



ENCAP INVESTMENTS L.P.



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## Current Themes in Oil & Gas Financial Markets

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April 13, 2016



## Overview of EnCap Investments L.P.

- Founded in 1988, EnCap is a leading provider of growth equity to the upstream and midstream sectors of the U.S. oil and gas industry
- Raised and managed aggregate capital commitments of over \$27B across 19 funds from an investor base that consists of 300+ institutional investors from 15 countries
- Investment strategy revolves around partnering with management teams comprised of seasoned oil and gas executives with demonstrable track records of success
- Capital provider to 227 oil and gas companies over the last 27 years
- Investment philosophy calls for equal emphasis on capital preservation and value creation; does not rely heavily on leverage

EnCap Energy  
Capital Fund X

**\$6,500,000,000**

*Private Equity*



ENCAP INVESTMENTS L.P.

*April 2015*

EnCap Flatrock  
Midstream Fund III

**\$3,000,000,000**

*Private Equity*

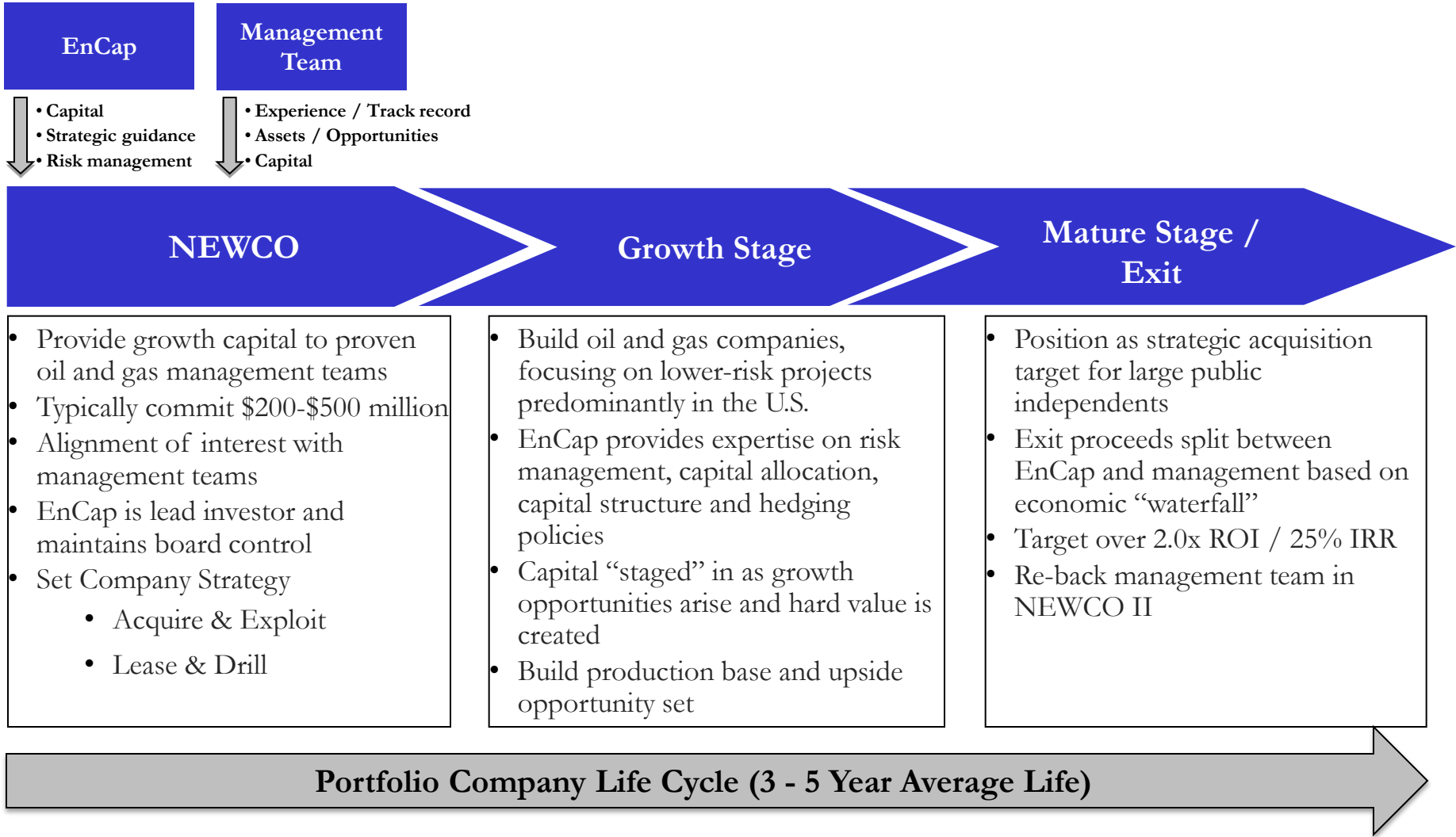


EnCap Flatrock  
Midstream

*May 2014*



# Investment Model





## Portfolio Companies Utilize Various Strategies to Capture Opportunities

- Leasing Acreage
  - Early Stage – emerging plays and/or extensions of existing plays in known producing regions
  - Mid Stage (fast follower) – target highly sought after areas/acreage & execute on land inefficiencies
- Acquisitions
  - Acquire production & exploit undeveloped reserves
  - Acquire shallow production & develop deeper resource upside
  - Acquire small non-operated position to learn → expand position
- Capital & People
  - JV/farm-in with small operator without expertise or capital
  - JV/farm-in with large operator spending capital elsewhere
  - Relationships that lead to proprietary/private negotiated opportunities



