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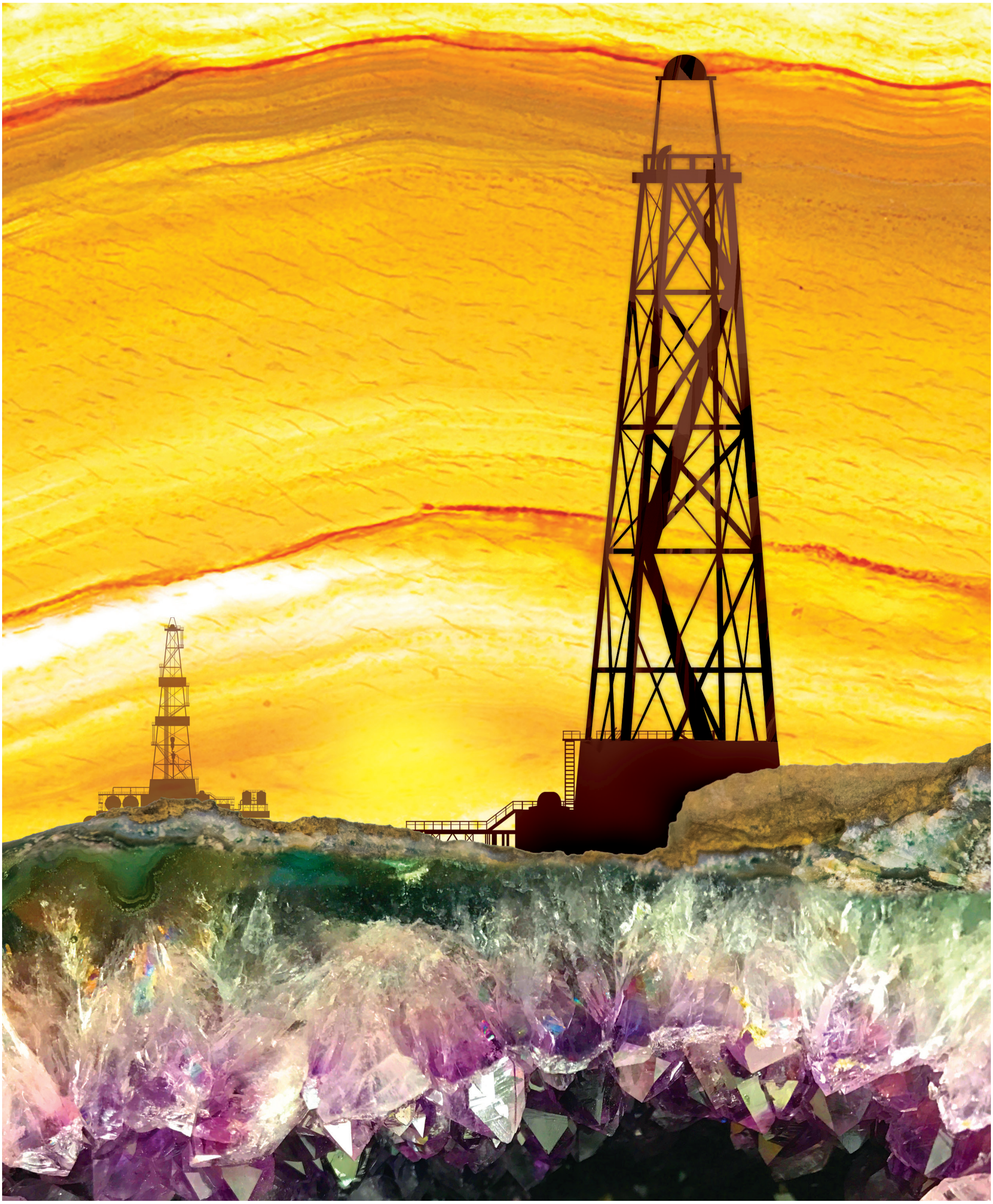

Mineral interests capture the fancy of operators and investors alike.

THE START-UP ROAD

Two launches illustrate the different ways entrepreneurs are putting money to work in today's oil and gas market.

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After helping to guide Memorial Resource Development Corp. from its launch in 2011 through a 2014 IPO then sale to Range Resources Corp. this past September, Greg Robbins hit the pause button. His family's growth had mirrored the E&P's expansion during those years. As one of Memorial's four original employees, he'd had one child; by the time the merger closed, he had four.

"I was leaving the best job I'd ever had," he said. "I needed to spend a couple of months in a relaxed situation."

He also wanted to ensure his priorities were in line and that he could be passionate about his next step. Having had financial success meant he could be selective.

