund the purchase of infrastructure such as laying pipelines and building platforms and refurbishing them, McCarroll adds.


Joseph Bryant, chief executive and founder, Cobalt International

Dynamic Offshore Resources was formed in January 2008 by McCarroll, Mike Moreno and Riverstone Holdings. McCarroll previously served as the president of Maritech Resources Inc., an exploitation and production company focused on the Gulf of Mexico, and a subsidiary of Tetra Technologies Inc.

DEEP WILDCATTING

Founded in late 2005, privately held Cobalt International is focused on oil and gas exploration in the deep-water provinces of the Gulf of Mexico and West Africa.

Last November, the company received a second round of private equity, $350 million from First Reserve Corp. This follows on the heels of prior commitments from a group including Goldman Sachs, Carlyle/Riverstone Holdings, Kern Partners and Cobalt management. This group at the company's founding committed some $600 million of private equity, which garnered a lot of industry attention at the time, as private equity wasn't known for investing in startups with that magnitude of capital, especially for companies focused on exploration offshore.

No producing-asset deals for this company. Instead, Cobalt has used its capital aggressively to build a base for future grassroots drilling by purchasing federal leases in the Gulf of Mexico. It was the high bidder for 53 blocks in October's Gulf of Mexico Sale 205, placing it third in the industry's largest offshore leasehold auction in 24 years.

Assuming all blocks are awarded, Cobalt will own a total of 107 blocks, 69 of which are Cobalt operated. This acreage inventory is sufficient to feed the company's exploration plan for the next five years, says chief executive and founder Joseph Bryant.

For 2008, Cobalt plans to spud two to three deepwater wells, says Bryant, but he would not disclose specific amounts to be spent. •

Regional credit no problem

Bullish energy lenders have increased their price decks. They are also buying discounted energy loans from money-center banks.

By Gary Clouser, Contributing Editor

Despite the credit morass that has hit the behemoth New York-based money-center banks the hardest, regional energy banks report having capital available to exploration and production companies as that sector continues to outperform the broader market.

In fact, many energy banks are seeing more business come down market to them, as bigger institutions adversely affected by subprime mortgage losses try to shed loans in an effort to improve liquidity.

Ironically, oil and gas, once perceived as a risky, even alternative investment by some, is now perceived as safe, as in the old saw “flight to quality.”

Thus far, the E&P bankers agree, the structure and terms of first lien or senior debt have been little changed by the credit crisis. The bankers note that senior debt is linked to proven oil and gas reserves, and with such a high demand for these assets, the risk of holding that collateral is minimal.

However, second liens, roughly analogous to a second mortgage, are getting tougher to obtain and more expensive, bankers say.

Kyle Hranicky, executive vice president and manager, Wells Fargo Energy Group

Terms vary greatly depending on the quality of the E&P management teams, their reputations, track record, and familiarity and comfort level the banks have concerning a company and its assets.

Kyle Hranicky, executive vice president and manager of the Wells Fargo Energy Group based in Houston, says the bank has purchased at a discount $50- to $75 million in E&P-related loans from institutions affected by the credit crisis.

Wells Fargo has about $10 billion in commitments to the oil and gas industry, of which 60%-70% is in the E&P sector. One of the nation’s largest banks, it enjoys a long-standing niche as a loan provider to the E&P sector. With it Triple AAA credit rating intact, Wells Fargo is seeking additional discounted loan purchases, taking advantage of its strong liquid positioning.

Steve Kennedy, senior vice president and manager of the energy group of Amegy Bank, based in Houston, also is bullish on energy, and has also bought some loans. “We are seeing more opportunities because some banks with large subprime exposure are not able to make new commitments, and they are shedding some of their existing loans at fairly sizable discounts.

“We bought some loans at 95 cents on the dollar earlier this year to increase our exposure in some existing E&P and midstream relationships.” Since then, some offers are even coming in for less, he notes.

“This is a year where relationship banking is making a comeback, as opposed to transactional banking, with the lowest-cost provider—regardless of whom that might be. Terms in the E&P market are somewhat better than the terms in the general commercial or corporate market because credit quality among E&P companies is excellent compared to other sectors,” Kennedy says.

NEW OPPORTUNITIES

Regional banks are happy to be stepping into the void while their larger city cousins deal with restructuring their portfolios, obtaining fresh capital and repricing risk on exotic financial instruments. Says Tulsa-based Mickey Coats, manager, Bank of Oklahoma Energy Group: “It appears that we are being asked to take larger hold levels due to syndication failures or reductions, and/or big banks may have liquidity problems and are taking less themselves.”

Texas Capital Bank is also seeing new deal flow as a result of the debt crisis. “We had a number of opportunities open for us in the past six months that didn’t previously exist due to the issues facing the larger financial institutions,” says Chris Cowan, Dallas executive vice president. “We see this as a bigger portion of our growth in 2008.”

Mark Thompson, Denver-based senior vice president and head of energy banking for U.S. Bank, says that the bank in the trailing six months through March had picked up about $40 million in discounted loan purchases. Most were priced at the low- to mid-90s on the dollar. However, lately the bank has tapered off on making such purchases.

“We have seen an increase in the number of loans for


Where Independents get their Start

sale and it appears that the discounts are getting steeper. We have become more selective in the secondary market recently because of rising loan demand and the need to maintain sufficient lending capacity to meet the credit needs of customers. However, we are still purchasing loans when there is a relationship reason to do so," Thompson says.

He compared U.S. Bank to Wells Fargo in that both are national banks that have avoided the liquidity problems brought about by the subprime crisis. As a result they have sufficient liquidity to purchase discounted loans from institutions seeking more liquidity. Also, like Wells Fargo, U.S. Bank has a reputation and history of being an energy banker, says Thompson.

The fourth-quarter 2007 discounted loan purchases helped propel U.S. Bank's petroleum lending to its best year ever, growth of 37% over 2006. For 2007, the bank's petroleum-oriented loans—about 70% of which were for E&P loans—totaled $2.8 billion. That year featured E&P-oriented loans to 28 new clients, a 25% increase over 2006.

Thompson says the bank "expects 2008 to be a very strong year." Much of its new business through the first quarter came from existing E&P clients wanting to increase their senior credit facilities and borrowing bases, he says.

