

DEEP-POCKETS PARTNER

GE Capital Oil & Gas has already invested more than \$1 billion in upstream partnerships. And its appetite for deals is far from sated.

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For decades, General Electric's slogan has been "We bring good things to life." And starting in 1994, one of its divisions began doing just that in the U.S. onshore oil and gas industry.

Overall, GE Capital Services has investments spanning 28 businesses whose assets total \$345 billion. Within its Structured Finance Group, whose investment portfolio totals \$12 billion, resides GE Capital's Oil and Gas Group. During the past seven years, that group has ponied up through partnerships better than \$1 billion to help small- and midcap U.S. producers make upstream acquisitions and monetize assets. Interestingly, it's now looking to make \$500 million more of domestic E&P partnership investments.

The attraction of this capital: it's low cost and a partnering producer can walk away with a very hefty payday.

"We make direct equity investments in the assets, that is, the reserves of an operator—not in the company itself," explains John Schaeffer, managing director of the GE Capital Oil & Gas Group in Stamford, Connecticut. He notes that during the past decade, the average annual growth rate of independent producer stocks has been a lackluster 5% versus 17% for the S&P and 27% for GE's stock.

"The reserves of producers, on the other hand, trade constantly, and that's what we focus on—investing side by side with operators to purchase assets or monetize them," he says. "Currently, we're active with both public and private independents in virtually all the producing basins in the onshore U.S."

Because GE Capital Oil & Gas is an AAA-rated credit, it brings to the table the kind of low all-in cost of capital that usually only a major oil can access. Says Schaeffer, "We're looking for rates of return in the 11% to 13% range; however, because we've managed to invest with good operators, we've often exited partnerships with annualized returns well north of 20%."

Focused on a predictable net income stream

as well, his group targets investments in proved reserves, whether they're producing, behind pipe or undeveloped; it doesn't pay for probable reserves. "Typically, we strive to make sure that at least 70% of the reserves we acquire with our partners are producing—we're not aggressive financiers of exploration drilling," says Schaeffer. "And to mitigate the volatility of commodity prices, we usually hedge a fair portion of that production, anywhere from three to

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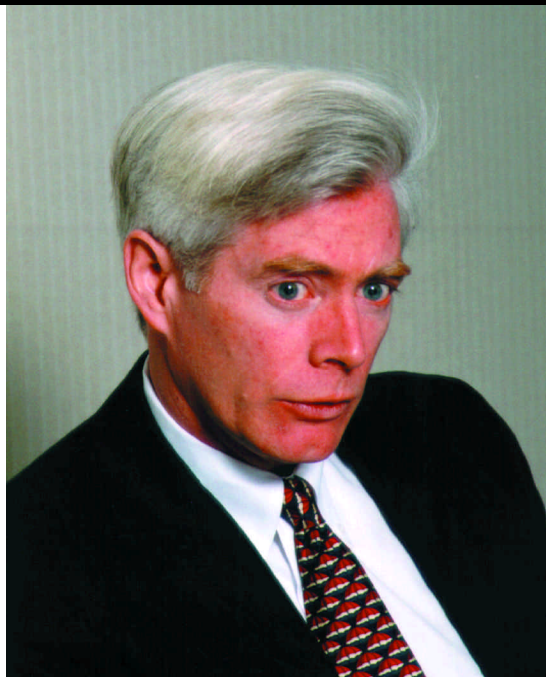
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seven years, depending upon where the commodity price curve is."

Ultimately, if the market timing is right, GE Capital and its partner may mutually agree to sell the partnership's assets into the market.

How do these partnerships work? Assume an operator is looking to acquire producing oil and gas properties. Through a partnership structure, GE Capital, as limited partner, will invest up to 95% of the money needed for the asset purchase; the operator, as general partner, puts in 5% of the purchase price. Once GE receives its threshold cash-on-cash 11% to 13% return—which assumes the operator has managed to grow the partnership's asset base—the operator is able to back in for more than a 35% interest in the partnership.

