

QUANTUM ENERGY PARTNERS<sup>SM</sup>

*[www.quantumep.com](http://www.quantumep.com)*

*2007 MLP Investor Conference*

*(Hosted by Lehman Brothers)*

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# Overview of Quantum Energy Partners

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- ▶ Family of energy-focused private equity and direct property acquisition funds with a primary emphasis on the oil and gas sector (upstream) and a secondary emphasis on midstream, oilfield services, coal, power and alternative energy sectors.
- ▶ Currently manage \$3.2 billion; latest fund (Fund IV) recently raised: \$1.32 billion.
- ▶ Quantum Energy Partners:
  - Private equity fund.
  - Target equity investment size: \$25 to \$150 million, & up to \$200 million.
  - Multidisciplinary investment team with complimentary expertise in finance, engineering, geology, geophysics, operations, tax and law.
- ▶ Quantum Resources Fund (QRF):
  - Direct property acquisition fund, structured similarly to an E&P MLP – akin to a private MLP.
  - Investment size: > \$200 million.
  - Partnership with Don Wolf (ex-Westport) and Alex Cranberg (Aspect).
- ▶ Most noteworthy MLP transaction: Linn Energy was formed in March 2003 with a \$15 million equity investment from Quantum. Linn Energy was taken public in January 2006.

## The Questions Posed

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- ▶ Will E&P MLPs become a major portion of the MLP space or grow to dominate the MLP space?
- ▶ Why do private equity firms that are funding E&P ventures find the MLP vehicle an attractive structure?
- ▶ How did Quantum and Linn Energy conceive the MLP structure?

## Six Publicly Traded E&P MLPs

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- ▶ **Six Energy MLPs:** Average yield: 6.39% (vs. 7.84% a year ago). Average EV/EBITDA = 10.9x compared to 4.0 to 6.0x EV/EBITDA for E&P C-Corps.
- ▶ **Linn Energy, LLC:** Quantum Energy, Mike Linn and Lehman Brothers: IPO on 1/12/06. Was an 11.75 MM unit offering at \$21 per share. Assets in the Appalachian Basin. Was intentionally structured as an LLC with no subordinated units and no IDRs. The limited partners were made equal. Did not have the structure where the GP was taking an inordinate amount of cash from the LPs as it grew.
- ▶ **EV Energy, L.P.:** IPO completed in September 2006. Asset base primarily in the Appalachian Basin and N. Louisiana. Was structured similarly to the Alliance Coal MLP.
- ▶ **BreitBurn Energy Partners, L.P.:** IPO completed in October 2006. Asset base primarily Los Angeles Basin and Wyoming.
- ▶ **Constellation Energy Partners, LLC:** IPO completed November 2006. Asset base: CMB in Black Warrior Basin. IDRs (incentive distribution rights) up to 15%.
- ▶ **Atlas Energy Resources, LLC:** IPO completed December 2006. Asset base primarily Appalachian Basin. Very similar to Constellation, but with IDRs up to 25%.
- ▶ **Legacy Reserves, L.P. :** IPO completed January 2007. Asset base is primarily in the Permian Basin and SE New Mexico. No subordinated units or IDRs.

Sources: Quantum and Vinson & Elkins.

## Will E&P MLPs become a major portion of the MLP space?

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- ▶ **In our opinion, yes.** The running room for the vehicle's use and growth for E&P assets is substantial, in our opinion. In the 1980s (1981-1987), over 100 MLPs were formed, of which 31 were upstream MLPs. We believe that E&P MLPs could again represent at least 30% of the MLPs in this era. Possibly a higher % this go round given the more prudent management of the types of assets being placed into and well-hedged in these MLPs.
- ▶ **Current market capitalization of the six E&P MLPs is  $\approx$  \$4.5 billion.** Current combined enterprise value of  $\approx$  \$5.0 billion. Compare this to the total market capitalization of publicly traded MLPs of  $>$  \$100 billion.
- ▶ **Pool of assets that are candidates for E&P MLP ownership is significant.** We estimate that  $\approx$  \$270 billion assets in North America are PDP (proved, developed, producing) assets, many which technically qualify for MLP treatment. Remember: current combined market cap. of E&P MLPs of \$4.5 billion with a pool of assets of \$270 billion available.
- ▶ **What is the incentive to E&P management teams to place these assets into the MLP vehicle?** Several incentives, but simply put, publicly traded E&P companies (C-Corps) are currently valued for 4-5x EV/EBITDA vs. 9-12x EV/EBITDA multiples for publicly traded E&P MLPs. The majority of assets owned by publicly traded C-Corps are mature, lower decline rate assets, many which could be revalued on a distribution yield basis and resultant multiples that are much higher. \$270 billion pool of assets with significant arbitrage between C-Corp vs. Flow through structure valuation is compelling.
- ▶ **Is it different this time?** In some ways no, but in a lot of ways, yes.

