Amount Of Capital Is ‘Truly Staggering’

Michael Madere April 25, 2012

Panel members at Mergermarket’s Houston conference earlier this month offered their perspectives about finance as it applies to oil and gas exploration. They talked about the upstream and midstream financing, private equity, investment strategies and business practices.

Here’s a sampling of the comments:

Alfonso Leon, vice president of Planning and Strategy for Apache Corp.: “Some people need to realize that this is a very volatile business. There have been some success stories, but we just came off of 2008 … “A cautious approach to a balance sheet goes a long way. If you’re rolling the dice for a potential quick profit -- in and out -- maybe you’ll get lucky. But you can also lose your shirt.

“For us, managing for growth for over five decades, being very careful with our balance sheet, not using that credit card for the last dollar, a highly balanced portfolio -- 50 percent oil, 50 percent gas, and then 50 percent North America and 50 percent not North America -- has been very, very valuable and honestly has kept us in business. I think all of this capital coming in might just generate opportunities for us a couple of years down the line.”

Janet Clark, executive vice president and chief financial officer, Marathon Oil Corp.: “If you have cash on the balance sheet, it’s really the cheapest source of capital that you can find. But you do have to look at the overall capital structure, and you do want to have some debt in that capital structure to maximize return on equity.

“We (Marathon) choose not to maximize the value of equity by having a maximum leverage because we think that you can ultimately add greater value for your shareholders if you have the right firepower when the time comes.”

Michael Jamieson, co-head of Citigroup’s North American Group: “I have spent roughly 20 years of my career focused mostly on the midstream sector and the upstream sector. When we look at what’s happening across both of those sectors with the amount of capital and the amount of activity that is currently in the energy sector, it truly is staggering how much capital is being spent and how much new capital is coming to support the spending of the industry.

“When you look at the private equity side of the equation, whether it’s on the upstream or the infrastructure side, at Citi we track capital rates for the purpose of investing in energy sector. When you look at upstream and midstream, right now there’s about $30 billion of available capacity to the investor.”

Brad Thielemann, director, EnCap Investments LP: That’s the number I’ve seen as well -- $30 billion available. This year we looked at funds that are currently raising money just for oil and gas opportunities, and it’s $27 billion to $28 billion being raised. As we look at all the deals, we think that [number] will get raised.

“There’s a lot of appetite from institutional investors. I think there are a lot of reasons for that -- just from a macro standpoint and trying to figure out what sectors they want to be in. They’ve watched since the early 2000s and seen pretty strong returns. I think it’s good for the industry. We’ve gotten to the point where with all of these resource plays it’s really capital intensive. The average well back in 2001 was about $1 million. Ten years later it’s more than $5 million. Just the intensity of capital going into the ground is much greater.”

Hana Askren, Mergermarket, the panel moderator: “The most interesting aspect of financing for me is that there seems to be a divide in the way E&P companies think about financing. That goes for M&A as well as operations. Some, like the infamous company that shall not be named, run their companies on the edge of the balance sheets and use any financing structure available, from royalty trusts, VPPs, JVs with multiple companies, asset sales, debt, and various kinds of equity to bring capital in the door at a reasonable cost, which is something you can do right now and can’t always do.

“But others, like some of the [corporations represented] on the panel today, are more risk-adverse and try to keep their balance sheets simple. As one person said to me, ‘They save their pennies in order to be protected in case of a market or commodity
crash and also so they can take advantage of M&A and other activities when they come up.’”

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