Accessing and Raising Capital for Jr. Oil & Gas Companies

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The financial fortunes of oil and gas juniors have traditionally been heavily influenced by the price of crude oil and, more recently, natural gas. The steep rise in oil prices over the past year led to the expansion of both exploration and development programs, many of which have been curtailed as a result of the steep and sudden drop in prices. With oil prices now below $70 per barrel and financial market woes limiting the availability of debt, the task of sourcing, accessing, and raising new capital and investment is becoming increasingly challenging.

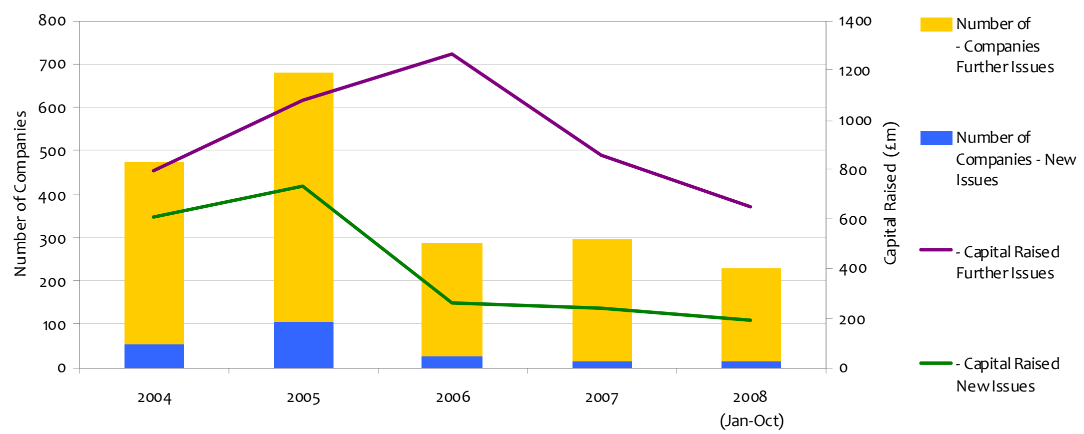
This commentary was prepared as an abstract for the **World Junior Oil & Gas Congress**, held by Terrapinn from 1-3 December 2008 in London, UK.

CEO Terry Newendorp was the special guest chairman and panel moderator on the topic *£ / $ / ¥ / € – Sourcing, Accessing and Raising New Capital and Investment*.

Public Equity Markets

Despite record oil prices in the first half of 2008, this year marks the worst year since 2004 for oil and gas companies listed on the London Stock Exchange Alternative Investment Market (AIM), both in terms of the number of issues and the aggregate amount of money raised from these issues (see chart). Equity investors, though still active in the sector, are assuming a more cautious approach in their investments. Many companies are now trading below their listing price, and, in several cases, moves to the main market or proposed private placements have been postponed or cancelled due to the state of financial markets.

AIM Oil & Gas Company Listings



Source: AIM

Although over the past six months the AIM Oil & Gas Index has substantially outperformed the AIM All-Share, downward revisions in demand forecasts coupled with the dramatic declines in global stock markets are likely to greatly limit the ability of smaller, exploration-only companies to access public equity markets on favorable terms.

Debt

Availability of debt has traditionally been limited in the upstream sector, as banks are unwilling to take on exploration risk and will look for collateral in the form of producing assets or proven reserves. A company's ability to monetize its assets or to put forward significant collateral in the form of P1 reserves can greatly improve the risk profile and therefore improve the terms and availability of finance. Graduation from exploration-only to exploration and production is therefore highly advantageous not only from the public equity perspective, but also for improving access to debt.

For similar reasons, larger, more mature companies are frequently able to access corporate finance against the strength of their balance sheets. However, even these companies have found access to credit more restricted, as the first half of 2008 saw reductions in unsecured revolver commitments in the energy sector.

In recent transactions, however, bidders have been forced to lower their purchase agreements or cut their capital budgets as a result of tight credit markets. In September, for example, Antero Resources lowered its purchase agreement with Dominion Resources by over $200 million due to financing problems, and in a recent report, Barclays Capital has forecast a spending drop of 15% among North American E&P companies. Even where debt is available, it is likely to be more expensive or on more stringent terms.

Private Equity

As a result of the aforementioned trends, institutional, private, and strategic equity investors are becoming an increasingly important source of capital for oil & gas juniors. Private equity funds have also become an important source of capital for many oil & gas juniors. Kayne Energy Funds estimates that the amount of private capital available in the energy sector has risen from less than US$2 billion in 1998 to approximately US$24 billion in 2007. Private equity capital is available in a range of sizes, from small investments to multimillion dollar placements.

Apart from private equity funds, strategic investors have also become quite prominent, and may offer a longer-term funding source than some other forms of private capital. Taking advantage of the market opportunity presented by falling oil prices to acquire large stakes in assets or companies, oil & gas majors, utilities, and national companies are poised to increase their investments in junior companies. In June, for example, Iberdrola acquired a 22.64% stake in Petroceltic, increasing its access to upstream natural gas assets.

Conclusions

As market uncertainty continues and spreads across markets and sectors, oil & gas juniors will have to look to the full range of capital sources to finance their capital investments and their mergers & acquisitions. While public equity markets have been shaken and some companies are delaying their issues, firms with producing assets and strong management continue to be able to raise capital in these markets. Similarly, debt markets are less liquid, but financing remains available for sound projects and companies with strong bank relationships. Strategic investors offer a potentially long-term, significant source of capital, however they may take a more active role in the management of companies.