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TRANSCRIPT

Why PE's Wait for Distressed Energy Deals Might Be Over
With Mark Proctor of Vinson & Elkins LLP

Q1: What are you seeing for energy fundraising so far in 2016?

Mark Proctor, Vinson & Elkins LLP:
2016 has definitely been a slower year for fundraising in the energy markets. If you look at the numbers, there were about 16 funds that closed on about $16 billion of capital in the first half of 2016. Compare that with prior years: in 2015, funds—energy funds specifically—raised about $64 billion of capital. In 2014, they raised about $40 billion of capital. So, from just sheer amount of capital raised, we're on a slower trajectory.

Q2: Is it taking longer for funds to reach their target amounts and to close?

Proctor: If you look at targets and time to fundraise, the average energy funds that held…its final closing in 2016 spent about 20 months in the market and raised about 96% of its target capital commitments. If you compare that with the market overall for private equity funds, private equity funds in general spend about 14 months in the market and raise about 103% to 105% of target capital commitments. So, you definitely see a slowdown in the energy side.

Q3: There's a record amount of dry powder in energy funds. Why isn't it being deployed?

Proctor: Energy funds are sitting on probably about $160 billion of dry powder right now, according to one estimate. And they've been slow to deploy it mostly because of the commodity-price environment. I think what's happened is for a while [is that] buyers have been reluctant to go out and do deals because, first, they were worried about catching the falling knife. That is, are commodity prices going to call even further? They all felt like they paid too much for assets. Then, the next phase was uncertainty about whether oil prices specifically were going to climb back up to around $100 a barrel, which is where they were, or even $80 a barrel, or whether they were going to hover long-term around this $40 to $50-a-barrel range.

It seems like people are getting comfortable now that they're not going to climb back up to $100 a barrel and they're going to be somewhere in…this middle range of, say, $40 to $80 a barrel. So, as buyers become more comfortable with the commodity price environment, it seems like they're more willing to go in and do deals. On the sell side, I think that…the clock is starting to run out for certain companies. Some of them have taken on too much leverage and they need to either raise capital or sell assets. As time goes on, the price at which they're willing to part with their assets is going down.

Q4: What kinds of opportunities is the dynamic between buyers and sellers creating for PE?

Proctor: The capital markets have been slower to recover and, if you look at the numbers, we're provably on pace to do half as many deals in 2016 as we did in 2015 and historically. What that's led to is companies that need to raise capital—either to acquire assets because they think they're getting great prices or to de-lever—have looked to alternative sources of capital including private equity. So, private equity firms have the ability not just to acquire assets directly, but also to jump in and finance other asset buyers that otherwise would have looked to probably the public capital markets in order to raise equity

Q5: Some players are starting to do energy M&A deals again. What in the market has changed?

Proctor: I think there are certainly more distressed deals out there now than there were six months ago. If you just look at the latest headlines, you've had over 90 companies in the oil and gas space—specifically E&P companies—file for bankruptcy in the last two years. I think you've have about as many oil-field services companies file for bankruptcy.

You've had banks considerably pulling back in the market and re-underwrite reserves and, as a result, reduce borrowing basis. So, companies have been in a position where they've needed to raise more capital. I think a lot of the sellers have been either in distress or near distress where they—the private equity firms that are on the buy side—have been able to get comfortable with the pricing.

Q6: What changes have you seen in deal volume in the first half of 2016?

Proctor: It was very slow at the beginning of the year, but I think as the situation stabilizes and as distress builds on the sell side, you're definitely seeing uptick in activity.

A lot of the players that we saw flooding into the energy space that were more generalist private equity firms that don't really have the deep technical bench…or the same level of contacts and experience in the industry are still sitting on the sidelines. They're still waiting for things to even out a bit and to develop. But I think the more experienced buyers are back in the market.

Public capital markets activity continues to be slow, [which] I think is driven by a couple of factors. At this point, the big institutional investors are looking more to the private markets to deploy capital in oil and gas because I think they're still concerned about valuations and…concerned about pricing…and concerned about commodity prices. So, they're looking for an experienced pair of hands to guide them in.

Q7: With LPs looking at the energy market again, does that mean more fundraising ahead?

Proctor: I think the rest of 2016 and probably 2017 are going to be quieter years in the fundraising environment for energy funds specifically. We've got this big capital overhang that firms need to work through before they really return to markets in earnest. So, I think it'll be probably in 2018 [when] we'll see the dynamics improve and fundraising return to previous levels—probably not 2015 levels, because that was a banner year, but probably 2012 to 2014 levels.