PErspective in NATURAL RESOURCES

A FEATURE EXAMINING THE ROLE OF PRIVATE EQUITY IN THE NATURAL RESOURCE SECTOR

Depressed oil prices are hitting deal flow hard in the natural resources sector, with many companies hanging onto assets until they can command higher valuations. But with prices struggling to rebound, this strategy may not last – and investors may see more opportunities ahead.

Stay up-to-date on the latest trends

Many PE firms were hit hard by the almost 50 percent drop in crude oil prices between June and December last year. In the fourth quarter of 2014, Kohlberg Kravis Roberts (KKR) wrote down the value of its energy investments by about $225 million, or about 24 percent below cost, according to *The Wall Street Journal*. Apollo Global Management and Carlyle Group also took losses, but Blackstone was luckier, as it had previously divested $6 billion in oil-related assets at very high multiples, the *WSJ* reports.

Q4 2014 and Q1 2015 were slow in terms of closing deals, but with the price of crude still scarcely more than half what it was a year ago, many PE firms had expected a fire sale in exploration & production (E&P) assets by now. However, so far this year, acquisition opportunities have not been as plentiful as predicted. Convinced oil prices will rebound, E&P firms have preferred to hold on to key assets – and have turned to the debt and public markets instead to boost liquidity.

With buyout activity down, PE firms with mountains of dry powder for energy deals have turned to alternative transactions like buying into company debt or buying securities through private investment in public equity (PIPE) deals, *Oil and Gas Investor* reports. A February *Wall Street Journal* blog post reported that KKR, despite previous losses, had $5 billion in dry powder for energy transactions, and was mostly looking at private credit opportunities. According to *Forbes*, Blackstone has $9 billion set aside for energy investment and EnCap and Warburg Pincus have set aside $5 billion and $4 billion respectively. PE firms have lent capital especially to smaller players where banks would not – and non-energy PE firms have become increasingly interested in the space, sensing growing opportunity, according to *Forbes*.

However, E&P firms can only hold on to assets for so long in this negative cash flow environment. Raising debt and equity has increased liquidity for the time being, but this is only a stop-gap measure. If prices do not rebound by the end of the year – or even if they stabilize – some experts believe E&P firms will have no choice but to start divesting, low-quality assets first and higher-quality shortly thereafter, *Oil and Gas Investor* reports. PE firms are poised to pick up deals when that happens.

One area where deals are still taking place is the less mature, highly leveraged shale oil and gas sector. *Forbes* reports increased PE activity in Houston as PE firms look for smaller, less established shale energy players that are struggling in the down market. According to *Reuters* data, energy assets worth $112 billion are up for sale globally. Half are North American, and most of these are U.S. oil and gas shale fields such as Anadarko Petroleum's Wyoming field, according to *Oil and Gas Investor*.

PE activity has certainly been affected by price volatility in the energy sector, but opportunities are still to be found whether in the shale subsector or in the alternative investment space. And if the price of oil does not recover soon, PE firms might yet get the fire sale they have been waiting for.

▶ Read more

People who know Natural Resources, know BDO.

www.bdo.com/naturalresources

Natural Resources Industry Contacts:

CHARLES DEWHURST
Houston
713-986-3127 / cdewhurst@bdo.com

KEVIN HUBBARD
Houston
713-986-3149 / khubbard@bdo.com

RICHARD BOGATTO
Houston
713-407-3723 / rbogatto@bdo.com

TOM ELDER
Houston
713-407-3959 / telder@bdo.com

LANCE FROELICH
Houston
713-986-3186 / lfroelich@bdo.com

VICKY GREGORCYK
Houston
713-407-3955 / vgregorcyk@bdo.com

ROCKY HORVATH
Houston
713-986-3150 / rhorvath@bdo.com

JIM JOHNSON
Dallas
214-665-0614 / jwjohnson@bdo.com

RAFAEL ORTIZ
Houston
713-986-3176 / rortiz@bdo.com

CLARK SACKSCHEWSKY
Houston
713-986-3101 / csackschewsky@bdo.com

CHRIS SMITH
Los Angeles
310-557-8549 / chsmith@bdo.com

ALAN STEVENS
Dallas
214-665-0786 / astevens@bdo.com

JIM WILLIS
Houston
713-986-3115 / jwillis@bdo.com

Private Equity Industry Contacts:

LEE DURAN
San Diego
858-431-3410 / lduran@bdo.com

SCOTT HENDON
Dallas
214-665-0750 / shendon@bdo.com

KEVIN KADEN
New York
212-885-8000 / kkaden@bdo.com

RYAN GUTHRIE
Costa Mesa
714-668-7385 / rguthrie@bdo.com

DAN SHEA
Los Angeles
310-557-8205 / dshea@bdocap.com

JOE BURKE
McLean, VA
703-770-6323 / jburke@bdo.com

FRED CAMPOS
Miami
305-420-8044 / fcampos@bdo.com

JERRY DENTINGER
Chicago
312-239-9191 / jdentinger@bdo.com

JOE GORDIAN
Dallas
214-969-7007 / jgordian@bdo.com

TUAN HOANG
Los Angeles
310-557-8233 / tmhoang@bdo.com

TODD KINNEY
New York
212-885-7485 / tkinney@bdo.com

MATT SEGAL
Chicago
312-616-4630 / msegal@bdo.com