Repeat executives find new, profitable ventures in expanding shale industry

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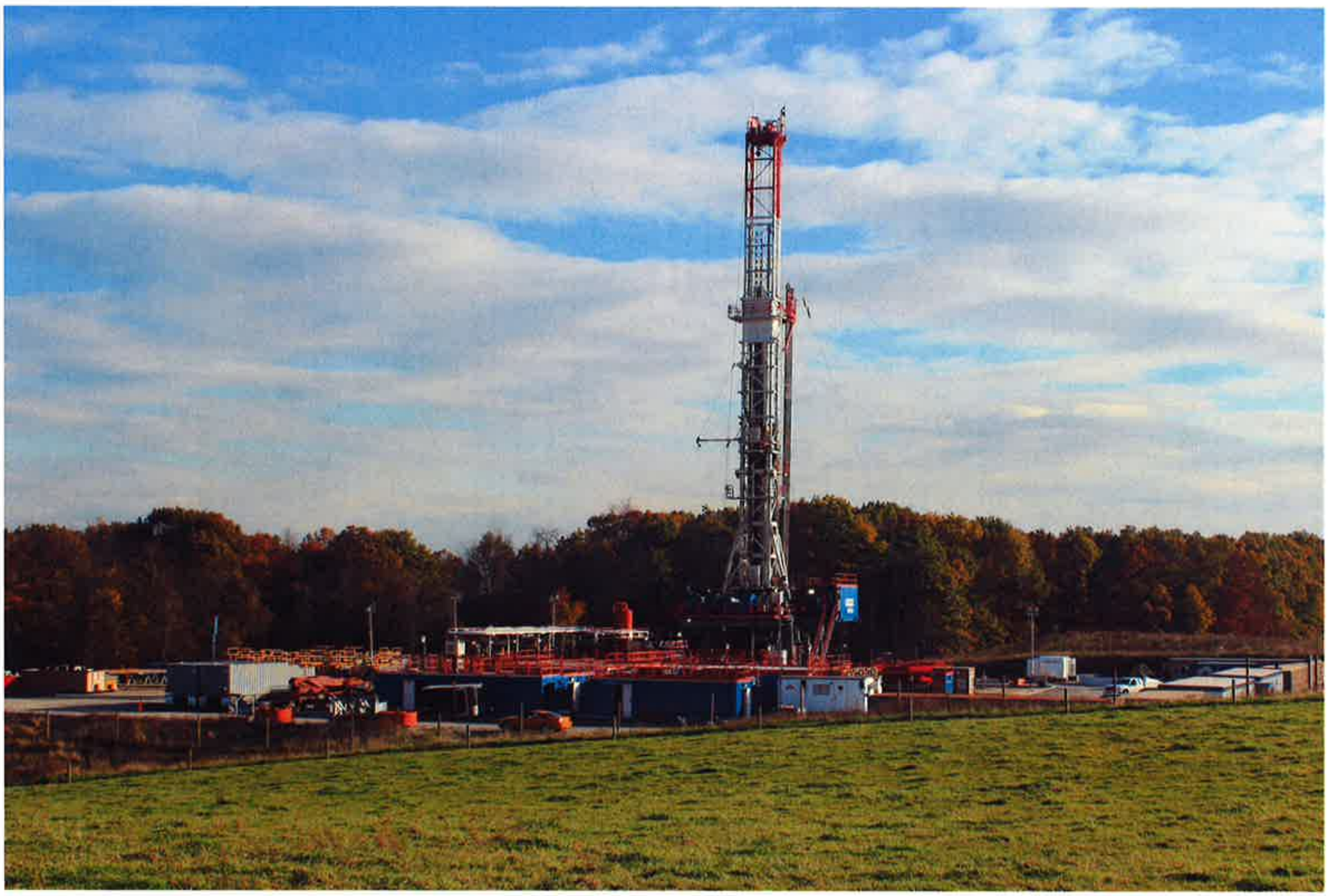

(http://www.post-gazette.com/image/2014/07/22/PennEnergy-rig.JPG)

Courtesy of PennEnergy

A rig at a PennEnergy Resources well site in Clinton Township, Butler County.

By Anya Litvak / Pittsburgh Post-Gazette

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For PennEnergy Resources, as for many other oil and gas startups, it started in a bar. Or at a dinner table, or on the golf course. A couple of former executives from major energy companies were sitting around, talking about their hunch that the majors were leaving some valuable crumbs in the earth. A small, nibble player could sweep those up and make a nice profit in five years' time, they thought.

