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Private Equity Pivots to New Oil Frontiers as Permian Rush Ends

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By Ryan Collins

(Bloomberg) -- As costs surge in America's hottest oilfield, private equity cash is being shifted to cheaper corners of the shale patch. The Permian Basin in West Texas and New Mexico has long been the world's biggest magnet for private equity dollars. Now, though, with drilling rights there costing twice what's seen at other basins, and giant publicly traded drillers such as Exxon Mobil Corp. expanding in the region, there's little room for a quick financial score.

The result: Investors are increasingly turning their sights elsewhere, said Wil VanLoh, chief executive of Quantum Energy Partners, in an interview. Oklahoma, for instance, has drawn $5.6 billion for drilling rights since the start of 2016, almost twice the amount spent in the Permian's Delaware section, according to investment bank RBC Richardson Barr. "Private equity is buying in pretty much every other basin" aside from the Permian, said VanLoh, who oversees a portfolio of companies that collectively pump almost as much crude and gas as Marathon Oil Corp.

Drilling rights in the Permian soared to $60,000 an acre during the height of the oil boom and even after the 2014-2016 crash they command at least twice as much as lesser regions. In response, private equity money is beginning to search out cheaper drilling rights in places like the Powder River Basin in Wyoming and the Cotton Valley in Louisiana. To get an idea of how attractive the Permian's mile-thick expanse of oil-soaked rock has been for investors, consider that almost one-third of the roughly 360 private-equity backed American drillers are focused there, VanLoh said. Private firms devoted to oil, natural gas and the pipelines and cryogenic plants that attend to them have raised about $200 billion since 2010, he said.

Midland, Texas

Wells in West Texas and New Mexico have proven profitable even during the worst of the market collapse. That triggered a scramble for drilling rights that sent prices skyrocketing. For example, in Midland, Texas, access to a single acre costs more than $38,000, according to RS Energy Group. That's a far cry from places like Colorado's Denver-Julesberg Basin, where it's around $15,000. And in Canada's Montney Shale, prices can be as low as $5,000.

"Really what people need to think about is the cost of the well along with the acreage position that I paid for," Sarp Ozkan, manager of energy analytics at DrillingInfo Inc., said by telephone. "Now people are trying to look for the next big areas."

In fact, the Oklahoma rock formations known as the Scoop and Stack have become one of the premier zones for private equity investments now, taking a back seat only to the Eagle Ford shale in South Texas and the Rocky Mountains, RBC Richardson Barr's data showed.

IPO rush

To be sure, private backers haven't completely washed their hands of the Permian. Heavy hitters Apollo Global Management LLC and Warburg Pincus LLC have committed almost $1.5 billion to various Permian start-ups so far this year. In fact, Warburg is in the process of opening a Houston office to improve access to new energy investments.

Typically, private equity likes to hold an asset for three years or so and then flip it to make their return. But that's set to change, VanLoh said. In a time when investors are scrutinizing drillers that don't practice capital discipline, public companies are tightening the purse strings and making fewer acquisitions. That means private equity will have to hold on for longer and instead of waiting for a corporate suitor take their creations public.

If private equity "doesn't have the larger guys to sell to then that is the next best option," Ozkan said. "Any exit strategy is a good exit strategy if they're making money." VanLoh sees a lot more initial public offerings coming down the road. His own Jagged Peak Energy Inc., an oil driller dedicated to the Delaware region on the western edge of the Permian, went public in January 2017 and has a market valuation of $2.6 billion.

"We're just building bigger companies," he said. "You're going to have to" take them public "to get the exits. Over the next three or five years, you'll see a pretty good number of energy" IPOs.

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