Bloomberg: Buyout, Hedge Funds Still Buying Aging Oil Fields, Quantum Says

By Joe Carroll

(Bloomberg) — Buyout firms and hedge funds will continue to snap up aging oil and gas fields that the world's largest energy companies shed, undeterred by a doubling or tripling in price, said Wil VanLoh, co-founder of Quantum Energy Partners LLC.

Quantum, a private-equity firm founded in 1998, has built its assets to $3.2 billion by acquiring fields that produce as little as 1,000 barrels a day and tripling output with new wells. Such fields are too small to bother with for Exxon Mobil Corp., Chevron Corp. or other international oil companies, VanLoh said.

"We've made so much money from assets the Exxons and Chevrons of the world let go," VanLoh said in a March 27 interview. "A 1,000-barrel-a-day field that can be raised to 2,000 or 3,000 barrels a day is insignificant to them on a worldwide scale. But the management teams we deal with can get filthy rich off of that, and they do."

New investment in fields that no longer produce enough oil to interest the biggest oil companies are helping slow the decline in U.S. crude production, said David Hobbs, a managing director at Cambridge Energy Research Associates. U.S. output fell 0.8 percent in 2006, compared with a five-year average annual drop of 2.3 percent, Energy Department data show.

Crude oil prices have more than doubled in the past five years, while natural gas sells today for almost four times as much as the average price in the 1990s, based on benchmark New York futures.

"The price of playing poker has risen," said VanLoh, who co-founded Quantum in 1998 with Tony Neugebauer and A.V. Jones. "But there's still a huge appetite for assets out there, despite the run-up in commodity prices."

Castoffs

Exxon, Royal Dutch Shell Plc, Marathon Oil Corp. and other international energy companies are focusing their efforts on places like West Africa and Russia, which offer better odds for making billion-barrel discoveries, Hobbs said.

Older fields those companies leave behind in places like West Texas and Utah still contain enough oil and natural gas to justify the expense of drilling additional wells, VanLoh said.

U.S. drilling surged 20 percent in December from a year earlier to 3,693 oil and gas wells, led by small producers like those backed by private-equity firms, according to the Independent Petroleum Association of America.

Hedging
"Our portfolio companies hedge 60 to 70 percent of their expected future production six to eight years out to lock in returns," said VanLoh, 36.

The hedges, in the form of futures and options contracts, cover the acquisition price, deal costs, debt and Quantum's fees while generating returns of at least 25 percent. The 30 to 40 percent that isn't hedged represents additional profit, which increases or shrinks as commodity prices fluctuate. "We're not making a bet on commodity prices," he said. "We tell potential investors that if you want to bet on oil and gas prices, go find a commodity fund. There are plenty of them out there. We look for investors who will want to double down with us when prices for oil and gas collapse."

Quantum closed its fourth fund, the $1.32 billion QEP IV, in December. Goldman Sachs Group Inc. has been the biggest investor in Quantum's last three funds, VanLoh said.

Quantum teamed up with Westport, Connecticut-based Lime Rock Energy Partners LLC and the Carlyle/Riverstone Global Energy and Power Funds in December to bankroll Vantage Energy LLC, a start- up run by Roger Biemans, the former president of Encana Corp.'s U.S. business. Quantum put up $210 million of the $470 million committed to the company.

Startups
Denver-based Vantage's first priority will be to acquire oil or gas fields, VanLoh said. "In about half of our deals we just back a team in a startup situation. The important thing to us is that they've run assets before."

Investing in startups has reaped handsome rewards for Quantum in the past. Chalker Energy Partners LP, which Quantum launched in December 2003 with a $20 million investment, was sold 27 months later to Forest Oil Corp. for $255 million.

VanLoh said the firm is now considering venturing outside North American oil and natural gas for the first time. Quantum hired former Morgan Stanley analyst Scott Soler last year to research opportunities in pipelines, oilfield services, coal, power, wind and solar energy.

As much as one-fourth of the $1.32 billion raised for QEP IV will be invested in non-petroleum energy businesses, VanLoh said. He ruled out backing new nuclear plants as too costly. The firm is also considering investments in the North Sea and Australia.

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