



Prospecting in the Middle Market: CIT hires long-time energy banker to manage expansion in New York and Houston

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21 January 2008

With oil at close to \$100 a barrel — up from a five-year average of just over \$50 — and natural gas \$1 over its five-year average, Wall Street firms have recognized the need to finance different businesses in the energy industry. CIT Group, which is based in New York but is expanding its presence in Houston, is no exception.

Last week, CIT announced the hire of Peter Gaw, a former ABN AMRO banker, to run its expansion in the energy sector. Gaw has for 23 years been involved with the energy sector as a banker. Most recently, he ran the energy group for the Americas at ABN AMRO and he was in charge of the Dutch banking giant's power group.

CIT is looking to add bankers specializing in exploration and production as well as oil field services. Also, the firm is looking to hire engineers to help it in underwriting loans to exploration businesses. The focus — as is the case with most CIT businesses — will be on middle-market companies.

"The middle market is the fastest growing segment from a finance standpoint within the energy sector," Gaw says. While CIT has already had a presence within the energy and gas sector, the hire of Gaw is part of an effort to buttress the company's energy business.

Black gold

Wall Street may have, to some degree, lost its appetite for underwriting securities backed by consumer debt after the subprime debacle. So, many firms have embraced the business of trading commodities and financing businesses involved with the production and refining of energy products.

As a recent report by Deutsche Bank notes, commodity investments have performed well despite the subprime mess and the increasing likelihood of a recession. The dislocation "has only enhanced the appeal of commodities as an event risk hedging asset class."

The current uptick in oil prices has its roots in 2001 and it has been the most powerful and durable on record, according to Deutsche Bank, which noted that the rise in oil prices reflects a combination of higher total finding and development costs — bonuses, royalties, labor and materials — as well as poor reserves replacement.

"With commodities prices where they are we are seeing a rise in the exploration and production space," says CIT's Gaw.

To that end, CIT plans to expand its lending to smaller exploration firms. The loans to these exploration businesses will be so-called asset-based loans. The asset, in this case, is the reserve of oil or natural gas that the business is looking to extract. Those engineers that Gaw wants to hire for CIT's energy group would be charged with verifying that the pool of oil can be cost-effectively pulled out of the ground. "We are willing to fund a projected amount of oil or natural gas a certain field will produce. We will have a full-time petroleum engineer with decades of experience to look at reserve reports. We will provide financing off of this analysis."

The \$250 million market cap

Gaw says that many Wall Street firms are being drawn to the energy arena because not only has the price of natural gas and oil gushed steadily higher, but the extraction costs have risen, which means it takes more money to uncover and drill a field. CIT's energy group aims to help finance private businesses and public companies with a market cap of \$250 million. While that may be a smallish business when compared with the likes of a BP or Exxon, Gaw points out that one of his long-term clients grew from a business with a \$100 million market cap to a business with a \$17 billion market cap. He did not identify the client.

While extraction costs have risen, the price for crude oil has increased enough to make it cost-effective to allow smaller participants to come in using improved seismic data and improved drilling equipment. "A lot of big companies won't go into smaller fields that for smaller companies can be more lucrative," says Gaw.

Many banking firms and lenders are angling for major players, but CIT's energy group is prospecting in the middle market. "We want to grow with these new generation energy companies," says Gaw. "Our strategy is that as companies expand, we expand our relationship with them as they grow."

Gaw says CIT is willing to offer first- and second-lien loans as well as equity or mezzanine financing. That lien is on the reserves in the ground.

Although Houston may be known for its place in the history of NASA's space exploration, the Texas city has become an important stomping ground for energy financiers, possibly because of its status as a port close to many refineries. CIT already has a presence in Houston — roughly 12 professionals — but the buildout of the energy group will take place in Houston and New York where the firm has some 20 professionals.

"We'll expand our footprint in Houston as we move more aggressively in the oil and gas space," says Gaw.

CIT will have a physical presence in Texas and New York, but the exploration it will help finance likely will include fields in California, Canada, Louisiana and Colorado.

All of the financing provided by CIT will be for projects in North America, according to Gaw.

In addition to financing oil and natural gas exploration businesses, CIT's Gaw says the firm also will lend to companies involved with the development of renewable energy technology, such as wind turbines and photovoltaic cells. "The carbon issue is not one that will go away," he says. "We are very targeted on that space."

And, though there are increasingly signs that the US economy is slowing, the CIT energy banker believes that commodity prices will remain high.

Some of that expectation may be tied to the steady demand for oil outside of the U.S.

"Although a US downturn may depress the oil price, for as long as world GDP growth remains above 3%, we expect OPEC will be in a powerful position to defend any short term price weakness," according to the Deutsche Bank report. "We expect OPEC will be quick to defend oil prices particularly in an environment of US dollar overshooting to the downside."

But, if there is a global recession "prices could be impacted by a global slowdown in GDP."

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