## Track Record of Investing Across Cycles

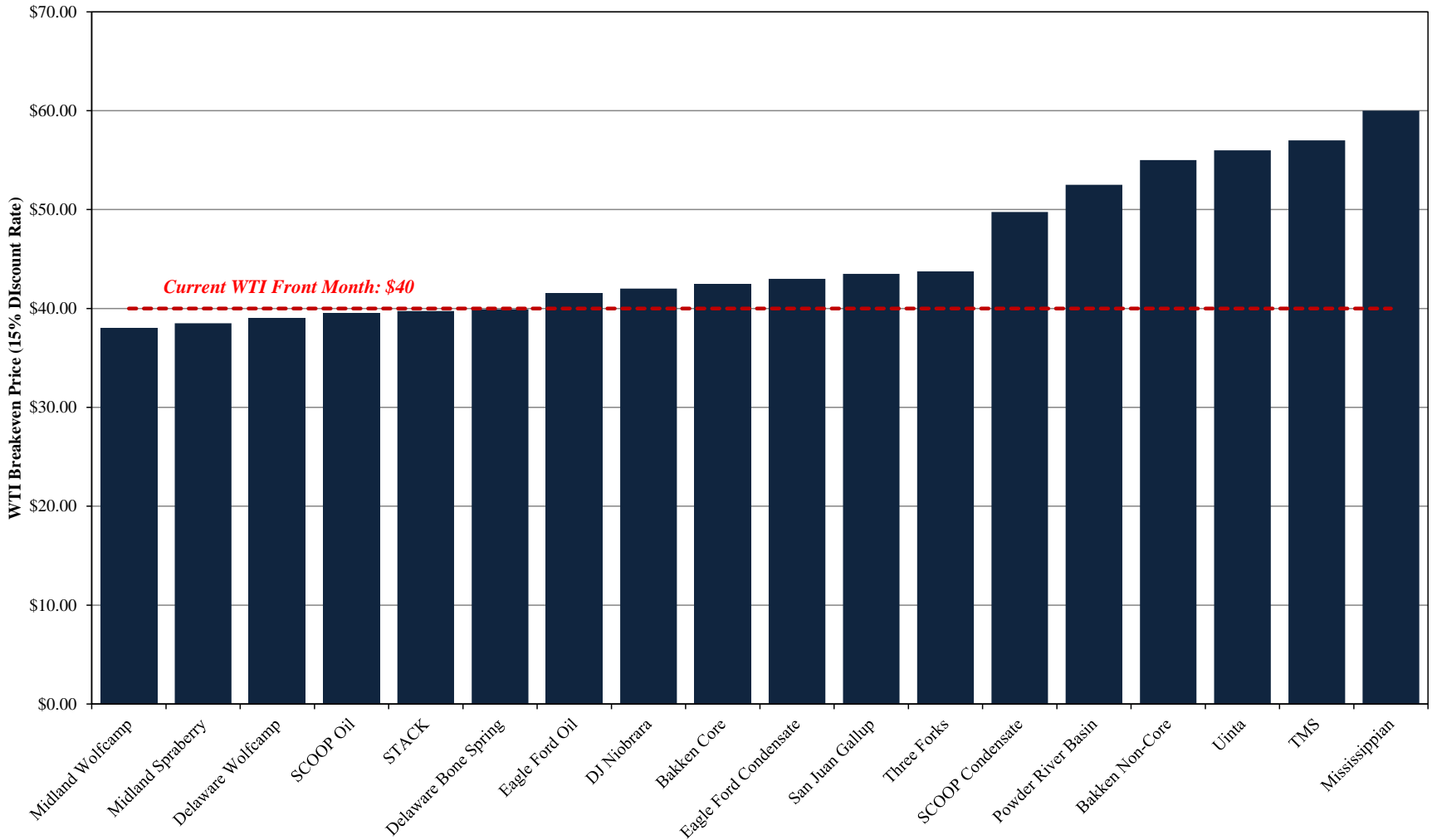
- Consistent approach and results over the last two decades across multiple hydrocarbon price cycles
- 165 monetized / realized investments have generated aggregate returns in excess of our targets





## Breakeven Prices in Oil-Weighted Plays

- Drilling economics across the U.S. are challenged at current commodity prices



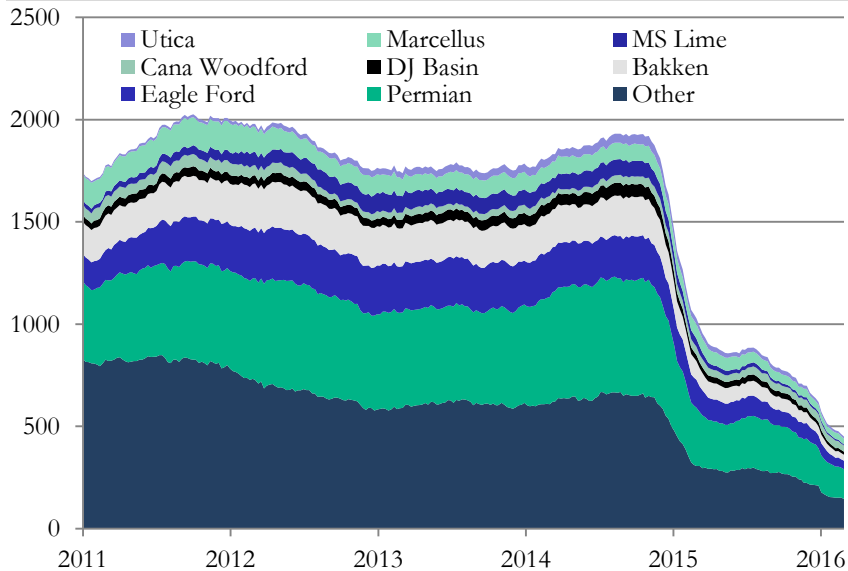
Source: Raymond James, March 2016.



## Industry Reducing Activity

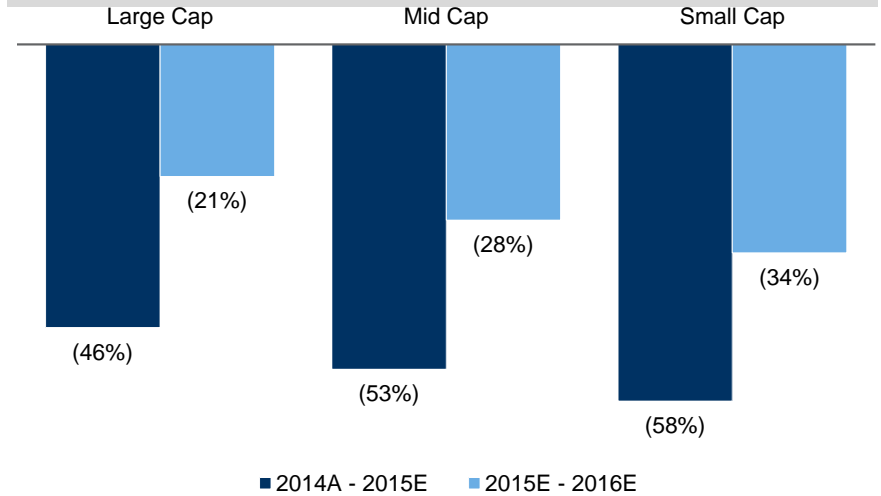
- Incremental ~30% reduction in 2016 capex after ~50% capex reduction in 2015
- Rig count down ~1,500 rigs (~76%) from September 2014 peak<sup>(1)</sup>
- Steep decline profile for shale and tight oil drilling should have near-term impact to supply