Borrowers changing major loan terms, such as amounts and maturity dates, however, are beginning to see pressure from their banks to increase loan pricing in response to the generally rising cost of long-term debt capital.

David Reid, head of the Houston-based energy lending group for Capital One Southcoast Inc., says that bank plans to purchase discounted loans as well, some for as little as 88 cents on the dollar. Such purchases will help fuel the bank's growth of total commitments to E&Ps.

Capital One experienced about 60% growth in loan commitments to the oil and gas industry during 2007, to just under $1 billion. About 70% was for the E&P sector. Reid says at the beginning of 2008, he had budgeted for growth of about 20%, which he now expects to "handily exceed." Capital One also has increased the maximum size of loans provided to individual companies to $50 million from $30 million.

Emerging themes from regional E&P Bankers

- Banks are very bullish on E&P loans, as they are viewed as relatively safe, and even a "flight to quality."
- Regional banks that were not stung by the subprime morass are being offered E&P loans at a discount, from money-center banks that are shedding those loans to gain more liquidity.
- Regional banks are increasing their total commitments to E&P loans.
- Transaction structure for first-lien, or senior debt, does not seem to have changed much. But terms for second-lien debt have changed dramatically, essentially doubling the interest rate in a year's time.

LOWER RISK

The E&P sector has become one of the lowest-risks businesses for banks, Reid says. For the past decade the loss to the banking industry on proven reserve-based loans has been virtually zero.

Reid, who has been involved in oil and gas finance since 1976, still has vivid memories of the downturn in the 1980s. He notes the irony that the oil and gas industry, which has historically been perceived as being high risk, is now viewed by most bankers as safe. "Now, the flight to quality is to the oil patch," Reid says.

Bank of Oklahoma's Coats adds, "Historical loan losses for E&P lending are and have been minimal, and E&P has been proven to be a safe sector to place capital."

Amegy's Kennedy agrees, saying, "Energy lending is one of the few bright areas for banks in this current market. Banks are allocating a healthy share of capital to the energy sector. Energy companies should have adequate funds available for senior debt in 2008."

Amegy's energy group grew loan commitments 30% to a total $2.3 billion during 2007. Its outstanding loans grew 61% to $1.2 billion during that same time.

"About half of that growth was on the E&P side, with 33% being in oilfield service lending and the remaining 17% in midstream," Kennedy says. "We expect this year's growth in loans and commitments to be in the 25% to 30% range."

Cowan says Texas Capital Bank's energy business grew by more than 50% in 2007. It is focused on loans of $40 million or less, and at least 90% of its portfolio is concentrated in loans where it is the only, or primary lender.

"Our growth in 2008 will be dictated by the opportunities we see in the market. Most of that growth has historically come from finding E&P companies that have current borrowing needs below $10 million and significant capital needs to drill up existing fields," he says.

"Because we're a relationship-focused and entrepreneurial bank, we look at ways to help our clients grow their businesses. In fact, we've helped many of these clients turn five- or six-well fields into very strong E&P companies. We're a Texas-based bank that primarily focuses on owner-managed, middle-


Fig. 6
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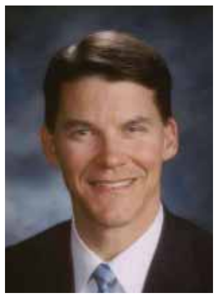
market companies, primarily in the upstream sector."

Cowan says while the bank does have a number of midstream clients whose assets allow it to evaluate the reserves and throughput on those systems, "we made the decision not to pursue opportunities in the service sector and stay focused on upstream. Our expertise in financing companies that utilize the drill bit has served us well, particularly given the current price environment and acquisition market."



Stephen Kennedy, senior vice president and manager of the energy group, Amegy Bank

SECOND–LIEN BLUES

While the senior debt market appears to be little changed by the credit crisis and heightened concerns about retaining liquidity, this is not true of second liens. LIBOR, (the London Interbank Offering Rate) is a crucial indicator of the severity of the credit squeeze because it is the rate at which banks lend to one another, and it reflects increasing liquidity pressures in funding markets. LIBOR had risen to 6% at the end of March, the highest level since late December 2007.

To the chagrin of E&P companies, LIBOR is rising, even as the U.S. prime rate is declining, and that affects second-lien deals.

"I hear that loan terms are getting tighter, but I haven't seen it yet. The big banks and syndicators must do it first. We are seeing less of second-lien debt, as hedge funds and others are backing off," Coats says.

The second-lien market is less active because many of the investors that were buying that paper have experienced losses in other parts of their portfolio "that have created some capital and liquidity challenges," Amegy's Kennedy says.

Wells Fargo's Hranicky says that senior debt is priced at LIBOR plus 100 to 125 basis points on the low end, to 200 to 250 basis points on the high end—about what it was before the credit crunch.

But, since June 2007, second liens have gone from LIBOR plus 400-500 basis points to 600-700 basis, or higher. Second liens are harder to place and will take higher pricing to get done, he says, noting that Wells Fargo is an active participant in arranging second-lien loans.

Reid says the second-lien range continues to expand and rates have gone from 3%-4% a year ago to 6%-8% now.

Tranche B loans are priced roughly in-between senior debt or first-lien loans and second-lien loans. Senior debt is sometimes referred to as Tranche A. When a borrower seeks to add to the dollar amount of the first loan, usually for a short time and scheduled around a one-time event such as an acquisition, the borrower may seek a Tranche B, or Term B loan. Such a loan usually has a maturity of one year and is linked to the timing of a specific goal. A second-lien is essentially starting all over again, with a longer time period, much as a second mortgage.

The lowest-priced loans are the first-liens, with Tranche B slightly higher, and second-lien loans, considerably higher still, Reid says.

An example from Amegy illustrates the differences in terms of pricing. It recently completed a deal with a $54-million borrowing base, of which $44 million was designated "conforming," or Tranche A, and $10 million was "non-comforming," or Tranche B. Tranche A was priced at LIBOR plus 2.25%-2.75%, whereas the Tranche B was priced at LIBOR plus 3.5%. Tranche B was supported by a strong initial equity/liquidity position, a strong equity sponsor and an active low-risk development drilling program.

NEW PRICE DECKS

Some banks use price decks tied to the New York Mercantile Exchange strip, or tied to hedges of clients, whereas others have more absolute targets. "We (Bank of Oklahoma) have consistently used a price deck based on Nymex futures prices. That has not changed. Whether prices go up or down, we are consistent in our deck. I can't say that about all energy banks," says Coats.

