

# Energy Financing: the World Needs Energy and the Industry Needs Capital



talks to RBS executives Kevin Howard, Managing Director of North American Energy Finance, and Richard R.S. Smith, Managing Director, Head of High Yield Capital Markets, Americas

As the Energy Industry continues to evolve, quality banking relationships remain an important component to the industry's growth. World Energy visits with Kevin Howard and Richard R.S. Smith from The Royal Bank of Scotland (RBS), to discuss the firm's suite of services for the global Energy Industry. In this Q&A, we get the straight story on what they are doing, where they are going, and what they see for 2010.

**World Energy:** What kind of energy finance footprint does The Royal Bank of Scotland have in North America?

**Howard:** We have been pioneers in the oil and gas industry for more than 30 years. We continue to have deep relationships with a wide range of clients, and continue to support their strategic business initiatives.

**World Energy:** So today, in the North American oil and gas market, where do you see your clients' focus?

**Howard:** Well, clearly, in the E&P the unconventional shale plays are a major focus. Initially this development was spearheaded by the independents. Only recently have the majors begun to establish a footprint in the unconventional gas opportunities, with Exxon buying XTO, and the other majors buying positions from existing companies like Chesapeake.

**World Energy:** In your portfolio, do you work with the independents, or do you work with the majors – where do you focus your efforts in North America?



Above: Kevin Howard, Managing Director of North American Energy Finance, and Richard R. S. Smith, Managing Director, Head of High Yield Capital Markets, Americas.

**Howard:** We have nearly 150 clients that span the whole value chain of the oil and gas sector beginning at the well head including heavy users of the product. We have clients that fit the description of the smaller independent or fit in the "mom-and-pop" category. But we also work with the ExxonMobils of the world, and have since the early 1970s. In fact some of our original contacts are still working with those companies giving us very deep, long relationships with them.

**World Energy:** For the smaller oil and gas companies, what kind of services does RBS offer?

**Howard:** Our platform is one of the most extensive of any bank in the market and represents a complete set of services to help smaller oil and gas companies navigate the complexities of the financial markets. We offer clients a broad array of banking and markets capabilities, including investment-grade and high yield bond and loan origination and syndicate, commodity-hedging, interest rate derivatives, foreign exchange, and asset securitization. Our high-yield energy business—which we started three years ago—has been an area of growth for us and is already number four in the high-yield league tables for oil and gas.

**Smith:** We have grown our high-yield energy business organically. At the start, we had a great franchise as reserve-based lenders and are now involved in all aspects of the industry. At the beginning of 2009, we had a very clear message on where the direction of the high yield market was going to go; we advised our clients that the high-yield market as a funding source would predate the improvement in the bank market. This enabled our clients to access the high-yield market quickly and our accurate advice enabled us to gain credibility and stature in the eyes of our clients. We now have 30 dedicated professionals in our capital markets group who focus on high yield products.

**World Energy:** So is RBS in a position to grow with your clients in today's market?

**Howard:** Absolutely. We have a robust product suite to complement our balance sheet which helps to contribute to our oil and gas business as one the most established in the industry.

**Smith:** I believe the high-yield bond market will continue to grow through 2010. As bank consolidation and balance sheets slowly improve, and the equity markets find their



way, the high-yield bond market will be the funding source for our clients. We continue to see a tremendous amount of fund flows into our market.

**World Energy:** Well, let's look at reserve-based lending for just a moment. Are you focused more on-shore or off-shore, or does it really not matter?

**Howard:** When we go into a deal with a company we tend to look primarily at the management, the track record, and the business opportunity. So, where the client's assets are located really doesn't matter. Of course, there are different considerations for an on-shore vs. an offshore opportunity but our team is well equipped to evaluate those differences and provide the best recommendation to the client.

Another area that's growing exponentially for us is the mid-stream finance business. As the unconventional plays have developed, more and more infrastructure must be built to carry the gas to market. This has created opportunities for pipeline financing, gas storage, and terminals. Over the past year, we have seen this business grow which has led to new relationships and business opportunities for us.

**Smith:** We continue to advise our clients who work with us closely in reserve-based lending to term out these bank facilities in the senior unsecured bond market as interest rates continue to improve. We are also seeing first and second lien bank structures as a viable funding source for our smaller and developing energy company clients.

**World Energy:** Understanding that your focus is North America, Canada and Mexico, can you work with international companies as well?

**Howard:** Absolutely. On the integrated side of the industry—across the big majors—we have a global approach to our business. For example, our colleagues in London could be working on a big deal in the Middle East, but the client may be based in Houston. This happens quite often.

**World Energy:** What would you identify as your greatest competitive advantage, your global footprint, your tenacity in the marketplace?

**Howard:** The longevity of our client relationships is the most important competitive advantage we have. However, there are certainly other key characteristics such as our robust global banking and markets platform and our

solutions-based approach to clients that continues to set us apart and define our success.

**Smith:** To build on Kevin's thoughts, the model of our success starts with our clients and the great bankers and local client coverage we have in Houston which is supported by a U.S. balance sheet that broadens out to take advantage of RBS's global franchise. With a now fully built-out front-to-back global distribution capability and strong balance sheet, we are well positioned to increase our presence and stature in an industry we have followed for years

**World Energy:** Where do you see the biggest bright spots for natural gas in North America?

**Howard:** People are looking at future power generation being fueled by natural gas because it is cleaner burning and the carbon footprint is much less. So I think this industry has an important future in the U.S. For a company like ExxonMobil to be buying XTO, it clearly shows "they" see a very bright future for it.

Additionally, we may see a national energy policy around natural gas, and if we really want to be energy independent in the U.S. going forward, natural gas provides a direction that might get us there.

**World Energy:** Do you guys do anything in the downstream? What do you see as some of its challenges?

**Howard:** We have several clients in the refining industry, both in the integrated and in the independent refinery space.

At the moment – this sector is facing many challenges. Mainly, because of the extra capacity that's come on board globally, and the reduction in demand that's been caused by this recession.

The golden age of refining that we thought was the new paradigm in 2004 and 2005 may take a long time to return. However, we will continue to work closely with our clients to help them achieve their financial goals and be at the forefront of financing the future development of energy infrastructure in North America.

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