Oil and Gas Investor

Oilfield Services Investing: Private Equity's Tech Pivot

Private equity's interest in oilfield services is expanding the definition of what is investable in the OFS space.

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Private equity firms' interest in the oilfield services (OFS) space traditionally meant investing in hard assets: rigs, frac pumps and trucks, a sand mine or downhole equipment. Firms always focused on companies with emerging technologies that advance E&P efficiency, including the abilities to drill or complete a well more accurately and faster.

A lot of debt flowed into the industry as private equity-backed startups developed new technology or sought to buy divisions from larger companies such as Halliburton.

"That's all come unhinged," said G. Allen Brooks, managing director of PPHB LP, a Houston boutique focused on oilfield services. "The overriding environment for private equity in the service sector right now is trying to make their companies profitable. And, private equity itself is getting beat up, because it's suffering not only from the industry downturn, but from the fact that the funds they can raise [from limited partners] are drying up.

"The marketplace has changed and is going to be smaller."

Combine these travails with the fact that the oil and gas industry in general is slowly figuring out what its new role in the energy transition will be, and you'll find that private equity firms are expanding their scope of investments.

"We're not going to own the resource, but we'll invest in companies that are helping to do anything related to production," said one source, who also invests in alternative energies. Increasingly, that means private equity is no longer turning to hard iron and downhole tools, and instead is considering anything digital, ranging from technologies involved in the supply chain leading up to a completion, to data management or software as a service (SaaS) concept.

Private equity funds focused on oilfield services took a serious pause during the bleak atmosphere of 2020. Now these funds will not open their coffers for new platforms. Rather, they may inject capital to stave off threats to their existing portfolio companies amid a wave of oilfield service bankruptcies, not to mention the near collapse of activity in the frac equipment and sand business lines. Some are making acquisitions of tech divisions being hived off the giants like Halliburton Co., Baker Hughes Co. or Schlumberger Ltd.

The 2020 downturn threw into stark relief a sad truth: The traditional OFS sector is suffering a glut of capacity. It has been overcapitalized for a long time, even before the pandemic, so a wave of consolidation needs to be underway. The total market for oilfield services keeps shrinking; companies must battle for market share amid the surfeit of equipment, clients demand discounts and stronger players are seeking scale.

Despite these hurdles, and a pullback in buyout activity for new OFS platforms, private equity firms continue to be active in OFS, albeit in new ways.

Tech software is the allure

For a while now, the most prominent private equity firms traditionally active in the E&P space have also been investing in energy technology—it makes sense, especially during the downturn as finding new efficiencies has become even more important.

“People don’t want to buy hard assets like drilling rigs or pressure pumping equipment. They want to back AI, software, anything digital,” said PPHB’s Brooks. “What we’re finding is that people are innovating in things like managing access to remote sites. Somebody pulls up in a truck … and you keep track of all the vendors and contractors out there. Are they supposed to be there? What are their credentials? Are they trained in safety? These kinds of things are percolating throughout the industry.”

Quantum Energy Partners, a leader in providing equity to E&Ps, has always made some investments of $5 million to $75 million in services or technology; these checks are typically smaller than what Quantum would provide to an E&P client, which has been anywhere from $300 million to $500 million. (Counting follow-on investments, the firm has up to $1 billion invested in some of its E&P portfolio clients, because they are building toward a strong exit later.)

"In oilfield services, however, the risk can be higher, [so you might advance less capital]. But, you can get a higher return, so you might make three to six times your money. It's more akin to what venture capital firms do," explained CEO Wil VanLoh.

Lately, Quantum has gone all in on digital applications for energy. "Investing in a sand company or a drilling rig, that doesn't get us as excited. But to create an ecosystem to capture, clean and store data, that's a theme you'll see more and more with us. We've really invested heavily on data science in the last three or four years, both internally, which has helped us in our own investing process and in our portfolio companies. We hired a chief technology officer this past year who was with Chevron to take us to the next level."

Quantum recently partnered with another private equity firm, Global Reserve Group, to infuse $11 million into Datagration Solutions Inc., which provides PetroVisor, a software for the upstream. Datagration is the sixth energy technology venture capital investment that Global Reserve Group has made with Quantum, said Jeffrey Harris, founder of Global and formerly a senior partner and principal for 29 years with Warburg Pincus.

"We've always looked at service companies. At any given time, we might have one or two of these per fund. It's a unique business where we see growth trends in 'smart iron' as opposed to 'dumb iron,'" said VanLoh. Speaking more broadly of the devastation suffered by the OFS sector in the past year, he added, "I do think, be careful how much you beat them up, because we need these companies if we're going to have an upstream business." Across Quantum's E&P portfolio, about 22 rigs are running on average all the time, so he certainly knows what the OFS sector contributes.

Two years ago, Quantum invested in RigUp, which provides contract labor to the oil and gas industry. But where once about 90% of its business was in oil and gas, today that's only about 30%, as RigUp expanded into residential, commercial and industrial sectors. It's a common theme as capital providers and service companies themselves diversify away from traditional equipment and services to digital, data management or to other sectors such as the downstream and industrial.

Tech takes many forms these days as the energy industry evolves. In December, NGP filed to take public its second tech-oriented SPAC, Switchback II Corp., which is looking "to evaluate targets across numerous sectors, including energy technology, clean and renewable energy infrastructure, … energy efficiency and battery storage…" and other energy-related opportunities, according to the S-1.

NGP IPO'd Switchback I in July 2019 (NYSE: SBE), raising $345 million. In September 2020, Switchback pulled the trigger, agreeing to buy ChargePoint Holdings Inc.—one of the world's largest public EV (electric vehicle) charging networks. (That deal was scheduled to close by December 31.)

This transaction illustrates what private equity firms are doing to expand their view of what is investable, based on what they think the future of energy may hold. According to Simmons' Shah, "In fact, many traditional OFS-oriented investors are now focusing on a broader definition of energy that includes downstream/industrial, power/utility, infrastructure and alternative/new energy exposure."

They are also taking a page from history: The people who made the most money during the California Gold Rush were not the prospectors. It was merchants, the middlemen who sold the prospectors picks, shovels, denim jeans and whiskey.

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