Executive Summary of an Exclusive Networking Event Q3 2015

Privcap/Presents

A Conversation With

James Hackett
Riverstone Holdings

Karl Kurz
Canyon Oak Energy

With insights from:

Vinson & Elkins LLP

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About Privcap Presents

Privcap Presents is a series of invitation-only networking events designed to bring together GPs, LPs and other guests. The events are organized by Privcap Media and hosted in partnership with leading professional service providers.

Each Privcap Presents event begins with an intimate, on-stage interview with a notable leader from the private equity industry. A transcript of that interview is used as the basis for a digital report (like the one you're reading now) that is made available to Privcap's global audience. Also included in Privcap Presents reports are perspectives from the event partners, including a non-profit selected by the featured interviewee.

Energy's **Trillion-dollar** Evolution

Two former **Anadarko Petroleum** executives discuss the state of the private equity opportunity in energy and compare notes on their transition from a prominent public corporation to fleet-footed private investors

Speakers

James Hackett
Partner,
Riverstone Holdings

Karl Kurz
Senior Advisor,
Canyon Oak Energy

➜ BIO

Hackett is a partner at Riverstone. Previously he was chairman of the board and CEO of Anadarko Petroleum Corp., was president and COO of Devon Energy Corp. following its merger with Ocean Energy, and has also held senior positions at Seagull, Duke Energy, and Pan Energy. In addition, he's had positions in engineering, finance, and marketing with NGC Corp., Burlington Resources, and Amoco Oil Corp. He received a B.S. from the University of Illinois and an MBA from Harvard Business School.

➜ BIO

Kurz is a senior advisor to Canyon Oak Energy, serves as a member of the advisory board at Talara Capital Management, and served as the managing director and co-head of the energy group of CCMP Capital Advisors. He was also the chief operating officer—among other senior positions—at Anadarko Petroleum Corp. He previously worked for Atlantic Richfield Corp., Vastar Resources, and ARCO Oil & Gas Company. He holds a B.S. from Texas A&M University and is a graduate of Harvard Business School's Advanced Management Program.

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At a Privcap Presents event on June 3rd in Houston, **James Hackett** and **Karl Kurz** reunited onstage for a candid conversation about the state of the energy business and the role that private capital will play in its continued evolution. Hackett, the former CEO of Anadarko Petroleum, and Kurz, the company's former COO, discuss technological advances in energy, why private equity returns may not live up to expectations, and what gives PE an edge in partnering with entrepreneurial energy operators.

David Snow, Privcap: Private equity has been playing a bigger and bigger role in the energy sector. Now that the world has changed with regard to oil prices, how will the role of private equity change?

James Hackett, Riverstone: It's clearly going to play a bigger role, because the strategic money has retreated in a big way, at least in terms of cap-ex. The $80B that's been raised so far by the PE universe is going to play a much bigger role in financing the industry. But it's intriguing to me that the role we thought we were playing has not exactly followed the playbook.

The very active M&A market that we thought might be appearing within a six-month period of the oil prices drop is not there. When you hear executives at Anadarko—who aren't fond of speaking in superlatives— saying it's a seller's market for assets, you've got to perk up.

There's a lot of money out there still chasing the available opportunities. If oil prices stay where they are for much longer, let's say another year, I do think some of that activity will pick up.

PE will play a large role, and there are huge capital needs in the industry. But I don't think [PE] plays as big of a role as it probably thought it would, and it probably isn't going to have the kind of compelling returns that a lot of people thought it would.

Karl Kurz, Canyon Oak: I agree. Talking about returns, I've always said it's hard to maintain a 1,000-basis-point difference from what is considered the risk-free rate of return on capital. Private equity groups think they can deliver 19 percent, 20 percent when the long bonds are 2 percent to 3 percent. Even a few years ago, we saw bids coming in from some large PE firms that were bidding stuff down to the 12 percent to 14 percent rate of return.

Actually, there are a lot of LPs out there now that would love to have 12 percent to 14 percent rates of returns. The liquidity out there is huge. The money is still going to come into this space. It's one of the best places to put money to work.

There are a couple of deals we're looking at right now that are very novel concept plays in large-producing basins that the majors are not aware of and large public companies are not aware of.

