

Oil & Gas Financing and Investment Series

Private Equity and Oil and Gas: Opportunities and Challenges

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Haynes and Boone Borrowing Base Redeterminations Survey: Spring 2015

Summary of results

April 2015



Objectives of the Survey

- Haynes and Boone, LLP conducted a survey in April 2015 that included executives at:
 - **Financial institutions**
 - Private equity firms
 - **Majors**
 - Independent E&Ps
- **The objective was to get a clear sense of what lenders, borrowers and others are expecting regarding spring 2015 borrowing base redeterminations in light of the uncertainty in the market**
- The results that follow include a summary of responses from 88 participants


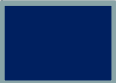

Question #1

Are you a reserve-based lender or borrower (either lending or borrowing against a borrowing base of oil and gas reserves), or neither?

- Energy lender
- Borrower - producer
- Neither



Answers to #1

		Responses	Response ratio
Energy lender		35	39.7%
Borrower - producer		15	17.0%
Neither		38	43.1%
Total		88	100%

Question #2

Based on what you see in the market today, what percentage of borrowers do you anticipate **will see a decrease** in their spring borrowing base redeterminations?

Question #2 – Survey Says:

Based on what you see in the market today, what percentage of borrowers do you anticipate **will see a decrease** in their spring borrowing base redeterminations?

68%
will see a decrease



Question #3

What is the average amount that you anticipate borrowing bases **will be decreased** this spring?

Question #3 – Survey Says:

What is the average amount that you anticipate borrowing bases **will be decreased** this spring?

25%
decrease



Question #4

What percentage of reserve-based loans do you anticipate **will skip** this spring's borrowing base redetermination?

Question #4 – Survey Says:

What percentage of reserve-based loans do you anticipate **will skip** this spring's borrowing base redetermination?

19%
will skip

Question #5

How much below this spring's borrowing bases do you anticipate fall borrowing bases to be?

Question #5 – Survey Says:

How much below this spring's borrowing bases do you anticipate fall borrowing bases to be?

31%
below spring

Outside Bankruptcy Distressed M&A



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The Waiting Game

- Valuation Disconnect
- Securing Financing
- CAPEX Reductions

Opportunities

- Acquire control (large equity stake) through debt-for-equity exchanges (Halcón Resources)
- Consolidation and Reserve Growth (Shell / BG Merger)
- Private Equity
 - Liquidity for current portfolio companies to grow
 - Back experienced management teams
 - Undrilled acreage

***Lord, Thank You For The Oil Boom...
Now, Please Help Me Survive the Bust!***

What is Likely to be For Sale

- Distressed companies
- Non-core oil and gas assets
- Undeveloped acreage
- Midstream assets

Positioning Company for Opportunities

- Strengthen balance sheet
- Look for partners
 - Industry partners
 - Financing sources

Stages of Distress

- Operating results
 - Lower revenues due to declining oil prices
 - Negative borrowing base adjustment
 - Covenant default
 - New large liability e.g., environmental claim
- Liquidity constrained
 - Reduced CAPEX
 - Inability to maintain reserves, production and production growth
 - Inability to maintain existing leases
 - Mounting P&A liabilities
 - Industry partner defaults
- Payment default
- Bankruptcy

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Distinct Oil & Gas Distressed M&A Issues

- Termination of oil & gas leases for non-production
- Joint Operating Agreements (JOAs)
 - Other working interests owners have failed to pay
 - Target has failed to pay
 - Offset rights
- Mechanics' and materialmen's (M&M) statutory liens
 - Generally, under state law, the liens apply to the entire leasehold estate on which work is performed or materials are furnished, including wells, pipelines and other equipment and fixtures on the property or used in operations
 - Liens may also attach to proceeds of production
- Costs of plugging and abandoning (P&A) wells
 - Often first thing delayed when CAPEX cut

Advantages of Out-of-Court Distressed M&A

- Avoids bankruptcy taint
- May preserve greater value for equity holders
- Greater likelihood for management to maintain control or stay on
- May be less expensive than bankruptcy