### Historical Rig Count by Basin<sup>1</sup>

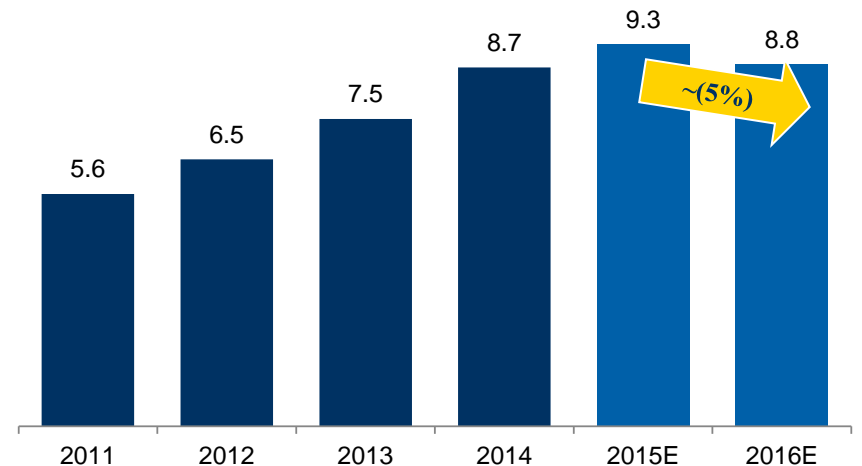


(1) Baker Hughes  
 (2) RBC Richardson Barr

### Significant Capex Reductions<sup>2</sup>



### U.S. Oil Production (MMBo/d)<sup>2</sup>





## Sources of Investment in Oil & Gas

- The availability of third-party capital for the O&G industry has materially changed in the last 18 months

### \$100 Oil Environment (2012 - 2014)

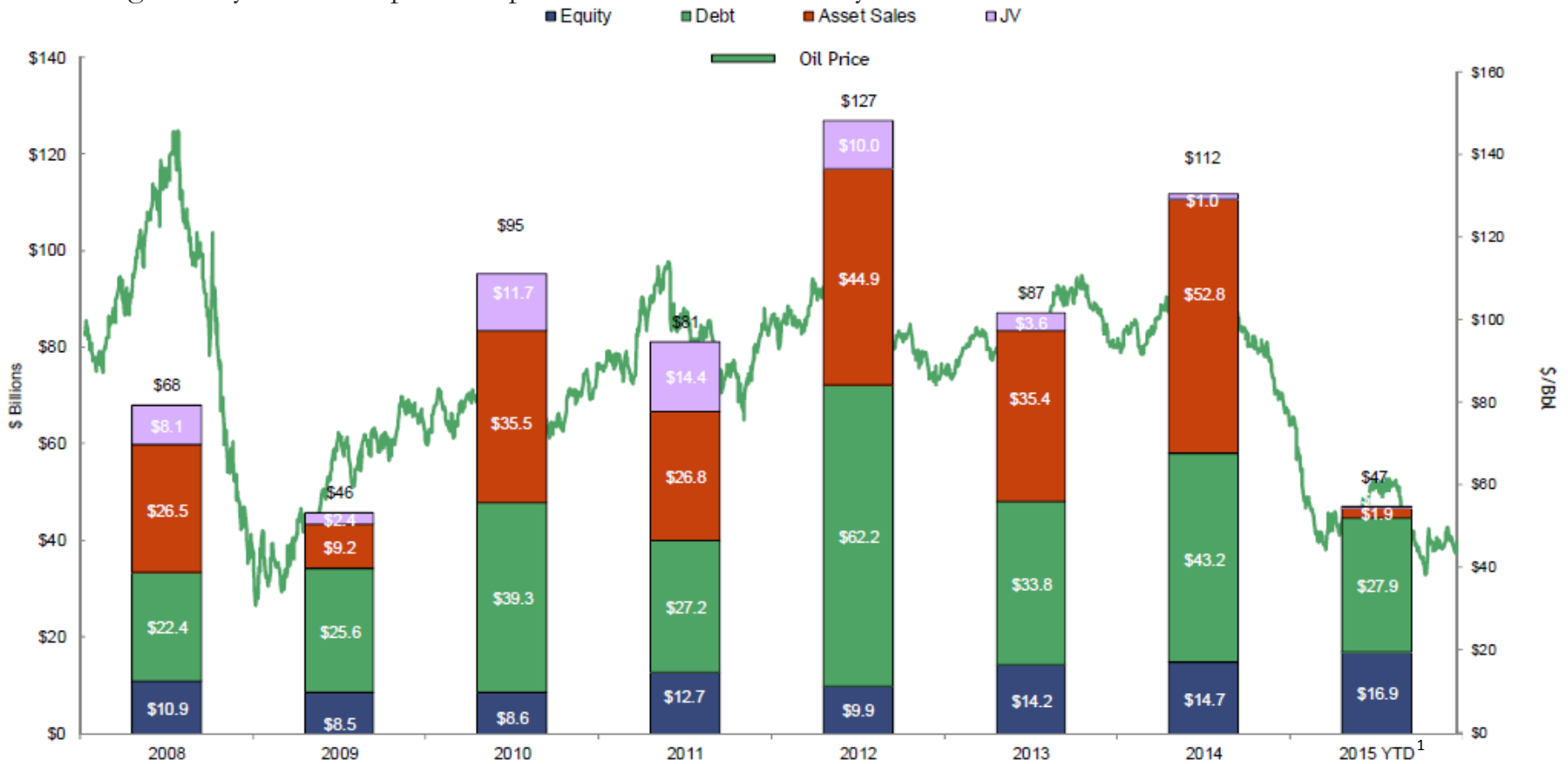
### \$40 Oil Environment (Current)

		\$100 Oil Environment (2012 - 2014)		\$40 Oil Environment (Current)
Debt	High Yield Debt	<ul style="list-style-type: none"> <li>Market wide open at a low cost; record low rates with light covenants</li> <li>Average E&amp;P yield to worst of 5-7%</li> </ul>		<ul style="list-style-type: none"> <li>Market closed for new issuances</li> <li>Average E&amp;P yield to worst of 14%</li> </ul>
	Bank Debt	<ul style="list-style-type: none"> <li>Expanding borrowing bases as PDP reserve value increases with growing production</li> <li>Operators continually replenish borrowing base liquidity through debt and equity offerings used to pay down revolver</li> </ul>		<ul style="list-style-type: none"> <li>Borrowing bases re-determined lower as PDP reserve value declines from reduced price decks and declining production</li> <li>Cautious approach to new loan originations</li> </ul>
Equity	Public Equity	<ul style="list-style-type: none"> <li>Market wide open for both secondary issuances and IPOs</li> <li>Strong stock performance enables accretive equity issuance to fund acquisitions and outspending</li> </ul>		<ul style="list-style-type: none"> <li>Market closed except for highest quality secondary issuers; IPO market completely closed</li> <li>Equity market weakness results in prohibitive cost of equity for most issuers</li> </ul>
	Private Equity	<ul style="list-style-type: none"> <li>Significant energy-focused private equity available</li> <li>New energy-focused private equity funds raised from generalist funds in response to increasing opportunity set</li> </ul>		<ul style="list-style-type: none"> <li>Significant "dry powder" from energy-focused private equity funds remains on the sidelines and seeking opportunities</li> <li>Shrinking opportunity set from lower prices results in increased competition for core assets</li> </ul>
Assets	Acquisition & Divestiture Market	<ul style="list-style-type: none"> <li>Operators regularly divest non-core properties to large buyer universe to fund continued outspending of cash flow</li> <li>Acreage multiples increase as resource plays are de-risked</li> </ul>		<ul style="list-style-type: none"> <li>Prohibitive bid-ask spread develops between buyers and sellers due to uncertainty around future price environment</li> <li>Universe of economic assets shrinks, placing a scarcity premium on core properties</li> </ul>



