



Natural Resources Private Equity Investment: Recent Growth and Investor Appetite

With 2012 a bumper year for natural resources fundraising, **Stuart Hunter** explores the recent growth of the natural resources industry and the outlook for private equity investment in the space in 2013. We examine the latest data on investor appetite for this fund type, past performance, and historical fundraising.

The natural resources industry has seen increased levels of private equity investment in recent years. In 2012, 22 natural resources funds, including those targeting investment in commodities such as agriculture, precious metals, and oil and gas, raised a significant \$22.5bn in capital commitments from investors, more than triple the \$6.8bn raised by 13 funds that closed in 2011 (Fig. 1). The aggregate capital raised by natural resources funds that closed in 2012 neared the peak levels of capital secured by funds closed in 2006 and 2009 at \$24.0bn and \$23.6bn respectively. All of the top five natural resources funds to close in 2012 secured capital commitments of over \$1.5bn, as shown in Fig. 2, the largest of which was Natural Gas Partners X, which held a final close on \$3.6bn. In this article, we examine the recent growth in interest in the natural resources industry in terms of fundraising and investor appetite, the past performance of the asset class, and the outlook for 2013.

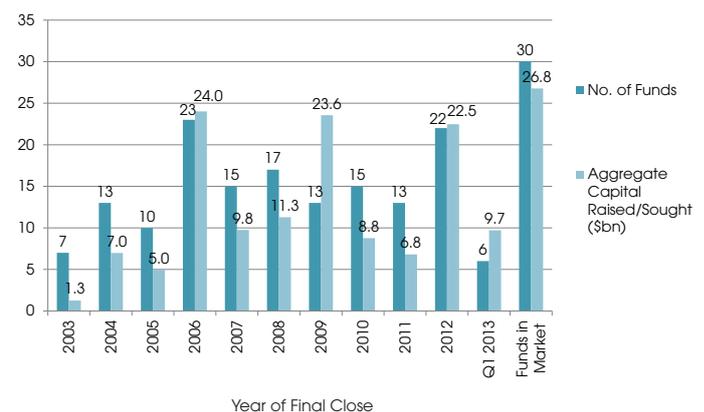
The natural resources industry is continually looking to source new production methods in order to address both the finite supply of natural resources and the growing demand for energy around the globe. Recent technological innovations, particularly in the hydraulic-fracturing (fracking) industry, have made new oil and gas exploration and production techniques economically viable, and have resulted in onshore oil and gas production company profits in the US increasing significantly. However, while the fracking method is effective at obtaining oil and gas from deep shale deposits, the technique is also considered controversial due to its impact on the environment. Nevertheless, the technique has received less opposition in North America than in Europe; the technique is exempt from the environmental regulation set out in the Energy Policy Act 2005 and President Obama has promoted it as part of the country's clean energy future.

Six natural resources funds have already managed to close in 2013, raising a total of \$9.7bn, already exceeding the aggregate amount raised by funds that closed in either 2010 or 2011; this indicates that 2013 may well be another strong year for this fund type. All six natural resources funds that have closed since the beginning of 2013 have either met or exceeded their target size, which is encouraging for fund managers currently on the road.

Performance of Natural Resources Funds

Fig. 3 shows that the PrEQIn Natural Resources Index has consistently outperformed the PrEQIn All Private Equity Index over

Fig. 1: Annual Natural Resources Fundraising, 2003 - Q1 2013 and Funds in Market



Source: Preqin Funds in Market

the past seven years when both indices are re-based to 100 as of 2005. The strong track record of natural resources investments, particularly in recent years, has driven interest from both private equity firms and investors. A number of LPs have even created separate allocations to natural resources funds and are planning to establish such funds as a core part of their investment portfolios.

Growing Investor Appetite for Natural Resources Funds

Natural resources funds have typically been viewed by private equity investors as more of a niche strategy, but Fig. 4 demonstrates growing investor interest in the fund type. The proportion of new fund searches and open mandates issued by LPs over the last 12 months for natural resources steadily increased from 8% in Q2 2012 to 18% in Q4 2012, before falling slightly to 12% in Q1 2013. This growth paralleled the increase in natural resources fundraising levels in 2012.

Foundations make up the largest proportion of investors (21%) that have either previously committed to natural resources funds or stated a preference for doing so, as shown in Fig. 5. Public pension funds account for a further 18% of LPs with an interest in natural resources funds, followed by endowment plans (17%) and private sector pension funds (11%).