"We do not ordinarily require hedging unless a deal is at the high end of leverage. If the advance rates are high, then we look to require amortization and some amount of hedging to protect our downside risk."

"We do not ordinarily require hedging unless a deal is at the high end of leverage. If the advance rates are high, then we look to require amortization and some amount of hedging to protect our downside risk."

Mickey Coats, Bank of Oklahoma

Amegy has used for the past year, and continues to use, a price deck for oil and gas that is equal to 75% of the futures' strip for the next five years, held flat thereafter. "We have seen a number of banks putting a cushion between futures prices and their price deck as prices increase," says Kennedy.

"We have chosen not to do that, but to instead encourage any customer that intends to use a high degree of leverage to lock-in their oil

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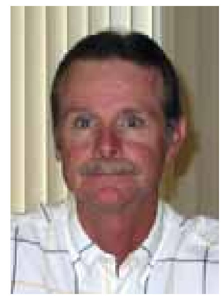
and gas prices via our derivative capabilities. Generally, if hedging is required, something in the 70% to 80% range is required, with 85% to 90% generally being the maximum amount of hedging allowed."

Wells Fargo's Hranicky notes that most of his clients hedge, particularly if a private equity firm is involved, so the bank uses whatever hedge the client has, making the bank's price deck less significant. Wells Fargo's price deck for oil is currently $65 per barrel, slipping to $55 over the next five years; and for natural gas, $6.75 per thousand cubic feet dropping to $6 over the same time period.

The price deck for Capital One is $60 falling to $55 over five years, and $6.50 dropping to $6. With current prices far exceeding those price decks, Capital One clients have built their coffers, and further strengthened their credit-worthiness, Reid says.

U.S. Bank's Thompson notes that just three years ago, most banks had a long-term oil price deck of about $30 per barrel, but the average now is about twice that at $55 to $60. U.S. Bank's near-term price deck for oil is $65, and $55 long term.



Mickey Coats, manager, Bank of Oklahoma Energy Group

Banks had been cautious about raising their price decks in response to rising oil prices during the past several years, which created room for other debt providers like Term B and second-lien lenders to meet the growing debt capital needs of E&P companies. Now that banks have nearly doubled their price decks and have become aggressive in structuring their senior debt, the B and second-lien debt providers may be starting to get "squeezed out" of the market, Thompson says.

Amegy has also found another E&P-related profit center, Kennedy says. It is now an active investor in about 14 private-equity funds, with just under $50 million invested.

"This has proven to be a very good place to become involved early on with new, developing companies. And, because of our familiarity with these private-equity groups, we have been in a position to help several companies find a good equity sponsor. We have made excellent rates of return in these energy private-equity funds to date, so we anticipate continuing this activity for the foreseeable future." •

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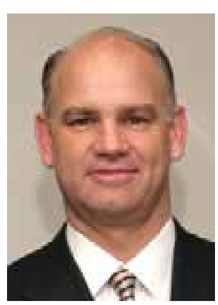
Tracinda takes stake in Delta Petroleum

Famed investor Kirk Kerkorian has closed on his first direct oil and gas investment, enabling Delta Petroleum to jumpstart its Paradox Basin promise.

By Ellen Chang, Contributing Editor

Funding for exploration and development companies usually comes from traditional means such as industry partners, commercial bank loans, public or private equity. And then, there are the high-net-worth individuals.

Delta Petroleum Corp., however, has joined with a unique source—at least, unique for the upstream industry. In December 2007, it agreed to a financing deal with Tracinda Corp., the privately held Nevada company owned by renowned billionaire investor Kirk Kerkorian, who has owned a wide range of companies, including airlines and casinos.



Roger Parker, chairman and chief executive, Delta Petroleum Corp.

Delta, a Denver-based E&P company, whose core areas of operation are the Gulf Coast and Rocky Mountain regions, received $684 million by selling 36 million shares of Delta's common stock at $19 per share.

The deal closed February 19, 2008, after shareholders approved the transaction, which in effect sold Tracinda a 35% stake in the company.

The size of Delta's board also increased from 10 to 12 members, by adding two Tracinda representatives: James Murren, president and chief operating officer of the MGM Mirage, and Daniel Taylor, an executive with Tracinda. Tracinda will have the ability to nominate an additional three members to the board in the future.

At the time, Roger Parker, Delta's chairman and chief executive, said, "With the closing and funding of the transaction, Delta is positioned to deliver substantial reserve, production and cashflow growth. We look forward to having Mr. Kerkorian and his leadership team at Tracinda as a significant shareholder and supporter of Delta. We believe the acceleration of our drilling inventory will provide for many years of shareholder value creation."

While Kerkorian has invested in dozens of companies over the years, the well-known investor was a newcomer to the energy business. He had never acquired a stake in a publicly traded oil company, much less a company that is small compared to some of his other holdings.

MEETING IN LAS VEGAS

The deal evolved quickly last December and negotiations proceeded rapidly during a three-week period, Parker says. His first discussion with Kerkorian began on December 2 and within 24 hours Parker met with the investor in Las Vegas.

Kerkorian had decided about a year ago that he was interested in the energy sector.

Edward "Tiger" Mike Davis, who has been friends with Kerkorian for the past 60 years, introduced the two businessmen and suggested that Tracinda take a look at the energy company. Davis was familiar with Delta's assets and strategy because about five years ago, Delta acquired some property from Davis.

Parker was intrigued with Tracinda's interest because his company's stock was undervalued and trading sideways at $15 per share. "The company had a $1–billion market cap and we felt it was worth more than that," he says.

The company has an attractive property mix that includes substantial low- to medium-risk natural gas activity and significant growth in its Piceance Basin acreage, which is fairly predictable and repeatable.

But the sizzle is a "meaningful" discovery in the Paradox Basin in Utah, where Delta has 80,000 acres and five gas prospects. One of its Utah wells encountered 906 feet of net pay. (See "Prospering in the Paradox," *Oil and Gas Investor*, August 2007.)

Delta also has two large wildcat areas with tremendous reserve potential in the Utah Overthrust and the Columbia River Basin in Washington, where the company has 110,000 and 450,000 acres, respectively.