Says Schaeffer, "The better job the producer does in growing the partnership's asset base, the quicker he gets to that pay-out."

In early 1998, privately held MV Corp., the amalgam of Wichita-based Murfin Drilling and Vess Oil, came to the GE Capital Oil & Gas Group with the idea of purchasing all of Occidental Petroleum's oil and gas interests in Kansas. The two parties formed MV Partners LP, which purchased for \$74 million all of Oxy's Kansas interests.

"We were attracted to MV because Murfin and Vess had been active producers in Kansas for generations," says Schaeffer. "At the moment, the company is maximizing the value of the Oxy properties for us. But at some point, if we both agree those assets should be sold, we'll take them to market."

More recently, Abraxas Petroleum Corp., an Amex-listed producer, approached GE Capital with a different need. In early 1999, the San Antonio operator was seeking liquidity. The solution: a monetization of assets.

"Together, we and Abraxas formed a partner-

ship that purchased for \$60 million an interest in the company's Wamsutter Field in Wyoming," says Schaeffer. "During the next year, the market for that field's natural gas reserves improved so dramatically that by early 2000, we and general partner Abraxas jointly agreed to liquidate the partnership and sell the reserves held within that structure for \$127 million. As a result, Abraxas not only got up front the \$60 million it needed for liquidity—when it needed it—but also it got another payday when the assets were sold, based on its back-in after our cash-on-cash return."

With total oil and gas partnership investments currently north of \$500 million, GE Capital Oil & Gas is now looking to double that level of investment, not only through its Stamford office, but also through its Houston office, run by Paul Nidoh, and its newly opened Denver office, run by John A. Cleveland.

Last summer, a client, a small publicly traded Denver producer, wanted to buy an interest in a large Rocky Mountain oil property that a major oil indicated it was going to sell, says Cleveland. "We worked with that independent to evaluate the property, structure an acquisition partnership, and come up with a \$150-million bid—all in about 25 days."

While the major subsequently withdrew the oil property from the market, the deal effort shows the speed at which GE Capital can move, says Cleveland. "Also, it demonstrates how we can position a small producer to go after an acquisition it might not otherwise be able to financially pursue on its own."

More recently, GE Capital's Denver office provided similar assistance to another small, publicly traded Rocky Mountain-based producer who wanted to acquire a Rockies oil property from a midsize, privately held Dallas operator. Says Cleveland of the pending \$50-million transaction, "Again, without the partnership we arranged, the client wouldn't have had the financial muscle to bid for an acquisition that could so materially affect its size."

In addition to its acquisition partnerships, GE Capital Oil & Gas is now focusing on yet another investment vehicle: development-drilling partnerships. "Currently, we're looking very hard at situations where the drilling of proved undeveloped reserves could be put under the same partnership structure as the acquisition and monetization deals we've done," says Cleveland.

In such partnerships, GE would put up 80% of the required drilling capital; the operator or general partner would put up the other 20%.

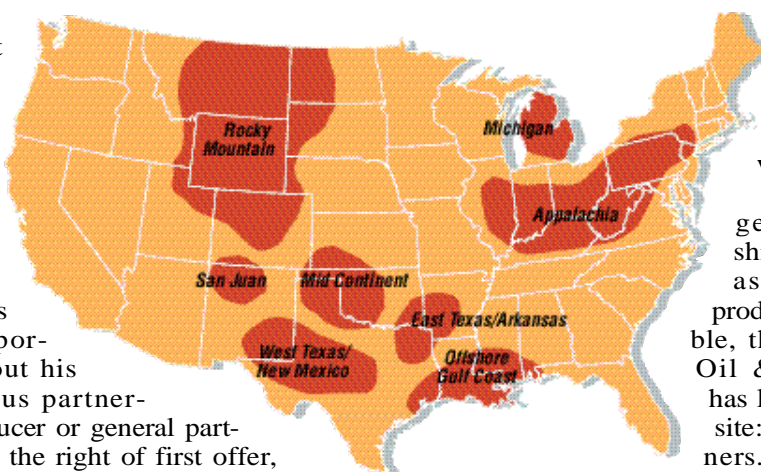
After GE achieves its targeted cash-on-cash rate of return—in this case 14% to 16%, given the higher risk profile of development drilling—the general partner would back in for a higher interest, around 40%, while the limited partnership interest would decline to around 60%.

