REUNITING JONAH

With private equity backing, Jonah Energy LLC has consolidated a famous field that competes at current natural gas prices.

ARTICLE BY
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Combining its core Wedge position with the acreage in the adjacent Pinedale Anticline and normally pressured Lance areas, Jonah Energy LLC now owns just under 150,000 contiguous net acres in the area.

For Jonah Energy LLC, its recent purchase from Linn Energy Inc. is like arranging the ideal family reunion. Reintroductions are required, but the task at hand is made easier in that it involves bringing together parties that share a common background. And reuniting the parties is expected to deliver significant upside for Jonah.

The $566-million purchase by the Denver-based producer "is the most synergistic bolt-on acquisition that I've been involved in," said CEO Tom Hart. "We're laser-focused on the Jonah Field area. To be able to buy the other half of the field and drop it into our operation is very efficient for us. We don't need to add substantially to almost any of our operations."

Jonah Field, situated in the Green River Basin in Wyoming, has a long and illustrious history. Discovered in 1986 and initially developed in the 1990s by McMurry Oil Co., substantial portions of the field were subsequently sold in two main transactions. One saw a predecessor of Encana Corp. buy assets that were sold to private equity-backed Jonah Energy in the spring of 2014. The other involved a farm-in by Snyder Oil Co. Those assets were bought by Amoco Corp., taken over by BP Plc and, in 2012, sold to Linn.

"The Linn acquisition really puts those two pieces back together that made up much of the entire field as it was originally discovered by McMurry," Hart said. "What we were operating before the deal was about the size of one township, producing about a half a billion cubic feet equivalent per day, gross. Now, with the Linn acquisition, it's about two townships."

Production is mainly from Lance and, in many places, Mesaverde—together referred to as the "Lance Pool." Production is typically 87% gas and 13% condensate and NGL.

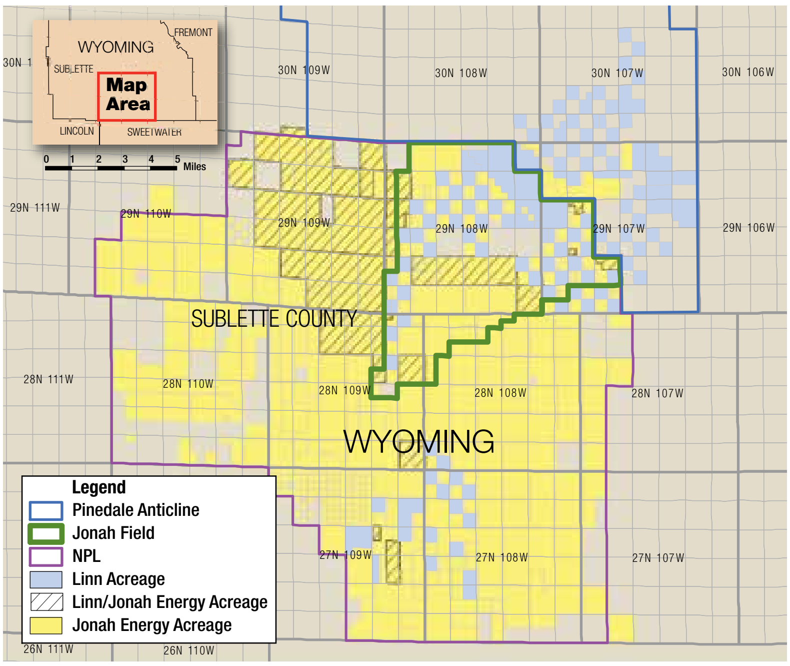
Ranked among the top 10 gas fields in the U.S., it has stood the test of time. "The Jonah Field is still a very special resource," said Hart. "The original gas in place is a unique concentration of hydrocarbons.

"The field is capable of competing with the big shale plays that have been providing the majority of the new gas supply that's been brought on over the last 10 years. Our team has been able to get the cost structure right-sized so the resource can continue to compete."

In the spring of 2016, when the U.S. rig count was at its lowest—and operators had only seven rigs running in Wyoming—Jonah Energy accounted for two of the rigs, according to Hart. The company has typically run between two and five rigs, he noted, and currently has three rigs in operation.

Private equity backers for Jonah Energy are TPG Capital LP, which is the majority shareholder, and EIG Global Energy Partners LLC. Management and a group of high-net-worth investors own approximately 10%. To fund the expansion of Jonah's footprint in the basin, existing investors provided equity financing, which the operator combined with borrowings under a credit facility that was increased from $825 million to $1.125 billion.

Jonah's And Linn's Combined Acreage



Source: Jonah Energy LLC

Financial strength

What encouraged the investor base to step up despite the ongoing downturn? Hart said that, despite the generally soft natural gas market, the company retired more than $300 million of its original acquisition debt with cash flow while simultaneously delivering modest production growth.

"During the downturn, we had to make sure we were prudent with our financial position," Hart said. "We elected not to grow production unprofitably, but, rather, focus on profitable operations and continue to delever.

"In doing that, we emerged with a very strong balance sheet, happy lenders and very pleased investors. When it came to doing the Linn deal, we had the financial strength and backing to be able to do it."

