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Shift to Renewables May Be on the Horizon

By Luis Garcia

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Some of the world's largest oil-and-gas companies are embracing renewable energy, as growing demand for solar and wind power, stricter regulations to curb carbon emissions and a gradual change in public and investor attitudes all point to a future with less fossil fuel.

These factors are also a reminder that private-equity firms focused on the energy industry also may have to make a decisive shift toward renewables sooner rather than later.

French oil giant Total SA is taking steps to become a big electricity seller to prepare for an eventual decline in crude-oil demand, The Wall Street Journal reported last week. Other big energy companies such as Royal Dutch Shell PLC and Statoil ASA also are increasing their bets on renewable energy.

As with the major oil companies, private equity has been allocating more capital to the renewable sector in recent years. A June report from data provider Preqin Ltd. shows fundraising for the sector, which includes biomass, geothermal, hydroelectric, solar and wind power, reached $13.8 billion and $12.6 billion for 2015 and 2016, respectively, above an average $8 billion raised annually for the preceding seven years.

Some recent deals in the space illustrate the trend. Pattern Energy Group LP, or Pattern Development, a developer of renewable energy and power transmission assets backed by Riverstone Holdings, said Monday said it received a $724 million commitment from an investment entity managed by the New York firm. The money will be invested in wind and solar projects in the U.S., Japan, Mexico and possibly Canada.

A sharp decline in the cost of renewable energy is giving a lift to the sector, too, energy executives said. In high-wind areas such as Texas, Pattern Development can quote electricity from a wind project at less than two cents a kilowatt-hour, according to Michael Garland, the company's president and chief executive.

"That's really cheap power," he said, adding it represents a 75% drop from five or six years ago.

The private-equity industry still invests much more money in conventional energy than in renewable sources, however. Renewables accounted for 21% of the total energy capital raised between 2008 and April 2017, compared with 46% for conventional energy funds and 33% for vehicles with a mixed-energy mandate, according to Preqin's report.

For all the cost reduction, private-equity executives said it is still difficult to generate superior profits from renewables. The median net internal rate of return since inception for renewable-focused funds was 4.6% a year, compared with 10.3% for their conventional-energy peers, according to Preqin.

Part of the difficulty has to do with technology. Advances in battery storage are needed to make solar energy more competitive, experts said. Also, uncertainties regarding the new U.S. administration's policies on incentives to renewable projects and competition from cheap natural gas as a fuel for power generation are clouding the renewable sector, the experts added.

Still, with the economics of wind and solar energy improving fast, it is likely just a matter of when—rather than if—private-equity investors will begin to drive significantly more capital to the renewable sector.

"Renewables are for real," Wil VanLoh, founder and chief executive of Houston-based Quantum Energy Partners, said in an email. "Any serious energy investor will have to have exposure to renewables over the next decade."

For now, Quantum's portfolio remains heavily concentrated on upstream oil-and-gas companies: The firm is targeting up to $5.25 billion for a new fund to invest primarily in the conventional energy space.

But the firm's approach could change in the future.

"As [renewable-energy] technology continues to improve, the opportunities will become more interesting and should generate better rates of return," Mr. VanLoh said.

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