"Although it is certainly high risk, we see a lot of reserve potential and each of the two areas possess company-changing opportunities," Parker says.

Tracinda first offered Delta $17 per share for 36 million shares, which the company rejected, but discussions continued. Although Delta had initially sought a deal that was less dilutive, Kerkorian would not budge from his desire of acquiring 36 million shares, Parker says. Kerkorian's response was that his company only went after meaningful positions.

"It was also their feeling that we, Delta, needed that much money to accomplish our goals, which included significant proven-reserves-per-share growth through an increased drilling effort," he says. "We realized that even with the significant dilution, we would experience much greater per–share reserve growth."

Parker and the Delta board had a few days to mull over Tracinda's offer. About six days after the initial proposal, both groups agreed to the final amount of $19 per share—a 26% premium over the stock's trading price in December 2007.

Delta would have used its existing cash flow, along with its credit facility, to continue its drilling activity if the investment from Tracinda had not emerged, Parker says. But Tracinda's investment will allow Delta to accelerate its drilling in its core areas, especially in the Piceance and Paradox basins. The funding has also given the company the financial flexibility for increased acquisitions.

THE ENCANA DEAL

Indeed, that is exactly what has occurred. Subsequent to the Tracinda deal closure, Delta entered into a transaction with EnCana Oil & Gas (USA) Inc. to jointly develop a portion of EnCana's leasehold in the Vega area of the Piceance Basin. As part of this agreement, Delta has acquired more than 1,700 drilling locations on approximately 18,250 gross acres with a 95% working interest. Delta also increased its interests in currently producing wells and realized an increase in production of 6 million cubic feet of gas net per day.

The deal increases Delta's working interest in the North Vega project leasehold to 95%, with additional acquired acreage that includes the 4, 300-acre Buzzard Creek federal unit and approximately 6,000 acres immediately adjacent to the Buzzard Creek Unit. Delta's acreage position in the Vega area totals over 20,250 net acres.

Delta estimates that the transaction's total resource potential is in excess of 1.4 trillion cubic feet equivalent, giving it in excess of 2.0 Tcfe in the Piceance Basin.

This also brings the company's estimated total proved reserves to approximately 530 billion cubic feet equivalent. Delta has committed to fund $410.5 million, with $110.5 million already paid and three $100-million installments over the next four years that have been guaranteed with a letter of credit.

"This transaction more than doubles our position and drilling inventory in the southern Piceance Basin into one large contiguous acreage block," Parker says.

The company has also announced an increase in its 2008 drilling budget to a range of $350- to $370 million. The increase allows for acceleration of the Vega area drilling program, which should realize significant reserve growth and increased value of its Piceance Basin assets.

Delta is now running four rigs full-time and expects to double that number during the next 12 months in the Piceance Basin, Parker says.

> "The key to the deal is that Kerkorian recognized that by removing the issue of funding, Delta's management would be able to spend its time fully on executing its game plan."
>
> Tom Petrie, Merrill Lynch

"Tracinda's stated intention was to be supportive and they have been," Parker says. "We believe that they will continue to be supportive as we go forward. They like our current business plan and the direction of the company. We think they're a great partner."

Delta was advised on the Tracinda deal by Morgan Stanley and Merrill Lynch & Co. The deal demonstrates the work and reputation of Parker, says Tom Petrie, a vice chairman of Merrill Lynch.

"It does reflect a nice validation of what Roger has been building," Petrie says. "He's built a company with an interesting position that predominately has reserves in the Rockies and Gulf Coast. I think this deal represents the validation of building up a company through grass-roots drilling, acquiring and exploitation. They also have some organic growth with some of the plays they have pursued. They have had encouraging results in Utah in the Paradox Basin."

The key to the deal is that Kerkorian recognized that by removing the issue of funding, management would be able to spend its time fully on executing its game plan, Petrie says.

"This deal really puts them in position to do that. I think there was a real benefit that will show up in the next several years and Delta can focus on the operating side of its business."

The transaction was a "good-sized deal" that gave Delta a "reasonable" premium, Petrie says.

"If Delta didn't do this deal, or if they pursued their other plays, they would have been diluting their capital. It's a Midas proposition. It's a question of timing and development. By virtue of this Tracinda deal, they can accelerate their drilling in a more timely way.

"I would argue it's a very good deal and it's pretty effective." •

Record capital available raises the bar

Three private-equity providers share their views on the opportunities ahead.

By Gary Clouser, Contributing Editor

The pile of private-equity dollars available for financing exploration and production, midstream and service companies has never been larger.

In the 2007-2008 cycle alone, private-equity funds specializing in energy, with a lion's share going to E&Ps, are estimated to have more than $35 billion at their disposal—and that's just in the checkbooks of the seven largest funds in the sector, says S. Wil VanLoh, the president and chief executive officer of Quantum Energy Partners in Houston.

This compares to the 2005-2006 period in which about $20 billion was available. The growth in private equity has been dramatic. At yearend 2005, private-equity sources reported having $10 billion to invest, according to the COSCO Private Capital Energy Index.

In recent months, two of the three largest private-equity firms in the E&P sector—Natural Gas Partners, and EnCap Investments, L.P.— have announced the closing of new funds with a combined $6.5 billion in capital.

In December 2007, EnCap closed its Fund VII with total capital commitments of $2.5 billion, many from repeat investors. At the time of its announcement, EnCap's fund was the largest ever raised strictly for private equity in oil and gas.

S. Wil VanLoh, president and chief executive officer, Quantum Energy Partners

No time was wasted in deploying those dollars. Through March 2008, EnCap already had 15 deal agreements totaling about $900 million, including investments with seven management teams with whom it had previously invested.

One of the more recent deals? Former senior managers of KCS Energy Corp. and Charlie Prioleau formed Houston-based Force 5 Energy LLC with a $100-million equity commitment from EnCap and other minority investors. Force 5 will focus onshore South and East Texas and northern Louisiana.

Just a few months later, in March 2008, Natural Gas Partners, a unit of NGP Capital Management, raised an even larger total with the closing of its ninth fund, a $4-billion raise that will invest largely in E&P and service companies.

A majority of the private-equity investments from these types of funds are going to start-up E&Ps, which are often led by management teams with whom the fund has invested previously. Private-equity firms usually plan for a three-to-five year investment cycle, with the goal of providing growth capital so that their portfolio companies become attractive acquisition candidates for large company buyers at the end of the cycle.