The acreage game is over. I don't think there's going to be another huge Bakken play, Eagle Ford play, or Permian play—whether it's Delaware Basin or Midland Basin. Everything's gotten tied up.

You're not going to make a lot of money in the PE space from flipping things. You're going to see a shift back to buying producing assets and having to operate them well, which the private equity world hasn't really been good at. We've basically been able to throw money at stuff, group acreage, and flip it.

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>
> –James Hackett, Riverstone

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James Hackett
Karl Kurz
David Snow

Above: Hackett and Kurz discuss a question from Privcap CEO David Snow. *Right:* Guests network and watch the interview.

Privcap/
Vinson&Elkins LLP

What are some examples of capabilities that private equity firms have that other players do not?

Hackett: You have access to a world that the public companies don't, because of either size or the nature of the money. There is a large entrepreneurial community in that smaller space feeding the system for the larger companies. It's where innovative ideas occur.

But in private equity, you're funding several firms at one time. What you miss is having one mission, one team, doing something for a long-dated purpose.

Kurz: On the question of advantages private equity has over public companies, my first thought is compensation. The private equity business is very attractive from a compensation perspective. The ability right now of private equity to attract management teams is unparalleled. When Jim and I were in the public space, we never really worried about losing anybody to private equity startups. Now the public companies are faced with that threat all the time.

Aside from compensation, what attracts talented management to private equity?

Kurz: A lot of it's [that you get to] run your own show. It's the freedom. If your career is not going as fast as you want, you have this ability to go out and grab a few of your colleagues that you think are really sharp and run your own show and pursue your concepts.

What advice would you give to an entrepreneurial energy operator who's thinking about partnering with a private firm?

Kurz: I'd tell them to come talk to me before they talk to Jim.

Hackett: But we'd still get them.

Kurz: Choosing your private equity partner is critical. Do as much due diligence on your potential partner as they're going to do on you. And I tell my friends, "If you want to take my money and be a portfolio company, the best scenario we're going to have is that you still might be my friend." Because when you're putting LP money to work, it creates tension. And if things don't go as planned, that tension can be intense. We have returns we're trying to meet. We're trying to manage people's money, and there's a huge moral responsibility.

Hackett: I'd add to that simply that the culture of who you join up with is important. Do you want to be managed actively or not? There are some PE firms that like to actively manage. They actually put 25-year-olds with spreadsheets in front of you in a board meeting and ask you questions. That's not exactly what I would want. If

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you're investing in me, you're investing in me. And if I fail, I'm out the door.

For the benefit of people in this room who perhaps are not private equity junkies, can you paint a picture of why large institutional investors are finding private equity energy opportunities so attractive?

Kurz: Energy is one of the few spaces in private equity where you can put large amounts of capital to work. And it has one of the higher return areas in private equity. At CCMP [Capital Advisors], we had four sectors. We had energy, we had consumer and retail, we had healthcare, and we had industrial. And energy would always beat the other sectors on a long-term basis. It's also one of the most liquid markets in terms of getting out of your deals, and that's very attractive to the LPs.

Hackett: You can't replicate what private equity does very easily on your own. You have to have infrastructure to take advantage of opportunities in many businesses and many institutions. And what private equity provides the institutional investor is infrastructure to deal with portfolio teams, to get repeat access to teams, to value deals, to screen deals.

What do you predict will be some of the dominant themes over the next five to 10 years in the private equity energy world?

Hackett: I have a very robust view of future oil prices and a fairly modest view of gas prices. And if that's true, you have trillions of dollars of capital to find.

Do I see a revolutionary technology on the horizon? No. Do I think wind and solar are an answer? Hell no. Do I think that ethanol is an answer? Not in your wildest dreams. Until we develop battery technology that can store energy from intermittent sources, I don't think you get any better than where we're currently at.

Energy remains a very important sector of the world and is still one of the four pillars of physical existence. It's going to have huge demands for capital. The margins are going to be squeezed a bit. Maybe everybody will get comfortable with a lower rate over time.

To what extent are each of you interested in investing outside the U.S. and Canada?

Hackett: Mexico is interesting to us, because it is nearby. We found a local team there that we can trust.

We've gone to Angola, we've gone to Brazil, but it's all been because the portfolio team took us there with the skill sets they had because they had worked in those areas. We've done some shale stuff in the U.K. because of John Brown running our office there.