Robbins had served as senior vice president of corporate development at Memorial, which grew to 550 employees and fetched $4.2 billion at sale. Like other alums, he couldn't sit still for long.

Memorial CEO Jay Graham and others reupped with Natural Gas Partners, the E&P's original backer, and in December took Wild-Horse Resource Development Corp. public. For his part, Robbins couldn't put on the back burner the chance to assemble the "perfect" management group as Memorial employees became available because of redundancy with Range's organization. He and his business partner, Larry Forney, formerly COO of Memorial and now CEO of the new start-up, knew the odds were remote of finding another point in time to reassemble the band.

"When you find that perfect group, you do everything required to put it together," Robbins said. "At the end of the day, that's your edge."

They named the start-up Grit Oil & Gas LLC, adding four more Memorial veterans: chief accounting officer Dennis Venghaus, vice president of operations Anthony Sayre, vice president of geology Tim Parks and reservoir tech Melinda Montgomery. Grit is initially targeting conventional assets primarily in the ArkLaTex region.

"We weren't sure yet where we wanted to spend our capital, but we knew we wanted to work together," Robbins said. "There are real risks in this business, and if you can mitigate one of them, it's by working with people you trust, communicate well with and who have complementary skill sets."

They secured a blind pool commitment of just under $100 million from private equity firm Carnelian Energy Capital Management (including contributions from Grit's team), subleased Houston office space and prepared to hit the ground running on March 15.

Robbins knew Carnelian's co-founder, Tomas Ackerman, from the latter's stint at Natural Gas Partners and had a strong personal connection with him. "I've seen him in tight spots and have been impressed with how he handled himself and ultimately how various decisions got made. He and Daniel Goodman [Carnelian's co-founder] are excellent communicators."

Given its plan to stay private, Grit wanted an equity backer that had fewer management teams and could give the start-up more attention. "We don't need help with assets as much as we need a sounding board for when we're reviewing assets, structuring, negotiating, strategizing and for financial-category-type resources," Robbins said.

The current cost of private equity capital—in fact, the cost of all capital—is cheap, he said. "I'd rather take slightly more expensive

Grit Oil & Gas LLC CEO Larry Forney (top) and president Gregory Robbins recognized the value of assembling a top-notch team, gathering together many Memorial Resources veterans.

PE capital and benefit from the resources attached to it than take cheaper capital that is truly passive money, without the ability to provide perspective."

As for competing in the current sizzling A&D market, "We're looking at deals from $50 million to $500 million in value. If we found a $300 million deal that we and Carnelian liked, they have no problem finding direct LP money or other partners, with potentially a lower cost of capital, to get it done.

"Most of Carnelian's LPs are the same as in larger PE funds, which do sidecar stuff all the time," he said. "At Memorial, we met many points of capital: direct investors, funds, nonop guys, drilling funds. The industry is capital-rich, deal-poor. We like to say, 'Good deals get done, period.'"

The start-up is being opportunistic on deals that come in and doing from-the-ground-up technical work in the ArkLaTex. "If we have a lead on a proprietary deal, we're going to work it. We'll also look at the Arkoma and Eagle Ford. We have the overlapping experience, Rolodex and skill sets to be competitive in those basins."

Grit's focus on conventional assets means there may not be economic PUDs in deals at current prices. "We've got to do the cliché: cut costs, get production up, stabilize production if buying an-off-the shelf asset." Conventional assets will require a longer hold.

There's a disproportionate premium for assets in areas with PUDs that are economic or at least touted as economic, he said. "If you've got a PUD-heavy deal between $100 million and $500 million, you are right in the fairway for a PE team to come in and do the PE two-step—fix it up, raise production, book more reserves and sell it.

"Conventional assets may need a whole lot more time and capital than assumed and may not have economic PUDs today. You're not depending on prices getting better to make money as much as you are depending on prices to make your upside economic. In this market, we think adding proved reserves to your project is how you exit."

Today's commodity prices have fueled a lower-risk, lower-return model and the question is, according to Robbins, does that fit private equity?

"Five years ago, probably not," he said. "Now, I think it does. In general, investors today are willing to consider lower return assets. For a lower return deal, it is still our job to underwrite it and believe it is proportionately lower risk.

"PE has to make their slice—at least 20% IRR a year, or it's not worth your time or theirs. Still, at 20% you can underwrite conventional deals without losing upside, by enhancing production and reducing costs. There are assets, with a little hair on them or in the tail-end of their life, in less desirable basins. Many fall into the value-buying bucket. If you are opportunistic, underwrite well and can execute with a lean staff, good returns can still be had." □