
Energy Insider

Stanger on the key to the drilling funds

by William Engdahl

In response to reader requests, the Energy Insider held an interview with one of the country's top analysts of oil and gas drilling funds, Robert A. Stanger, of Rumson, New Jersey, who publishes the monthly Stanger Report, an investment guide for Wall Street brokerage houses evaluating and advising clients on investment into oil and gas.

Engdahl: Mr. Stanger, right now the press is filled with talk of an international "oil glut," stock prices for major oil stocks such as Exxon, Gulf, etc. are generally down. How does this affect prospects for investment in the various independent oil and gas drilling funds?

Stanger: First, we must be clear that there is no direct link at all between Exxon common-stock price and the raising of drilling fund capital. A drilling fund, by its nature, is very different. It is a medium-term 12- to 15-year investment in an oil and gas reserve. It could be a year and a half or two years before any revenue is realized from the drilling fund. So the earnings per share for, say, Mobil or Exxon are much more directly linked to the immediate day-to-day world market.

Another attraction is the fact that a drilling fund is, by its nature, an investment in domestic, onshore U.S. exploration. This has a long-term security attraction in these times.

Engdahl: Will drilling funds continue to be as attractive for investment over the next 6 to 12 months as they have been in the past months?

Stanger: The publicly registered drilling-fund business will continue to grow again in 1981, this time by 30 to 40 percent. It grew by 100 percent in 1980 over 1979. That was because of unique, specific circumstances. Drilling funds will continue to grow, but the rate of growth will be slower for two reasons: 1) the underlying economics are not growing as fast as in 1979-80 [price decontrol, etc.—W.E.]. 2) With the passage of the Reagan tax-cut bill, the tax-shelter attractiveness need will be slightly less than before; although, studies we have done show

that on a *successful*, and I emphasize that, oil and gas investment, the return on investment is actually improved by the tax-cut package. So it cuts different ways.

Engdahl: In 1980, there were 93 publicly registered drilling funds. Why are most of these geared to natural gas rather than crude oil development?

Stanger: Right now, natural gas is one-sixth to one-eighth the BTU [British Thermal Unit]-equivalent price of crude oil. If it was fully equivalent, \$36 per barrel crude oil would mean \$6 per thousand cubic feet [mcf]. Now, under the terms of NGPA [Natural Gas Policy Act of 1978], it's at an average of about \$2.75 per mcf. We face what I call a "happy" price scenario for natural gas, even with continued sluggish crude markets. Tight gas or so-called deep gas [15,000 feet or deeper] is now decontrolled under the NGPA. It is sold and blended with cheaper gas, for \$5 to \$8 per mcf. The problem is that if you're an independent with deep or tight gas holdings, you don't want decontrol of other gas because your advantage is gone. Thus, the industry is split on decontrol of NGPA. . . .

Engdahl: What criteria do you use to evaluate a drilling-fund investment?

Stanger: Of 93 publicly registered drilling funds in 1980, 45 had raised public money for three or more years going, and raised \$5 million or more in 1980. For specific criteria, I look at a number of things. Continuity of personnel as well as area of operation; track record—what is their finding cost for proven reserves? Is it \$10 per barrel oil equivalent or less? Is it a company with market net worth, balance sheet plus reserves, of \$10 million or more?

I would look closely at a company looking to raise \$10 to \$15 million through a drilling fund if it had a drilling budget last year of \$3 million. Why do they think they can make such a large leap? This has to be scrutinized. . . . No independent should enter into a drilling fund unless he is willing to stand the scrutiny of a public company, though technically he isn't, because that's what we look at before we recommend an issue for "due diligence" to an underwriter.

Engdahl: What trends do you see for drilling fund investment?

Stanger: Institutional investment is growing. Prudential Insurance recently announced a \$400 million drilling investment program. The entire drilling-fund industry last year was only \$1.8 billion. Goldman, Sachs just placed a single \$118 million private placement for Coseka Drilling out of Canada. That's the largest private placement in history. These large institutional investors see drilling fund investment as a better performer, insulated from inflation over the long term.