## Then vs. Now – Is it different this time? In many ways, yes.

### THEN: 1980s

- ▶ Inability to effectively hedge commodity prices for lengthy periods. Commodity prices dropped materially from over \$30 per barrel in the early 1980s to \$10 per barrel in 1986, with relatively no hedging in place.
- ▶ Cash flow distribution policy left little room for replenishing depleting reserves
- ▶ Low reserve / production ratios in most cases with steep decline curves. Very poor fit for a cash flow through vehicle.
- ▶ Insufficient equity capital available for MLPs available to fund capital expenditures.
- ▶ A number of these upstream MLPs were simple roll-ups that had very poor histories before being public.
- ▶ Changes in tax laws – passive activity rules: prevented MLP losses from being offset against active income or even income from other passive activities.

### NOW: 2000s

- ▶ Can effectively hedge five years of production (in some cases longer). Both the amount of production and the duration of the production that can be hedged has materially improved.
- ▶ Today, MLPs budget “maintenance” (sustaining) capex (15% to 20% of EBITDA) to replenish reserves and hold production flat. Expansion capital is raised to support growth, but only if the projects support the capital.
- ▶ High reserve / production ratios allows for relatively predictable production rates long into the future. The vast majority of these assets are far down the decline curve already – mature properties.
- ▶ Plenty of “cheap” capital for MLPs to access today from increasingly more sources: closed-end funds, hedge funds, retail, private placements, etc.
- ▶ The E&Ps today are generally well-managed by professional managers and often supported by smart private equity firms and strategic sponsors.

Sources: Morgan Stanley and Vinson and Elkins.

## Why do PE firms find the MLP vehicle an attractive structure?

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- ▶ **Because the vehicle affords PE firms a financing (exit) strategy to maximize ROI.** Four of the keys to successful energy PE investing: (1) acquisitions via low cost-of-capital, (2) significant arbitrage opportunity between asset valuations and MLP valuations, (3) an increasingly easy and profitable exit strategy, and (4) an incentive for strong management teams to have a very liquid, public currency to more quickly realize wealth from their efforts.
- ▶ **Because the vehicle is well suited** for mature, lower decline rate PDP properties, of which the pool of these assets in North America is substantial.
- ▶ **Because the vehicle enables acquisitions at a favored cost-of-capital,** the same driver driving Midstream MLPs to use the vehicle.
- ▶ **The ideal structure, in our opinion: MLP with no IDRs and in an LLC structure.** Affords the E&P MLP a few attractive features: (1) allows for a very competitive and more-or-less constant cost-of-capital, given no increasing payout to a GP, (2) allows the MLP to continue to fund distributions and capex requirements without the burden of paying out increasingly higher distributions, and (3) offers the limited partners a “square deal,” in that they are not subordinated to the GP.

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***INNOVATIVE EQUITY CASE STUDY:  
LLC Equity Offering (IPO)***



# CASE STUDY – Deal Overview & Hurdles

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- ▶ **The challenge:** To introduce the first U.S. E&P MLP/LLC (in a generation) and make it a growth-oriented, distribution-yielding vehicle to capture a premium valuation for Quantum’s investors and for Linn’s management.
  
