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Feature Article

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How Private Equity Funds can Spur New Investment in the Global SAM and MOGI Sectors (Part-2)

SAM: Stand Alone Mining

MOGI: Mineral Oil Gas Integrated

(Continued from the part-1)

Oil and Gas Industry

BlackRock Inc, KKR & Co Inc, Brookfield Asset Management Inc, Tailwater Capital LLC, and 3i Group Plc are among the top 5 private equity investors in the oil and gas industry in 2021 by deal volume.

In terms of the geographic split, 9 out of the world's top 10 private equity investors in the oil and gas industry are headquartered in North America, and the remaining 1 is based in Europe. They employed a total of 208, 575 people in 2021.

The Kayne Anderson-Black Knight deal was one of the major deals in the oil and gas sector in 2021. Vinson and Elkins LLP served as legal advisor to Black Knight Energy LLC. Black Knight Energy LLC, an oil and gas company, has received an equity commitment of $500 million from funds managed by Kayne Anderson Capital Advisors LP including Kayne Private Energy Income Fund II LP and Kayne Anderson Energy Fund VIII LP, alongside Black Knight's management team. The deal was completed in Q2 2021.

The KKR-SK E&S deal was another major deal in the oil and gas sector in 2021. Simpson, Thacher and Bartlett served as legal advisors to KKR. KKR & Co Inc (KKR), a private equity firm, has made an investment of KRW2.4 trillion ($2 billion) in SK E&S Co Ltd, a diversified energy company. The deal was completed in Q4 2021[6,7].

The Saudi Arabian-Aramco Oil deal was another major deal in the oil and gas sector in 2021. HSBC Bank plc served as a financial advisor, while Latham and Watkins served as a legal advisor to EIG. Saudi Arabian Oil Co (Saudi Aramco), a petroleum and natural gas company, has completed the sale of a 49% equity stake in Aramco

Oil Pipelines Co to a consortium led by EIG Global Energy Partners (EIG) for a sale consideration of $12.4 billion. Saudi Aramco holds a 51% stake in Aramco Oil Pipelines. The deal was completed in Q2 2021 (Table 2).

Private Equity Deals in 2024

In the global oil and gas industry, there were 21 private equity deals announced in Q1 2024, worth a total value of $1.6bn, according to GlobalData's Deals Database. The $1.1bn institutional buy-out (ibo) Portland Natural Gas Transmission System by BlackRock and Morgan Stanley Infrastructure Partners was the industry's largest disclosed deal. In value terms, private equity deal activity decreased by 62% in Q1 2024 compared with the previous quarter's total of $4.2bn and fell by 82% as compared to Q1 2023. Related deal volume increased by 11% in Q1 2024 versus the previous quarter and was 5% higher than in Q1 2023.Notably, foreign direct investments (fdi)-related deals accounted for a 29% share of the global oil and gas industry's private equity deal activity in Q1 2024, up 20% over the previous quarter.

Table 2. Top 5 private equity deals by value in the oil and gas industry since 2023

Target	Acquirer	Deal value	Date announced	Deal type
Univar Solutions	Apollo Global Management	$8100m	Mar, 2023	Private Equity
Columbia Gas Transmission; Columbia Gulf Transmission	Global Infrastructure Partners	$3900m	Jul, 2023	Private Equity
PureWest Energy	A.G. Hill Partners; Cain Capital; Eaglebine Capital Partners; Fortress Investment Group; HF Capital; Petro-Hunt; Wincoram Asset Management	$1840m	May, 2023	Private Equity
DuPont de Nemours - Delrin Acetal Homopolymer (H-POM) Business - US	Jordan Company	$1800m	Aug, 2023	Private Equity
AM Green Ammonia (India)	Gentari; GIC Private	$1750m	Oct, 2023	Private Equity

Source: GlobalData Oil and Gas Intelligence Center

Why Private Equity Investors are More Active, Particularly in Critical Minerals

In 2022 Private equity funds were emerging as a major financing source for new critical minerals projects, with traditional bank financiers taking a lesser role as risk perception grows. Traders, streamers, off-takers and end-users who were anxious to secure supplies of critical minerals including lithium, cobalt, nickel, silicon, niobium, rare earths and graphite, were also coming to the fore as financiers. Governments in the future are expected to be more supportive as they build up their own lists and stockpiles of materials that are used increasingly for applications in energy transition, including in electric-vehicle batteries and wind towers as well as defense, participants at the event said. Initiatives by the US, Canada, the EU and the UK to develop critical minerals infrastructure and supplies were highlighted as most of the reasons.