## Sources of Investment in Oil & Gas

- From the aftermath of the financial crisis through 2014, operators relied on a mix of equity, debt and asset sales to finance capital expenditures (both acquisitions and drilling) that outpaced operating cash flows
- During periods of decreasing commodity prices, A&D activity tends to decrease as bid-ask spreads widen and drilling activity slows as operators pursue cash flow neutrality



Source: TPH; excludes private placements

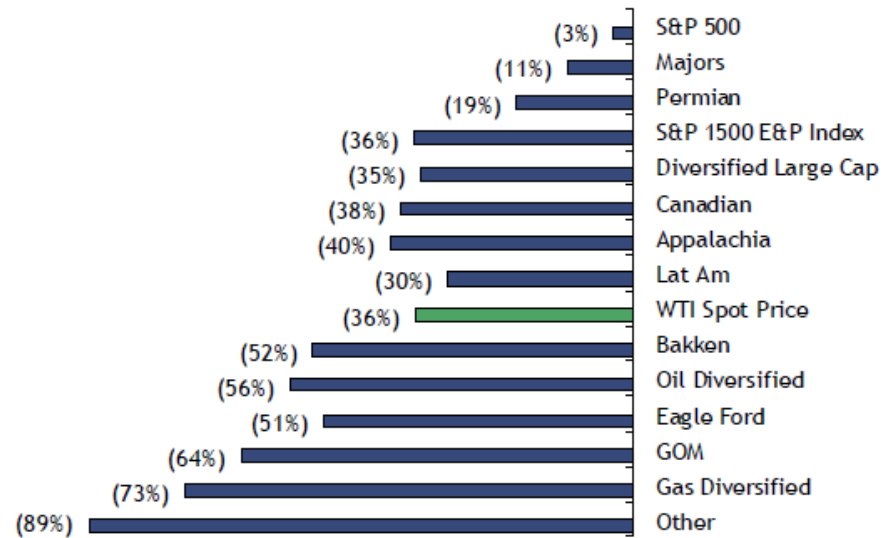
1) Through November 2015



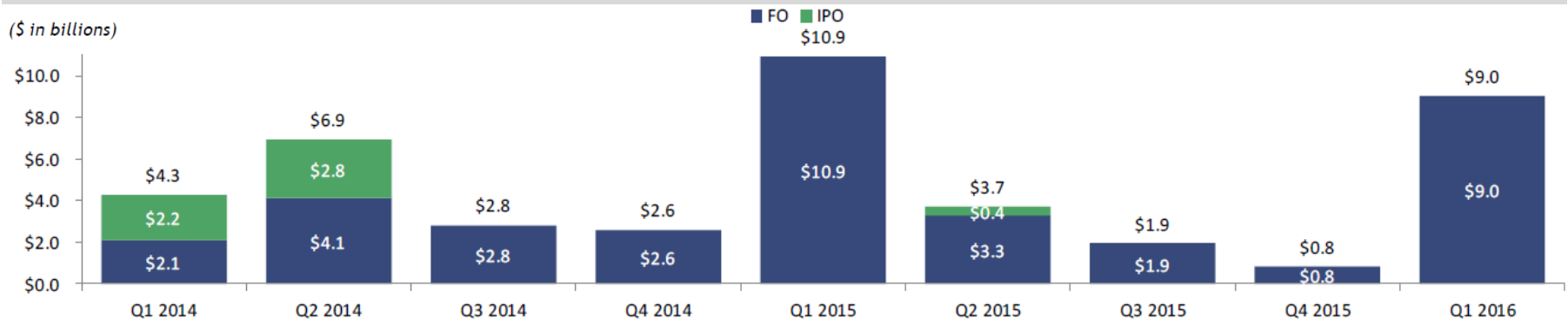
## Public Equity Markets

- From 2012 – 2014, healthy equity capital markets enabled E&Ps to continually outspend cash flow
- IPO market peaked in Q2 2014 before closing down as commodity prices and equity valuations materially declined
- Q1 2015 experienced a high volume of secondary offerings as equity investors predicted a “V-shaped recovery” in commodity prices
- In Q1 2016, E&Ps re-entered the equity markets to protect their balance sheets in a “lower for longer” commodity price world

### Equity Performance Since 2015 WTI Peak (6/10/2015)<sup>1</sup>



### E&P Equity Issuance Since 2014<sup>2</sup>



(1) As of 3/24/2016  
 (2) Source: TPH



## 2016 YTD Equity Issuance

- Similar to Q1 2015, the E&P equity window opened up in Q1 2016, with \$9.0 billion of equity being issued in Q1 2016 vs. \$10.9 billion of issuance in Q1 2015
- Ability to access equity markets has primarily been limited to operators with high quality assets and relatively sound balance sheets
- Equity offering proceeds have predominantly been used to pay down outstanding borrowings on credit facilities and improve balance sheets
- Investors have been rewarded for participating in 2016 E&P secondary offerings with an average gain of 27% to-date

