

SPEE Denver Chapter July Luncheon Meeting, Wednesday, July 12, 2023

Laura Freeman, Managing Director, BD and Engineering, Highpoint Global Capital



M&A Update: Headline Corporate Consolidations while Asset and Private Capital Markets Continue to Falter

Abstract.: The US Oil and Gas deal and capital markets are at the lowest points in over a decade with no sign of a post-Covid rebound. There continues to be large dollar value corporate consolidation but no sign of life for the broader markets. Deal counts are at the lowest in 18 years even doubling the current first half count as an annual estimate. New private equity (PE) funding announcements have dropped from around \$15 billion in the years leading up to 2017 to only \$1-3 billion over the last few years. New PE team formation is at the lowest in years and even well-funded teams with strong track records and excellent folks are struggling to find assets often searching for 15-24 months without taking down a deal. The RBL (reserves backed lending) market continues to be weak and the recent slide in forward strip and hedging are problematic for companies with RBL's and fairly heavy hedging requirements on existing and new production. Despite high spot prices, \$77/bbl at the time of writing, the forward strip has become highly concerning for A&D and drilling heading into the back-half of 2023. The US rig count had the largest monthly slide since 2020 a few weeks ago. Join us for a lively discussion on current capital and deal markets as we all anxiously look towards the second half of the year!

Speaker Bio.: **Laura Freeman** is a Managing Director at Highpoint Global Capital. She has been an integral part of over \$5 billion in acquisitions and divestitures including the high-profile acquisition of all of Hunt Oil Company's Permian Basin Assets in 2021. Laura specializes in technical valuation, financing, and navigating the complexities of dealmaking.

Laura has a Master's in Petroleum Engineering, an MBA, and a bachelor's degree in Physics. She has been featured as an expert on M&A, finance, and Reservoir Engineering for various magazines, industry events, and online publications including Oil and Gas Financial Journal, Society of Petroleum Engineers (SPE), American Association of Petroleum Geologists (AAPG), and Journal of Petroleum Technology (JPT).

M&A Update: Headline Corporate Consolidations while Asset and Private Capital Markets Continue to Falter

Denver July 2023

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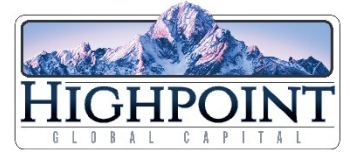
Born and raised in Colorado!



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Disclaimers



- Contains an informal compilation of various public sources – have attempted to correctly cite each; however, errors may exist. Further information available on request.
- Personal opinion and observations on the current oil and gas M&A market
- For informational and discussion purposes only
- May not be relied on in any manners legal, business, financial, tax or investment advice
- Is not an offer to sell or a solicitation of an offer to buy an interest or to participate in any trading strategy
- Significant effort to validate and cross-check data; however, errors may exist

Not an advertisement – credibility and indicative of market trends

2021:

- Hedge fund A&D
- Large billion plus buy-side work
- Hunt deal
- Company spin-up and takeover Hunt deal

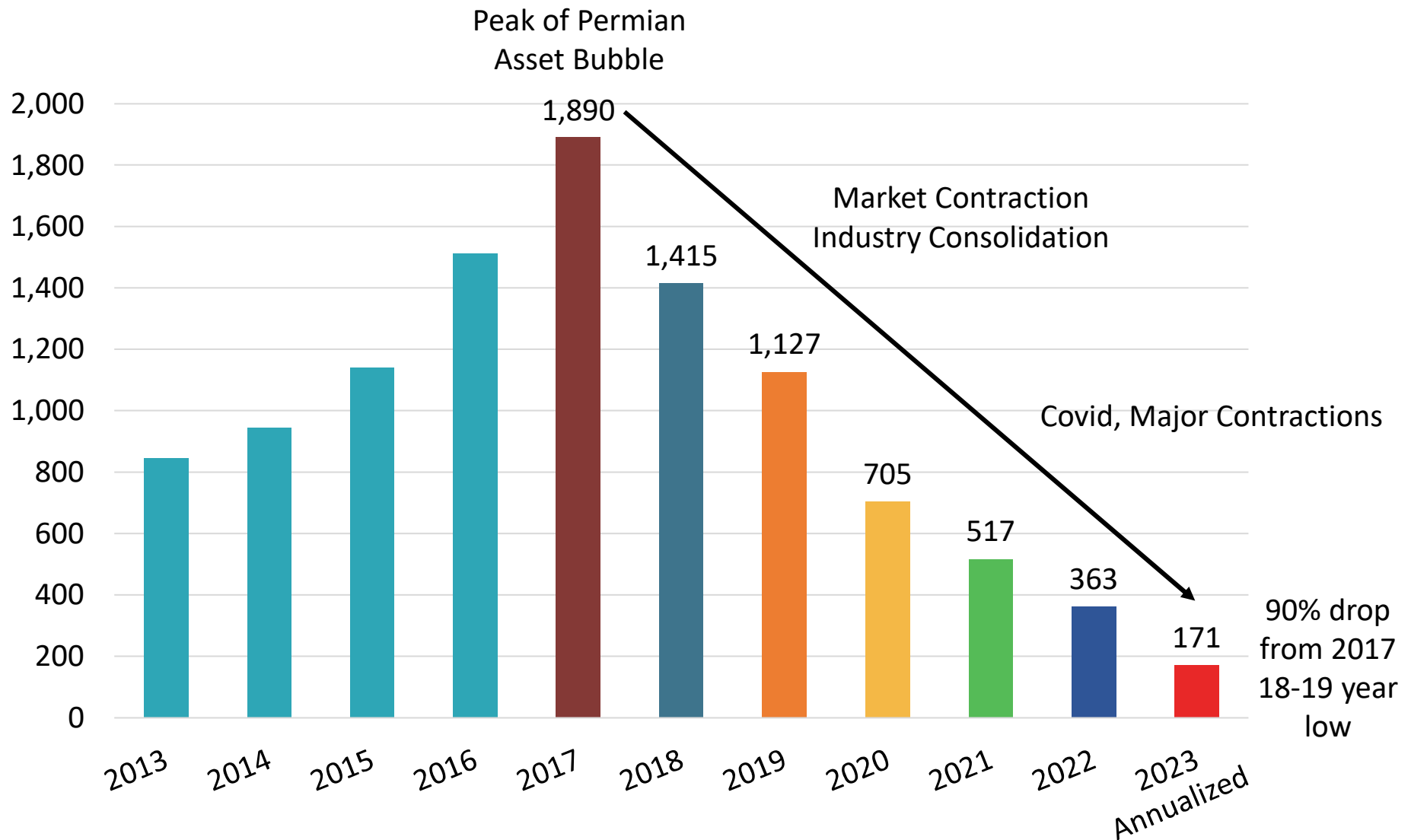
2022:

- Sell-side work - sold PDP asset at PV6! At late summer price decks
- Buy-side work - difficult and requiring much more savvy buyers
- Start of drilling deal and drilling strategy

2023:

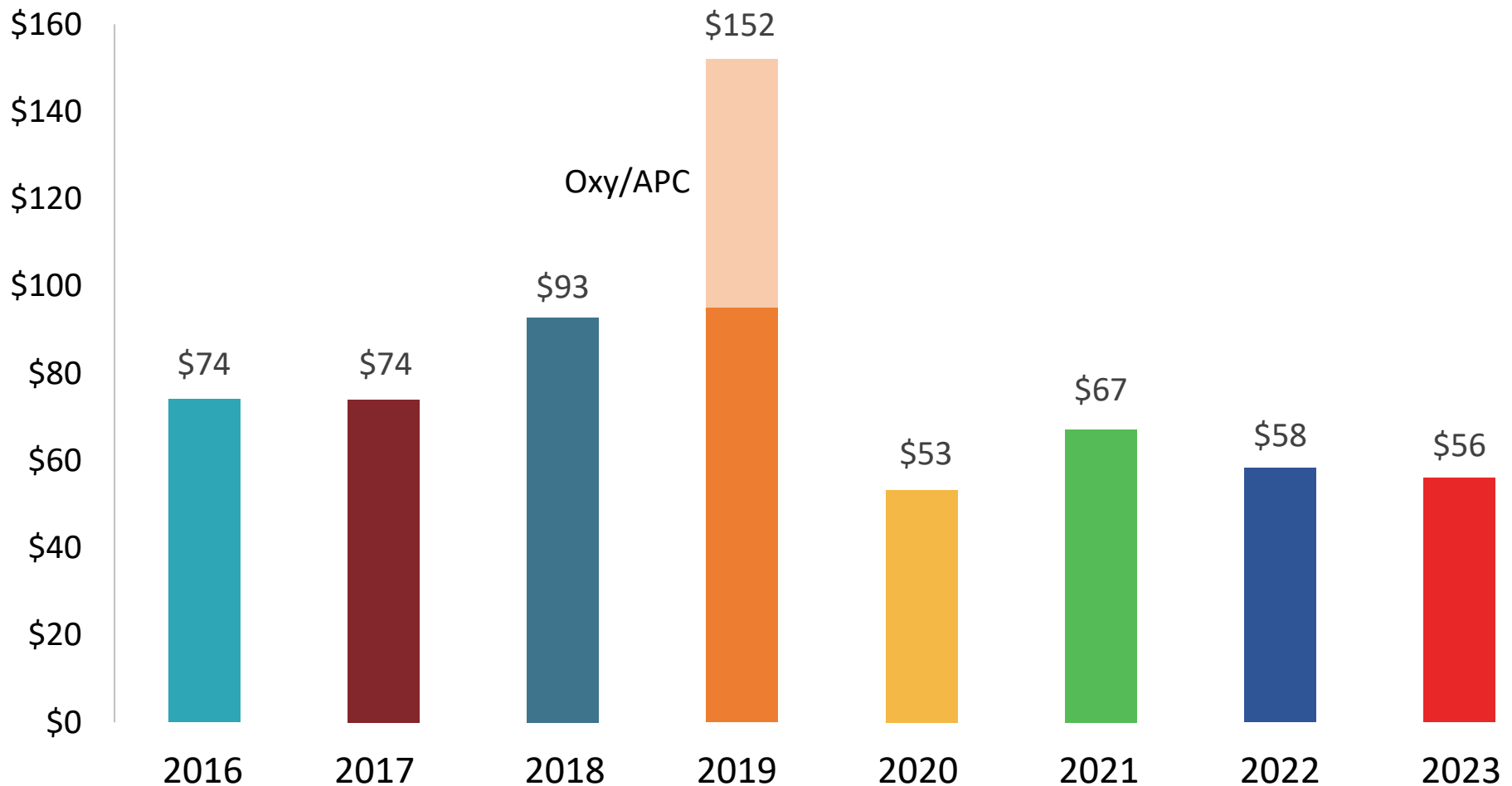
- Drilling deal
- Pipeline for future drilling
- Client Work - mostly outside of A&D!
- Buy-side work - highly relationship based, off-market discussions, buyers above strip price

