COSCO: Higher Oil, Gas Prices Overcoming Higher Interest Rates

Capital Advisory Firm Discusses Current Capital-Access Marketplace

By Erica Shillings, Associate Editor, *E&P*

While the increase in U.S. interest rates this past year has affected some producers' weighting to equity, Bill Weidner, managing director of capital-arranging and advisory firm **COSCO Capital Management**, says it does not, but with one caveat.

"Growth in oil and gas prices has generally exceeded growth in interest rates. In fact, if anything, we have begun to see growing interest in debt financing as the credit capacity of cash-flowing oil and gas properties has grown significantly, thus reducing the need to issue equity to fund growth."

Tangentially, the 14-year-old New York-based, energy-capital-focused firm has observed that the growth of income-oriented investment vehicles, such as royalty trusts and master limited partnerships, has been born out of a low-interest-rate environment.

"Now that these vehicles are around and since they are typically awarded fairly low-cost capital in the equity markets, they have, in fact, increased the equity available to producers via fully priced M&A valuations upon exit, despite rising interest rates," Weidner adds.

At what prevailing interest-rate level would these income vehicles become less attractive to investors, relative to bonds, thus less of a source of equity to selling oil and gas producers?

"Time will tell," Weidner says. "Last year, we assisted a client with a heavily debt-financed oil-production business to sell itself to a Canadian royalty trust. In that example, our client decided to weight itself to equity through a cash exit that might become less available in a higher-interest-rate environment. That's the caveat."

Bill Weidner

There have been many newcomers to the E&P space as oil and natural gas prices have held higher in the past few years. Is deal quality declining?

"Yes and no," Weidner says. "We have observed the extension of more generous deal terms from both equity and debt providers, and in both cases, the more generous terms were extended by a new entrant to the oil and gas investment space. So, we can say, anecdotally, that there is some dragging down of quality."

Not all are takers, though.

"We have also observed oil and gas producers who actually turned down more generous terms from new entrants, due to the underlying concern that the industry environment may change and the investor behavior may change with it, to the producer's detriment. This response from producers is not without our input," he says.

As for use of the 144(a) method of an initial equity offering versus the traditional S-1 format, why would choose the long S-1 format versus the short 144(a) format?

"Good question," Weidner says. "We think that the Rule 144(a) issues have made a tremendous amount of sense for those issuers seeking to access public financing for their business plans."

COSCO Capital Management focuses on helping producers grow through private financings.

"Our clients typically seek to grow outside the view and regulatory burdens of the public equity markets and to access these markets only once they have reached the size and growth profile where access to public markets is necessary to finance continued growth or to pave the way for an exit," he says.

The firm is bullish on oil prices right now.

"A barrel of oil will be very valuable 10 or 20 years from now, not that it isn't already, but we certainly don't attach dates to prices, because it's only important if you're selling, and we're mostly buying," he says.

The firm currently has two clients, in particular, that appear to be reaching their natural limitations to growth.

"In both cases, we think they should sell. Does that mean we think acquisition prices have peaked? Well, no, but in their cases, why take the chance?" Weidner says.

Producers should know that, in the current capital-access climate, there is plenty of discriminating private capital available for management teams or assets capable of providing income and capital gains, while sharing risk together.

"We emphasize the sharing of risk, because investors will take risk, if the entrepreneur is willing to take risk along with them. With success, those investors will generously share the rewards associated with that risk. The same cannot be said of those situations where the investor is asked to take risk that the entrepreneur will not," he says. ●