PE in Mergers and Acquisitions

PE firms bring added value to M&A transactions in a number of areas[8]:

1. Capital Infusion
PE firms provide substantial funding to support growth and expansion in M&A transactions. Their dedicated focus on specific investments allows them to allocate resources effectively for maximum impact.

2. Expertise and Strategy
PE professionals offer industry-specific knowledge to enhance the potential of the acquired company. Specializing in particular sectors, PE firms possess deep insights into market dynamics, enabling them to make informed strategic decisions.

3. Operational Improvement
PE investors optimize operational efficiency by identifying areas for enhancement and implementing best practices. Their operational agility and hands-on approach facilitate swift decision-making and effective execution of changes.

4. Management Support
Experienced PE executives guide the target company's management team, contributing valuable leadership. Their external perspective allows them to provide fresh insights and objective guidance for improved management practices.

5. Expansion and Growth
PE firms leverage networks and resources to expand the target company's market presence. Their strategic connections and industry contacts provide opportunities for rapid market expansion.

6. Financial Management
PE experts optimize financial structures, working capital management, and profitability strategies. Their extensive financial expertise allows for efficient resource allocation and maximization of financial performance.

7. Acquisition Strategy
PE firms create synergies among portfolio companies through strategic acquisitions. Their expertise in identifying complementary businesses leads to a targeted and cohesive portfolio strategy.

8. Exit Planning
PE firms plan for successful exits to realize substantial returns. Their experience in timed exits drives a focused approach and the implementation of strategies to enhance company value.

9. Cultural Alignment
PE firms ensure alignment of cultures between acquiring and acquired companies. Their ability to manage cultural integration and collaboration fosters smooth transitions and efficient cooperation.

From the early 2024, the M&A activity has been tepid. If there is one certainty in all this uncertainty, it is that M&A activity will bounce back- although likely faster in some sectors than others. The M&A show must go on, even if the timing is uncertain. This is in large part because the need to do deals is greater than ever. The circumspect and restricted flow of deals creates more pressure on the strategic and economic fundamentals that underpin transactions. The lower levels of M&A activity over the past two and a half years have created pent-up demand (and supply), particularly in the Private Equity (PE) universe. In addition, corporates are turning to M&A to accelerate growth and reinvent their businesses at a time of dynamic change: AI is disrupting business models, and it seems as though everyone is investing in it. CEOs' desire to accelerate their companies' growth in a low-growth economy is also creating opportunities for M&A. And within sectors, specific factors are favouring a buy-versus-build approach in many situations[8].

PE Investment in the Oil and Gas Sector

The Oil & Gas sector is currently struggling on weak operating margin, low growth, uncertainty and high manpower cost in some segments. But industry thinks things have bottomed out and it much have to rise again. One CEO says "within 12 months, many of the plays that were uneconomic at $50 per barrel are going to be economic again". In the latter half of 2024 as the service costs are likely to coming down to whatever levels are needed to get rigs running again, the oil and gas industry is going to be able to make good returns in a $50 to $60 per barrel price environment. Nobody sees oil prices shooting back up to where they were any time soon", he added.

Another more imminent opportunity for PEs is in oil and gas companies who are overleveraged, and who lack the cash flow to endure this bearish market cycle intact. These are ideal carve-out and takeover candidates for PEs, as distressed-E&P bank creditors will pressure them to sell assets to fulfill their debt obligations. Another promising theme for prospective private equity investors is the midstream subcategory, which includes the processing, storing, transporting and marketing of oil and gas resources. According to a June Dow Jones Business News article, the relationship between the US dollar and oil prices is generally an inverse one. The dollar is bound to appreciate and exert further downward-pressure on crude prices (Figure 4).