So they went to a private equity firm and made their pitch. It went something like this: We have no product, no assets, no office and no employees. We'd like about $300 million.

And they got it.

Because they're Rich Weber, former CEO of Atlas Energy Inc., which sold most of its Marcellus Shale assets to Chevron in 2011 for $4.3 billion, and Greg Muse, an Atlas and Marathon Oil veteran.

Or because they're Jim Addison, who once headed Newfield Exploration's Rockies business unit, or Mark Rothenberg and Ed Long, both former EXCO Energy executives who now run Wexford startup Apex Energy LLC.

"These guys are proven operators and moneymakers," said Ryan Devlin, a director at EnCap Investments, a Texas-based private equity firm that funded PennEnergy and Mr. Addison's new company, Travis Peak Resources.

Most of the time, when young oil and gas companies, or the idea for a company, present themselves to EnCap, there are no acres yet. Just resumes.

It's very likely that if EnCap investors fund a management team once, they'll do it over and over again.

About half of the company's last four funds have been repeat executives coming back with new ventures.

"There's that comfort there," Mr. Devlin said. "We've got several companies currently on their fifth entity."

The model of private equity chasing empty-handed repeat executives appears to be unique to the oil and gas industry, and it's been fortified by the opportunities of shale plays.

"A conventional formation is a statistical play," explained Dan Rice, CEO of Canonsburg-based Rice Energy Inc. It's not ubiquitous, like shale. You can strike gas or come up with a dry hole.

For shales, the gas is in the ground — albeit there's more of it in some parts and less in others. Still, it's much more of a sure thing. The game is in finding the hot spots and getting the gas out most efficiently to maximize returns.

Private equity calling

Mr. Weber said private equity firms approached him within a week of Atlas Energy's deal closing with Chevron. He'd signed an agreement with Chevron to remain an employee there until June 2011, which he honored. "But you can't take it out of your head."

When June came, he sprung into action.

Mr. Muse, who left Chevron within a month of the Atlas sale, was talking to other companies when Mr. Weber invited him to have a drink. One beer in and they decided to give it a go. They even named the company on the spot.

For the next several months, Mr. Weber and Mr. Muse used the conference room at the Edgeworth Club in Sewickley as their office. Sometimes, Mr. Muse invited contractors to his dining room.

"Before we had another employee, before we had a pencil, we sat and drafted values," Mr. Weber said. "One of the fun things about being a startup is we can be exactly who we want to be."

PennEnergy's business strategy called for the company to put together 50,000 to 75,000 acres in southwestern Pennsylvania, because the founders knew it well, it had the right geology and the most pipelines. They planned to acquire deep drilling rights from small producers and add on as needed.

Now, they needed a landman. They invited to lunch 20-something hotshot Zach Dixon, who'd been cutting his teeth working for a large company, and laid out their plan.

"Rich says,'Why don't you quit your job and come work for us?' and I see Greg punching him under the table," Mr. Dixon said.

Right away, Mr. Dixon said yes, even before the company founders could tell him they didn't yet have money to pay a salary. Instead, they agreed to accrue his wages for about six weeks and pay when they closed the deal with EnCap. If the deal fell through, Mr. Weber and Mr. Muse vowed to give Mr. Dixon $10,000 out of their pockets.

Then came John Johnston (there's also a Tommy Thompson on staff), who leads the company's geology division.

"Every employee was targeted," Mr. Weber said. "We knew exactly who we wanted to hire."

For the most part, employees came with decades of experience.

"Mistakes in our business are hugely expensive, and you don't want to pay for somebody's learning curves," Mr. Weber said.

All of PennEnergy's 30 employees employees are part-owners of the company. That makes it easier to swallow that in a few years, this company likely won't exist.

Most private equity-based exploration and production firms look for an exit in three to seven years. They either sell to a larger player or go public, an option that just six months ago Mr. Weber rejected out of hand.

Now, he says he wouldn't rule it out.

Could it be because of the recent success of a string of oil and gas IPOs, most notable among them a $924 million offering by Rice Energy?

"It's pretty interesting what these companies have done," Mr. Weber said.

The outlier

Rice Energy Inc. didn't come up through private equity, at least not right away. It didn't start with a pair of gray-haired former executives but instead with three brothers, each in their 20s, who do things like name their wells after superheroes and get heavyweight champion belts engraved with their company's name.

Rice started in 2007 with Toby Rice going door to door getting leases in the Marcellus. He was establishing a foothold, leasing small chunks in southwestern Pennsylvania, as well as in Lycoming, Clearfield and Tioga counties. Over the next two years, the company would focus all of its efforts on Washington and Greene counties.

