

Rodman Energy Group: State of the energy capital markets

"Get while the gettin's good."

By Cameron O. Smith, senior managing director, and Scott D. Edwards, vice president, *The Rodman Energy Group, a Division of Rodman & Renshaw Capital*



Cameron O. Smith

There are two distinct capital markets—public and private—and each has its peculiar and often diametrically opposed drivers. What's the state of the capital markets today, as they relate to energy investing?

Private capital markets for energy

Private capital has been eerily quiet during the first half of 2009, following the bunker

mentality of fourth-quarter 2008. The Rodman *Private Energy Investment Review* (PEIR), published twice yearly, is based on surveys of the 24 private capital providers that have agreed to constitute our Rodman Energy Index. At the end of 2008 the survey revealed that never before has the index presided over so large an aggregate of fresh commitments or been so bullish about investing during the unfolding crisis.

But, something appears to have happened on the way to the forum! Based on our marketing efforts over the

past six months and other anecdotal information, it would appear that private capital has largely sat on the sidelines during the first half of 2009. Perhaps it is awaiting better times, distracted by the train wrecks in its own portfolios, or loath to call on its own institutional investors' commitments for fear they will not be honored.

As of this writing, our Index Surveys for the first half of 2009 have only just gone out, so we, like you, can only look forward to a more definitive snapshot of this part of the capital markets when we analyze the returns and publish our findings in the October edition of *Oil and Gas Investor* and in our next PEIR.

What we do know with confidence is that private equity is universally looking to invest in going concerns having great managements which, for reasons not of their own doing, and notwithstanding lots of PDPs, are suffering an acute lack of liquidity. Also, these companies must have significant acquisitions under contract that they are eager to consummate, but simply lack the capital.

We also know that private equity is not looking for drillbit-oriented investments, start-ups, natural gas, or large lease plays. It also has pulled back significantly

from international opportunities, seeking primarily to invest in the U.S., onshore, in focused plays, one basin at a time.

Despite the hurdles, a few deals have been announced. Morgan Stanley's private-equity investment in Triana Energy LLC is a good example: A generalist fund with little exposure to E&P over the past couple years deciding to return to the sector and selecting a management team with which it has had previous experience. The company is a dominant operator in the Appalachian Marcellus, one of the sexiest plays of recent times, which features close proximity to markets and thus commands premium wellhead prices.

Furthermore, new funds are, in fact, closing—Quantum, Kayne Anderson, First Reserve, to name but a few—and their success demonstrates that institutional investors have far from abandoned energy-focused private capital.

So, what is our outlook for private capital's investment in energy? There's simply too much pent-up capital and too much opportunity remaining in this crisis for private capital to remain paralyzed. Sooner or later, it will heal its wounds and, as it always has, fan out, discover, and back those professionals who know how to turn hard times to advantage.

Public capital markets for energy

In contrast to the private capital markets, the public capital markets exploded in the second quarter of 2009, with more than 250 follow-on offerings completed year to date (as of June 30, 2009). Twenty such transactions were completed for upstream oil and gas producers, raising an aggregate of more than \$4.5 billion. The average dilution to existing shareholders was approximately 15%, including shares issued in over-allotments.

There were also 20 private placements completed for publicly listed oil and gas producers so far this year (as of July 20, 2009), raising more than \$400 million, with average dilution of 17.5%.

The precipitous fall in commodity prices during the second half of 2008, and thus, equity values, had investors and issuers alike avoiding the capital markets all together. The recent rally couldn't have come at a better time for producers: Balance sheets were hemorrhaging, cash flow was rarified, and redeterminations loomed.

We are all asking ourselves, "What's in store for the capital markets, going forward?"

To answer that question we must first understand the underlying driver of recent activity. We in the energy industry all know that equity value is inextricably tied to commodity prices (correlation $R^2=0.92$). Oil's rebound happened to coincide with a longer and stronger than expected rally. The S&P bottomed in mid-March at 676 and has since rallied 40%, closing at 951 as of July 20, eking out a slight gain year to date.

