

# Expanding Breadth And Depth

As competition heats up, private capital providers look at drillbit service and international ideas.

By Leslie Haines, Editor-in-Chief, *Oil and Gas Investor*



Cameron O. Smith

Despite a pullback in natural gas prices during the summer, the world of private capital is still fast-paced and looking for more energy investment opportunities, says Cameron O. Smith, senior managing director of **COSCO Capital Management LLC**, a financial intermediary that connects E&P ideas primarily with professionally managed capital sources.

There are always subtle changes in the marketplace; however, and COSCO is well positioned to discern them.

"We are seeing fewer resource-play business plans seeking capital and more of what I'd call traditional drill-bit and acquire-and-exploit plans than in the past few years," New York-based Smith says. "Given that gas prices are lower, acquisitions of stranded assets and hurting companies, as well as the margins in conven-

tional drilling plays, are both considered more attractive, right now."

Smith says private capital players are also beginning to consider opportunities on the service and equipment side, given the current slow-down, and more private capital is looking at international opportunities as well.

"But as always, we at COSCO are looking for good people first, people who are seeking to do bigger and better what they have done well in the past, and where we can match them up with the right capital. But it always starts with the people," he says.

The expansion of institutional interest to international E&P opportunities is accelerating, but may not be as far out on the risk curve as it sounds.

"Typically, they are looking for something with exotic opportunity, but managed by North American-trained teams, so that the business culture of North America is applied to the international market," Smith says.

Clearly, this year, as last, the biggest challenge for private capital providers is the amount of money now available in the sector from new entrants and the expanded

holdings of established players. One of the consequences of this competition is that hold periods may be lengthening.

"The bigger risk now may be associated with reinvestment, not exit timing," Smith says.

As private capital flocks to the energy scene, the competition has intensified. One of the results, Smith reports, is inflation in deal terms.

"By that I mean the back-end percentage that management receives at monetization is getting larger, in some cases beyond prudence. Moreover, all the private equity providers are becoming significantly more proactive. For instance, we see them getting out into the field far more in places like Tulsa, Billings [Montana] and Salt Lake City," Smith says.

Despite this, COSCO has not slowed down its activity. Indeed, the firm is busier than ever. Three of the six transactions it had closed in 2007 as of press time illustrate the breadth of the company's expertise and the variety of E&P business plans private equity is looking to back.

In May 2007, COSCO arranged for Jones Energy of Austin a \$100-million private placement of secured notes with **Guggenheim Capital Partners**. Proceeds will be used for development and infill drilling of proved undeveloped locations in a tight-sand play in the Texas Panhandle. An unusual twist was that Jones put up none of its own capital.

A second deal, which closed in July 2007, will fund a suite of 20-plus onshore exploration prospects from Texas to Alabama for **Ausam Energy**, a company listed on the Toronto Venture Exchange but based in Houston. The \$25-million deal, structured as units of debentures and warrants, will be used to farm-in to the prospects, which range from low and medium to high risk.

"What was unusual, here, was that this financing backed a completely drillbit-oriented business plan, with no current income," Smith says.

The third deal, which also closed in July, funds an acquisition-development business plan focused on south and east Texas as well as northern Louisiana. Private Houston company **Red Arrow Energy LLC** sponsors it. A small percentage of the proposed capex was identified before closing, so this was essentially a blind pool. Various affiliates of **EnCap Investments LP**, Houston, and COSCO's own investment affiliate, will provide a line of equity of \$85.6 million, which can be drawn down during the next three years at the discretion of Red Arrow's board. This financing significantly expands Red Arrow's original backing of \$21 million provided in 2006 through pledges from certain family offices that have supported R. Carter Overton and Brock Hudson, Red Arrow's principals, during much of the past two decades. Total capital available to Red Arrow as a consequence of this financing, therefore, is now more than \$100 million.

COSCO, itself, is also branching out a bit as it sees opportunities. In December 2006, it committed to a 20% participation in the creation of **Strategic Energy Research and Capital (SERC)** of Summit, New Jersey. SERC provides research and trading expertise principally to hedge and mutual funds, as well as the capacity to execute private and public placements with these investors. The principals, Mark Kellstrom, George Ross and Doug Foulsham, formerly worked for **Pritchard Capital Partners**.

"This initiative materially expands our access to a market with which we previously had deep, but very narrow, contact," Smith explains. "Until now, our absolute strength has been our relationships with the closed-end equity and mezzanine funds which aggregate institutional capital, as well as with institutional investors, themselves.

"Now, when one of our private company clients or portfolio investments goes public or a public company client wants to raise capital, we are in great shape to help them out." ●

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July 2007



A Private Placement of  
**\$85,600,000**  
Line of Equity



ENCAP INVESTMENTS L.P.  
and  
COSCO Investments LP

July 2007



A Private Placement of  
**\$25,000,000**  
Units of  
Debentures and Warrants  
To  
**The Huff Energy Fund, L.P.**

December 2006

An Affiliate of



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Secured Notes

To



May 2007

An Affiliate of



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To



June 2007



With Respect to Its Investment of  
**\$30,000,000**  
Units of Convertible  
Notes and Warrants

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For further detail on COSCO, its Services and Track Record, please visit [www.coscocap.com](http://www.coscocap.com)

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