US Deal Counts per Year



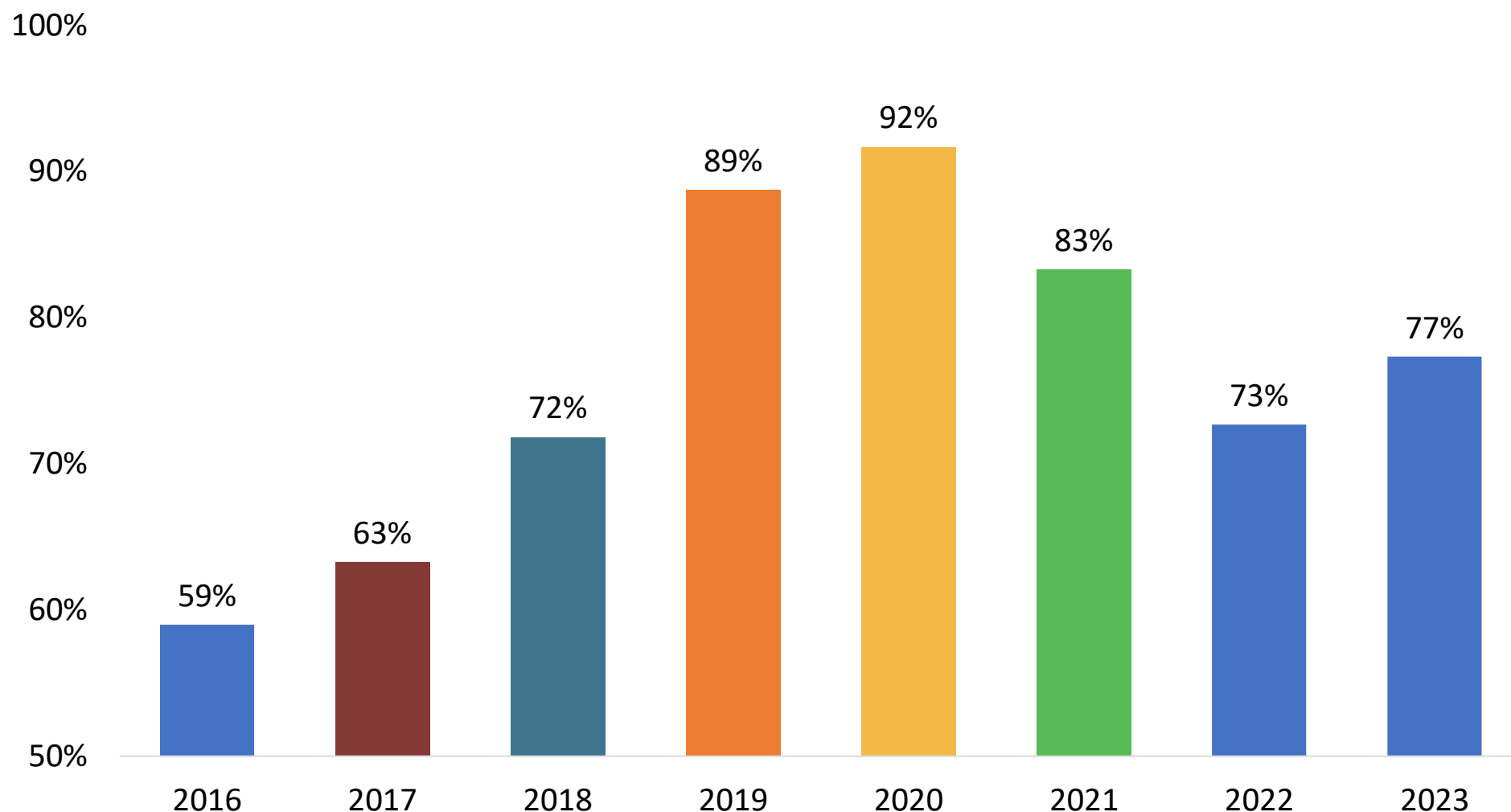
Total Deal Values

Total Deal Value per Year Billion \$ *(deals with announced values)*



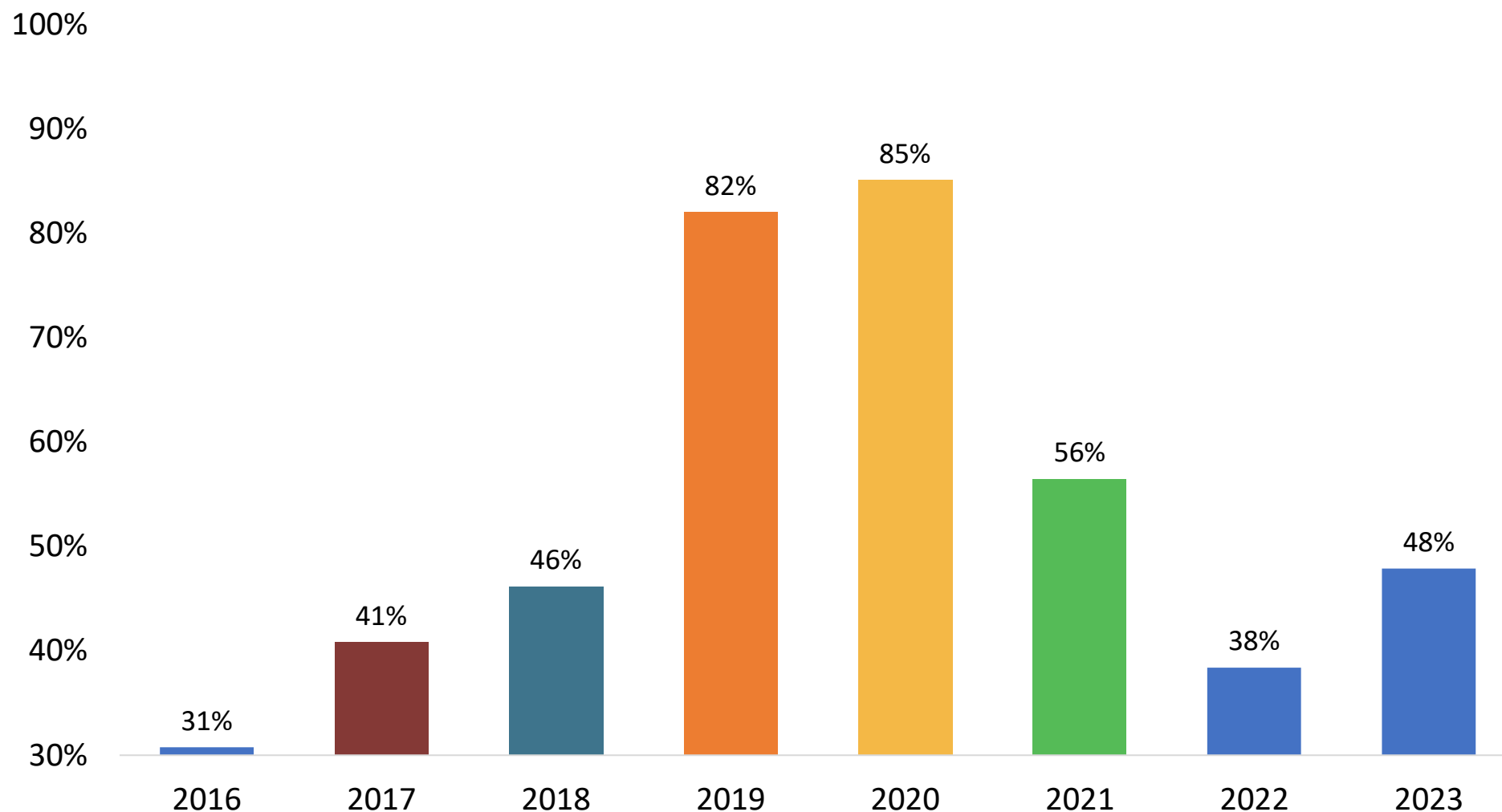