- ▶ **Why did we think it was possible?**
  - 34 Canadian royalty trusts with a combined market capitalization in excess of us\$60 billion, of which U.S. investors own approximately us\$10 billion.
  - U.S. investors owned \$5 billion of U.S. Royalty Trusts.
  - U.S. midstream MLP’s had a collective market capitalization of \$55 billion.
  - It made sense – Majors have been doing it privately for decades.
  - But still no U.S. E&P MLP/LLC or Canadian-style royalty trust existed.
  
- ▶ **What were the hurdles?**
  - Convincing a U.S. investment bank (& Scott Soler) to get behind the idea.
  - Convincing investors that this vehicle was different than the E&P MLP’s formed in the 1970’s and early 80’s.
  - Demonstrating that we could:
    - Mitigate commodity price exposure
    - Overcome embedded cash flow decline associated with production run-off.

# CASE STUDY – Launch & Results

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## ▶ What finally compelled us to try one?

- Claim U.S. first mover competitive advantage.
- Copano Energy, LLC provided roadmap to ideal E&P yield/growth structure.
- Nameplate management and optimal asset base.
- The baby boomer “yield + growth” megatrend.

## ▶ The result:

- 12 months later, completed successful IPO:
  - Gross IPO proceeds of \$246.8 million, of which \$95.3 million went to Quantum.
  - Priced at top of filing range at \$21.00 per share, representing 7.6% yield.
  - >4x oversubscribed.
  - Institutional ownership about 30%.
  - This was all done with only \$16.3 million of equity.

# CASE STUDY – Valuation (Information from the IPO)

## Valuation Summary

(\$ and units in millions)

	<u>At IPO</u>
Price per Unit	\$21.00
Pro Forma Units Outstanding	27.8
Equity Value	<u>\$584.10</u>
Net Debt <sup>(1)</sup>	128.6
Enterprise Value	<u>\$712.60</u>
Yield	7.6%

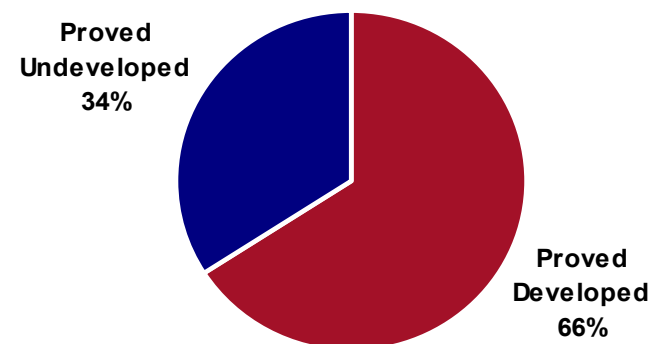
## Valuation Metrics

Enterprise Value / 2006E EBITDA	10.2x
Enterprise Value / Proved Reserves (\$ / Mcfe)	\$3.76
Enterprise Value / 2006E Daily Production (\$ / Mcfe/d)	\$30,054

## Credit Statistics

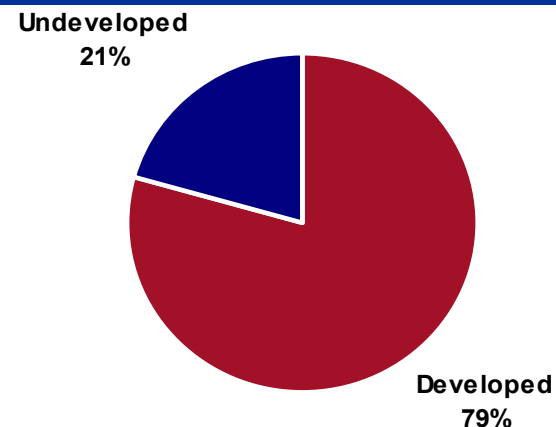
Net Debt / Enterprise Value	18.0%
Net Debt / 2006E EBITDA	1.8x
Net Debt / Proved Reserves (\$ / Mcfe)	\$0.68

## Proved Reserves by Category <sup>(2)</sup>



**189.6 Bcfe; 99% Natural Gas  
PV10 \$898.7 million**

## Net Acreage <sup>(2)</sup>



**140,045 Net Acres**

1. September 30, 2005 net debt balance pro forma for the IPO.

2. As of September 30, 2005.