Hart quoted one of Jonah's board members: "If you look for companies that, during 2016, managed to grow production and also delever—without issuing equity or selling assets—good luck. There aren't many. But we did do that and, while we sacrificed some growth during that period, we are now positioned to grow much faster if we choose to do so."

Pro forma for the Linn acquisition, what is Jonah's new corporate profile? Hart first pointed to the Jonah "Wedge," a central area of Jonah's position where the Lance Pool is substantially overpressured. There, the company's initial acreage of 12,000 net acres, which has produced about 4 trillion cubic feet equivalent of gas to date, will be expanded by about 11,000 net with the Linn acquisition.

"So, pro forma, our net acreage in that core position roughly doubles," he said.

But, while the higher acreage count in the Wedge area tells part of the story, the more compelling factor is the development stage of the additional acreage, according to Hart. "The two parts of the field were developed at different paces," he said. "When we look at the Linn assets, they are substantially less developed than our existing, core, Wedge acreage. The acreage we're acquiring has seen minimal investment over the last several years. It's like taking our acreage and rolling back the clock 10 years. "While we have lots of remaining opportunity on our acreage, we also see an opportunity afforded by the Linn acreage to go back to a more lightly developed part of the field and apply what we've learned. Our team has spent the last three years becoming experts in everything about this field, so now we get to apply that expertise across a larger asset base."

In many cases, Jonah and Linn have a common interest in wells in the field. Jonah operates about 1,750 wells and has picked up operatorship of a further 380 from Linn. In addition, Jonah has acquired a sizeable minority interest from Linn in some 450 wells, boosting its already "very high" working interest, as well as royalty interests in additional wells. Combining its core Wedge position with its acreage in the adjacent Pinedale Anticline and the normally pressured Lance areas, the company now owns just under 150,000 contiguous net acres in the area.

Last year, Jonah spent $150- to $160 million on capex. This year, it plans to spend in excess of $200 million. With the Linn assets having produced an average of 150 million cubic feet equivalent per day (MMcfe/d) in 2016 and the Jonah assets, more than 300 MMcfe/d, the company's plan is to reinvest much of the cash flow generated by that production.

"You have a cash-flowing asset from a large base of proved producing properties," Hart said. "You have the luxury of thinking about what to do with that excess free cash flow. We think it's a perfect match of existing cash flow and high-return reinvestment opportunities."

Asset growth

With plans to commence development of the Linn properties in the second half of this year, projections call for "full-year 2017

"[Jonah] field is capable of competing with the big shale plays that have been providing the majority of the new gas supply that's been brought on over the last 10 years," said Tom Hart, CEO, Jonah Energy LLC.

This rig is drilling for gas for Jonah Energy in the southern part of the Jonah Field.

PHOTO COURTESY JONAH ENERGY LLC

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EBITDA from the assets to exceed $100 million as production growth replaces historical declines," the company reported.

Relative to a purchase price adjusted at closing to $566 million, implying roughly 5.5x full-year 2017 EBITDA, how did the valuation for the Linn assets sit with Jonah as buyer?

"We believe it's a great number," Hart said. "We expect to be able to generate a lot of growth off this asset over the coming years. A 5.5x multiple on an asset that has a relatively low decline rate, is a free cash-flowing asset, and which we're confident will grow materially—not just over one or two years, but for multiple years to come—we're very happy with the valuation."

Looking at just its pre-acquisition assets, Hart said Jonah was able "to run a nicely profitable business," assuming $3 gas and $50 oil.

"The scale and focus and concentration of the asset base really helps," he said. "Over the last three years, we've been successful in reducing costs across the board through sustainable operating efficiencies and a focused procurement effort. We're not trying to manage five different basins and run a big exploration program."

As an example of greater capital efficiency, well costs have come down "materially," he added, while average 30-day initial production rates last year were "the highest in the field since 2008." This was in spite of increasing the density of field development in the intervening years, he said.

Reducing risk

Jonah Energy has a robust, ongoing hedging program, Hart said. Hedges were in place, covering a substantial majority of Jonah's near-term legacy production. Additional hedges are on both legacy production and the acquired assets for up to five years.

"As a policy, we consistently add to our hedge portfolio on a regular basis," he said. "We assess our plans on a quarterly basis. If we're confident in the returns we expect to generate, then we're prepared to protect those returns through hedging. Over time, the strategy has paid off in that it has allowed us to move the business consistently forward despite the downturn."

What sort of growth profile is projected for the company, given its hedges and the expanded asset base? "Now that we're through this downturn, and [now] have the Linn acquisition under our belt, we expect to be able to grow production at a double-digit rate for the foreseeable future and build on our position as the third-largest privately held gas producer in the U.S."

As for an eventual exit strategy for the company's private equity sponsors, Jonah is "open to exploring all opportunities to continue increasing value for our stakeholders," Hart said, "whether it's continuing to build the business privately or, at some point, accessing the public capital markets." □

Behind an antelope sits a gas combustor used to incinerate vapors from oil and gas storage vessels to eliminate waste gas emissions.

PHOTO COURTESY JONAH ENERGY LLC