



Q&A with Kerogen Capital: A Closer Look at International Energy

This month, Preqin spoke to [Jason Cheng](#), Co-Founder, Managing Partner at Kerogen Capital, regarding recent trends in the natural resources industry and the outlook for the future.

What recent trends have you seen in natural resources private equity?

Natural resources is an established asset class and has enjoyed increased attention as investors look to diversify their private equity portfolios and hedge against inflation.

The energy-focused private equity model has been successfully developed in North America for some time, yet there are few internationally focused oil and gas managers. This is not because the opportunity set is small; on the contrary over 90% of the world's proven oil and gas reserves are outside North America.

The difficulty historically has been two-fold: firstly the lack of institutional quality managers with adequate fund sizes and secondly, the challenge in translating the private equity model to suit the opportunities presented in a wide range of local conditions. Throughout our engagement with investors, we have seen a significant level of interest for internationally focused strategies developed by "home grown" management teams. It has become increasingly clear that the opportunities for private capital are large and growing.

What are the main industry drivers and fundamentals?

The fundamentals for the energy sector continue to be positive. The growth in demand for energy globally continues, driven mostly by Asia; however, proven resources in production are constantly depleting. The International Energy Agency estimates some \$12 trillion needs to be invested over the next 20 years for supply and demand to be in balance. In response, the industry continues to push the boundaries and innovate. New technologies such as hydraulic fracturing have opened up an unconventional oil and gas industry and exploration activities have made new large conventional discoveries such as offshore East Africa, Brazil, etc.

Asia is the key driver of demand, with China and India together forecasted to account for around 83% of net oil demand growth over the period to 2035¹. Asian national oil companies (NOCs) have responded to Asia's energy security concerns with a rapid wave of large scale international acquisitions, accounting for over 20% of oil and gas global M&A in 2012.

Where are the opportunities now?

A lot of capital has been raised by North American energy managers in recent years and we understand competition for investments has been intense. Private capital will eventually flow to the international sector, following public markets. Many investors may not know that 73% of Exxon Mobil and 83% of Chevron's reserves are located outside the US and that 94% of the world's undiscovered conventional resources in oil and gas are similarly located outside the US². In recent times, most of the world's large discoveries

have been in Africa, Central Asia, MENA and Latin America etc. – geographies that are relatively untapped by private capital.

At Kerogen Capital, we tend to focus on international basins with proven hydrocarbon systems where we partner with portfolio companies to develop assets into potentially world class projects that typically become of strategic interest to growing Asia.

What are the key risks associated with oil and gas investments?

When evaluating a potential investment in the oil and gas sector, investors should focus on risk adjusted returns, and pay particular attention to how a manager evaluates and manages key risks such as technical and commercialization risk, management effectiveness, country risk, and oil and gas price risk.

Country risk is often the first risk that comes to mind for financial investors. It is a multifaceted issue, but it helps to focus on the context of the oil and gas industry in each particular country. We prefer countries with a long history of oil and gas production with established international companies successfully operating there in a profitable manner. Energy tends to be so vital to many countries that governments are usually highly reluctant to take action that may damage investment flows - some countries in Latin America being the exception. What tends to matter most in managing country risk is whether the team has significant experience operating in the country with its own established networks and resources.

How does Kerogen ensure success in its investments?

At Kerogen Capital, we focus on investing in companies with a clear path for success while constructing a sensible portfolio to diversify specific risk exposures. We target companies that combine a first rate management team with an established portfolio of assets that typically include a core flagship asset, which has the potential to be of strategic importance or of world class ranking. We work closely with our internal technical and operational experts to assist in the selection, evaluation and operation of investments. We act as a partner to our portfolio companies and provide active support through strategic, technical, operational and financial engagement. In addition, at the outset of any investment we have a clear view on the logical set of buyers for each asset.

Kerogen Capital

Established in 2007, Kerogen Capital is an independent private equity fund manager focused on providing growth and development capital in the energy sector internationally with a focus on upstream oil and gas.

www.kerogencap.com

¹US Energy Information Administration

²US Geological Survey