

ROYALTY BUYERS

Several firms are making a business of gathering mineral and royalty interests across the country's producing oil and gas basins.

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The landscape for acquiring oil and gas royalties has changed. Major investor-backed royalty buyers have seen royalty prices increasing during the past few years due to the surge in commodity prices—and the fact that there is more competition to acquire these interests.

The marketplace remains competitive as savvy landowners demand more as they attempt to cash out during the current boom in commodity prices, and buyers that specialize in royalties step up their game by acquiring ever-bigger packages.

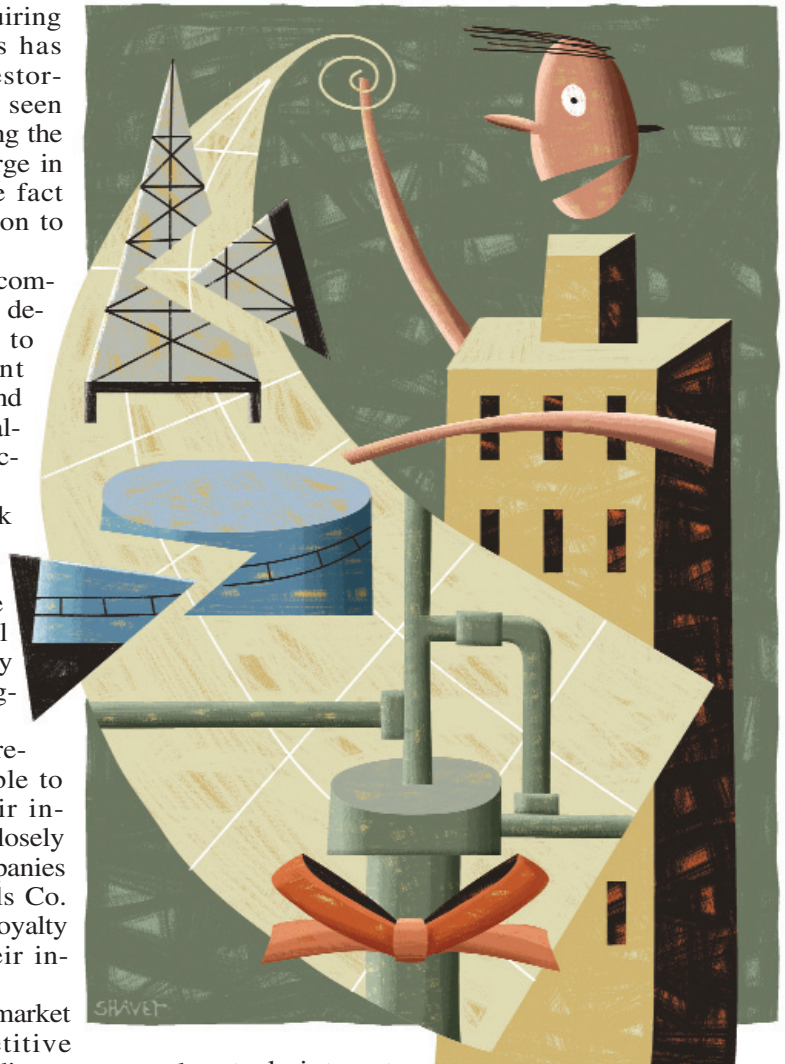
Investors who seek low-risk yield vehicles are drawn to royalty and mineral investments. Given that there are larger amounts of capital available in the market, royalty buyers are taking a more aggressive stance.

Other royalty specialists report they, too, have been able to maintain interest from their investors. Most of the buyers closely guard their strategy, but companies such as Black Stone Minerals Co. LP report they have created royalty investment vehicles for their investors.

The minerals and royalties market has become a very competitive space, with interests now trading at extremely high cash-flow multiples, says Bill Pritchard, chairman and chief executive officer of Indigo Minerals LLC. Investors are finding royalties and minerals to be prudent and safe investments and a good addition to their portfolio.

However, some say the royalty market has peaked, at least for now, after experiencing a run-up in prices from fall 2005 to summer 2006. Here's how the market looks to four royalty buyers.

Black Stone Minerals Co. LP is a Houston-based privately owned limited partnership. One of the largest private fee-mineral- and royalty-owners in the U.S., Black Stone owns or con-



trols interests, either directly or through its institution-supported partnerships, in more than 15,000 wells and approximately 15.6 million gross acres.