Kurz: I used to work with a guy who said, "We're never going to go anywhere internationally that you and I aren't willing to go ourselves." I like the lower 48. I like the countries that touch us.

Jim, you said you don't predict any revolutionary energy technologies around the corner. But in what areas of the oil and gas business do you think technological innovation will have the biggest impact?

Hackett: When I say no revolutionary technology, I didn't exclude evolutionary. There's a lot of evolutionary technology in our business. What we do all the time—with regard to different frack patterns, with regard to how you're drilling each portion of the curve, what fluids you're using—all

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of that is evolutionarily improving, which is allowing some people to, at least in the core areas, do really well at $60-a-barrel oil.

There is an unbelievable amount of evolutionary technologies throughout every space in the services sector, in the downstream, in the upstream. The midstream's a little harder. It's a little more conventional. But there is still more to be done there with different compression capabilities.

Kurz: You have to look at where you can create the most value. And so the first phase is in the capital cost, right? The biggest capital costs we have are the drilling and completion. What we're doing technology-wise is amazing. I'm affiliated with Canyon Oak Energy as an adviser, and they have an unbelievable concept to improve the drilling performance of these long horizontal wells. It's not magic; it's known technology, but putting the right processes together.

We're going to see some improvements on the down-hole production side. Getting pumps to operate in a horizontal mode versus a vertical mode is going to be a huge technology change, if somebody could figure that out. ■

Hackett and Kurz answer questions.

The Purest Form of Capitalism

Karl Kurz *explains why he left the corporate world for private investing*

I joined Anadarko [Petroleum] in 2000, and Jim [Hackett] came in in 2003. We made some big decisions to turn it around.

I left Anadarko in April of 2009. This private equity thing was really interesting to me. I thought it was the purest form of capitalism I'd ever seen. I had this play that I was really passionate about that I'd gotten started at Anadarko, called the Eagle Ford. I went to somebody to back it. They wanted me to sign my life away in exchange for them giving me $30M.

And I said, wait a second, [at Anadarko] I was managing billions of dollars of capital. I thought, well, maybe instead of me taking money from these guys, I ought to be the guy giving the money. So then I went to work for a firm called CCMP Capital, which is a multi-sector private equity firm. It had about $10B of assets under management, and I co-headed the energy group there.

I stayed [at CCMP] for three years to learn the private equity space, and then I came to another brilliant conclusion: I could do this myself. So I sat out for a year, and since then, I have basically been choosing who I partner with.

Expert Q&A

With Creighton Smith,
Partner,
M&A and Private Equity,
Vinson & Elkins LLP

How have you seen transactions in the oil space change in the past year, before and after the drop in oil prices?

Transactions have significantly slowed since the drop in oil prices. PwC recently produced a report showing an over 40 percent drop in energy deals in the first quarter of 2015 as compared to the first quarter of 2014. This is consistent with what we have seen: deal volume is down, buyers are wary about transacting in an uncertain commodity price environment, and sellers are reluctant to part with their assets while prices are low. Once prices rebound or at least stabilize, we would expect deal volume to increase.

Private equity firms are well positioned to capitalize on this current price downturn as capital from banks and the high-yield market becomes less accessible. Our energy-focused private equity clients are excited about the opportunity to invest their capital in a lower-price environment and are now looking at distressed oil and gas assets at discounted prices.

In addition, a number of our energy private equity clients continue to sign up line-of-equity capital commitment deals with management teams in an effort to be well positioned to execute on asset transactions when the market rebounds.

What sectors have you seen being impacted the most?

Oilfield services companies and oilfield products manufacturers have been impacted the most by the drop in oil prices. In a lower-price environment, these companies suffer first as drilling activity and related capital expenditures decline and producers pressure their service providers to provide pricing breaks. That being said, there are still transactions getting done in the oilfield services space if the circumstances are right.

Have you seen a change in any of the transactions you advise clients on?

In M&A transactions that are being negotiated, there is a heightened focus on earn-outs and contingent consideration provisions. These provisions have, of course, been around for a long time, but they serve an increasingly important role in an atmosphere of volatile commodity prices where there is a gap between the seller and buyer regarding the perceived value of the assets. In addition, I am personally seeing more joint venture transactions, which provide an effective way for parties to share capital costs and risks in an uncertain environment. ■