Fig. 2: Five Largest Natural Resources Funds Closed in 2012

Fund	Firm	Fund Size (\$bn)
Natural Gas Partners X	NGP Energy Capital Management	3.6
Denham Commodity Partners Fund VI	Denham Capital Management	3.1
Blackstone Energy Partners	Blackstone Group	2.5
TIAA-CREF Asset Management	TIAA-CREF Global Agriculture	2.0
Kayne Anderson Energy Fund VI	Kayne Anderson Capital Advisors	1.6

Source: Preqin Funds in Market



Fig. 3: PrEQIn Natural Resources Index vs. PrEQIn All Private Equity Index



Source: Preqin Performance Analyst

Almost a quarter (24%) of LPs that have an appetite for natural resources funds have a current private equity allocation of between \$250mn and \$999mn, while a further 29% have a current allocation to the asset class of over \$1bn. This is perhaps unsurprising given that natural resources funds tend to be larger in size than other private equity funds types, in order to finance investments in sizeable, capital-intensive oil and gas projects. Indeed, in 2012, the average natural resources fund size was \$979mn, more than double the \$443mn average fund size for all private equity funds.

Separate Allocations to Natural Resources Funds

As natural resources funds have become increasingly attractive to investors, a number of LPs have created separate allocations to this fund type. US-based public pension fund New Mexico Educational Retirement Board (NMERB) has a target allocation to natural resources funds of 3.5% of total assets with the aim of improving risk adjusted returns and providing a source of diversification. It plans to commit \$125mn to natural resources funds in 2013 and reach its target allocation by 2018.

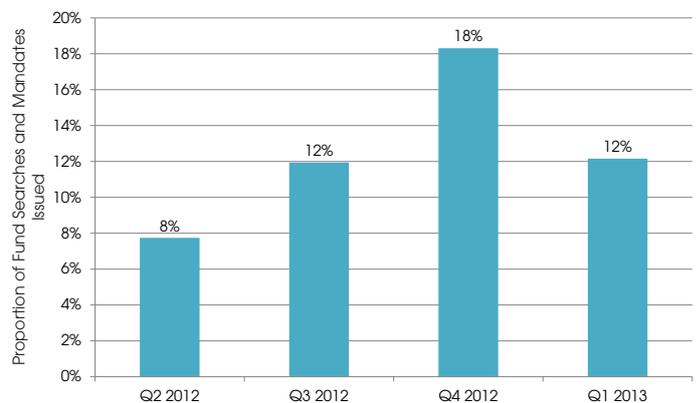
Other LPs which have a separate allocation to natural resources funds include University of Texas Investment Management Company (UTIMCO), which has a target allocation to such funds of 13% of total assets, and Yale University Endowment, which has a target allocation to natural resources funds of 7% of total assets.

Natural Resources Investment by Region

US-based private equity natural resources fund managers continue to attract a significant proportion of institutional investor capital, particularly from domestic LPs. Preqin's Investor Intelligence reveals that the vast majority (81%) of LPs that have previously committed to natural resources funds or have indicated they are considering doing so are based in North America; a further 12% are located in Europe, 2% in Asia and the remaining 5% in the Rest of World.

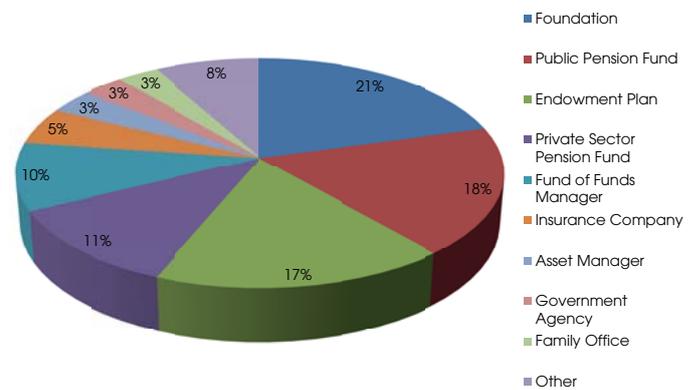
Fig. 6 shows that North America-focused funds have accounted for at least three-quarters of the aggregate capital raised by natural resources funds each year. The exception to this is 2007, when North America-focused natural resources funds accounted for 64% of the aggregate capital raised by natural resources funds globally. Rest of World-focused funds accounted for 17% of the total capital raised by funds closed in 2012, demonstrating the demand for investment in natural resources in certain emerging markets, such as Latin America and Africa.