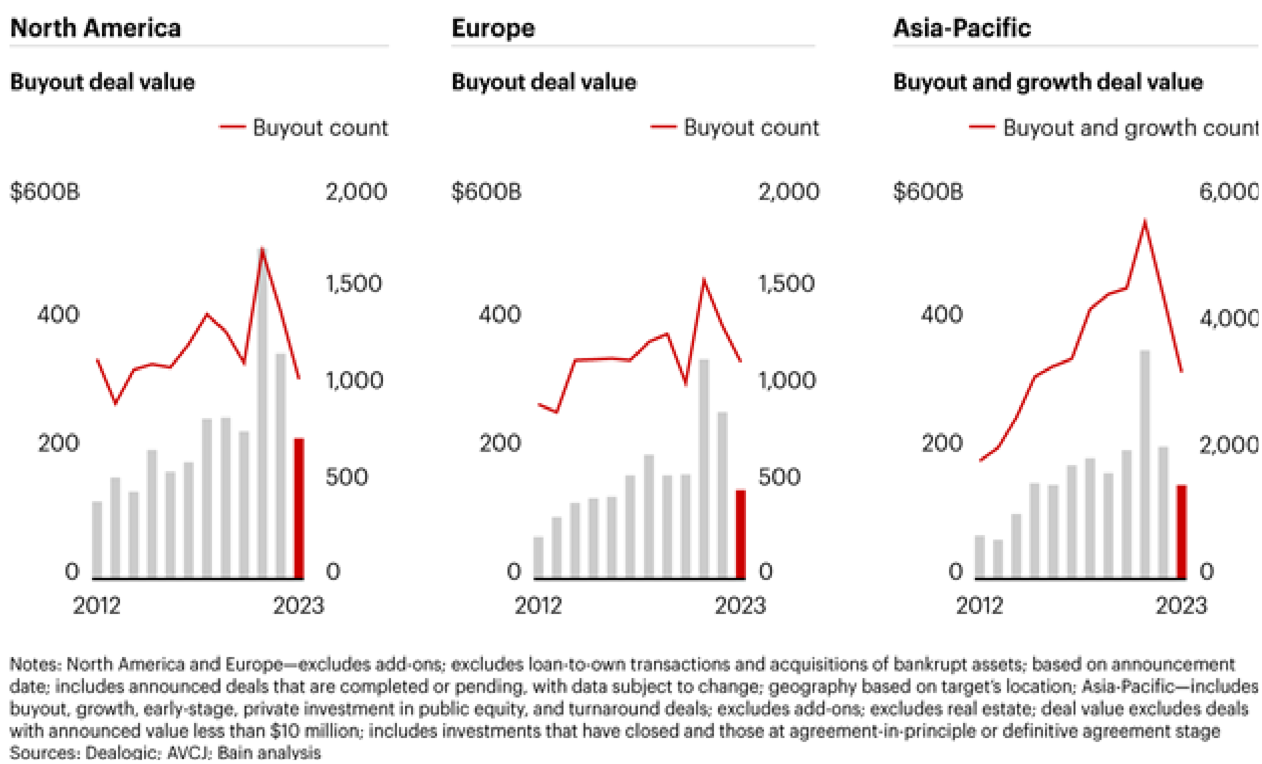

Figure 4. Deal activities were dull in 2023.

The Regulatory Environment for PE Capital

Traditionally, regulation of the PE industry has focused on potential risks to investors and markets that can stem from conflicts of interest, a lack of transparency, and anticompetitive conduct. These focus areas have attracted more regulatory attention in recent years as PE firms have grown in influence and size. Regulators are also attuned to newer issues that are growing out of global competition in the critical minerals sectors; the adoption of net zero carbon goals; the emphasis on Environmental, Social, and Governance (ESG) reporting; and the increase in cybersecurity risks. Compared with other financial institutions, PE firms have the additional concern of being held responsible for legacy compliance issues at the companies they acquire. Because of this, regulators require PE firms to complete a compliance risk assessment when they conduct commercial due diligence[8,9].

Newer regulatory tightening is occurring against a backdrop of increasing global geopolitical tension. One source of friction has been the increase in technological competition, which has already resulted in measures in the US and EU that block or regulate cross-border high-tech investments. Because of these diverse concerns, the regulatory environment is complicated, spanning many regions and topics. For example:

a. The US Department of Justice (DOJ) is stepping up its corporate enforcement efforts and adding corporate crime prosecutors to enforcement divisions to prevent M&A transactions from compromising national security.
b. Regulators in the US and EU have increased their scrutiny of deals involving PE firms that could potentially harm competition.
c. The US Securities and Exchange Commission (SEC) has brought enforcement actions in cases where PE firms allegedly misallocated expenses or failed to adequately disclose fees to investors.
d. In the EU, measures such as the Alternative Investment Fund Managers Directive (AIFMD) and the Markets in Financial Instruments Directive II (MiFID II) require PE firms to meet certain reporting, transparency, and investor-protection standards.
e. The European Commission's Directorate-General for Competition has broadened whistleblower rules that were previously aimed at gathering information on illegal cartel practices, so citizens can now report merger-related, anticompetitive infringements.
f. The EU has been leading efforts to promote ESG regulations, such as the Corporate Sustainability Reporting Directive, that increase disclosure requirements for PE firms operating in the EU or dealing with EU-based investors, with implications for the firms' investment strategies and reporting practices.
g. PE firms, which handle sensitive information during the due diligence process and in their portfolio management operations, must comply with data privacy regulations such as the EU's General Data Protection Regulation (GDPR), as well as similar state laws in the US and regulations in countries worldwide.

What will PE funds Look for in a SAM and MOGI Sector Investment?

Private Equity (PE) funds look for few things before investing in a SAM/MOGI investment, including:

1. Consistent and Non-Partisan Government Policy

This is the most important thing in the investment decision. They will also look for policy continuity. Exogenous risks are in their calculation.

2. Business Plan

A realistic and ambitious plan with good sales and profitability prospects, and facts and figures that support those forecasts. PE firms may want to see an annual profit of at least 20–25%.

3. Growth Potential

Factors that indicate the sector's potential for growth, such as the industry's positive state, a large enough market, and an open and competitive leadership.

4. Type of Investment

PE funds can invest in early or growth stage companies, mature companies, or failing businesses-from exploration to the value chain expansion.

5. Growth Capital

PE Invests in companies to support their expansion plans, research and development, or working capital needs. Growth equity deals often give investors minority ownership in the form of preferred shares.

6. Buyout

Investors acquire a controlling stake in an established company to restructure and improve its operations.

7. Distressed Funding

PE involves purchasing failing businesses with the goal of improving management and financial performance.

Finally the Outlook for Late 2024 and Early 2025

As of now, business conditions are more perplexing than predictable. Interest rates have risen faster than at any time since the 1980s, and it remains unclear when the US Federal Reserve will reverse course or where rates will eventually settle. Concerns about "the most anticipated recession in history that hasn't happened yet" continue to linger. These crossed signals have left private equity hamstrung. The sheer velocity of the interest rate shock was something few in the industry had ever experienced, and the impact on value has driven a wedge between buyers and sellers[9].

The sellers are bringing to market only the highest-quality assets, those they are confident will move at a reasonable return. Otherwise, the exit channels have largely dried up, leaving General Partners (GPs) with a towering $3.2 trillion in unsold assets and stanching the flow of capital back to Limited Partners (LPs).

These declines in activity have had a chilling effect on fund-raising. Slower distributions have left LPs cash flow negative, crimping their ability to plow more capital back into private equity. The industry still raised an impressive $1.2 trillion in fresh capital in 2023, and the buyout category attracted $448 billion. But LPs were highly selective. While capital flowed to the largest "reliable hand" buyout funds, fund-raising for most was as hard as it's ever been.

Until GPs can begin moving assets out of their portfolios in a timely fashion, raising the next fund won't get any easier. And the threat to returns is real. Buyouts typically involve term loans that expire in five to seven years. Already, interest coverage ratios among buyout-backed portfolio companies in the US have dropped to 2.4 times Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA), the lowest level since 2007. That is pressuring GPs to both find liquidity solutions and devise new ways to generate profits through operating leverage-not just the multiple expansion and revenue growth the industry has leaned on for years.

A General Partner (GP) is a private equity firm that manages the operations of a private equity fund. GPs have the legal authority to make decisions for the fund, including:

a. Identifying companies: GPs choose which companies to buy and when to sell them.

b. Raising capital: GPs find investors, called Limited Partners (LPs), and raise the capital needed to acquire companies. LPs typically include pension funds, institutional accounts, and wealthy individuals.

c. Managing investments: GPs manage the fund's portfolio of investments, including monitoring the acquired companies and managing them as needed.

d. Seeking returns: GPs try to exit investments in the future for large returns.

In Private Equity (PE), limited partners (LPs) are investors who contribute capital to a fund managed by a general partner (GP). LPs are similar to shareholders in a corporation, with limited liability to the extent of their investment and no management authority. They are often called "silent partners" because they have a more distant role in the company's management and operations, leaving those decisions to the GP. LPs' involvement is generally limited to financial contributions, valuations, and advice, but they do actively participate in fund governance to ensure alignment with their investment objectives.

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