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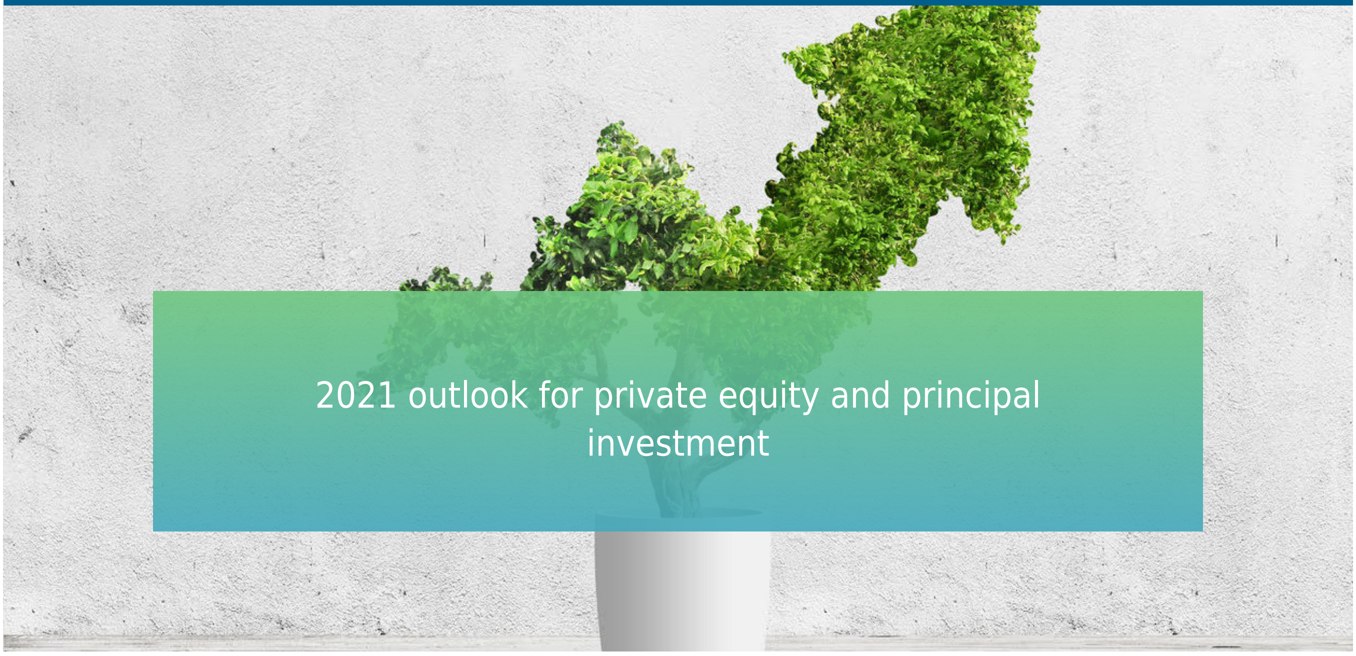

2021 outlook for private equity and principal investment

HC Insider speaks to a wide range of participants in the private equity and principal investment space to find out how Covid-19 has affected their business strategy and their views on the outlook for investment activity in the energy markets in 2021.

In 2020, we saw large private equity firms focus on internal investment and portfolio growth and the joint venture market strengthening. This has placed a renewed emphasis on sustainability, corporate responsibility, and company (and country) resilience in 2021. Having spoken to participants in the private equity and principal investment space, it appears we are witnessing an awakening of the investment community, led by fund managers and PE firms, to the true volumes and cost of abatement required to achieve climate objectives laid out within the Paris Accord.

“This along with the raft of voluntary pledges of net zero emissions within the corporate sector,” Ariel Perez, Head of Environmental Markets at Hartree said, “has led to significant increases in physical carbon reduction initiatives. In particular, we are seeing an exponential growth in demand for products that synthesise carbon permits and offsets with more traditional assets and investment products.”

Covid-19 has also accelerated the energy transition agenda for companies such as Gunvor. Tawfik Sadfi, Head of Origination and Structured Finance at Gunvor, said the pandemic has accelerated the company’s strategy towards cleaner energy, reallocating capital to the upcoming low carbon future. “Our investment strategy will include power and renewables as part of the energy mix that will be complemented with traditional fossil fuel, such as natural gas,” Sadfi added.

The infrastructure sector has also been impacted by the pandemic, although some subsectors have been impacted more than others. Martin Krastev, Executive Director at DC Advisory said digital infrastructure was positively impacted by Covid-19 due to increased demand for virtual connectivity and data transfer, resulting in increased capex deployment and capital requirement. Negative impacts, however, have been felt by investors that currently own airports, ferries, certain rail, and road infrastructure. DC Advisory is currently focused on proactively managing the assets in question, including tapping available liquidity facilities, amending financial covenants of existing debt facilities and utilising various government support schemes. The impact on energy infrastructure, such as renewables, midstream, district heating and regulated utilities, has been limited, and there is constant deal flow and interest from investors to acquire such assets.

Opportunistic acquisitions

In 2021, a focus on innovation, new technology, and the need to adapt to new ways of working and consuming will likely spur mergers and acquisitions across multiple sectors, including cross-sector investments. Investment and origination shareholders also predict opportunistic acquisitions across all sectors by companies with strong balance sheets to capitalise on Covid-19-related distress and immediate liquidity needs.

Deal activity in the energy markets is likely to be driven by the push for decarbonisation beyond the power sector. Electrification of transport is another area that was non-existent a few years ago but is now becoming more active. Krastev tell us that multiple providers of EV charging points were acquired in 2020, mainly by oil majors or through mergers with SPACs. Investment in solar and wind generation is also likely to continue at a steady pace. Krastev says there is also an increase in deal activity in the MENA region by recently established emerging market focused infrastructure funds.