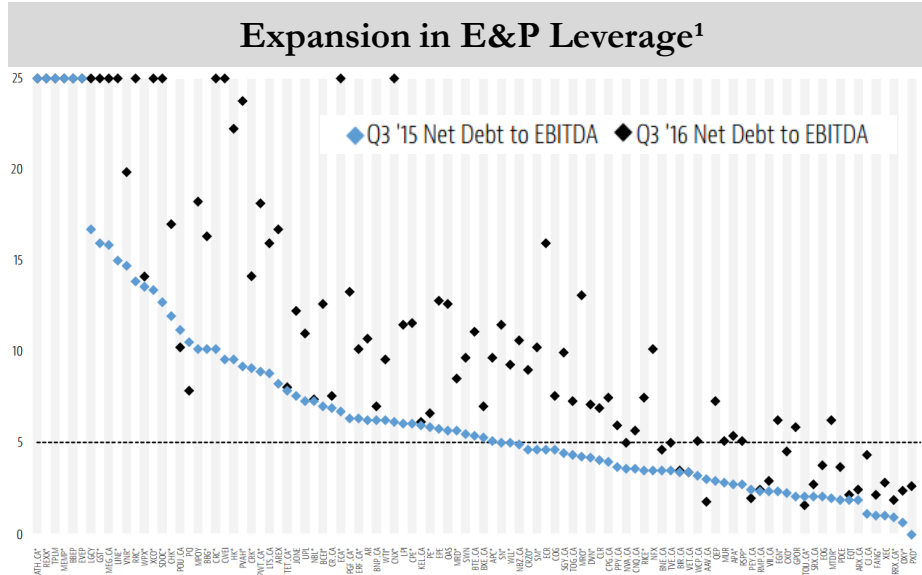
Pricing Date	Issuer	Deal Type	Deal Value \$MM	Deal as % of Mkt. Value	% Secondary	% Price Change		
						File/Offer	1-Day	Current
3/9/16	Gulfport Energy Corp	FO	\$371	12.9%	0.0%	(4.6%)	1.5%	9.5%
3/7/16	Matador Resources Co	FO	\$144	8.5%	0.0%	(2.9%)	(5.6%)	(2.2%)
3/7/16	PDC Energy Inc	FO	\$306	14.6%	0.0%	(2.1%)	1.6%	11.7%
3/3/16	Callon Petroleum Co	FO	\$86	15.6%	0.0%	(5.0%)	12.8%	28.9%
3/1/16	Antero Resources Corp	FO	\$245	3.9%	100.0%	(4.4%)	5.9%	13.0%
2/29/16	Marathon Oil Corp	FO	\$1,109	19.9%	0.0%	(6.8%)	4.1%	34.5%
2/29/16	QEP Resources Inc	FO	\$330	17.4%	0.0%	(7.1%)	(3.9%)	33.9%
2/26/16	Newfield Exploration Co	FO	\$698	17.5%	0.0%	(4.8%)	12.0%	39.3%
2/22/16	Cabot Oil & Gas Corp	FO	\$880	9.9%	0.0%	(7.2%)	(3.7%)	9.9%
2/19/16	EQT Corp	FO	\$380	4.1%	0.0%	(4.0%)	0.7%	10.4%
2/17/16	Devon Energy Corp	FO	\$1,294	15.5%	0.0%	(7.8%)	5.1%	41.2%
2/17/16	Energen Corp	FO	\$334	18.5%	0.0%	(7.6%)	20.7%	60.6%
2/4/16	Hess Corp	FO	\$975	7.8%	0.0%	(10.3%)	(2.5%)	33.6%
1/28/16	Oasis Petroleum Inc	FO	\$161	21.4%	0.0%	(10.9%)	12.9%	50.6%
1/21/16	Synergy Resources Corp	FO	\$81	11.6%	0.0%	(8.6%)	1.7%	31.7%
1/13/16	Diamondback Energy Inc	FO	\$226	5.8%	0.0%	(3.5%)	10.9%	37.0%
1/5/16	Pioneer Natural Resources Co	FO	\$1,404	7.5%	0.0%	(6.5%)	(0.7%)	19.0%
<b>Median</b>			<b>\$334</b>	<b>12.9%</b>	<b>0.0%</b>	<b>(6.5%)</b>	<b>1.7%</b>	<b>31.7%</b>
<b>Mean</b>			<b>\$531</b>	<b>12.5%</b>	<b>5.9%</b>	<b>(6.1%)</b>	<b>4.3%</b>	<b>27.2%</b>

(1) Source: TPH



# High Yield Debt

- High yield markets supplied the largest source of external capital to the E&P sector during 2012 – 2014
- Consistent with equity markets, high yield investors bought into the V-shaped recovery thesis during 1H 2015
- The high yield market effectively closed in 2H 2015 as commodity prices continued to decline

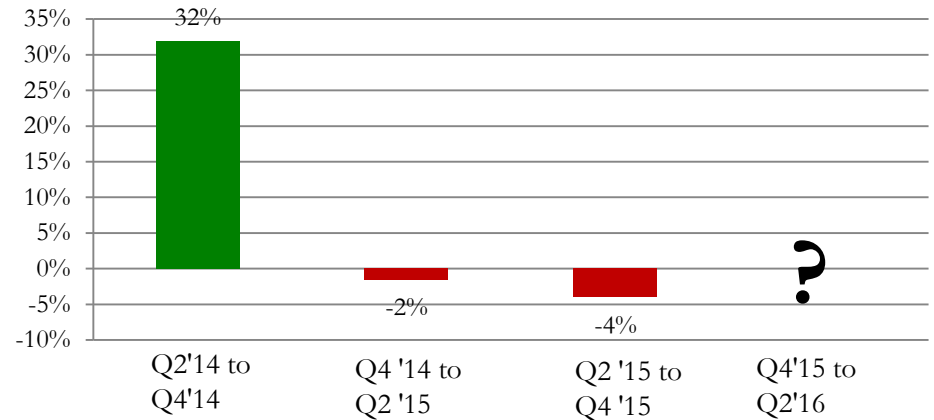




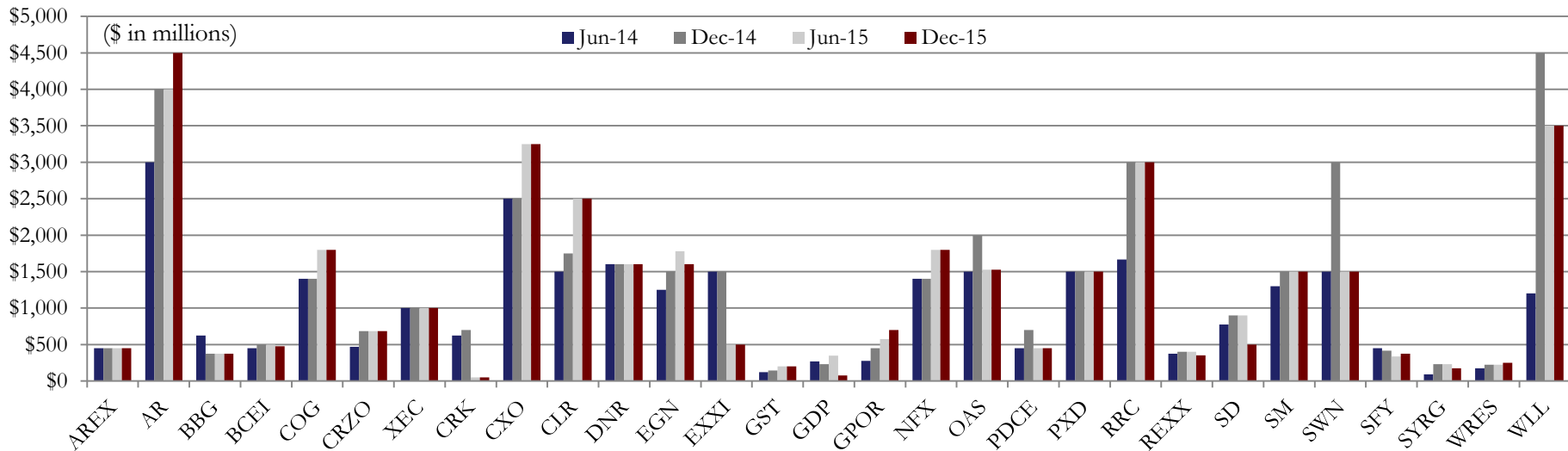
# Reserve-Based Loans

- Reserve-based loans are senior secured lines of credit underwritten to the value of a company's PDP reserves
  - Represent primary source of liquidity for operators
- Borrowing bases have been resilient due to production growth, acquisitions, hedges, and lenient banks, BUT many of those factors are temporary
- Operators with lower-quality assets and high-leverage are facing increased scrutiny from banks
- Cautious approach toward new issuance due to increased scrutiny from the regulators

