Energy startups eye private capital

Oilpatch vet happy with new role

Steve Sugianto, president and CEO of New Star Energy in Calgary, pictured at the company's offices earlier this month.

Photograph by: Leah Hennel, Calgary Herald , Calgary Herald

After years of enduring the twists and turns of the public stock market, oilpatch veteran Steve Sugianto is clearly enjoying life at the head of a new private Calgary junior oil and gas company.

As co-founder and president for nine years of Toronto Stock Exchange-listed Galleon Energy Inc., the 49-year-old engineer knew the rush of announcing big discoveries but also the despair when natural gas prices tanked and the company's stock price and reputation fell along with them.

Early this year, after a brief fling with "retirement," Sugianto became president and CEO of New Star Energy Ltd., a low-profile private company that identified an undervalued asset for sale from a major oil company and quickly raised $128 million from a handful of investors in Calgary to buy and develop it.

Sugianto's technical team went to work on the parcel of land 50 kilometres southwest of Edmonton this spring. There they are producing 1,700 barrels of oil equivalent per day while refining their horizontal wells and multi-stage hydraulic fracturing technology to boost oil output.

"In this business, you need three things," he said in an interview. "Good people, a good asset base and good financing.

"I think the private company model is a much better platform with which to grow."

Over the past five years, the S&P/TSX Energy Index, which tracks industry stock prices, has varied between 1,750 and 4,240 as the New York oil price swung between $34 and $145 US per barrel and gas wavered between $1.91 and $13.58 US per million British thermal units.

The volatility has hurt producers' ability to raise money - low commodity prices cut into cash flow, crippling the drive to replace production through acquisition and the drillbit, and selling shares when prices are low waters down the value of existing shares.

The grind of quarterbyquarter reporting and "immediate gratification" demanded by public markets has convinced many to leave it behind, said Lauchlan Currie, president of Calgary's biggest energy-focused private equity firm, ARC Financial Corp.

"The longer-term trend has been more private equity coming into the energy space. It's been building significantly," he said.

"ARC started 15 years ago and it was very modest. Now we've just raised another $1 billion and there are a number of players participating."

It's difficult to get a handle on exactly how much private equity is invested in the Calgary oil and gas sector, although it's a fraction of what's been sunk in public companies.

It's safe to say the total is in the billions - ARC alone has raised $3.7 billion in seven funds through which it has invested in over 160 portfolio companies since 1997, targeting investments of $25 million to $100 million for terms of three to eight years.

Meanwhile, Calgary-based JOG Capital, one of New Star's biggest backers, is in the process of raising $600 million in its sixth fund since 2002, bringing its total under management to more than $1 billion.

President Don Cowie said it's been difficult for energy startups to find capital since the economic meltdown of 2008 because markets are more risk-adverse.

"The institutional market acceptance of the juniors really isn't there from a startup perspective," he said.

"Teams like Steve's and some others we've invested in were ex-public teams that realized they can't just go and do an IPO (initial public offering) like they did three years ago."

Cowie said bigger, multibilliondollar private equity funds are often looking for deals that are much larger than those JOG does.

"We think the sweet spot in the market is raising between $100 million to $150 million," he said.

"When you go sell that, when that company grows up, it's in that $350-million, $400-million range and that's the sweet spot in the M&A (mergers and acquisitions) market. You always have to build something you can sell."

Typically, the company looks for payout in three to six years, he said. So far, it has invested in 16 companies, all startups and all with JOG representation on their boards of directors.

Toronto-based Sprott Resource Corp., a publicly traded private equity fund, recently agreed to tender its 81 per cent stake in private heavy oil junior Waseca Energy Inc. to a takeover offer by publicly traded Twin Butte Energy Ltd.

After four years, its $44-million investment will deliver the equivalent of about $99 million if the deal goes through, including a nine per cent stake in Twin Butte.

Paul Dimitriadis, Sprott chief operating officer and a director on the Waseca board, said private equity availability is growing in Calgary, especially for management teams that have succeeded in the past.

"People are attracted to the public markets when it's easy to get money but, all things being equal, a lot of people would prefer to avoid it; quite frankly, it's a bit of a headache," he said.

"When the public markets are soft, people take a harder look at private capital and enter into relationships with private equity people."

Both Currie and Dimitriadis point out that more private equity from the United States is also showing up in Western Canada.

"When you're in a market like we've got now with protracted weak gas prices and oil with the differentials increasing, there's lots of uncertainty in the business," said Currie. "Private equity thinks long-term and can ride out cycles and isn't as focused on the next quarter of results."

Dimitriadis said some entrepreneurs prefer the public market, where there could be thousands of shareholders but no one person with a lot of influence.

On the other hand, the structure of a private company with a few wellheeled investors is much simpler.

"If you have three shareholders who can easily write $50 million or $100 million cheques, you know you're going to get funding for your business, if it's a good business," he said.

Tom Pavic, vice-president of Calgary-based Sayer Energy Advisors, a mergers and acquisitions consultancy, said he's noticed the trend in Calgary where former executives from public companies are emerging as leaders of private startups. The list this year includes New Star, West Valley Energy Corp., Velvet Energy Ltd. and Red River Oil Inc.

"There is a higher percentage of private equity versus public equity now than in the past," Pavic said. "Only a few companies now are able to raise money in the public markets."

Sugianto's experiences as the head of a publicly traded company culminated in his resignation last year after Galleon tried and failed to find a buyer, sold assets, then wound up being recapitalized, renamed and merged into something bearing little resemblance to the Galleon of old.

"Basically, the gas price killed us," Sugianto recalled.

"When you are in the public market, you have to grow every month and the market is not very forgiving. Being private, you have more flexibility and better cost efficiency - for instance, you can time when you want to drill and complete your wells."

For now, he is focused on this year's $30-million New Star development budget, using it to drill about 20 wells while chipping away at a longer-term goal of changing the company's 40 per cent oil weighting to 70 per cent or better.

Private investment is "patient money" but Sugianto knows his investors will want their payout in three to five years.

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