

Shale Industry Intelligence Report | Private Equity Trends

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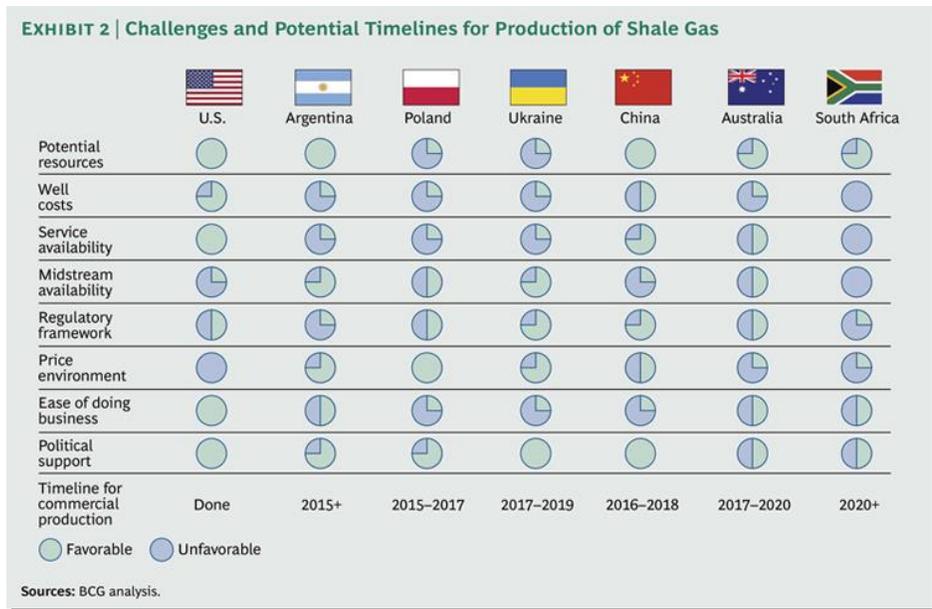
▶ National & International trends and issues

Prospect of a global “second wave” shale boom attracts PE interest, but also caution

Until recently, shale gas development was predominantly a North American phenomenon. However, as businesses and governments witness the transformation of the U.S. energy sector brought about by shale plays, interest has grown in exploration and development of global shale reserves.

A new BCG report finds that [six countries are leading the pack in the next wave of shale gas development](#):

Argentina, Poland, Ukraine, China, Australia, and South Africa (see graphic). These countries started their exploration efforts at about the same time, but each faces unique challenges that will affect the pace at which production occurs.



Meanwhile, AT Kearney, another global consultancy, reports that investment in shale development in markets like [Europe](#) is likely to be hampered, at least in the near term, by less than favorable economic and regulatory environments. This analysis of private equity's "trepidation" regarding the uncertainties surrounding shale development in Europe is [echoed](#) by Unquote.

Comment: *There are large reserves of shale gas present in many locations outside North America (though reliable estimates remain elusive), and it is highly likely that there will be a second wave of shale development that will have significant impact on global energy markets. While the impact of this next wave is not imminent, in the long term it will create opportunities for U.S. shale players, as well as risks.*

Private equity favors equipment and services investments in U.S. shale

According to a recent [report by Bain & Company](#), the hottest area for private equity investors in energy is the oil and gas sector, in particular the "vast new extractable hydrocarbon deposits once locked up in shale rock or in deep-water seabeds."

Observing that many private equity players are investing in oilfield equipment and services (accounting for 45% of deals in 2012), the Bain report notes that these businesses are similar to more traditional industries and suggests that this trend is understandable because it is "the most approachable way" for private equity funds to play in this sector. Owning a stake in these services businesses also provides a vehicle for these funds to participate in markets outside the U.S. and Canada, where state-owned oil companies dominate exploration and production.

Comment: *At a national level, it appears reasonable that private equity would remain interested in oil and gas services businesses – we have witnessed this trend in the Ohio region (though we have also seen PE investing in acreage, see below for more details). Bain's outlook remains positive regarding the underlying growth prospects for oil and gas development in the U.S. and globally.*

► Ohio area trends in shale-related private equity

Report: Private equity interest in Marcellus and Utica remains active, while 2Q deals decline nationally

According to an [assessment of US oil and gas M&A activity](#) released this week, second quarter deal volume decreased 26 %, with deal value dropping 43%, compared to the 2Q 2012. However, shale deals remained a key driver in this period, with 15 deals valued at \$7.5 billion, or 44% of total deal value. The most active shale plays for major M&A deals last quarter were the Eagle Ford in Texas, followed by the Marcellus Shale, and then the Bakken in North Dakota.

According to PwC, there were two primary factors driving the decline nationally: "Companies remained focused on the critical task of integrating assets they acquired during 2012 and sellers

bringing deals to market that are fully priced.” PwC believes interest in the sector continues to be robust, despite the drop in the volume and value of deals so far this year.