## Average Change in Borrowing Base



## Semi-Annual Borrowing Base Changes



Source: Keybank Capital Markets



## E&P Debt Extinguishment

- Over-levered operators have undertaken debt exchanges, restructurings, and bankruptcies to eliminate debt from their balance sheets in an effort to create a viable entity with a manageable leverage profile
- Since 2015, there have been 37 bankruptcies and 11 debt exchanges across 27 securities, representing a total of ~\$27 billion of debt being restructured

E&P Debt Exchanges (2015 - Current)						
Company	Date of Exchange	Maturity	Rate on Old Note	Par Amt Exchanged	Exchange Price (% of Par)	Rate on New Note
American Energy Partners	6/23/2015	2022	9.00%	\$ 340	70.0%	12.00%
California Resources	12/11/2015	2020	5.00%	534	80.0%	8.00%
California Resources	12/11/2015	2021	5.50%	921	80.0%	8.00%
California Resources	12/11/2015	2024	6.00%	1,358	80.0%	8.00%
EXCO	10/26/2015	2018	7.50%	376	50.0%	12.50%
EXCO	10/26/2015	2022	8.50%	201	50.0%	12.50%
EXCO	11/2/2015	2018	7.50%	175	43.0%	12.50%
EXCO	11/2/2015	2022	8.50%	76	43.0%	12.50%
Halcon Resources	12/18/2015	2020	9.75%	117	39.0%	12.00%
Halcon Resources	12/18/2015	2021	8.88%	138	39.0%	12.00%
Halcon Resources	12/18/2015	2022	9.25%	35	39.0%	12.00%
LINN Energy	11/12/2015	2019	6.50%	584	50.0%	12.00%
LINN Energy	11/12/2015	2019	6.25%	824	50.0%	12.00%
LINN Energy	11/12/2015	2020	8.63%	286	50.0%	12.00%
LINN Energy	11/12/2015	2021	7.75%	184	50.0%	12.00%
LINN Energy	11/12/2015	2021	6.50%	121	50.0%	12.00%
Midstates Petroleum	5/21/2015	2020	10.75%	280	80.0%	12.00%
Midstates Petroleum	5/21/2015	2021	9.25%	350	80.0%	12.00%
PetroQuest Energy	2/17/2016	2017	10.00%	214	67.5%	10.00%
SandRidge	10/8/2015	2020	8.75%	7	75.0%	8.13%
SandRidge	10/8/2015	2021	7.50%	189	75.0%	8.13%
SandRidge	10/8/2015	2022	8.13%	74	75.0%	8.13%
SandRidge	10/8/2015	2023	7.50%	31	75.0%	8.13%
Vanguard Natural Resources	2/5/2016	2020	7.88%	168	45.0%	7.00%
Venoco	4/2/2015	2019	8.88%	194	77.5%	8.88%
Warren Resources	5/26/2015	2022	9.00%	70	61.4%	L+850
Warren Resources	10/22/2015	2022	9.00%	63	63.6%	12.00%

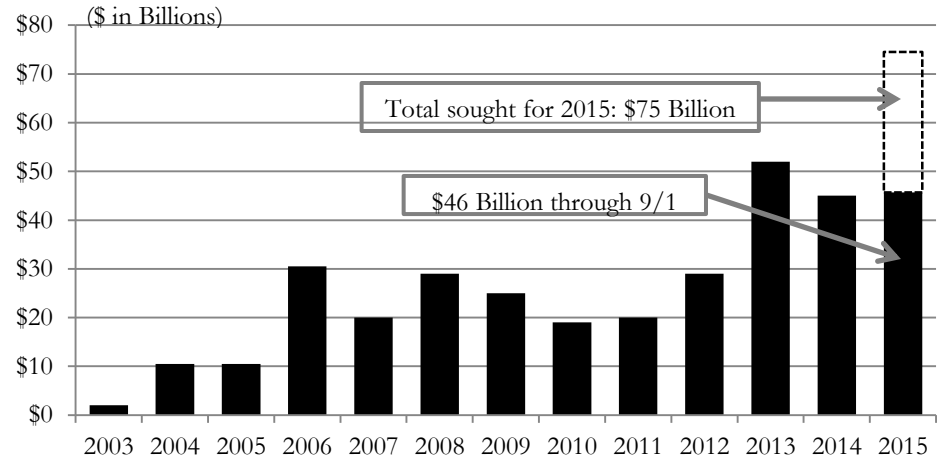
US Oil & Gas Bankruptcies (2015 – Current)		
Company	Filing Date	Debt (\$MM)
Osage Exploration & Development	2/3/16	\$25.1
Swift Energy Company	12/31/15	\$1,200.0
New Gulf Resources, LLC	12/17/15	\$575.0
Magnum Hunter Resources Corp.	12/15/15	\$1,019.8
Cubic Energy, Inc.	12/11/15	\$126.4
Transcoastal Corp.	12/8/15	\$21.9
Energy & Exploration Partners	12/7/15	\$1,204.6
Parallel Energy, LP	11/9/15	\$168.9
Escalera Resources Co.	11/5/15	\$42.8
Republic Resources, LLC	10/31/15	\$11.2
RAAM Global Energy Company	10/26/15	\$304.1
AIX Energy, Inc.	10/22/15	\$34.8
Miller Energy Resources, Inc.	10/1/15	\$2,165.5
Samson Resources Corp.	9/16/15	\$4,331.7
Continental Exploration, Inc.	9/2/15	\$4.3
Buckingham Oil Interests, Inc.	9/1/15	\$3.5
Armada Oil Inc.	8/31/15	\$3.1
American Natural Energy Corp.	8/31/15	\$22.7
Sable Operating Company	8/28/15	\$16.5
Black Elk Energy Offshore	8/11/15	\$144.7
Samco Oil, LLC	8/10/15	\$0.9
Luca International Group, LLC	8/6/15	\$2.8
American Standard Energy Corp.	8/3/15	\$38.4
Sabine Oil & Gas	7/15/15	\$2,861.2
Milagro (Holdings) Oil & Gas, Inc.	7/15/15	\$1,072.7
Arabella Petroleum	7/10/15	\$18.2
Sefton Resources (dismissed)	7/8/15	-
Saratoga Resources (Harvest)	6/18/15	\$206.0
Primera Energy	6/3/15	\$7.2
Sun River Energy	5/21/15	\$11.6
Duer Wagner Oil & Gas	5/15/15	\$122.2
American Eagle Energy Corp.	5/8/15	\$193.6
ERG Resources, LLC	4/30/15	\$401.6
Quicksilver Resources	3/17/15	\$2,074.1
BPZ Resources, Inc.	3/9/15	\$238.5
Dune Energy, Inc.	3/8/15	\$107.9
WBH Energy Partners	1/3/15	\$48.9