With 2007 projected production estimated to be 5 million barrels of oil equivalent, Black Stone has properties in 43 states and virtually every major onshore producing basin. It and its partnerships' primary operations include leasing minerals to E&P companies and acquiring additional properties for future leasing and development activity.

Black Stone's strategy in acquiring minerals is to seek long-life oil and gas properties, says Thomas L. Carter Jr., president. About 70% of



Investors consider minerals and royalties as safe investments, says Bill Pritchard, chairman and chief executive of Indigo Minerals LLC.



Royalty market values may have peaked, but the action is still competitive, says Scott Noble, founder and chief executive of Noble Royalties, now in its 10th year.

its mineral interests are natural gas, but he does not have a preference for gas over oil. The company scopes out properties where it can increase the life of the reserves and achieve a strong positive total return. "If the return is good, we'll do anything," he says.

The company owns, and to a limited extent operates, oil and gas properties through eight investment vehicles. Black Stone is both the general partner and the largest limited partner in each of its investment vehicles.

Black Stone's niche is acquiring mineral properties with a strong producing component as well as undeveloped acreage where it can improve performance by encouraging development of the nonproducing acreage, Carter says. The company takes a very active approach to leasing its properties and provides operating companies with opportunities unique in the industry. Because of its broad acreage footprint, Black Stone can make trades that other mineral-owners can't. The company also acquires nonoperated working interests in proven fields, and prefers long-term properties with upside potential.

In fourth-quarter 2006, Black Stone closed five transactions for an aggregate \$70 million. These acquisitions included nonproducing acreage in multiple resource plays, a nonoperated working interest in the famed Carthage gas field in East Texas, certain fee-mineral and overriding royalty interests in the Barnett shale and acreage in the Austin Chalk play in East Texas.

Black Stone takes a proactive approach to acquisitions, Carter says: "We don't wait for auctions or brokers to come to us. We are constantly talking to people."

Noble Royalties Inc. buys, sells and manages energy royalties. Founded in 1997 by chief executive Scott Noble with four employees, the Dallas-based company has since grown to 92 professionals with experience in all facets of the industry and additional offices in Denver, Houston and Midland.

The company manages approximately \$715 million in properties that produce an aggregate of 44.6 million barrels of oil and 277.7 billion cubic feet of gas per month, derived from more than 94,000 wells. These are spread across 28 states, on more than 6.5 million acres of land. The A&D team has closed more than 175 acquisitions ranging from \$1 million to \$91 million in deal size.

The firm's strategy in acquiring minerals is to work as a partner with royalty-owners to help them understand the fair market value of their property, while at the same time helping to offset the risk for royalty-owners associated with owning a declining asset. Noble uses market comparables combined with in-house and third-party engineering to discuss values and options in maximizing value for the seller.

Noble Royalties raises funds in three distinct

sectors: institutional investors, a nationwide independent broker-dealer network and private high-net-worth individuals. This diversification allows the company to raise capital quickly, closing on properties in cash, usually in less than 30 days with no claw-backs.

Its niche is that it buys, funds and manages in-house. It can also simply manage the seller's asset if a transaction price cannot be achieved. The proprietary enterprise system is in real-time and fully transparent.

Noble Royalties' most recent acquisition was in June: the Concord properties, involving more than 2,000 wells in eight states, primarily Texas, Oklahoma and Colorado, for a purchase price of \$40 million.

Scott Noble says the royalty market has remained competitive, however, he believes the market is "where it should be for decades to come; a tough decision for both the buyer and seller. No one in a transaction should be able to determine the winner for at least 10 years. That is a good transaction. Then the transaction lies with estate planning, other needs for monetization, or a need to transfer the current risk to other parties that will accept the risk."

Market values are decreasing, Noble says. Royalty valuations peaked from October 2005

DEFINITIONS

Mineral interest is ownership of the oil, gas or mineral resources. Landowners can sell the mineral rights, or a percentage thereof, to another person or company, or they can sell the land and retain all or part of the minerals. Rights of the mineral estate-owner and the surface estate-owner vary depending on the state. If these estates are split (held by different parties), the landowner may not prevent the mineral-owner from accessing the land to drill.

Royalty interest is a share of the gross oil or gas production at the wellhead, free of expenses except for taxes and marketing fees. It does not include drilling expenses. One-eighth (12.5%) to one-fourth (25%) interests are the most common percentages held by royalty-owners, although the percentage is negotiable. From an oil well, royalty can be paid in barrels of crude oil or in dollars. From a gas well, the royalty is paid in dollars.

