

# CASH FLOWS

## Plenty of Private Capital Available—to the Right Type Companies

At the outset of 2002, private capital was settling in for a banner year: oil and gas prices were expected to weaken or remain low, and rationalization of the post-2001 M&A mania was forecast to place millions, if not billions, of high-quality properties on the market, leading to an acquisition-friendly feeding frenzy.

Fast forward to midyear. While some of the recognized management stars in the U.S. have secured private capital for their new companies, almost all in Canada have found swift, sure and soft access to their traditional public financing sources. The price of oil is at or near its highs for the past three decades, and gas prices have remained unrepentantly high.

The greatest unforeseen element in the initial forecast, however, was the almost literal meltdown of the unregulated utility sector. With the implosion of Enron, Aquila and Mirant, and the withdrawal of Shell, a crucial question may yet be: what assets and teams, well-suited to the private-capital psyche, are in, or are about to come into, the market, perhaps at distressed prices, perhaps with books of business yet available for instant gratification?

### Equity up, mezzanine down

During the past 18 months, there has been an unprecedented build-up of equity capital. Cosco Capital Management recently polled 22 private-capital sources. During the 18-month period, nine energy-specific equity funds have raised \$4.6 billion, and four general equity funds with significant energy interest have raised \$12.5 billion more. Three additional energy-specific funds currently remain in the market for another \$1.4 billion, hoping to close by year-end. This would bring the total new capital available from these 16 funds to more than \$18.5 billion.

This equity has been raised based on the strength of cash returned by energy-focused, private-equity funds during the past three years (consistently returning 20% to 45% to their investors, in stark contrast practically to every other sector).

As the market value of public stocks has dropped, the absolute capital available for new investment in alternatives has tightened. The manager of a recently raised fund reports, "We had two institutions give us fairly strong circles, subject to final board approval, then at the last minute call to say they had been put on a three- or six-month freeze re-

### Activity

Capital Sources By Tiers	Funding (\$MM)		Investing			
	2001	2002	Total	# Deals	2001 (\$MM)	2002 (\$MM) (to July 31)
<b>Tier 1 (Funds)</b>						
<b>General (4)</b>	5,400	7,100	12,500	5	184	9
<b>Specific (12)</b>	2,820	3,152*	5,972	67	1,285	48
Subtotal (16)	8,220	10,252	18,472	72	1,469	57
<b>Tier 2 (Companies) (6)</b>	<b>1,225</b>	<b>400</b>	<b>1,625</b>	<b>43</b>	<b>1,139</b>	<b>19</b>
<b>Total Sources (22)</b>	<b>9,445</b>	<b>10,652</b>	<b>20,097</b>	<b>115</b>	<b>2,608</b>	<b>76</b>

\* Includes three funds still in market for \$1.4 billion  
Source: Cosco Capital Management LLC

### Respondents

#### Tier 1 (Funds)

##### General:

CS First Boston  
JP Morgan Partners  
Morgan Stanley Group Inc.  
Warburg Pincus

##### Specific:

ARC Financial Corp.  
CamCor Capital Inc.  
EnCap Investments LLC  
Energy Spectrum Capital LP  
First Reserve Corp.  
Kayne Anderson Capital Advisors LP  
Lime Rock Partners  
Natural Gas Partners  
Quantum Energy Partners LP  
Riverstone Holdings LLC  
TCW Asset Management  
Yorktown Partners LLC

#### Tier 2

Aquila Capital  
BlackRock Energy Capital  
Duke Capital Partners LLC  
Mirant Americas Energy Capital LP  
Shell Capital Inc.  
Wells Fargo Energy Capital

garding investment in new private-equity funds. As a result, most equity fund managers are a little more cautious about investing right now."

### Mezzanine capital

Data rooms are now open on pre-assembled mezzanine assets, many with the complete team of professionals anxious to carry on their business. Add to this the collateral fallout of mid- and downstream assets being shed in troves by many of these sources' utility parents and you have a classic case of distress opportunity.

Ramping up to take advantage of their unexpected good fortunes are existing mezzanine providers Duke, Prudential and Wells Fargo, among others.

New announced entrants are Black Rock (ex-Range Resources Producer Finance), Macquarie Bank (ex-Cambrian Capital), and J.M. Huber.

Finally, rumored to be circling existing

mezzanine portfolios and management teams are Warburg Pincus, Morgan Stanley Private Equity, Deutsche Bank Private Capital, JP Morgan Private Capital, Natural Gas Partners, Quantum and various European banks.

### Back to the future

With equity capital in abundance, mezzanine in temporary distress, product prices high, a dearth of properties available, midstream/downstream assets and mezzanine portfolios on or coming onto the market and management teams as hard to find as usual, what's private capital to do?

While some may choose to wait, others are rushing right on in. As indicated in the accompanying table, the 16 "Tier 1" funds that responded to our survey have invested \$1.1 billion in 57 deals through July 2002. This constitutes a run rate 35% higher in terms of number of deals and 30% higher in terms of total dollars committed, relative to activity by these same capital providers in 2001.

As you might suspect, the six "Tier 2" mezzanine respondents, on the other hand, have invested only \$245 million so far in 2002, a run rate 63% lower than last year.

What does this portend for energy companies seeking access to private capital?

- Midstream, downstream, marketers: If you're best-in-class, you're going to be a star!

- If your business is drillbit driven, you're likely to be kept in the wings until the private-equity providers have determined whether they can back acquisition strategies, and mezzanine capital, if you can get it, will be a lot more expensive for a while.

- If you have an acquisition-exploitation business plan, you're always welcome, but you may have to wait for commodity prices and mezzanine/midstream distress to sort themselves out.

—Cameron O. Smith,

Cosco Capital Management LLC