Oil & Gas Interests Explored
Pathways to Profit

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In an investment environment currently marked by low interest rates and high energy prices, many high net worth investors are seeking opportunities outside the mainstream—*and into the oilfield.*

With two distinct pathways to profit, direct investments in energy can play an important role in a well-diversified, returns-driven investment portfolio. With direct participation at the exploration and production, or E&P, level, oil and/or gas production revenue is distributed into two ownership categories, royalties and working interests. These categories are predefined long before drilling begins. Unlike public E&P stock where value is based on multiple (and often manipulated) factors, performance for both royalty and working interest investments is driven by production potential at the wellhead.

While oil and gas investments are not for everyone, they are worth exploring for experienced, accredited investors looking to enhance overall portfolio performance.

Mail Box Money – *Royalty Interest Ownership*

With next-to-no initial production risk and attractive return potential, royalties can be a great option for more conservative investors seeking an energy-based alternative to other income-generating investments like bonds and CDs.

When the term 'Royalty Owner' is used in the oil and gas industry, it is mostly associated with those who own mineral rights that have been leased to a Working Interest Operator for exploration. In exchange for the lease, royalty interest owners receive a percentage share of production revenues from wells operating on their acreage, and will do so for the duration of production. What makes royalty ownership distinctive is that owners do not bear any costs of exploration, drilling, producing, operating, marketing or any other expense associated with drilling and producing an oil and/or natural gas well. As mineral owners, royalty owners can enjoy additional income with new discoveries and leases, which could be many years, or decades, a part.

Many families, from generation to generation, have benefited financially from mineral and royalty ownership since the early 1900's.

A downside to royalties is that they are not easy to find and buy. For obvious reasons, most royalty owners just aren't all that interested in selling. The easiest way for private investors to participate is through a royalty fund that has been packaged by an experienced energy company. These funds will often include overriding royalty interests (ORRI) on acreage that the company has accumulated through active mineral leasing and/or drilling. An ORRI offers the same benefits as a regular royalty interest, delivering a share of production revenues free from all costs related to operations for as long as the wells produce, but are only exclusively in effect under a current lease term.

A Piece of the Action – *Working Interest Ownership*

When most people think about making money in the oil business, drilling and pumping oil is what comes to mind. While royalties offer an initially easier "check in the mail" investment option with generally slower and lower ROI potentials, working interest ownership is where the action is. From anticipating the rig first arriving on location to monitoring monthly production, many private investors with strong risk tolerances find the excitement—and higher return potential—well worth the added risk.

Working interests owners drive all US oil and natural gas production—from drilling new wells to day-to-day operations of existing producers.

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A Piece of the Action – *Working Interest Ownership* (continued)

Working interests owners literally pay the bills: they are 100% responsible for all costs and liabilities associated with drilling and operating wells. This may sound like a risky proposition. But, for the tens of thousand working interest owners involved in the multi-billion dollar domestic oil industry, the risk is worth the potential reward. Nearly 1,900 drilling permits were issued in March 2014 in Texas alone. Once successfully drilled and producing, new wells will join 850,000+ existing wells making money for working interest owners across the Lower 48. Sheer numbers show that there's profit to be made in the oil patch.

In return for bearing all risks and expenses, working interest owners are entitled to the majority of production sales if or when a well begins producing. In addition, Uncle Sam provides attractive tax advantages for individuals and companies willing to step up to help increase domestic production.

Revenue Distribution Example

In a typical 75/25 oil and gas lease agreement, 25% of production sales are paid to royalty owners straight off the top. Only production taxes are paid first. The remaining 75% of production sales are paid to the working interest owners. 100% of expenses are paid out of 75% of production sales. If the joint venture you've invested in owns 10% of the working interests, it pays 10% of the expenses and receives 7.5% of all the revenue – the net revenue interest. The Managing Venturer then distributes net cash available to venture partners on a pro rata basis based on their individual amount of ownership.

With drilling costs ranging from less than a million dollars for shallower wells to upwards of $12+ million for deep horizontals, it is extremely rare for one company to drill a well on its own. In fact, it is more common to have upwards of 20 or more minority interest owners in each well. The largest E&P companies in the world routinely partner up to share in the costs, risks, and rewards of drilling and production. For private investors looking to get involved, a joint venture partnership with Aresco provides an opportunity to participate alongside the Majors on quality drilling and production projects.

Aresco
2805 Dallas Parkway Suite 220
Plano, Texas 75093
Phone: 972-992-3127 Fax: 972-992-3137
www.arescotx.com

Which pathway to profit makes most sense for you?

At Aresco, we pride ourselves on educating prospective partners, communicating effectively, and allowing the time needed to evaluate each project. We spend a considerable amount of time discussing your objectives and risk tolerances and answering your questions before presenting any opportunity.

If you're interested in exploring how oil and gas may fit into your portfolio, give us a call at 972-992-3127.