

Investing In Those Who Make A Difference

Pearl Energy sees opportunity in tough times and backs teams that are capable of taking advantage.

By Joseph Markman, Senior Editor



Oppportunity lurks in the Permian Basin, even in a downcycle—*especially* in a downcycle—and a couple of ambitious guys in Midland, Texas, are primed to find it and pounce.

Colgate Energy LLC founders Will Hickey and James Walter bring years of industry experience in operations and finance to their venture, along with a well-thought-out strategy of building their business with unconventional acreage and legacy-producing assets that other companies don't want or can no longer afford.

This image captured by a drone shows Pearl Energy Investments' headquarters in Dallas. The private equity firm formed in 2015 is focused on exploiting opportunities created by the industry's downcycle.

Source: Pearl Energy Investments



Sounds like a plan, but what the two needed to execute their vision was a private equity backer able to provide not just capital, but business and operational expertise. Where do you find investors like that to back a first-time startup team?

Turns out, the answer was not far away.

Also launched in 2015 by a couple of ambitious guys in Dallas with years of industry experience in operations and finance, Pearl Energy Investments sees this downcycle as a target-rich opportunity environment, especially for those in the upstream and midstream space who work and play well with others.

"We pride ourselves on relationships," Chris Aulds, partner with Billy Quinn, told *Midstream Business*. "If we can back a midstream team that has a relationship with a producer, we feel like that gives us a competitive advantage vs. coming in and trying to develop a relationship with a producer from the ground floor."

Like Pearl's other portfolio companies so far, Colgate is an upstream company, but finding the right midstream teams to work with is an integral part of the private equity firm's plan to extend into multiple basins. So far, its funds have reached into the Permian Basin and Eagle Ford Shale in the U.S., and the Western Canadian Sedimentary Basin in Alberta.

Time to invest

Pearl began in the mind of its managing partner Quinn, a former managing partner at Irving, Texas-based Natural Gas Partners (NGP), a private equity firm that has invested more than \$17 billion since its inception in 1988. Quinn sat on the board of directors of TEAK Midstream LLC, which Aulds co-founded. TEAK was sold to Atlas Pipeline Partners LP in 2013 and Quinn retired from NGP soon after at a time of soaring markets.

"It was really Billy's vision," Aulds said. "As he saw the market correct and come down the way it has the last year or two, he felt like it was the time to start a new private equity firm. Market conditions were just ripe to get back in at these lower prices."

The two had enjoyed a great working relationship at TEAK and by last summer, realized it was time to take advantage of the opportunities presented by the industry's sluggish economics. Aulds and Quinn formally partnered and, by the end of September, closed on a \$500 million private equity raise. They were ready to invest and make a difference.

All they needed to find were a few difference makers.

"First and foremost, as a private equity firm, what we're backing is the people, we're backing management teams," Aulds said. "We're not specifically looking for midstream assets or upstream assets—we're more focused on the deal team."

Ideally, that midstream team will already enjoy a longstanding relationship with a producer. That takes experience, which Pearl also values highly. The partner need not have a long history as a serial entrepreneur, but playing a key role within an organization over time and understanding how the business works, particularly how it works in a specific basin, can be invaluable. Pearl anticipates that as much as 65% to 75% of its new investments may back teams that are starting a company for their first time.

The right partner

Colgate fit that mold.

"The Colgate management team has the complementary skillsets required to build a great company and they are great at what they do," Quinn said. "Both Will and James were rising stars at their prior employers."

Walter was an investment professional at Denham Capital, a private equity firm focused on energy, and Hickey had been a lead engineer with extensive drilling and operational experience at Pioneer Natural Resources Co., where most of his work involved West Texas. Colgate has also brought on Brandon Gaynor, a West Texas veteran with Concho Resources, to lead its land and A&D efforts.

"We understood what things look like from the other side of the fence," Hickey told *Midstream Business*.

Profile

“Because of that, we were very picky in who we wanted to partner with.”

They sought a financial partner well-versed in the various aspects of building an E&P, and one looking to invest in the \$50 million to \$75 million range. The deal that the Colgate partners struck late last year provided them with a total of \$75 million, with \$50 million supplied by Pearl and \$25 million from NGP.

“Billy’s track record is really, really strong,” Hickey said. “We like Billy and think he’s a great investor. Chris has shown on multiple occasions the ability to build a company from the ground up. Working with those two and their team has just been great. They help us think strategically.”

Get smart

Pearl also looks for the ability to manage risk.

“It’s one thing to speculate in the industry whether you’re in the upstream or midstream side,” Aulds said. “We look for teams that have some contracts in place, that have some existing cash flow, whether it’s a greenfield project or whether they’re acquiring assets.”

It takes effective management and balancing of risk vs. reward to grow a midstream company, he said, along with the savvy and creativity to compete in this extremely competitive sector.

That’s a lot to assess, but high standards are required when deciding if somebody is worthy to take possession of your \$50 million. Does it mean that only those with prior relationships would be considered? Not necessarily.