Observes Cleveland, "While there are other capital providers that offer development drilling

capital, I don't know of any out there offering that kind of capital at as low a cost as us."

The Denver-based vice president makes one other important point about his group's various partnerships: the producer or general partner always has the right of first offer, that is, it can propose to buy out GE's limited partnership interest on a market basis. After three years, GE itself can trigger liquidation of the partnership.

What type of operator is GE Capital looking for when it sits down to cut a partnership deal? "We look for management that has a proven expertise in the area where it's proposing to purchase assets," says Schaeffer. "We're also looking for producers that know how to control costs. Remember, these partnerships are a marriage between low-cost capital and operating expertise—and both el-



ements have to be present to make an investment work well."

In an effort to get its partnership story out to as many U.S. producers as possible, the GE Capital Oil & Gas Group has launched a web site: oilandgaspartners.com. The site

describes the group's business and products, as well as a sample partnership transaction and details of its partnership agreements.

The site also has an "Oil and Gas Reserve Valuator" feature, which allows operators providing reserve data to obtain an estimated market value for their reserves, along with an estimate of how much of those reserves GE Capital would be willing to monetize.

Concludes Cleveland, "This may be a very opportunistic time for domestic producers to monetize assets, because we're at a relatively high point in the commodity price cycle." □

GE Capital Oil & Gas Group is actively partnering with independents in virtually all the producing basins in the onshore U.S.

Select GE Capital Oil & Gas Transactions: 1994-2000

| Date | Transaction | Type | Investment | General Partner |
|-------|-------------------------------|--------------|-----------------|---|
| 10/94 | South Lake Arthur Ptshp. | Acquisition | \$51 million | EnerVest Mgt. Co. |
| 9/95 | EnerVest East LP | Acquisition | \$17.4 million | EnerVest Mgt. Co. |
| 11/95 | Eastern Producing Ptshp. | Monetization | \$17.4 million | Eastern American Energy |
| 1/96 | EnerVest Texoma Acq. Ptshp. | Acquisition | \$49.1 million | EnerVest Mgt. Co. |
| 9/96 | EnerVest San Juan Acq. Ptshp. | Acquisition | \$60.5 million | EnerVest Mgt. Co. |
| 5/98 | MV Partners LP | Acquisition | \$74 million | MV Energy LLC |
| 11/98 | Clayton Williams Acq. Ptshp. | Acquisition | \$41.8 million | Clayton Williams Energy Inc. |
| 12/98 | EnerVest Monroe LP | Acquisition | \$62.5 million | EnerVest Mgt. Co. |
| 12/98 | Sulphur River BMA, LP | Acquisition | \$30.7 million | Sulphur River |
| 1/99 | Abraxas Wamsutter LP | Monetization | \$60 million | Wamsutter Holdings Inc., subs. of Abraxas Petroleum Corp. |
| 6/99 | Apache Capital-I, LP | Monetization | \$35.4 million | Apache Corp. |
| 7/99 | Cody Kurten LP | Monetization | \$12.8 million | Cody Energy |
| 9/99 | EnerVest Appalachia LP | Acquisition | \$46.2 million | EnerVest Mgt. Co. |
| 9/99 | Merchant Resources #1, LP | Acquisition | \$58.4 million | Randall & Dewey Capital Solutions |
| 5/00 | Mallard Hunter LP | Monetization | \$23.15 million | Magnum Hunter Production Inc. |