# Private Equity

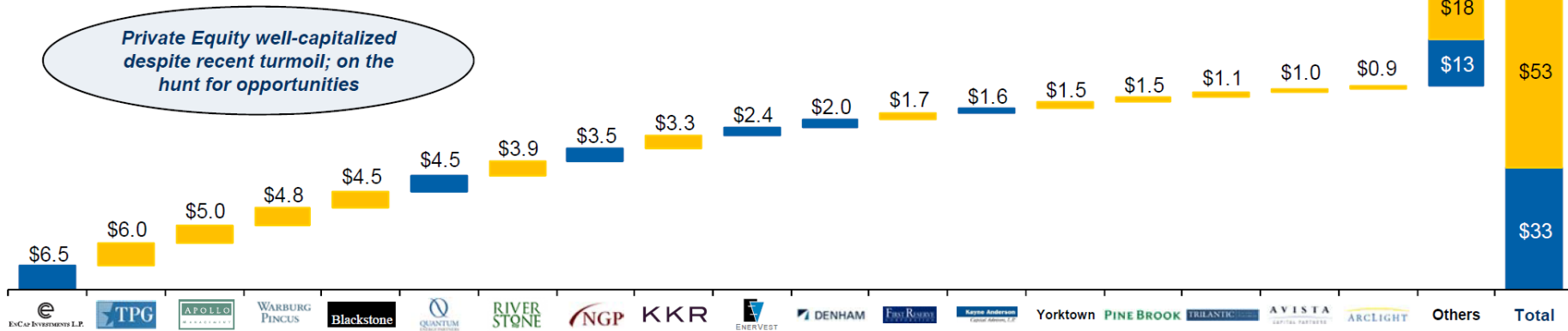
- Energy-focused private equity fundraising has steadily increased in response to the increased opportunity set and capital need associated with the development of resource plays
- 2015 was the third consecutive year of strong energy-focused private equity fundraising as investors sought to capture opportunities created by the downturn in oil and gas prices
- Private equity will play a key role in providing capital to the energy industry in the wake of restricted capital markets and A&D markets

## Energy Private Equity Fundraising<sup>1</sup>



## Active Financial Sponsors in the E&P Space – Most Recent Vintage Fund Size<sup>2</sup>

■ Non-Texas-based
 ■ Texas-based



(1) Source: Preqin as of September 2015

(2) Source: RBC Richardson Barr



# Multiple Forms of Private Equity Capital Available

## Energy Private Equity

ENCAP

DENHAM CAPITAL

NGP

LIME ROCK PARTNERS

QUANTUM ENERGY PARTNERS

THE ENERGY & MINERALS GROUP

ARCLIGHT

EnergyCapital Partners

FIRST RESERVE CORPORATION

RIVER STONE

Kayne Anderson  
Capital Advisors, L.P.

## Generalist Private Equity

APOLLO

KKR

TPG

Blackstone

WARBURG PINCUS

TRILANTIC CAPITAL PARTNERS

CCMP CAPITAL

## Drilling Partners

KKR

ELLIOTT

APOLLO

IOG CAPITAL

EIG GLOBAL ENERGY PARTNERS

## Credit Oriented

EIG GLOBAL ENERGY PARTNERS

THE CARLYLE GROUP

GSO

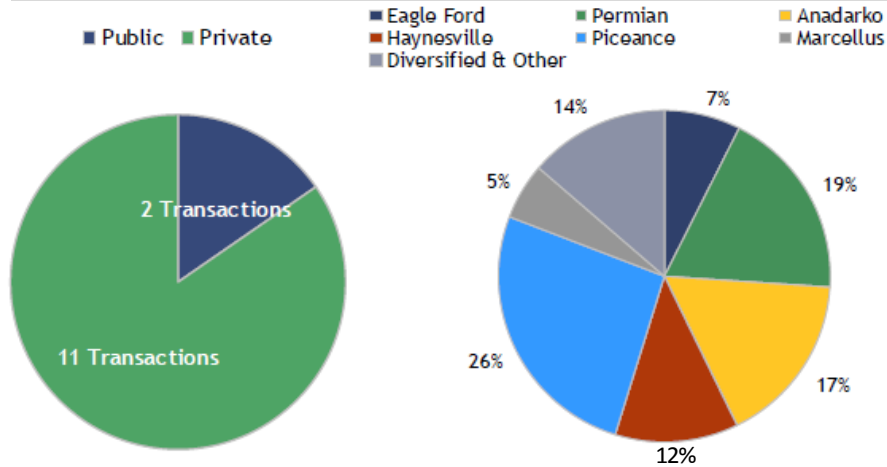
MAGNETAR CAPITAL



## Acquisition & Divestiture Market

- Consistent A&D transaction volumes define the period from 2010 – 2014, which was characterized by steady and generally rising oil prices
- The A&D market was largely frozen during 2015 due to extreme oil price volatility that led to large spreads between buyer and seller expectations
- 2016 YTD activity has remained muted as commodity price uncertainty remains high and sellers have been able to avoid forced divestitures through equity issuances and bank negotiations

