

Investing in the energy market

How business owners can profit from direct investments in petroleum **Interviewed by Arthur G. Sharp**

Why do business owners pay such close attention these days to the cost of energy? Because the energy markets directly affect fuel costs, and fuel costs directly affect bottom lines. It is possible, however, that some of the efforts and expense going into energy planning might be better spent in the energy market itself. In fact, earnings from oil and gas investments might offset increases in the rising costs of fuel, electricity, natural gas, transportation and shipping — and help the company's bottom line.

Smart Business talked with John Barnes, chairman and CEO of B&R Energy LLC, about the pros and cons of investing directly into energy markets.

Regarding energy investments, tell us how you define 'invest.'

First, business leaders can invest company funds in money-saving energy cost-cutting programs. Or they can see to it that employees drive less, telecommute more, drive more fuel-efficient vehicles, install smart thermostats, and develop a culture of conservation among their employees.

Second, they or their companies may also invest the savings into the energy market, particularly petroleum.

How does it benefit business owners to invest in energy?

Energy is the single most important way to advance and maintain civilization. Let me put it another way: a nation's GDP grows in proportion to its energy use. Technology gives us increasingly efficient and effective use of energy, but energy growth itself is the essential engine for economic growth. To maintain its growth, a nation must constantly find new energy supplies.

Is direct investment in petroleum ventures limited to businesses with specific capital in their investment portfolios?

There is no set dollar figure, but companies or individuals with at least \$1 million to invest might want to invest a reasonable



John Barnes
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portion of it in petroleum — a direct investment in drilling, perhaps, rather than in stocks. Drilling has tax advantages, but stocks do not.

Why is this a good time to invest in petroleum?

In recent years, investors have laser-focused on high-tech industries; in particular on computers, telecommunications and the Internet. Perceived low-tech fields, such as the petroleum industry, have attracted considerably fewer investment dollars.

Meanwhile, ironically, the high-tech industries have served the petroleum industry by improving the prospects on wells drilled. Few industries rely on and employ emerging technology more than the petroleum industry.

What motivates individual investors to pursue petroleum ventures?

Financial returns: in many cases payback is within a year or less, at an annual return that can top 30 percent.

Second are the IRS regulations on the investors' side. Up to 90 percent of an investment in oil and gas wells may fall under 'intangible drilling costs,' which

investors may deduct in the year paid.

The federal (IRS) tax code also gives the investor a 15 percent deduction in the form of percentage depletion of gross oil and gas income. Moreover, reinvesting oil and gas profits in drilling new wells enables the investor to defer taxes while earnings compound.

Are investments in oil and gas ventures risky?

The average risks of oil and gas ventures are well below what they were only a decade or so ago. Some projects offer a probability of success up to 80 percent to 90 percent. And many of them would result in profits even if oil and gas prices were to drop dramatically.

The same guidelines for investments in general apply to oil and gas. Investors should weigh opportunities against their personal risk avoidance threshold and anticipated returns on their money — and then thoroughly research every opportunity.

As with any investment, direct investments into petroleum are subject to rules and regulations. Of course, prospective investors should consult their tax advisers when deciding whether to invest directly in petroleum ventures.

What does doing your homework entail?

Determine how much experience the producer has. Companies with five or more years of experience might be more reliable than a first-time driller.

Find out something about the backgrounds of a producer's owners and managers. Find out how much of the producer's own money will be invested in the program. Often, such information is available through producers' Web sites and Internet sources.

Talk to other investors, particularly those who have put money into nonproducing projects. Read the producer's progress and year-end reports and other documents carefully.

In short, weigh carefully every potential advantage and disadvantage.

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