Happily, increasingly diverse sources of private equity provide plenty of opportunities for an E&P company to find a capital partner with similar strategy and risk profile. Private-equity providers say there is flexibility in structuring an equity-funded deal, compared to the inflexibility and fickleness of public equity and debt markets.

Despite growing credit concerns that are affecting the overall economy, private energy companies should continue to have access to debt funding because energy fundamentals remain strong. But this debt financing is based on reserve-based lending, an important distinction from other industries that are based on cash-flow lending, VanLoh says.

The returns energy-focused private-equity firms have achieved, against a backdrop of fairly low risk, have attracted increasing interest from the institutional community, leading to more private-equity firms, larger funds and an expanded pool of capital for early-stage E&P companies. More private-equity raises are known to be in the works that may be announced later this year.

Even though the pool of private equity has almost doubled since 2005, the $35 billion or more of anticipated capital now available should be able to find a good home for those disciplined funds that remain committed to their investment strategies.

"There is a growing realization that the energy industry—in all sectors—was underinvested for 15 to 20 years, and it is now having to play catch-up in order to meet the burgeoning demand growth in an under-supplied world," VanLoh says.

CHANGING TIMES

Start-up private equity assists early-stage companies seeking growth capital, strategic advice and broader

industry contacts. There is a trend toward larger up-front commitments from private equity firms than in the past, particularly with "recycles" or management teams these firms have backed successfully in prior funds.

Historically, the majority of private-equity deals have been investments in E&P companies with acquire-and- exploit strategies for reserve growth and value creation. But more recently, there has been a shift to drilling-oriented investments, due to the overheated M&A market and ferocious competition from public E&P buyers and master limited partnerships (MLPs).

The days of mere asset gathering are over, says Kenneth Hersh, chief executive officer of Natural Gas Partners. "It is now imperative that the operators have a thorough understanding of an asset base and have a unique plan to add value. However, that value-adding strategy can come from traditional and non-traditional places. NGP has built its investment platform with that in mind."

"The industry has always been capital intensive, and has gotten even more so in recent years," Quantum's VanLoh says.

"Not only has the 300%-plus increase in commodity prices since 2000 more than tripled the price of a given acquisition, but service industry costs have escalated commensurately. At the same time, resource plays, which are significantly more capital-intensive due to their increased drilling density and expensive completion procedures, have become the industry's primary growth driver."

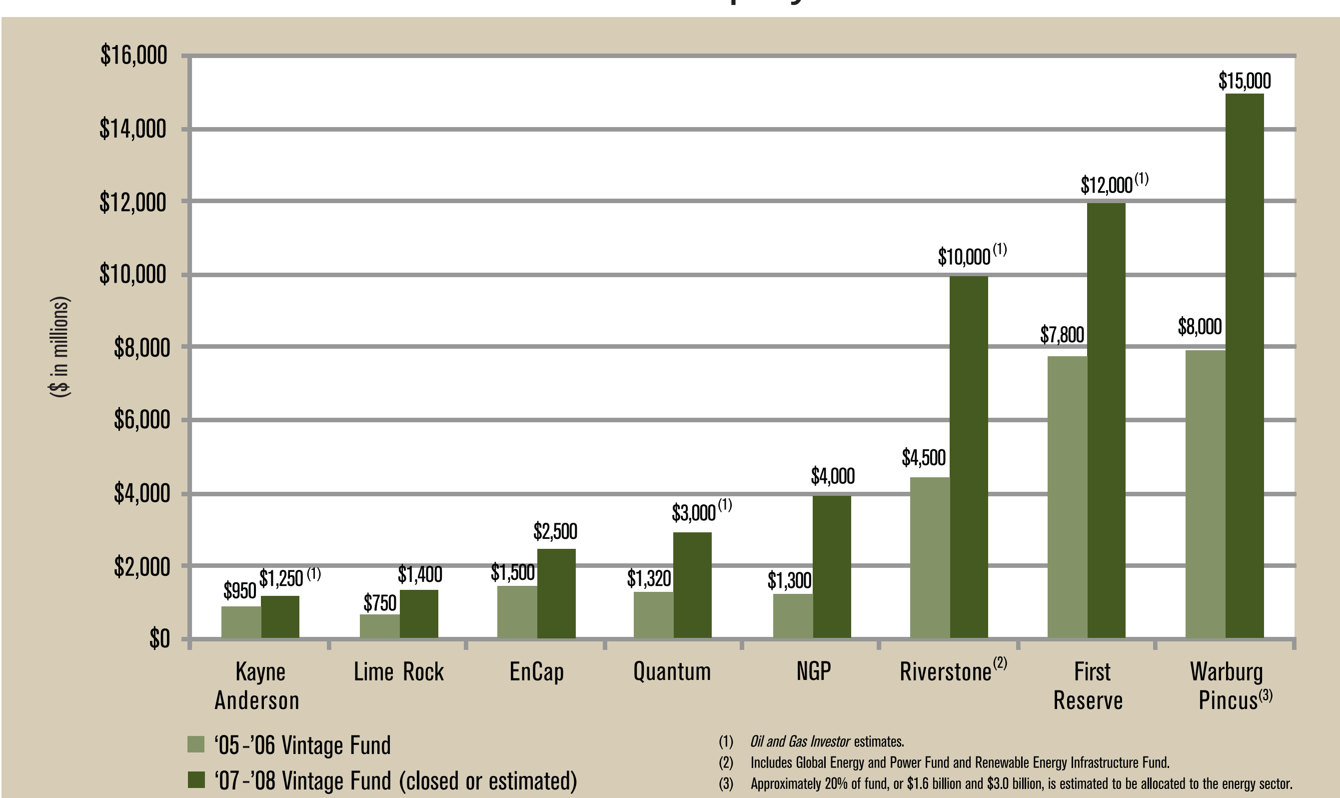
The abundance of capital, combined with E&P companies enjoying record cash flows, has changed the markets for financing E&P and A&D deals, VanLoh says. He notes that in the 1990s, E&P firms were generally paid only for proved developed reserves. Today, buyers pay meaningful value for proved undeveloped (PUD) and probable reserves, and in some instances even some value for possible reserves.

"Management teams who haven't adapted to this new environment won't be the successful acquirer on many deals."