Landowners (lessors) may sell this interest, or they might retain their surface and mineral estates but reserve part of the royalty for themselves and heirs.

Overriding royalty is an expense-free share of production, paid out of the working interest in the well rather than out of the royalty share.

through August 2006.

“This is due to the difficulty of maintaining daily production levels, years of rising federal-funds rates and a recent peak on royalty-owners’ checkstubs. The perfect storm has come and passed and now we are back to sound fundamentals, which still give royalty sellers historically 300% more than just four years ago.”

Prices vary regionally, but production decline, longevity and well-diversification should also be factored in. “Historically speaking, anyone with a production-decline curve higher than 7% should sell their royalty assets and reallocate the capital in an appreciating-interest or equity market. It is simple Finance 101. But the rub is that no one can predict where the pricing will be in 10 years, so the guessing game continues for some evaluations and a buyer-seller gap continues in certain situations,” Noble says.

Denver Mineral & Royalty Co. holds interests in 250 wells in the Denver-Julesburg and Williston basins, Midcontinent and South Louisiana, and in more than 150,000 net acres. Formed in 2004, the Colorado-based company is backed by private funding.

Its focus is on acquiring producing properties and minerals and royalties; acquiring nonproducing mineral and royalty interests that are being developed or are in areas of active development; and funding exploration teams to develop projects that are then offered to the industry.

The strategies are varied, but enable the company to grow cash flow and reserves through acquisitions, while providing upside potential with exposure to exploration and development plays, says manager Jim Powers. While the company evaluates and bids on properties that are on the open market, it prefers to partner with landmen and geologists with extensive experience and expertise in one area, Powers says.

Whether acquiring minerals and royalties or putting prospects together, most of the company’s transactions are done through existing relationships with individuals and small companies. The company has completed more than 50 transactions in 2.5 years, ranging from \$10,000 to more than \$25 million.

Its most recent transaction was the sale of some 50,000 net acres in the Williston Basin to an undisclosed buyer. Last year, it sold 40,000 net acres in the Williston Basin to Marathon Oil Corp. No price for either deal was disclosed. At press time, the company was working on yet another play in the Williston with nearly 50,000 net acres in hand. All three projects targeted the Bakken shale in the North Dakota portion of the Williston Basin. Dennis Flyer is vice president of acquisitions.

Indigo Minerals LLC was formed in late 2006 from a partnership of private-equity fund Yorktown Energy Partners VII LP and lease-owners Martin Cos. of Louisiana, resulting in Houston-based Indigo owning the oil and gas leases and minerals of two of the largest private



landowners in Louisiana: Roy O. Martin Lumber LLC and Martin Timber Co. LLC.

The company has royalty interests in 215 wells, primarily in the North Louisiana Salt Basin. Daily production is 2 million cubic feet of gas. Indigo’s principals have drilled and completed almost 100 wells (largely tight-gas sand or unconventional) during the past three years.

The company manages both its leased and unleased mineral acreage; operates wells on its mineral position; participates with others drilling on its minerals; and/or purchases undeveloped leasehold and/or producing assets and drill wells not directly related to its existing mineral position.

Indigo also seeks to manage or acquire other mineral interests and/or royalties in the Jurassic, Cretaceous and Tertiary plays of the Upper Gulf Coast basins of North Louisiana, East Texas, Mississippi and Alabama.

Indigo’s strategy in acquiring minerals is to seek tight-gas sand horizons characterized by low-risk, repeatable drilling success rates and moderate reward, says Bill Pritchard, chairman and CEO of Indigo Minerals.

Its niche is that it maintains a technical staff of petroleum engineers and geologists who can develop the company’s minerals. It also leases adjacent tracts and, ultimately, will seek to add drilling and operations engineers for future completions. “Indigo’s focus is to find locations to drill on our minerals,” Pritchard says.

Its initial acquisition was of 425,000 mineral acres contributed by Martin Cos. The \$100-million deal, which including matching funds from Yorktown, was completed in October 2006.

Pritchard says high natural gas prices have primarily driven strong sales of mineral interests. “Investors seeking yield now consider minerals and royalties as fairly safe investments.” □

Gas is flared at a rig working for Black Stone Minerals Co. LP in Tyler County, Texas.