Risks and Opportunities in the Energy Space
Webinar with Canterbury Consulting and Kayne Anderson's Robert Sinnott

On March 31, 2015, Canterbury Consulting hosted an exclusive manager webinar with Robert Sinnott, Chief Executive Officer and Chief Investment Officer of Kayne Anderson Capital Advisors. Discussion topics included the 'fair' price of oil with respect to the supply/demand dynamics of the market, the implications of lower oil prices on the market, and risks & opportunities in the current environment.

THE MULTI-STAGE FRACKING OF U.S. SHALE HAS BEEN A SIGNIFICANT DRIVER OF INCREASED GLOBAL OIL SUPPLY

- Increases in rig counts multiplied by increased efficiencies in drilling technology has caused U.S. and Canadian petroleum supply growth to exceed global demand growth since 2011
- These supply increases were partially offset by supply decreases in the rest of the world, namely due to sanctions placed on Russia and Iran
- Additionally, production declines are occurring at a higher rate for existing projects. This will force the percentage of production from new projects required to keep production flat to increase dramatically over coming years. The near-term decrease in new projects, coupled with the long-term need for more new project production, should help level out the current supply demand imbalance

PAYBACK PERIODS FOR NEW WELLS HAVE GREATLY INCREASED, DECREASING CAPITAL VELOCITY AND LIKELY STRAINING PRODUCERS' BALANCE SHEETS

- Based on a 10% threshold return, development activity only in core areas of the Permian Basin and Eagle Ford are still viable at $50/barrel oil. Only the very best acreage positions in the core areas of the Williston Basin remain economic at $50/barrel oil. In all cases, payback periods have materially increased which will stress balance sheets and further limit drilling and completion spending
- At $50/barrel oil, there are places that will experience negative payback periods – it isn't economic to drill a new well at current prices. This caused many high yield investors to start assessing whether or not companies would be able to survive in the current environment
- For the foreseeable future, only the most efficient wells are going to be drilled. This drop off results in a decrease in capital expenditures by oil companies in order to meet the demands of their creditors
- The crude oil price decline is driving a steep reduction in activity. About $125 billion has been lost in this industry with respect to cash flow or capital expenditure capabilities
- There is no way private markets can fill this void, which should provide opportunities for investors to provide financing at attractive terms to companies with a high probability of surviving this downturn

FORECAST SCENARIOS SHOW THAT THERE WILL BE A SOFTENING IN THE PRICE OF OIL

- There is going to be an increase in production in the first half of 2015, however, the natural laws of supply and demand will take momentum out of the system

- The implications on storage in the United States are that traditional storage is getting to an all-time high. The fact that incremental production continues to increase means that more storage needs to be found or created. As we reach storage capacity, this will result in a weakness in oil that should last until the term structure of the oil futures market steepens enough to incentivize investors to store the oil (buy oil at the spot price and hedge at the futures price, creating an arbitrage opportunity)
- The recovery curve for oil prices is still two years out, assuming price decreases will cause demand increases. Kayne Anderson, like many peers, are under the impression that the Saudis are managing to this scenario
- If the Iranian/Russian sanctions were to come off, this would push the recovery curve out another 6-12 months. If European stimulus keeps up, it could increase demand modestly

FORECAST RECOVERY SCENARIOS AND HOW INVESTMENT STRATEGIES SHOULD BE SHAPED ACCORDINGLY

- V-curve versus a U-curve recovery schedule: Kayne Anderson believes that both scenarios are overly optimistic and that full recoveries are too quick
- Other scenarios (reverse square root chart) more likely of recovery where prices test new lows between the first and second years before recovering. The recovery will not get back to $100/barrel because production has become too efficient. That said, Kayne Anderson believes oil prices will be back to $75/barrel to $80/barrel in 3-4 years
- From an investment strategy standpoint, it will be challenging because each scenario warrants a different strategy. The V-curve, assuming a quick and sharp recovery, should lead to purchasing the riskiest high yield investments. The reverse square root sign is a great environment for private equity as long as the investment gets done

DISCUSSION AROUND THE IMPLICATIONS OF THE PRICE OF OIL ON MASTER LIMITED PARTNERSHIPS (MLPs)

- The term MLP is only a corporate structure and not an industry defining term. These are oil companies that just chose a structure different than peers. These companies can acquire at a different cost of capital - they use debt differently than oil and gas companies. Oil & Gas MLPs are not infrastructure companies because they are upstream companies that are far more affected by the commodity price
- The second group of MLPs do a lot of processing in the liquid market and are more sensitive to price changes. Almost all have migrated over to a fee for service model
- Kayne Anderson expects high correlation between MLPs and commodity price for the first six months and then the recovery is sharp because the market realizes MLPs are actually well structured companies that will work through a downturn. Nonetheless, Oil & Gas MLPs need to be removed from the equation
- Lower oil prices should increase demand. MLPs benefit when demand increases, causing Kayne Anderson to be bullish on these companies

Robert Sinnott

President, Chief Executive Officer, and Chief Investment Officer

Mr. Sinnott is President, Chief Executive Officer and Chief Investment Officer of Kayne Anderson Capital Advisors. He has over 40 years of investment experience and oversees all of the Firm's investment teams as well as serving on each strategy's investment committee. Since joining in 1992, Mr. Sinnott founded and built Kayne's energy platform into one of the largest energy investment firms in the country with more than $22 billion in energy investments. He maintains a direct management role in the firm's energy private equity group and serves as the portfolio manager for two of Kayne's hedge funds. In addition, Mr. Sinnott is a director of Plains All American Pipeline, L.P. (NYSE: PAA), a large publicly traded MLP and its parent company, (NYSE: PAGP) and a director of California Resources Corporation (NYSE: CRC), California's largest independent oil and natural gas producer.

From 1988 to 1992, Mr. Sinnott was a member of Citibank's LBO Swat team concentrating on the energy and airline companies and also led its syndication loan activities in Southern California. Prior to that, Mr. Sinnott led Citi's midstream finance efforts in Houston, Texas. From 1981 to 1986, he worked for a large diversified pipeline company with subsidiaries in the oil and gas exploration and energy services industries. Mr. Sinnott and five others opened Bank of America's energy lending activities in Houston in 1976 where he financed independent oil and gas companies as well as diversified pipeline companies.

Mr. Sinnott earned a B.A. in Economics from the University of Virginia in 1971 and an M.B.A. in Finance from the Graduate School of Business Administration at Harvard University in 1976. He served three years aboard the U.S.S. Forrestal as a lieutenant j.g. He also is a member of the board of visitors of UCLA's Anderson School of Management.

About Canterbury

Canterbury Consulting is a leading investment advisory firm for foundations, endowments, and families. We currently oversee more than $13 billion for our clients. Canterbury designs and manages customized investment programs whereby we are the investment office for our clients. In that role, we provide objective and aligned investment advice, asset allocation, manager selection, risk management, implementation, and performance measurement. Our goal is to deliver a program that exceeds the needs and expectations of our clients in terms of performance and service.