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Startup E&P Companies Should Build To Sell

By Darren Barbee, Hart Energy June 18, 2013

HOUSTON – The ingredients of a successful startup E&P company are many, but the guiding principle perhaps boils down to this: make money, not stuff.

"Always make sure your business plan (includes) plans for an exit," Jordan Marye, managing director for Denham Capital, said June 17 at the Energy Capital Conference sponsored by Denham and hosted by Hart Energy and *Oil and Gas Investor* magazine.

While assets should be worthy of holding and sustaining through economic cycles, E&P companies are still in the business of building to sell, he said.

However, Marye said the business landscape has changed. Starting and building E&P companies in the past four, five or even eight years has been based on a model of leasing, drilling and selling. In the past six months to 12 months, that's changed dramatically, he said.

"I think today you need to be prepared to lease, drill and even develop and hold assets for long term," Marye said. "We've seen independents of all sizes sell noncore assets to fund their core assets. We probably see more for sale today than we have certainly in the last six or eight years, and all of this is the function of technology in our business and the supply impact that it has on our business."

To acquire capital, executives should realize that investors' money goes to a superb team, not individuals, no matter how experienced and talented.

"The pricing and understanding of technical risk is what determines value in our industry," he said. "That is obviously shepherded and led by people."

Speakers at the conference drew on their experiences in the E&P business to offer a guide to building a startup E&P and making it pay off.

Mike Oestmann, CEO of Tall City Exploration, agreed that the team is all important, more so even than the business model or plan.

"If the team is bad, you know what kind of results you're going to have," Oestmann said. "The rewards we all see will be directly proportional to the quality and performance of the team."

Oestmann said a good team should be experienced to a point where egos are no longer a factor. In May 2012, his company received $200 million in funding from Denham. The company has 22,000 net acres in the Midland, Texas, area.

His first key hire was a controller who could provide accurate numbers that partners never have to worry about when the time comes to sell. Another is legal counsel that can sift through contracts with a keen eye instead of trying to parse such a document himself.

Tall City also outsources many functions, such as payroll, taxes and computing because the costs outweigh the headaches of doing it in-house.

"They can just eat you up," he said.

And operations staff members need to be in place as early as possible, since so many regulatory hurdles await. Tall City won't spud its first well until August primarily because of such entanglements.

But acquiring the money for ventures is not a formula, said John Donovan Jr., founder of Donovan Capital.

“There’s no silver bullet,” he said.

When seeking capital, he said to keep presentations short, be ready to answer questions not outlined on paper and realize that from the moment you sit down you’re being judged.

“They’re learning how you deduce success and information, learning how to present it, how you analyze returns – and they’re watching you work,” he said.

Donovan said going for the money will require entrepreneurs to be specific and realize they’re often talking to less technical audiences.

On the flip side, Ken Friedman, a director at Denham, said that deciding on the right capital partner can be crucial. Investment partners range from absentee governors to day-to-day overseers.

Denham prefers the middle ground, he said.

“My advice is to put all your cards on table and ask sponsors to put all their cards on the table,” he said.

And a company may provide a lot of backing on paper only to disappear when things go south. “My advice would be not just seeking best terms or the largest equity commitment, but finding a partner that can actually follow through on that,” he said.

To get to the point of asking for funding, Bakken player Matt Steele, president and CEO of Ursa Resource Group II, said it’s important to recognize when you need the money.

Steele said companies should consider doing so when:

• Opportunity is available but it’s more than the company can tackle.

• The company needs to accelerate operations.

• An opportunity arises to align with a great partner.

• When growth is the obvious next step.

“When there’s more opportunity than you can harvest on your own, it’s the perfect time to go out and grow,” he said. Acquiring acreage rapidly and accelerating development also require money.

For instance, Ursa was able to hold 1,280 acre units in the Bakken, but it was also important to work the leases during the primary term, Steele said.

“We all know this business is PV (present value) driven, so there comes a point where it makes sense to put rigs on something, drill it up and pull that value forward,” he said.

But before going after the money, the company needs to get its story together, he said.

As Marye puts it, companies should know what its edge is; that advantage is the most important part of a business strategy.

“If you can’t write down what your edge is in one sentence on the back of your business card, you don’t have one,” he said.

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