The New Normal for Oil & Gas Funds

An interview with Latham & Watkins' Ivana Kovacevic Rouse

Privcap: Given the turbulence in the oil and gas markets, and the challenges that many upstream businesses are facing, has investor interest in regular-way oil and gas private equity funds dried up?

Ivana Kovacevic Rouse, Latham & Watkins LLP: The short answer is no. A recent Preqin report noted that while the last quarter of 2018 marked a five-year low for energy fund closings, the amount of capital raised during this period has been consistent with the amount of capital raised in prior periods. The report's findings suggest that the pie is not shrinking, but rather the slices are getting larger. Today's investors are sophisticated and are actively seeking strategic relationships with a smaller group of trusted managers with well-established track records in the energy space. In addition to seeking a smaller group of managers, energy investors are seeking to negotiate European waterfalls, reduced management fees and increased transparency.

Privcap: Are you seeing rising interest in any new niche strategies outside energy?

Rouse: Yes - we are seeing rising interest in a handful of strategies. The first strategy is private debt. Both managers and investors are actively seeking credit-focused funds to fill a financing void for sponsor-owned and middle-market companies. A recent survey reported that more than 60% of alternative investors expect to increase their allocations to credit funds in the next five years. The second strategy gaining traction is infrastructure, particularly domestic infrastructure. Given ongoing fiscal constraints, aging infrastructure, and support from recent administrations, investors are eager to invest in domestic infrastructure funds investing in roads, bridges, tunnels, ports, airports, power, water, and telecommunications.

The third strategy of increased activity is GP-led secondary fund restructurings. A large number of investors are looking to adjust vintage-year exposure by backfilling their portfolios with a range of assets with historic vintages offered by existing funds seeking liquidity. Finally, market-neutral strategies are swiftly gaining popularity with investors seeking to minimize market volatility risk. Over the last two years we have seen an increase in the launch of life settlement and litigation finance funds.

Privcap: How do the LPs view these GP-led secondary deals?

Rouse: Positively, generally speaking. As mentioned earlier, new investors seeking to build a diversified portfolio of assets of varying vintages view these deals positively as they provide investors with exposure to such assets. Similarly, depending on the deal structure, existing investors in mature funds with liquidity priorities can obtain the desired liquidity, while existing investors wishing to continue holding exposure to the relevant asset(s) can "roll over" into the new structure. Accordingly, assuming the inherent conflict of interests associated with restructurings are appropriately addressed, existing investors also view these deals positively.

Privcap: Are investors demanding ESG monitoring in energy funds?

Rouse: ESG is definitely a hot topic, especially in the energy space, and typically attracts two groups of investors. One group includes investors that have decided, because of ESG concerns, to cease future investments in natural resources funds. This group includes Norway's US$1 trillion sovereign wealth fund and the World Bank, both of which recently announced that they will cease investing in oil and gas developments. The second group includes investors that are still interested in investing in natural resources funds so long as fund managers acknowledge ESG priorities. These acknowledgements generally do not restrict fund managers from making certain acquisitions. ■

Ms. Kovacevic Rouse will be speaking at the upcoming Privcap Energy Game Change. [Learn more here.]