EnCap co-founder and principal David Miller says the M&A market is being driven largely today by the bigger public E&P companies "as they strive to satisfy their voracious appetites for reserve and production growth." He calls the market overheated, which can be a two-edged sword for private equity-backed companies.

"While it is more difficult for our portfolio companies to compete for acquisitions, we're beneficiaries of the larger companies' aggressiveness when we exit a deal, because that's who we sell to the vast majority of the time."

Growth in Private Equity Fund Sizes



Energy industry fundamentals have sparked dramatic growth in the amount of private equity available. Sources: Oil and Gas Investor, Oil and Gas Investor This Week *and company reports.*

Recent Large Private Equity Commitments

Company	CEO	Amount Invested	Private Equity Provider	Main area(s) of activity
Spearpoint Energy Corp.	Brian Schmidt	$250 million	Quantum Energy Partners	Canada
Cordillera Energy Partners III	George Solich	$225 million	EnCap Investments	Texas Panhandle, East Texas, and Mid-Continent
Common Resources	Roger Jarvis	$210 million	EnCap Investments	Domestic, multi-basin strategy
Vantage Energy LLC	Roger Biemans	$210 million	Quantum Energy Partners	Unconventional gas plays
Legado Resources	Mike Bridges	$155 million	EnCap Investments	Secondary and tertiary recovery projects
Oasis Petroleum	Tommy Nusz	$150 million	EnCap Investments	Williston Basin
Rimrock Energy	Terry Dobkins	$125 million	Natural Gas Partners	Unconventional gas plays
Laramie Energy II	Bob Boswell	$122 million	EnCap Investments	Rocky Mountains (primarily Piceance Basin)
Quatro Resources Inc.	Bill Pollock	$100 million	Natural Gas Partners	Canada
Chrysaor Holdings Ltd.	Phil Kirk	$100 million	Natural Gas Partners	North Sea
Quantum NGS Holdings LLC	Dr. Larry Bickle	$100 million	Quantum Energy Partners	Gas storage
Ceritas Energy II LLC	Don Sinclair	$95 million	Quantum Energy Partners	gathering and processing
Aspect Energy LLC	Alex Cranberg	$88 million	Quantum Energy Partners	Barnett Shale and Eastern Europe (Hungary)
Campanero Energy	David Kimes	$50 million	Natural Gas Partners	Midcontinent
Tanos Exploration	Mark Brandon	$40 million	Natural Gas Partners	East Texas

Top 5 deals from EnCap Investments, NGP, and Quantum Energy Partners

Those exits have been highly successful lately for all private-equity players, with some returns reportedly well in excess of 30%. "Private equity firms typically seek an internal rate of return of 25% or greater, but the target is a function of the relative risk profile of a portfolio company's strategy," Miller says.

Kenneth Hersh, chief executive officer, Natural Gas Pertners

NATURAL GAS PARTNERS

The Irving, Texas, company has been investing for 20 years in the industry and receiving a 33% compounded internal rate of return despite the ups and downs of commodity prices, Hersh says.

NGP's Fund IX that closed in March already has made 11 investments totaling $700 million. Several of the portfolio companies are headed by management teams from prior NGP portfolio companies that had exited when the time was right.

Skyrocketing oil and gas prices have spurred a lot of investor interest and E&P company activity, but Hersh stresses that NGP's investments are not based on commodity price cycles. It has made money through all the cycles and every year, invests and "harvests" or divests as conditions warrant. For example, in 2006, it invested in 11 energy companies and exited nine.

The new fund, Natural Gas Partners IX LP, is one of four fund families the company operates, bringing total assets under management to $9.2 billion. "Our investment platform is the most complete in the industry. We have an understanding of the E&P, service, energy technology, power, infrastructure dynamics, and minerals businesses right here in our extended NGP family," Hersh says.

QUANTUM ENERGY

Quantum's Fund IV, which raised $1.32 billion and began investing in October 2006, has committed more than $1.1 billion to 14 companies. Houston-based Quantum specializes in the energy industry with more than $3.2 billion in capital under management. Principals include Jim Baird, John Campbell, A.V. Jones Jr., Toby Neugebauer, Alan Smith, Scott Soler and VanLoh.

A year ago, VanLoh was bullish on the prospects of significantly more E&P-oriented master limited partnerships coming to market. But, for a variety of reasons, most notably the underperformance on acquisition projections by many of the MLPs, and the significant concentration and liquidity issues faced by many of the hedge funds purchasing the MLPs' equity PIPE (private investment in public equity) issues, the "bloom has come off the rose," he says.

The market is in a wait-and-see mode as it evaluates the business climate and performance of pioneering E&P MLPs, although VanLoh still believes that there are a lot of oil and gas assets that ultimately belong in MLP hands.

Like most private-equity firms, Quantum can point to some starts-ups it funded that went on to bigger and better things, through going public or selling to a strong buyer. For example, in 2003 it funded Linn Energy LLC with just $15 million. Linn grew substantially after that through acquisitions, went public in 2006 and today has a market cap of about $2.6 billion.

ENCAP INVESTMENTS

Established in 1988 with offices in Dallas and Houston, EnCap is marking its 20th anniversary. Since inception, it has managed more than $6.5 billion of institutional capital, in turn providing equity to 160 companies, more than 90% of which have been upstream-oriented. It is headed by four principals and co-founders, David Miller, based in Dallas, and Gary Petersen, D. Martin (Marty) Phillips and Robert Zorich in Houston.

In conjunction with the December closing of Fund VII, Petersen said, "We believe that the high level of investor interest is largely due to our track record, in addition to the fact that we continue to see compelling investment opportunities in our space."

According to Miller, the biggest shift in EnCap's strategy is that "a decade ago, about 80% of our funds went to back companies with an acquire- and- exploit growth strategy, in contrast with today, where a similar percentage is going to companies with lower-risk, drilling-oriented strategies in the various resource plays."

EnCap Investments LP is marking its 20th anniversary this year. Founding partners are, from left, Bob Zorich, Marty Phillips, Gary Petersen and David Miller. (PHOTO COURTESY ENCAP INVESTMENTS LP)

Deals have shifted more to common rather than preferred structures, and the promote (incentive arrangement), has become somewhat more favorable for management, but Phillips stresses, "We're still very focused on alignment of interest with our portfolio companies. Management has to have 'skin in the game' alongside us, and the structure continues to be such that they don't make money until we do."