% of Deals with Public Buyers - Total Deal Value Basis

(deals with announced values)



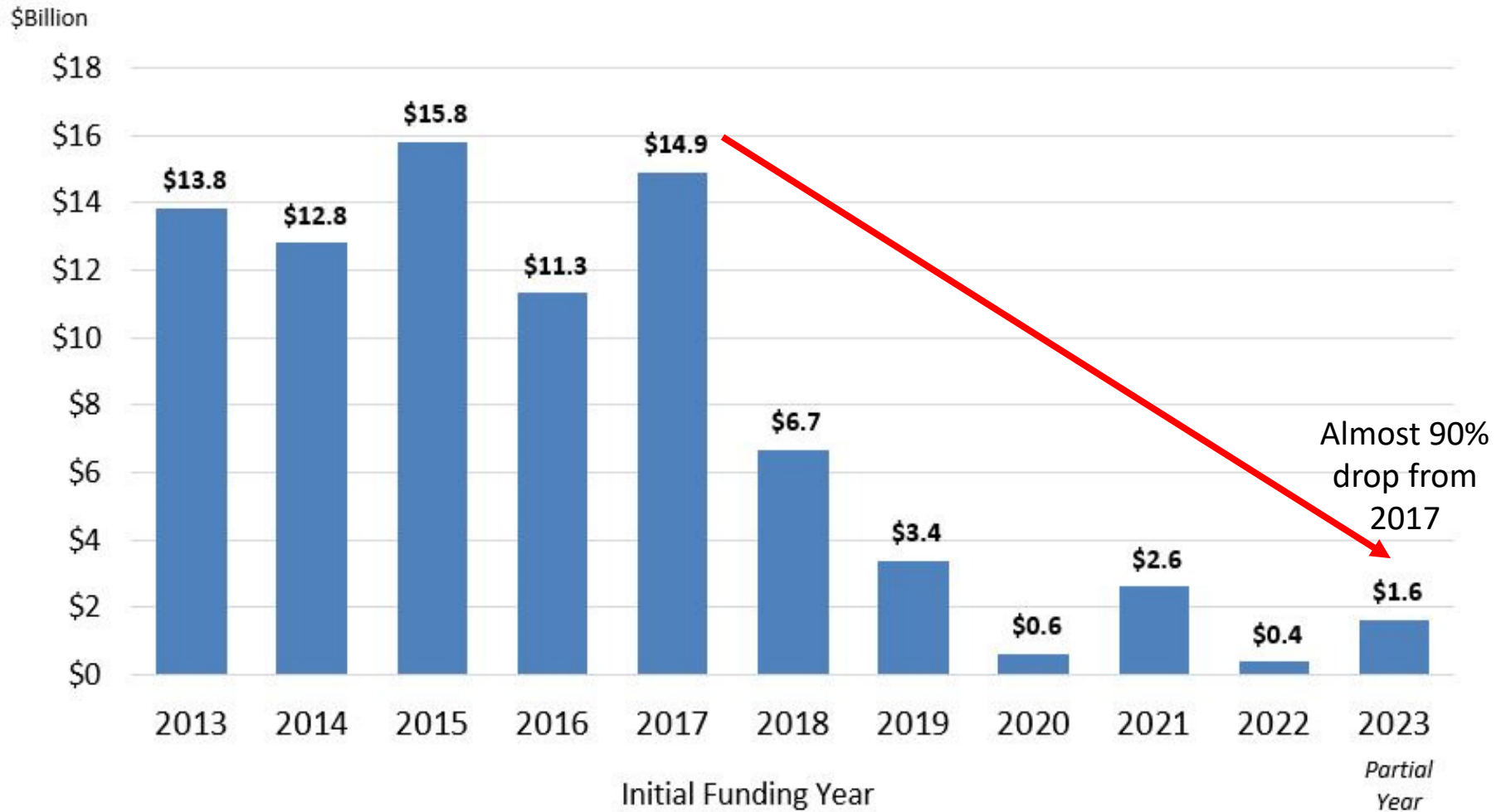
% of Deals Classified as Corporate - Total Deal Value Basis