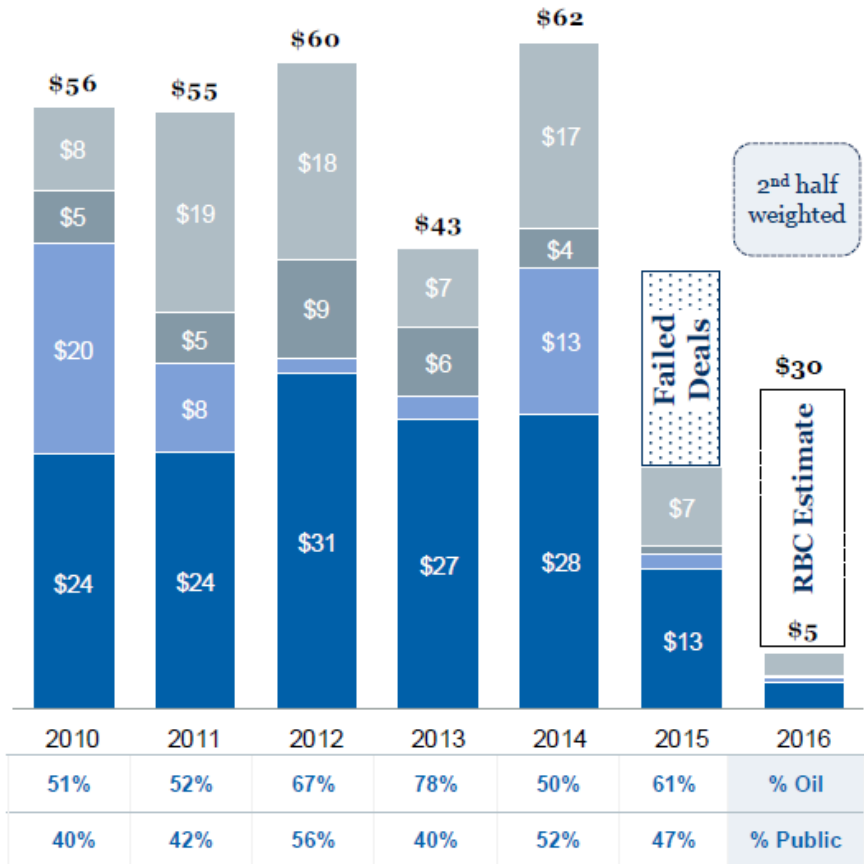
### 2016 YTD Transactions by Basin and Buyer Type<sup>1</sup>



1) Source: TPH  
2) Source: RBC

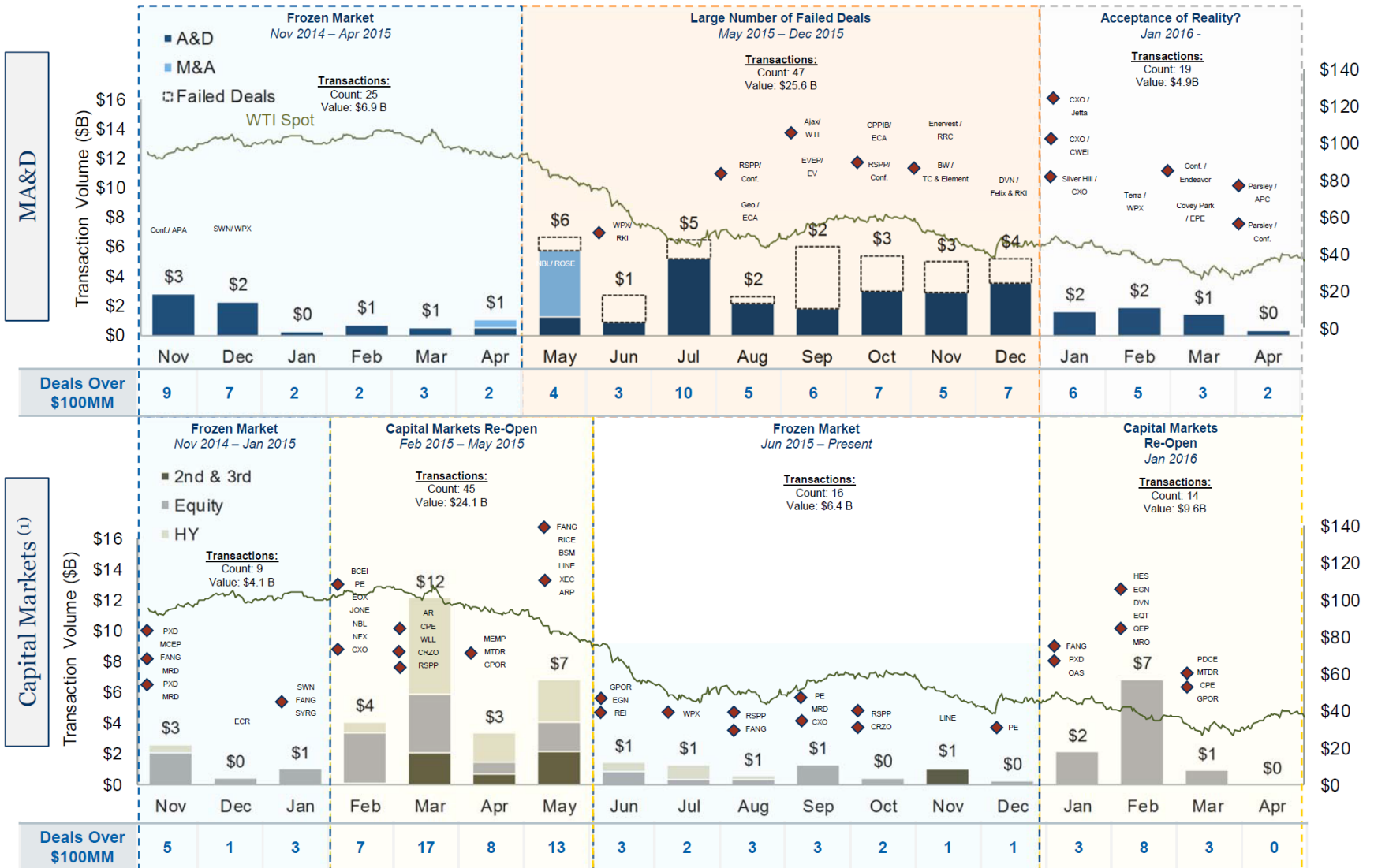
### Historical M&A Transaction Volumes (\$Bn)<sup>2</sup>

- Oil Resource Play
- Gas Resource Play
- Conventional Oil
- Conventional Gas





# E&P Funding Availability Closely Correlated to Oil Prices



Source: RBC Richardson Barr



## Key Takeaways

- Oil & gas financial markets have been highly volatile since commodity prices peaked in July 2014
  - Equity capital markets: after closing in 2H 2015, market re-opened to high quality issuers with relatively clean balance sheets in Q1 2016. IPO window has been closed since end of 2014
  - High yield markets: due to current over-levered nature of the industry, market remains closed with no new issuance in 2016 to-date
  - Debt restructurings: over-levered operators are undertaking debt exchanges and other restructurings to reduce leverage and create a balance sheet positioned to survive prolonged commodity price weakness
  - Private equity: record fundraising in recent years as investors seek to take advantage of distressed energy opportunities
  - A&D market: transaction volumes have been muted since the downturn began due to a wide bid-ask spread between buyers and seller. Activity expected to increase as commodity price volatility declines
- In recent months, oil prices have improved in response to drastic reductions in capital investment and the materialization of production declines
  - Prices will stabilize and volatility will decline after supply and demand is balanced and the inventory glut begins to be worked off
  - If the bottom in commodity price proves to be sustainable, the A&D market, IPO market, and high yield market will gradually re-open up as capital begins to be re-deployed into the industry



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