The trend toward more of EnCap's funds going to repeat management teams has accelerated, Phillips notes.

"About 25% of our 1997- vintage fund was committed to groups we had previously invested with, growing to about 40% in Fund VI, and our expectation is that about half of our current fund will fall into that category." For example, EnCap funds have provided equity five times to the management team that now heads Laredo Energy, a private E&P in Houston that focuses on South Texas drilling.

Still, EnCap does not want to give the false impression that only repeat management teams need apply.

Says Petersen: "While roughly 50% of Fund VII will probably go to managers we have made money with in earlier ventures, we are actively seeking opportunities with new teams that have solid industry experience, attractive value creation strategies, and a reasonable understanding of risk management.

"In fact, we have entered into 17 relationships during the past year with management teams new to EnCap."

The success over the past 15-20 years of the larger, established energy private-equity firms has indeed altered the way institutional investors view the relative risks and rewards of the oil and gas industry. Thirty years ago, most institutions thought only of high-risk, wildcat drilling and gyrating hydrocarbon prices when contemplating oil and gas investments.

Today, Zorich says, "Our investment philosophy attaches equal emphasis to capital preservation and value creation, and we can demonstrate clearly that we have been able to consistently deliver attractive equity returns across multiple cycles in the business." •

COSCO Capital Management LLC

Corporate Summary:

COSCO Capital Management LLC over the past sixteen years has become a leading advisor to professional investors in the energy sector and the foremost agent for private placements for small and mid-cap private and public energy companies in the US and Canada. Through its affiliate, Private Energy Securities, Inc. (member NASD, SIPC), COSCO has arranged private placements of over $1 billion since 2000, alone, primarily comprised of private equity and mezzanine debt and placed with energy focused closed-end funds. Over the past year, moreover, through a new affiliate, Strategic Energy Research and Capital, LLC (in association with FCG Advisors, LLC (member NASD, SIPC), COSCO has begun placing equities in public energy companies, as well, focusing on energy experienced hedge and mutual funds (see below for COSCO's most recently completed engagements).

As testimony to its unique position among financial intermediaries, since its inception in January 1992, COSCO has also assisted numerous professional energy investors, themselves, particularly in the East, to develop new investment strategies and purchase or sell approximately $500MM of portfolio companies or assets.

COSCO is far more than a financial advisor and placement agent, however. Because its personnel almost all came first from the oil and gas industry, before establishing careers in proprietary investing and finance, they understand intimately, are accepted in, and can bridge both worlds. As a consequence of this pedigree and having now advised over 150 industry clients and seen, literally, thousands of business plans and proposals, COSCO often can understand even better than managements, themselves, what constitutes their particular strengths and competitive advantages. COSCO

COSCO managing directors Lane W. McKay, left, William E. Weidner, middle, and Cameron O. Smith, right

typically provides major assistance in refining its clients' investment strategies and improving their presentations. It can also help effect mergers, acquisitions, or sales, and it has arranged several secondary placements for individual investors, as well as entire portfolios for funds, themselves.

Reflecting its confidence in its ability to select and nurture outstanding investments, COSCO now has over thirty current and realized portfolio investments and as a matter of principle invests in every private equity mandate it sponsors. Furthermore, COSCO personnel often continue post closing as advisors or directors to assist portfolio companies to execute their investment strategies and manage growth, thus helping to ensure the success of its investments.

$450+ Million in Energy Mandates Since January, 2006, Alone.

January 2008 LAKE RONEL ENERGY PARTNERS, LLC **$40,500,000** **Common Equity** For Exploration and Development	December 2007 ACTION ENERGY INC. (Calgary AB) **C$17,500,000** **Common Stock** Strategic Energy Research & Capital LLC	July 2007 Red Arrow (Houston TX) **$85,600,000** **Line of Equity** EnCap Investments L.P. and COSCO Investments LP	July 2007 AUSAM ENERGY CORPORATION (Houston TX) **$25,000,000** **Units of Debentures and Warrants** The Huff Energy Fund, L.P.	June 2007 KGL INVESTMENT CO. (Kuwait City, Kuwait) **$30,000,000** **Units of Convertible Notes and Warrants** Circle Oil Plc
May 2007 An Affiliate of JONES (Lafayette LA) **$100,000,000** **Senior Secured Notes** Guggenheim	December 2006 An Affiliate of Sanchez Oil & Gas Corporation (Houston TX) **$50,000,000** **Secured Notes** TCW	June 2006 ORBIT ENERGY, INC. (Lafayette LA) **$25,000,000** **Common Equity** Undisclosed	April 2006 Undisclosed E&P Company (Calgary AB) **C$26,375,068** **Line of Equity** Jog Capital Inc, BlackRock, Inc., et al	February 2006 ACTION ENERGY INC. (Calgary AB) **C$35,278,873** **Common Shares** Quantum Energy Partners, et al

COSCO Personnel:

Most of COSCO's personnel first enjoyed careers within the energy business before joining COSCO. Prior to founding COSCO in 1992, Cameron Smith, COSCO's Senior Managing Director, for over 15 years worked in the industry as a geologist and then ran various E&P companies in the U.S. and Canada. For the next four years as COSCO, Mr. Smith worked with Odyssey Partners LP, expanding his experience as an operator through the disciplines of proprietary investing. Bill Weidner, another Managing Director, also worked as a geologist for four years, then for a commercial bank for a year, finally as a proprietary investor with RIMCO, a mezzanine lender, for eight years, before joining COSCO. Lane McKay, COSCO's third managing director and CEO of COSCO Canada, worked in risk management for eight years, presiding over 30+ M&A transactions in a three-year period, on his way to building, taking public, and selling what is now the third largest property and casualty brokerage company in Canada.

In addition to its own members, COSCO has built a strong network of Colleagues, who are under contract to assist it to source and investigate new investment opportunities. COSCO's current Colleagues are based in New York, Connecticut, and New Jersey; Houston, Dallas, Oklahoma City, Tulsa, Denver, and Calgary; and, then, London, Sydney, and Caracas.