We asked Steve Jones, Partner at Energex what his view was on the outlook for investment activity in the energy markets in 2021, and where he thought deal levels might be the strongest. “It could be a challenge for some of the oil majors to achieve their ambitious net-zero targets during a time when their balance sheets have been severely depleted and capex budgets cut significantly,” Jones said. “There is an opportunity to accelerate this strategy by partnering with infrastructure funds that bring an abundant and relatively cheap source of capital. These partnerships can be developed to release capital tied up in existing infrastructure portfolios within the organisation and/or to co-invest in renewable and clean energy projects.”

The Board of Directors of Total SE has recently made important decisions in support of the transformation of Total into a broad energy company, its commitment to the energy transition and its climate ambition to get to net zero. The Board will propose, later this year, to shareholders to change the company name to TotalEnergies SE. According to the Group CFO of a top tier trader, we will see this happening across the world, with large pools of capital earmarked for green projects, but the bottleneck will result from the selection of projects and the risk management.

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Meeting ESG criteria

Environmental, social, and governance criteria is playing a major part in company expansions and market conditions. This will likely affect the 2021 outlook as we see a greater focus on ESG investment from companies that can responsibly address the needs of economic disruption across all sectors. We have seen this with the green bond emergence/issuance from some of the larger oil trading companies that are now looking to decarbonise their franchise. Some are tabling the ESG and energy transition push but are cognisant of the fact that there is still at least one more traditional oil investment cycle left to capitalise on fractured markets. The trickle-down effect to the energy and natural resources sector will most likely see the increased focus on carbon neutrality transforming the industry and driving deal activity and capital availability.

Every corporate in the world has made public commitments to a zero-carbon footprint or a migration towards such, David Stanton, Head of Commodity Finance and Deputy CFO at Hartree, tells us. He said the gap between Co2 targets and the current trend for emissions implies unprecedent levels of abatement. A focus on ESG is also impacting investment considerations, capital allocation, and financial market appetite. Tawfik Sadfi, Head of Origination and Structured Finance at Gunvor argues that traditional oil and gas companies will need to rebalance their asset portfolio towards the energy transition with more capital being invested in gas and power infrastructure.

Larger oil majors will have no choice but to push forward with ESG, David Gallagher, Head of Structuring and Investments at Mercuria told us, as they continue to face pressure from their main capital providers. As banks develop more consistent strategies related to ESG, borrowers will discover that the availability and cost of debt funding will be heavily influenced by their ability to meet certain targets related to the reduction of carbon intensity in their business. Oil majors have, however, made significant investments in renewables and EV charging infrastructure, according to Martin Krastev, Executive Director at DC Advisory.

In the past 10-15 years, Krastev said, the oil majors have rebalanced their asset portfolios from oil focused E&P assets to a mixture of oil and natural gas/LPG assets. “As global demand for gas is expected to grow until the end of 2030s and start declining in the 2040s, the proportion of oil exposure of oil majors’ portfolios will run off by 2050, while the proportion of gas will increase,” Krastev said. “The next phase of the rebalancing is starting now and includes the migration to hydrogen and carbon capture and storage (CCS).

The production of hydrogen requires a substantial amount of energy and the oil majors are best placed to deliver it. For example, BP recently announced plans to build a 1GW of blue hydrogen production facility in Teesside, which is equivalent to 20% of the UK 2030 target. By 2050, the oil majors are likely to have completed their transformation into 100% gas and hydrogen companies.”

This transition is not going to be easy however and will require large investments. Another challenge is the measurement of ESG-related activities as the criteria and methodology is fragmented and unclear, according to Marie-Christine Olive, MD and EMEA Head Energy and Natural Resources Corporate Banking at Citi.

Finance providers could address this challenge by supporting the transition of the oil and gas sector by providing solution-based financing packages that both incentivise/reward the customer to reduce their carbon output and/or incorporate an implied carbon-offsetting cost. Steve Jones, Partner at Energex, said the banks can help to ensure the integrity of the carbon removal strategy, either on a project specific or portfolio basis, by working with specialist companies that are focused on high quality, robust carbon removal programmes.

The ESG acronym is not appealing to everyone, however. The Group CFO of a top tier trader told us he prefers the concept of responsibility. For example, asking how the company can improve its environmental impact directly and indirectly, how the company can ensure that its social impact does not have blind spots, and how it can ensure the continuous improvement of the company culture. Thinking of ESG in this way, he argues, helps to attract talent, build long-term commercial relationships, and provide access to funding.

Recruitment challenges

Companies may focus their recruitment strategy on targeting individuals that have a personal interest in sustainable markets. Sustainability is clearly of interest to younger talent, Olivier Boujol, Managing Director and Vice President – Structured Trade Finance at ADM, tells us. Other companies are focusing on the UN's Sustainable Development Goals. DC Advisory, for example, has selected three goals to focus on – Good Health and Wellbeing, Reduced Inequalities, and Climate Action. Krastev tells us that his organisation wants its employees to be happy and healthy, to address diversity and inclusion and therefore future proofing the business by harnessing exceptional talent, and finally to act with a climate conscience and have a clear corporate climate strategy.

With the pandemic reducing energy demand in 2020, the energy markets are expected to bounce back this year as the global economy recovers. The growth of the circular economy, corporate sustainability, and ESG sectors surely points to renewed optimism for the remainder of 2021 and beyond. In particular, we have seen an emphasis on hiring the right talent to fulfill growth policies of the energy and natural resources landscape. We expect this will continue for the rest of the year.

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