“Obviously, if we know them, that certainly allows us to understand the DNA of the individuals and the skill sets that they bring to the table,” Aulds said. “Even if we don’t know that team, there are probably some individuals in the industry who we can reach out to for references on this new team. More than likely, we’re going to have some point of contact in the industry who is going to know these individuals and can give us some insight to their strengths and weaknesses.”

Access to advice

Pearl’s involvement with its teams is flexible. If the team wants to pick the brains of Aulds and Quinn, it is more than welcome. If they have everything under control, that’s fine, too.

“If it’s a team that’s pretty driven, that already has the relationship, they already have the project, they don’t need our involvement, then we certainly want to respect that,” Aulds said. “We think of it as a partnership. If they don’t feel compelled to reach out and use us then we’re certainly not going to force it upon them.”

By contrast, in Colgate’s case, having the Pearl partners on speed dial has been a plus.

“They’re a great team,” Hickey said. “If I have a question about an asset, I know who to call.”

Aulds and Quinn have offered insights on more than just bidding on assets. Many questions from Hickey and Walter have involved the nuts and bolts of building a business, such as how to conduct the hiring process and how many interviews are needed.

“Between Billy and Chris, they pretty much have done all of the above,” Hickey said. “I call Chris a lot on operations questions and James calls Billy a lot on finance questions. Works out pretty well for us.”

And that’s fine with the Pearl partners, who don’t mind sharing what they’ve learned in more than 50 years in the industry between them.

“If the team is wanting to utilize the skill sets and relationships and knowledge and expertise that I’ve developed in the 25 years that I’ve been on the midstream side, the 30 years that I’ve been in the industry, I certainly love to roll up my sleeves, as does Billy, and get involved as much as they might want us to get involved,” Aulds said. “I really consider it a partnership, not us being Big Brothers looking over their shoulder but a partnership with the team that we back.”



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— **Chris Aulds**, partner, Pearl Energy Investments

Upside in a downturn

The lament of so many during this prolonged rough stretch in the industry is that private equity has stayed on the sidelines. For Pearl, it's been the right time to get into the game.

"As a first-time private equity firm, we really see it as a tremendous opportunity for us," Aulds said. "You see producers that are needing to sell some of their midstream assets to generate some cash to shore up their own balance sheets, or so they can execute their own business plan."

Assets appearing on the market may be an obvious indicator, but Aulds also notes a significant change in the nature of the business. He and Quinn see it as a less competitive environment than it has been in the past.

"We see that the downturn in the MLP space creates a little bit less competition in the midstream sector as the once very competitive midstream MLPs seem to be focused on trying to shore up their own balance sheets and focus on their own issues," he said.

The Pearl partners see the current less aggressive environment as creating openings for new players to take advantage of opportunities while those competitors tend to their internal financial issues.

Exit strategy

The downturn also forces a private equity firm to think carefully about its exit strategy.

"The time frame and exit strategy on any investment really depend on the industry condition and market conditions at the time," Aulds said. An investment made in 2011 or 2012 may have come with the expectation that a business plan be executed in two years and monetized in three. Now things are less predictable.

"We think in today's environment with where market conditions are, certainly it could extend the life of a company before we exit," he said. "Today, it could be anywhere from three years to a high end of six to seven years, with the sweet spot being the four-year to six-year time frame."

Aulds and Quinn were brainstorming one Sunday afternoon in their new



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— **Billy Quinn**, *managing partner, Pearl Energy Investments*

offices, gazing out the window and trying to decide on a name for their firm. It needed to be something simple, something that conveyed what they wanted to be. The street sign caught their eyes: Pearl.

"Pearl Avenue runs from our office right to the downtown Dallas Petroleum Club," Aulds said. "We were looking at the street and said, you know what, let's just keep it simple. At the same time it obviously has a double meaning if you look at the fact that it's a gemstone that starts with a grain of sand and builds into something special. That's what we feel that we are as well."

Hickey and Walter had a street in mind when they formed their company, too. Colgate Avenue in Dallas is where both of them grew up. It's more than coincidence that these teams managed to join in a venture. They follow in the path of an industry built on relationships.

"We're backing young professionals who have spent most of their careers at what we would consider some of the best upstream companies, whether they're publicly or privately held," Aulds said. "They've gained tremendous knowledge and expertise working for other companies in the respective basins that they are going to focus on today."

"We felt like they were difference makers within their own organiza-

tions," he said. "They have a competitive advantage over some of the competition out there because they've spent most of their career working in the basin anyway as an employee. Now they have a chance to do it as an owner and executive of their own start-up company." ■

Joseph Markman can be reached at jmarkman@hartenergy.com or 713-260-5208.

Pearl Energy Investments

Founded: 2015

Headquarters: Dallas

Leadership:

- Billy Quinn, managing partner
- Chris Aulds, partner

Fund: \$500 million (closed on Sept. 30, 2015)

Energy sector coverage:

Upstream, midstream

Regions: Permian Basin, Eagle Ford Shale, Western Canadian Sedimentary Basin

Source: Pearl Energy Investments