Toby recruited his siblings — Derek Rice, a geologist, and Dan Rice, who worked in finance — to start the company, which Toby ran out of his 7th Avenue apartment in Downtown. For capital, they turned to their father, legendary oil and gas investor Dan Rice III.

"It's really hard to start an E&P company and compete with billion dollar companies," said Dan Rice IV, now the company CEO.

But Mr. Rice said it was a natural fit for the family, which remains the largest owner of the company.

"Everybody's biggest concern was our experience, so we made that slide No. 1 to nip that in the bud," Mr. Rice said.

The Rices funded their first few wells out of pocket — albeit a deep one. They trolled public data, looked at what the majors were doing, and they were able to draft their strategy privately before shareholders or capital funders came into the picture.

In January 2012, Rice got its first private equity commitment — $100 million from Texas-based Natural Gas Partners.

"Part of our definition of success is we want to have the best wells in the play," Mr. Rice said. "Part of it is our competitive spirit, given our age."

After all, he said, "We're the self-anointed heavyweight champions" of the Marcellus.

The advantage of being small

In March 2013, Jim Addison just up and left his job as general manager at Newfield Exploration. He'd been commuting from his home in Austin, Texas, to work in Denver, then in Tulsa, Okla., and he was tired of it.

For years, he'd had an itch for "something entrepreneurial" but nothing concrete in mind when he resigned. He thought about running a small company to operate stripper wells, which are typically on their last leg of production.

The issue was financing.

"You quickly come to learn that if you want someone to allocate capital to you and all you really have are people, that's the equity route," he said. "Commercial banks aren't going to do that.

"No assets to lend against. It's just us and our ideas and our track record."

Going into private equity meant coming up with a more compelling idea than stripper wells. It all but screamed shale.

By Nov. 1, Mr. Addison's new company, Travis Peak Resources, closed a $250 million financing deal with EnCap. But the feeling in the office at that time, where eight employees shared five rooms, was still very much like an incubator.

"I remember our CFO saying, 'I feel like an IT startup. I got my card table, my folding chair, my laptop,' " he said.

For about six months, Travis Peak poked around for opportunities in Oklahoma and Texas. In May, it decided to devote all of its efforts to Appalachia. It hired a Marcellus guy based in Pittsburgh.

The goal is to put together acreage blocks in several parts of the Appalachian basin "to see if we could make a case for extending known productive areas or going to places with average results to date and make a better well."

Drilling likely won't begin until late 2015 or early 2016. And Mr. Addison is in no hurry. Gas prices in Appalachia are depressed because the pipelines needed to take the fuel to hungry markets lag the burst in production.

"I believe the quick build-and-flip is over," he said. "We've got a long-term view. We're a five- to seven-year company."

Exit strategy

It used to be that a company could pull together 50,000 acres, drill five wells to prove up that acreage and sell it, Mr. Addison said. Now, "maybe you have 50 wells on it today. You've eliminated more unknowns."

"We will build with the exit in mind," he said. "We'll put on a buyer's hat, having been buyers in the past. We're going to be intentional with every dollar and every well bore that we drill."

Smaller firms regard that as flexibility. Not having the production targets and quarterly responsibilities of public companies, they are free to drill a well that may not produce much but could reveal something important about the geology of the site.

They also need to develop only as much as they need to sell the company.

For PennEnergy, that means drilling for at least the next two years and then starting to thinking about scaling up and packaging the company for a "liquidation event," as Mr. Weber said.

What comes after that? Maybe another startup.

“Yeah, I can do it again,” said Mr. Johnson.

“I might be thinking about that as well,” Mr. Muse said. He’s decided to stop prophesying retirement, having unsuccessfully predicted that he would retire from Atlas.

Private equity firms stand at the ready, especially in this neck of the woods. “We really, really like the Marcellus,” Mr. Devlin said. “We would love more opportunities to partner with teams up there.”

The land grab is gone, he said. But there are many opportunities left in the Marcellus and other resource plays.

There’s the potential to buy up land in an area that’s not considered a hot spot at the moment, and use newer and more efficient well techniques to make it hot. There are also other shale plays below and above the Marcellus Shale, he said.

Mr. Addison, too, is already thinking about Travis Peak 2, or “reloading” with new capital, as he calls it.

“Our ages [in the company] are 30 to 57. I tell the 30-year-olds: ‘If you choose, you can keep this thing rolling as long as you want to. You can continue to do Travis Peak 2, and three, and four. Maybe I’ll come back and work for you someday.’ ”

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