COSCO Services:

Capital Formation. COSCO's strength is in discerning energy companies and managements worthy of equity financing and projects suitable for mezzanine debt. This reflects the technical and industry training of its personnel. The COSCO Value Appreciation Process™ begins with a frank assessment of a client's management and the company's competitive position and value in the marketplace. If a financing is required, appears feasible, and COSCO, itself wants to invest, it then assists clients to prepare necessary descriptive documents and marketing materials, arrange meetings with likely financing candidates, negotiate agreements, and close on terms fair to all stakeholders.

From left to right: COSCO's Scott Kessey, Lane McKay, Bill Weidner, Cameron Smith, and SERC's Mark Kellstrom.

Advisory. COSCO provides financial, investment/divestiture, and general business advice to both industry and investors, alike. For investors, services include consultation on investment strategies and execution, specific due diligence, and peer comparison. For private and public energy companies, COSCO provides sound business and financial advice designed to focus managements on their own competitive advantages, business opportunities, and financing potential. COSCO's advisory role often extends well into the execution stage, post financing.

Mergers & Acquisitions / Divestitures, Secondary Placements. Because its personnel and Colleagues are located in almost all of the principal energy centers around the world, COSCO is well positioned to match industry clients with acquisition, divestiture, or merger candidates. Also, because COSCO has close working relationships with a vast majority of the professional energy investors in the U.S. and Canada, it is particularly adept in arranging secondary placements of public and private energy securities, as well as entire energy portfolios.

Principal Investing. COSCO currently participates in up to a ten percent "add-on" to each private placement equity financing it leads. It now has an active portfolio of twenty such investments, having to date monetized eleven, on which its aggregate realized return is greater than 7:1, with better than a 70% IRR (if only the past were a guaranty of future returns!).

Education. From the outset, COSCO has worked diligently to assist the energy industry to understand Private Capital and its crucial role in accelerating value creation for worthy entrepreneurs. In 1997, it founded the COSCO Private Capital for Energy Forum™, which over the past decade it hosted seventeen times in New York, Calgary, and Houston. In December 2007, however, COSCO agreed to sell the Houston-based COSCO Forum to *Oil and Gas Investor*. In early 2005, COSCO began publishing the *COSCO Private Capital Energy Index Report*™, which twice each year tracks the investing activities of the COSCO Private Energy Index™, a representative cross-section of the Private Capital community focused on Energy. This will now become COSCO's principal vehicle for communication about Private Capital.

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Finding Capital: A Directory

Although not exhaustive, the firms noted here are among known providers and/or arrangers of capital to the upstream and midstream energy industry. They include commercial banks, investment banks, capital intermediaries and advisors, and private-capital sources. Firms are listed once although they provide multiple types of capital. The codes that follow describe services each firm provides: *I = Investment Banking; C = Commercial Banking; M = Mezzanine; P = Private Equity/Debt; and A = Arranger/Advisor.*

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U.S.

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Advised on the divestiture of U.S. onshore assets to
Isramco
7 MMcfe/d
Financial Advisor
Scotia Waterous
March 2008
In connection with the acquisition, we provided
$150,000,000
Senior Credit Facilities
Lead Arranger and Administrative Agent for Isramco
Scotia Capital
March 2008

Advised on the divestiture of East Texas assets to
Classic
11 MMcfe/d
Financial Advisor
Scotia Waterous
November 2007
In connection with the acquisition, we provided
$150,000,000
Senior Credit Facilities
Joint Lead Arranger and Syndication Agent for Classic
Scotia Capital
November 2007

Advised on the divestiture of Gulf Coast and South Texas assets
16 MMcfe/d
Financial Advisor
Scotia Waterous
May 2007
$100,000,000
Senior Credit Facilities
Lead Arranger and Administrative Agent for Masters
Scotia Capital
July 2006

Enterprise Products Partners L.P.
$1,100,000,000
Senior Notes
Joint Book Runner
Scotia Capital
March 2008

Chesapeake Energy
$1,052,250,000
Equity Offering
Co-Manager
Scotia Capital
March 2008

Meridian
$200,000,000
Senior Credit Facilities
Joint Lead Arranger and Syndication Agent
Scotia Capital
February 2008

Bois d'Arc
$350,000,000
Senior Credit Facilities
Arranger and Administrative Agent
Scotia Capital
November 2007

PXP
Plains Exploration & Production
$2,900,000,000
Senior Credit Facilities
Joint Underwriter and Co-Syndication Agent
Scotia Capital
November 2007

elpaso
El Paso Production Holdings
$1,500,000,000
Senior Credit Facilities
Joint Lead Arranger
Scotia Capital
October 2007

Milagro
Interest Rate Hedging
Provider
Scotia Capital
December 2007

Enterprise GP Holdings
Interest Rate Hedging
Lead Hedge Advisor
Scotia Capital
August 2007

Helix Energy Solutions
Commodity Hedging
Sole Hedge Provider
Scotia Capital
January 2007

Canada

Husky Energy
Exchange of downstream capacity for upstream oil sands position
bp
Exclusive Financial Advisor
Scotia Waterous
March 2008

Crescent Point Energy Trust
C$125,008,750
Trust Units
Joint Book Runner
Scotia Capital
January 2008

Enbridge
Enbridge Pipelines Inc.
C$1,000,000,000
Credit Facility
Co-Lead Arranger & Administrative Agent
Scotia Capital
January 2008

Penn West Energy Trust
Advised on acquisition of
Canetic
for
C$5,250,958,500
Exclusive Financial Advisor
Scotia Waterous
January 2008

Birchcliff
C$300,000,000
Credit Facility
Lead Arranger & Administrative Agent
Scotia Capital
September 2007

Rider
C$210,000,000
and
US$100,000,000
Credit Facilities
Lead Arranger & Aministrative Agent
Scotia Capital
June 2007

FOCUSED ON YOUR SUCCESS

At Scotia Capital, the global corporate and investment banking business of the Scotiabank Group, we remain committed to client success. Our superior industry expertise and strong execution capabilities continue to deliver outstanding results. We offer best-in-class equity, debt, corporate lending and capital markets solutions for oil and gas companies throughout North America. Our capital markets platform also provides energy derivatives to help businesses manage their risk exposure. And Scotia Waterous, the global oil and gas M&A arm of Scotia Capital, delivers superior advisory solutions to the industry. We are focused on your success.

Because great relationships deliver great results.

Products. Industry Knowledge. Relationships.

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