Comment: *Private equity activity in the shale sector has been limited in the first two quarters of 2013, in part due to higher valuations that didn't fit financial investors' models. However, PwC sees continued strong interest from private equity in the U.S. oil and gas sector in general, and in shale in particular.*

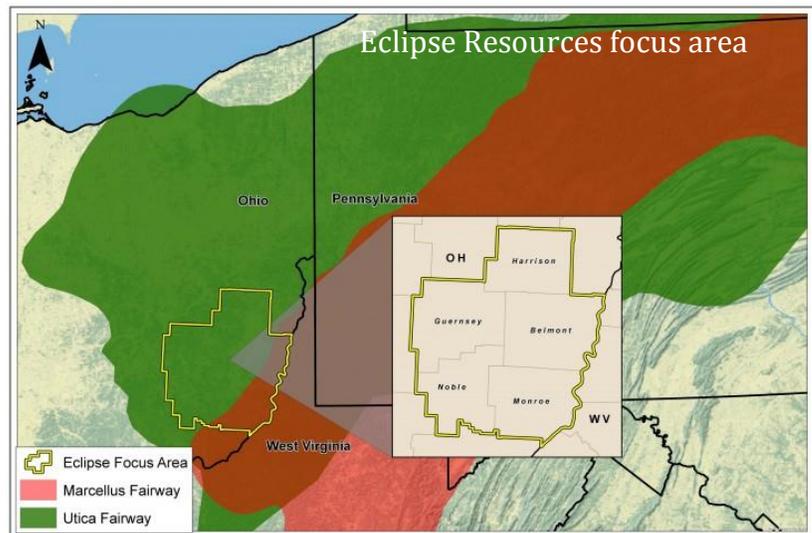
Private equity focuses on midstream and leases

Private equity has played a key part in launching two new midstream players in the regional shale market, as well as in a major acquisition involving 184,000 net acres in the Ohio shale region.

Century Midstream LLC was [formed this summer](#) to invest in midstream assets across North America, with an eye on investments in emerging shale plays such as in Ohio's Utica region. Century describes itself as a new energy company “created in partnership between a veteran management team and First Reserve, the largest global private equity firm exclusively focused on energy.” The new company is backed (up to \$500 million in equity capital) by [First Reserve](#), a global energy-focused private equity and infrastructure investment firm.

Earlier this year, a new [\\$1.5 billion joint venture](#) between Dominion and private equity firm Caiman Energy II was announced. The venture, Blue Racer Midstream LLC, will provide midstream services to the companies developing Ohio's Utica shale using existing Dominion assets and financing from Caiman to expand the pipeline system and other aspects of the region's infrastructure.

And finally, in late June, Eclipse Resources I, LP announced its [acquisition of Oxford Oil Company, LLC](#) in a deal estimated to be worth \$600-\$700 million. Oxford owned approximately 184,000 net acres in Ohio and 13.8 Bcfe of proved developed producing reserves. The deal particularly enhances Eclipse's position in the Ohio Utica region, where it goes from owning about 41,000 net acres to about 90,000 net acres (see map).



Comment: *Investment in midstream companies makes sense for private equity players seeking to participate in the Marcellus and Utica shale plays. The influx of investment in midstream capacity is a major factor in a recent Wells Fargo Securities research report that projects up to a five-fold*

increase in natural gas liquids production in the region by 2018, and a surge in natural gas production. As for Eclipse, some analysts believe that it is on a path to going public—and the Oxford acquisition brings the company closer to reaching this goal.

Former Chesapeake Energy CEO seeking private equity support for new company

Former Chesapeake Energy CEO Aubrey McClendon is attempting to [raise between \\$1-3 billion](#) in capital from private equity firms and sovereign wealth funds for his new company, American Energy Partners. McClendon established the new company in order to buy onshore US oil and gas assets and build a “best in class” exploration and production company.

This April, after a period of informal meetings with prospective backers, McClendon reportedly sent a six-page letter outlining his plans and conditions to about a dozen private-equity firms. In addition to raising up to \$3 billion in “initial capital,” the letter also stated that the American Energy Partners team wants to keep a large cut (50% after threshold) of any profits of the new business and expects to maintain more control than usual in these kinds of deals.

Many in the private equity community have been taken aback by the aggressiveness of terms requested by McClendon. For instance, a more typical profit share for managers of energy companies relying on private-equity funding is 20% after a certain return is achieved.



Comment: Key private equity players may continue to hold off, at least until American Energy Partners is ready to discuss terms closer to the norm. But it is clear McClendon believes significant opportunities exist for PE investment in this post-discovery phase of the shale-gas boom.

Though a controversial figure—he was forced out of the top spot at Chesapeake in a shareholder revolt—McClendon’s overall record at that company is one of building a small player into the second largest natural gas producer in the US. In addition to this track record, he may also be able to leverage data shared by Chesapeake under an [information-sharing agreement](#) with his former company that runs through 2016.

► Ohio and regional private equity deals making news

Company	Business	Location	Size Cost Scope
Summit Midstream Partners LP	Natural gas gathering systems	Bakken and Marcellus shale plays	Purchased from MarkWest Energy Partners LP and affiliate Summit Midstream Partners LLC for \$460 million . Announced June 2013.
Eclipse Resources	Leases/rights	Ohio Utica	Zanesville-based Oxford Oil, with 184,000 net acres in Ohio and 13.8

			Bcfe of proved developed producing reserves, is acquired in a deal that is estimated to be worth +\$600 million . Announced June 2013.
First Reserve	Midstream	Ohio (and other US shale regions)	Supporting Century Midstream LLC with up to \$500 million in equity capital.
Caiman Energy II	Midstream	Ohio Utica	\$1.5 billion JV with Dominion to create Blue Racer Midstream LLC
Gulfport Energy Corp	Leases/rights	Ohio Utica	Gulfport buying 22,000 net acres in eastern Ohio's Utica Shale from Windsor Ohio LLC, an affiliate of its partner Wexford Capital LP, for \$220 million .