(vs. Asset, Acreage, Royalty, etc., deals with announced values)



Collapse in PE Funding

Collapse in Oil and Gas Private Equity Funding

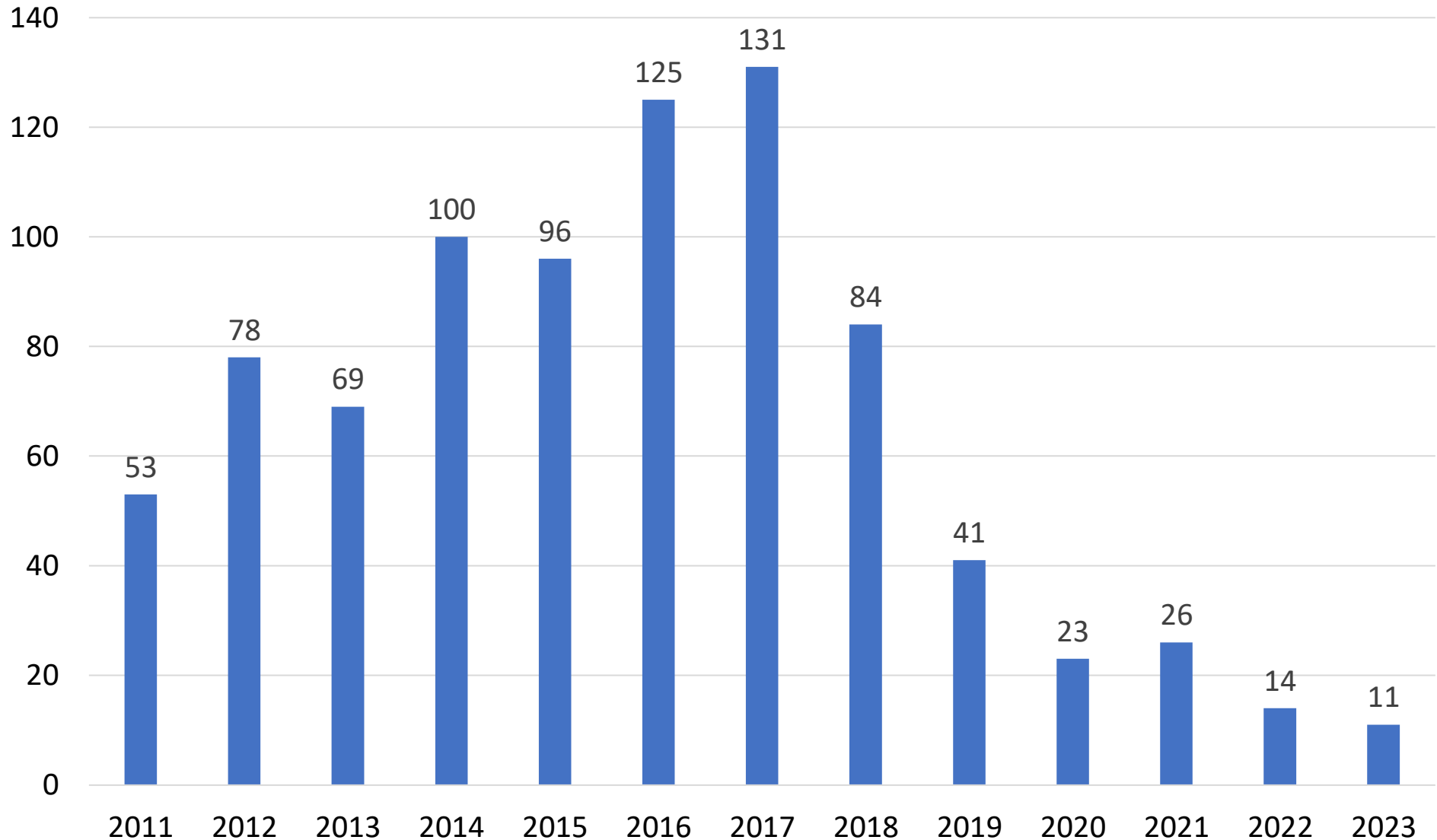


Enverus data updated 5/26/2023

New PE Teams and Funding



Initial Funding Year – New Teams and Second Commitments or Re-Ups



Enverus data, includes second commitments for example Krakken

PE Teams Failing to Acquire



Company	PE Sponsors	Initial Funding Year	Total Equity Commitment (\$ MM)	What's New	Status
Mesa Minerals Partners III LLC	NGP Energy Capital Management	2022	150	Yet to make first significant acquisition.	Active
North Hudson Production Partners LP	North Hudson Resource Partners LP	2022	127	Yet to make first significant acquisition.	Active
Slant Energy II LLC	Pearl Energy Investments	2022	90	Yet to make first significant acquisition.	Active
Western Natural Resources II, LLC	EnCap Investments LP	2022		Yet to make first significant acquisition.	Active
Live Oak Resource Partners III LLC	Trace Capital Management	2022		Yet to make first significant acquisition.	Active
Tumbleweed Royalty IV LLC	EnCap Investments LP, Apollo Global Management LLC, Magnetar Capital	2022		Yet to make first significant acquisition.	Active
Double Eagle Energy Holdings IV, LLC	EnCap Investments LP, Apollo Global Management LLC, Magnetar Capital	2022		Yet to make first significant acquisition.	Active
Selenite Energy Partners II LLC	Carnelian Energy Capital Management	2022		Yet to make first significant acquisition.	Active
Black Knight Energy LLC	Kayne Anderson	2021	500	Yet to make first significant acquisition.	Active
Kraken Resources II LLC	Kayne Anderson	2021	400	Yet to make first significant acquisition.	Active
Grenadier Energy Partners III LLC	EnCap Investments LP	2021	350	Yet to make first significant acquisition.	Active
Sabalo Energy II LLC	EnCap Investments LP	2021	300	Yet to make first significant acquisition.	Active
ARM Resource Partners LLC	EIV Capital LLC	2021		Yet to make first significant acquisition.	Active
Tailwater Royalties LLC	Tailwater Capital LLC	2021		Yet to make first significant acquisition.	Active
Ridgemar Energy LLC	Carnelian Energy Capital Management	2021		Yet to make first significant acquisition.	Active
FourPass Energy LLC	Oaktree Capital Management LP	2020	600	Yet to make first significant acquisition.	Active
JSTX Holdings LLC	Juniper Capital Advisors LP	2020		Yet to make first significant acquisition.	Active
Axia Energy III LLC	Old Ironsides Energy LLC	2020		Yet to make first significant acquisition.	Active
Paloma Partners V LLC	EnCap Investments LP	2020		Yet to make first significant acquisition.	Active

Why Traditional PE Isn't Working



Business Model fails in current environment

- Inability to meet business model returns for “aggregator PE”
- 3 and 30% (3X ROI and 30% IRR) only possible with rapid appreciation in very short time