The reason for the recent opening of the capital markets is, quite simply, a sense of optimism. Investors had cash

available, and equities had been oversold. Issuer's balance sheets were exposed to liquidity risk, which provided investors with the opportunity to equitize balance sheets. This, in turn, unlocked equity value, resulting in significant returns for both investors and existing shareholders. The great divide between issuers and investors narrowed as a result of the recent rally, driving both the desperate and the savvy through capital markets' open doors.

There does not seem to be any empirical evidence of fundamental value creation by companies over the past six months. It's not as if we saw a great deal of positive economic data, such as all that job creation our globe-trotting president keeps bragging about. And certainly product prices have not posted hockey-stick recoveries.

So where does the public capital for energy markets go from here?

Dare we say, "We just don't know?"

What we can say is that we've had a heck of a rally and that the capital markets for public energy stocks certainly have been open. And management teams that have taken advantage of the run must be breathing a sigh of relief. For those who have yet to do so, we say, "Get while the gettin's good!" Who knows how long it will last? Because without true recovery in underlying fundamental drivers, such as industrial demand, consumer spending, and supply/demand balance for commodities, we are likely to see a significant pull-back in the broader markets and a closing of the public capital market's doors. ●

Private Placements and Transaction Advice:

\$1.925 billion since January 2000, alone!

- Public Equity: \$200 million
- Private Equity: \$775 million
- Structured Debt: \$450 million
- A&D Advisory: \$500 million

In June 2008, Rodman & Renshaw, LLC (member FINRA/SIPC) acquired COSCO Capital Management LLC and formed **The Rodman Energy Group**. Virtually all of COSCO's former personnel and offices in Houston and Calgary have been retained, and two new bankers and two analysts have been added to the team.

Investment Banking • Mergers, Acquisitions, Divestments • Private & Public Placements

18,800,000 Shares



\$88,000,000
Common Stock
Price \$4.66 Per Share

Rodman & Renshaw, LLC
acted as Placement Agent
for BPZ Energy, Inc.

June 2009

Evergreen Energy, Inc.



\$15,000,000
Senior Secured Convertible
Promissory Note

Rodman & Renshaw, LLC
acted as Placement Agent
for Evergreen Energy, Inc.

March 2009

An Affiliate of
Dewbre Petroleum Corporation



and
HARBOR HILL INTERESTS, LP

\$35,500,000
Senior Secured Notes

Rodman & Renshaw, LLC
acted as Placement Agent
for Dewbre Petroleum Corporation

October 2008

Zodiac Exploration Corporation



C\$18,110,000
Common Equity

Rodman & Renshaw, LLC
acted as Placement Agent
for Zodiac Exploration Corporation

September 2008

Mt. Dora Energy Corporation



\$35,500,000
Line of Equity

COSCO Capital Management LLC
acted as Placement Agent
for Mt. Dora Energy Corporation

May 2008

Lake Ronel Energy Partners, LLC



\$40,500,000
Common Equity

COSCO Capital Management LLC
acted as Placement Agent
for Lake Ronel Energy Partners, LLC

January 2008

Action Energy Inc.



C\$17,500,000
Common Stock

COSCO Capital Management LLC
acted as Placement Agent
for Action Energy Inc.

December 2007

Red Arrow Energy, LLC



\$85,600,000
Line of Equity

COSCO Capital Management LLC
acted as Placement Agent
for Red Arrow Energy, LLC

July 2007

The Rodman Energy Group

For further detail on The Rodman Energy Group, its Services and Track Record, please visit www.rodman.com

| | | | |
|---------------------|-------------|--------------|----------------|
| Cameron O. Smith | New York NY | 212-430-1792 | cos@rodman.com |
| William E. Weidner | Houston TX | 860-658-6700 | wew@rodman.com |
| Lane W. McKay | Calgary AB | 403-237-9462 | lwm@rodman.com |
| T.P. (Scott) Kessey | Houston TX | 713-654-8080 | tpk@rodman.com |