M&A Deals to Shore Up Liquidity

- Asset Sales
 - Eliminate distraction of non-core assets / business (midstream), including Working Interests, Royalty Interests, Overriding Royalty Interests, Net Profits Interest (see exhibit for explanation of the terms)
 - Lender role
 - Consents
 - Haircuts
 - Risks
 - Fraudulent transfer (transaction could be unwound)
 - No cleansing of liabilities through bankruptcy process
 - Inability to perform post-closing obligations
 - No assignment provisions operative
- Debt-for-equity exchanges
 - High tender threshold to avoid holdouts
 - Move down capital structure
 - Change of control
 - All concerns of equity, it's almost like you bought the assets and management team
 - Change of control provisions operative
 - Lender consents
 - Ratings implications
 - Tax (COD income)

M&A Deals to Shore Up Liquidity (cont.)

- Equity issuance (PIPE)
 - Highly dilutive, may result in a change of control (but still preferable to bankruptcy for equity holders)
 - Could possibly avoid shareholder approval
 - Lender role
 - Consents
 - Haircuts
 - Partial debt-for-equity exchanges
 - Risks
 - May not be practical if large number of significant creditors
 - No cleansing of liabilities through bankruptcy process
- Merger
 - Similar considerations as equity issuance (above), except shareholder vote cannot be avoided

M&A Deals to Shore Up Liquidity (cont.)

- Loan-to-Own
 - Loan-to-own: capital infusion or purchase of securities to obtain control of debt
 - Can achieve goals through Chapter 11 case, out-of-court workout or hybrid prepackaged Chapter 11 case
 - Loan with hope of debt-for-equity exchange
 - May enhance leverage over the process
- Farmouts
- JVs

Private Equity

- Restructuring current portfolio companies
- New capital ready to invest in the market
 - Significant flexibility to structure for taxable, tax exempt and foreign investors
 - NPI and Royalty Funds (for tax exempt investors)
 - Leveraged Blockers (for foreign investors)

Management Team and Incentives

- Evaluate current management
- Aligning management incentives with goals – existing equity incentive plans may have no value
- Profits Interest Plans or Phantom Equity Plans

Exhibits

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Types of Oil and Gas Interests

- Working Interest
- Royalty Interest
- Overriding Royalty Interest
- Net Profits Interest

Types of Oil and Gas Interests

Working Interest

- An operating interest under an oil and gas lease
- Exclusive rights to explore for, develop and produce oil and gas from the leased land
- Pays full costs of operations
- Elects the operator who controls the activities subject to the rights of the other working interest owners
- Generally considered a real property interest in bankruptcy

Types of Oil and Gas Interests

Royalty Interest

- A cost-free share of production created by the lessor in an oil and gas lease in exchange for the right granted to the lessee to explore for, develop and produce the minerals
- A non-operating interest (for tax and business purposes)
- Bears none of the costs and expenses associated with the exploration, production and development of the minerals
- No right to conduct mineral exploration, development, production activities on the property
- Typically measured in terms of a fraction/percentage of all production
- Considered a real property interest in bankruptcy

Types of Oil and Gas Interests

Overriding Royalty Interest

- A cost-free share of production carved from the working or leasehold interest
- Bears none of the costs and expenses associated with the exploration, production and development of the minerals
- No right to conduct exploration, development, and production activities on the property
- A non-operating interest (for tax and business purposes)
- Typically measured in terms of a percentage of all production
- May be a real property interest in bankruptcy

Types of Oil and Gas Interests

- Net Profits Interest
 - A share of the proceeds of production that is measured as a percentage of the net profits derived from the relevant well or group of wells
 - Determined in accordance with the contractual provisions of the conveyance document creating the interest
 - Generally includes all gross proceeds from the sale of hydrocarbons offset by the expenses attributable to all operations
 - If there are insufficient gross proceeds in any period of calculation to offset the expenses attributable to that calculation period, the owner of the net profits interest will receive no distribution, but will not be obligated to cover any shortfall
 - Not personally liable for the costs of exploration, development and production of the property
 - A non-operating mineral interest that can continue for a term or the life of the lease and is carved out of the working interest

Types of Oil and Gas Interests

Net Profits Interest

- Calculation of net profits
- Procedures to fund development
- Treatment of non-oil and gas revenues
- May be a real property interest in bankruptcy

Thank you!

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