- A few teams got very wealthy during the Permian buy and flip which peaked 2016-2017

- Inability to acquire
- Inability to exit

Poor terms for management teams

- Many teams dealt with opportunistic PE backers who took all the profit
- A lot of good folks ended up broke and having “wasted” some of the most productive years of their careers
- Difficulty for folks to buy-in to the venture given the tough decade following the 2014 crash

Bad reputation in operations and decision making

In Midland “PE” is a bad word

PE Waterfalls and Prefs



PE Backers like to show teams waterfall calculations like this – where they get rich!

Waterfall Calculation - 80/20 Split

TRANSACTION		
Capital Invested	\$ (46,500,000)	Date 11/1/2019
Proceeds	\$ 127,134,000	1/1/2025
EQUITY PARTICIPANTS		
GP		
Limited Partners		
EQUITY PARTICIPATION TERMS		
Return of principle to Limited Partners plus an pref % cumulative return on principle. Then 80 / 20 split between GP / LP.		
IRR HURDLES		
	LP IRR Hurdle	
Principal	0.0%	
Preferred Return	12.0%	
PROCEEDS REQUIRED TO ACHIEVE HURDLES		
	Proceeds Required by LP for Hurdle	
Principal	46,500,000	
Principal + Preferred Return	83,511,459	
WATERFALL		
IRR Achieved	21.5%	
First Distribution:		
Limited Partners	83,511,459	100.0%
Proceeds Remaining		
	43,622,541	
Second Distribution:		
GP	34,898,033	80.0%
Limited Partners	8,724,508	20.0%
GRAND TOTAL PROCEEDS		
GP	34,898,033	27.4%
Limited Partners	92,235,967	72.6%
TOTAL	127,134,000	

Almost a 3X in 6 years most more aggressive on exit speed

Pref rate hits every year

PE Waterfalls and Prefs

Waterfall Calculation - 80/20 Split

TRANSACTION

		Date
Capital Invested	\$ (46,500,000)	11/1/2019
Proceeds	\$ 93,000,000	1/1/2025

Moving to a 2X return

EQUITY PARTICIPANTS

GP
Limited Partners

EQUITY PARTICIPATION TERMS

Return of principle to Limited Partners plus an pref % cumulative return on principle.
Then 80 / 20 split between GP / LP.

IRR HURDLES

	LP IRR Hurdle
Principal	0.0%
Preferred Return	12.0%

PROCEEDS REQUIRED TO ACHIEVE HURDLES

	Proceeds Required by LP for Hurdle
Principal	46,500,000
Principal + Preferred Return	83,511,459

WATERFALL

IRR Achieved 14.4%

First Distribution:

Limited Partners 83,511,459 100.0%

Proceeds Remaining 9,488,541

Second Distribution:

GP 7,590,833 80.0%
Limited Partners 1,897,708 20.0%

GRAND TOTAL PROCEEDS

GP 7,590,833 8.2%
Limited Partners 85,409,167 91.8%
TOTAL 93,000,000

Team goes from \$34.9 million to \$7.6 million and from 27% of grand total proceeds to 8%

PE Waterfalls and Prefs

Waterfall Calculation - 80/20 Split

TRANSACTION

		Date
Capital Invested	\$ (46,500,000)	11/1/2019
Proceeds	\$ 93,000,000	1/1/2026

Keeping a 2X return

Adding 1 year to how long it takes to exit

EQUITY PARTICIPANTS

GP
Limited Partners

EQUITY PARTICIPATION TERMS

Return of principle to Limited Partners plus an pref % cumulative return on principle.
Then 80 / 20 split between GP / LP.

IRR HURDLES

	LP IRR Hurdle
Principal	0.0%
Preferred Return	12.0%

PROCEEDS REQUIRED TO ACHIEVE HURDLES

	Proceeds Required by LP for Hurdle
Principal	46,500,000
Principal + Preferred Return	93,532,834

WATERFALL

IRR Achieved 11.9%

First Distribution:

Limited Partners 93,000,000 100.0%

Proceeds Remaining -

Second Distribution:

GP - 80.0%
Limited Partners - 20.0%

GRAND TOTAL PROCEEDS

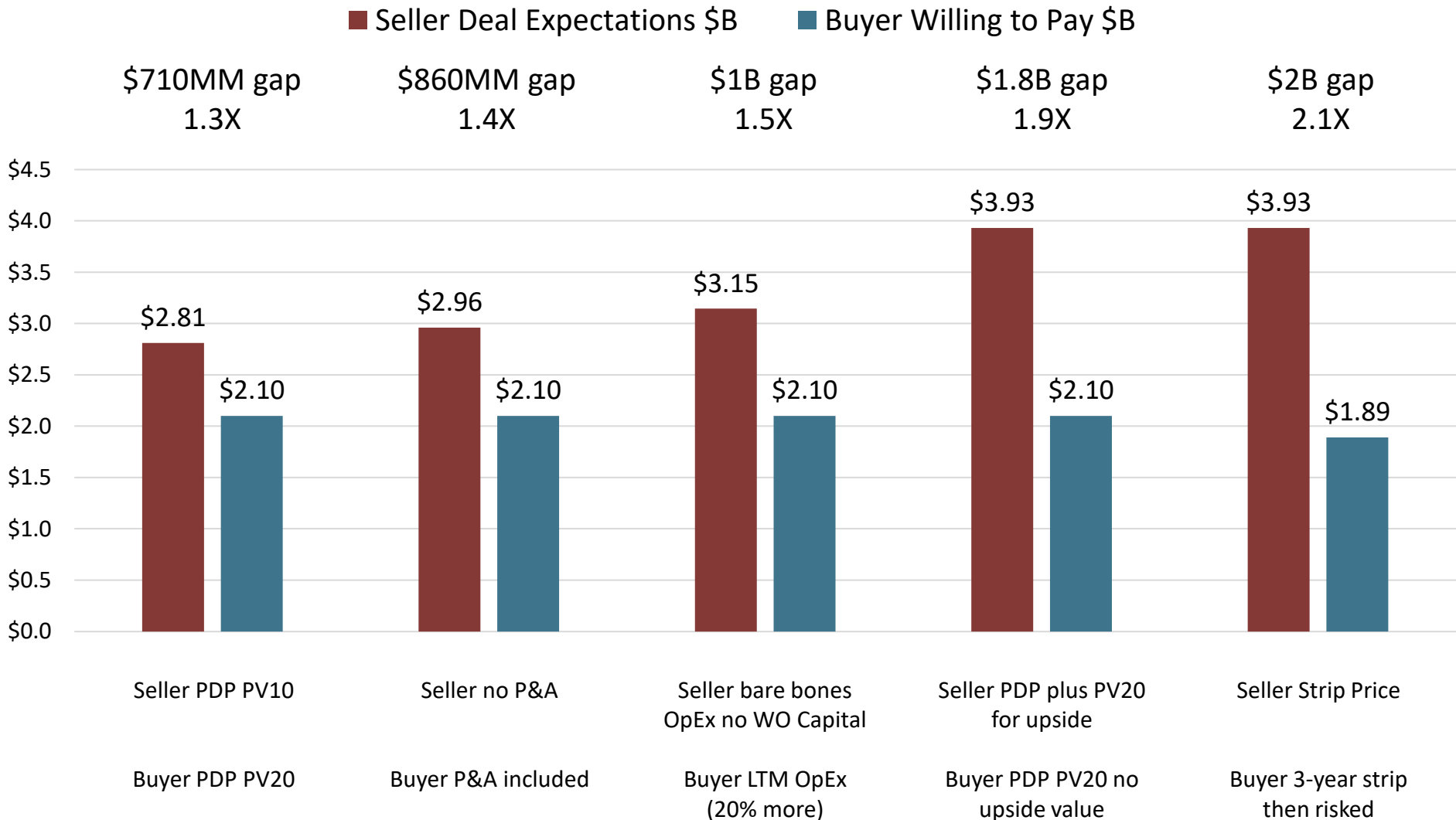
GP	-	0.0%
Limited Partners	93,000,000	100.0%
TOTAL	93,000,000	

Team gets no payout

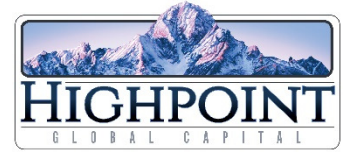
Buyer-Seller Gap



Real Deal Example

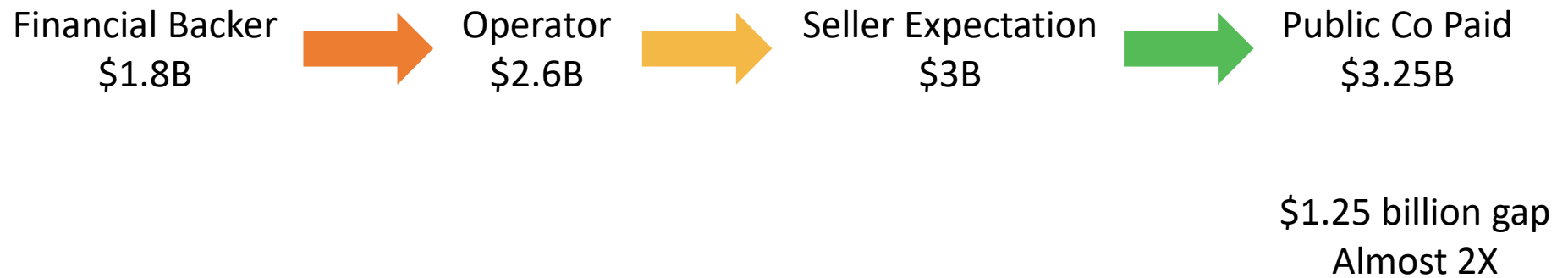


Buyer-seller Gap



Was that example overstated? Crazy?

Different Real Deal that Closed in 2021



Different Real Deal that Closed in 2021



What about reserves?

And asset valuations per SPEE guidance?

Very Slow Public Markets

- Public markets slowed dramatically after 2018-2019 activity
- No IPOs, SPAC market did not work in O&G
- Lingering ESG pressure
- Many used the ramp up in commodity prices starting in late 2021 to clear up balance sheets
- Lingering pain from how close many were to defaults and bankruptcy
- Not seeing much impact from interest rates overall – large publics do have pressure which also leads to fewer acquisitions and more pain for PE exits
- Not many deals

Pretty dire situation early
May 2020

Saved by Covid!

Got a “time out” then
saw significant price ramp
up even pre war in
Ukraine

Wells Fargo Sets Up Team To Handle Flood Of Oil Bankruptcies

By [Irina Slav](#) - May 01, 2020, 1:30 PM CDT




“It’s a **bloodbath**” one Reuters source from banking circles said, commenting on Wells Fargo’s preparation for a flood of bankruptcies. A survey amount oil companies conducted by the Federal Reserve Bank of Kansas City suggested as much as **40 percent could go under within 12 months, at WTI prices of \$30**. Currently the U.S. benchmark is trading at \$19.90 a barrel.

Remember How Bad 2020 Started!

Assets (finally) marked down to market and unbelievable write-offs announced:


Chesapeake 10-Q (quarterly SEC filing):

“An \$8.446 billion impairment because the carrying value exceeded estimated fair market value”

 Natural Gas Intelligence

Chesapeake's \$8.3B Loss Pointing Toward Possible Bankruptcy | 2020-05-11

Chesapeake Energy Corp., the trailblazing Lower 48 unconventional oil ...
\$8.5 billion impairment on assets primarily related to low oil and gas prices.
... “We expect to see continued volatility in oil and natural gas prices for ...
1 week ago




 Rigzone

Petrobras Books Hefty 1Q Impairment on Oil, Gas Assets


Brazil's Petrobras reported a whopping **\$13.4 billion impairment** on its exploration and production assets on May 14, according to written ...
2 days ago



 Natural Gas Intelligence


Baker Hughes Confident Natural Gas Markets Improving, but ...


“Internationally, we expect that the combination of lower oil prices and ...
The company also recorded a one-time impairment of **\$14.7 billion** for ...
1 month ago

 Wall Street Journal

Texas Shale Driller Concho Takes \$12.6 Billion Charge, Citing Coronavirus Impacts


Concho, a Midland, Texas-based producer with a market capitalization of about \$11 billion, attributed the impairment to a steep decline in oil and ...
3 weeks ago




 Business Wire (press release)

Magnolia Oil & Gas Corporation Announces First Quarter ...


...
During the first quarter of 2020, Magnolia recorded **impairments of \$1.9 billion** related to proved and unproved properties as a result of the ...
1 week ago



 EnerCom Inc. (press release) (blog)


Oasis Petroleum Inc. Announces First Quarter 2020 Results ...


In 1Q20, the Company recorded impairment charges of **\$4.4 billion** on its proved oil and gas properties in the Williston Basin and the Delaware ...
2 days ago

 WorldOil

Oxy cuts capex, takes \$1.4 billion writedown on oil price ...


Occidental's first-quarter loss included impairment charges related to its equity investment in Western Midstream Partners LP, the ...
2 weeks ago



 Journal Record

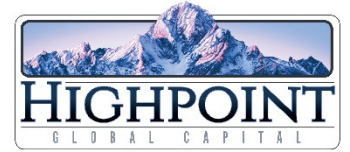
WPX Energy 1Q loss includes \$1B impairment charge

WPX Energy on Wednesday reported a net loss from continuing operations attributable to common shareholders for the first quarter of \$208 ...
2 weeks ago



Staggering ~\$60 BILLION in just these examples

Other Financing



Discuss the following:

- Banks and RBLs
- Mezz
- Private Debt
- Non “aggregator PE”
- Various other flavors of equity and debt

What Happened to ESG?

Significant build up and pressure from 2019-2022

Proposed that the SEC would require and regulate ESG disclosures like they do financials
Think about the manpower and cost of receiving, auditing, enforcing...

SEC proposal late May 2022, MUCH less than feared/expected

If then framework – if you do this, then you report – gave some clear easy outs, don't "do this"

Oil prices spiked

Dramatic shift

FC Fast Company

What does ESG mean? Not much anymore, says BlackRock CEO Larry Fink

Americans who are tired of hearing BlackRock CEO Larry Fink advance the tenets of ESG investing are in luck. advertisement.

2 weeks ago



QZ Quartz

BlackRock CEO Larry Fink is focusing on goals other than "ESG"

Fink said the ESG debate has been "misused" by both conservatives and liberals.

2 weeks ago



A Axios

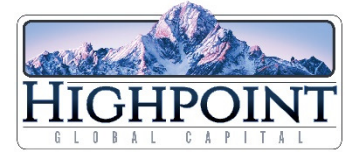
Black Rock CEO Larry Fink "ashamed" to be part of ESG political debate

BlackRock CEO Larry Fink said he's no longer using the term "ESG" (environment, social and governance) because it is being politically...

2 weeks ago



What's Next?



- Fairly uncertain
- We're moving into drilling and waiting for deal markets to recover
- Most thought deal counts bottomed out in 2019 – keeps getting worse
- Reversion to the mean – should come back up at some point
- Prolonged underinvestment is usually followed by a rebound
- Investment models need to change and support management teams
- Expect improvement but are unsure when
- Staying active and hanging around the hoop – if you try and start acquiring when the window opens you're 6 months too late

Working harder and getting more creative!

Thank you



Further questions welcome at
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