Fig. 4: Proportion of Investors that Have Issued New Fund Searches and Mandates for Natural Resources Funds over the Past 12 Months



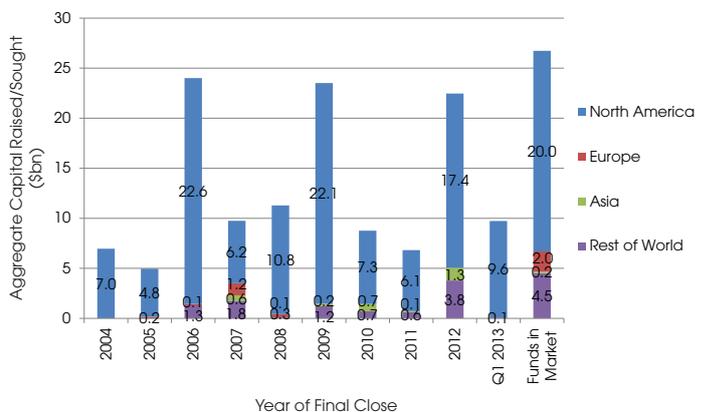
Source: Preqin Investor Intelligence

Fig. 5: Breakdown of Investors with an Appetite for Natural Resources Funds by Investor Type



Source: Preqin Investor Intelligence

Fig. 6: Annual Aggregate Capital Raised/Sought by Natural Resources Funds by Primary Geographic Focus, 2003 - Q1 2013



Source: Preqin Funds in Market

Interestingly, since 2008, no capital has been raised by predominantly Europe-focused natural resources funds, whereas for other private equity fund types, Europe-focused funds typically account for around a third of total capital raised in a year. Due to environmental concerns, Europe has not adopted the fracking industry as readily



Fig. 7: 10 Largest Natural Resources Funds in Market by Target Size (As of April 2013)

Fund	Firm	Target Size (mn)	Geographic Focus	Industry Focus
First Reserve Fund XIII	First Reserve Corporation	6,000 USD	Global	Oil & Gas, Energy, Mining, Power, Renewable Energy
Riverstone Global Energy and Power Fund V	Riverstone Holdings	6,000 USD	Global	Oil & Gas, Energy, Power
Resource Capital Fund VI	Resource Capital Funds	1,750 USD	Global	Mining
Broad Street Energy Partners	Goldman Sachs Merchant Banking Division	1,200 USD	Global	Oil & Gas, Energy, Power
Astra Natural Resources Fund	Astra Investimentos	1,000 USD	Brazil	Oil & Gas, Mining, Timber
Crimson Ant Natural Resources Fund	Crimson Ant Investment Management	1,000 USD	Global	Energy, Infrastructure, Materials
Forbes & Manhattan Growth and Resource Fund	Forbes & Manhattan	1,000 USD	North America, Global	Mining
Macquarie Crop Partners	Macquarie Infrastructure and Real Assets (MIRA)	800 USD	Australia, Brazil	Agriculture
China Mining United Fund II	China Mining United Fund	5,000 CNY	China, North America, Global	Mining
Blue Water Energy Fund I	Blue Water Energy	750 USD	Global	Oil & Gas, Energy

Source: Preqin Funds in Market

as North America, which may be contributing to the lack of private equity natural resources investment in the region in recent years.

Historically, natural resources funds have directed little capital to opportunities in Asia; however, in 2012, two funds raised a combined total of \$1.3bn, representing 6% of the total capital collected by natural resources funds that closed in the year. These two funds, China Mining New Energy Fund and Posco Woori EIG Global Fund, are both managed by GPs based in Asia and focus on investing in commodities outside of the oil and gas arena.

Average Fund Size

The average size of natural resources funds has increased year on year from \$626mn for funds closed in 2010 to \$682mn in 2011 and then to just under \$1bn in 2012, suggesting that investor appetite has remained strong over the last three years, with LPs increasingly committing larger sums of capital to these funds. New York State Common Retirement Fund and Teacher Retirement System of Texas both committed \$200mn to Apollo Natural Resources Fund I, which held a final close in December 2012 on \$1.3bn.

Established Managers vs. First-Time Fund Managers

Traditionally, natural resources fundraising has been dominated by large, experienced firms that have an established fund series specializing in the sector and a proven track record. However, recently a number of major buyout players have begun launching funds in the natural resources space, hoping to diversify and take advantage of the opportunities opening up in the sector, along with increased LP appetite for such investments. Two of the largest firms in the buyout industry, Blackstone Group and Kohlberg Kravis Roberts, closed their maiden natural resources funds in 2012, raising \$2.5bn and \$1.25bn respectively.

Another major player from the buyout sector looking to invest in natural resources is Goldman Sachs Merchant Banking Division. The firm's first natural resources fund, Broad Street Energy Fund, is currently the fourth largest natural resources fund in market by target size and is looking to raise \$1.2bn for investment in oil and gas, and energy companies across the globe.

While established natural resources fund managers, and now increasingly buyout firms, are attracting a significant proportion of LP commitments flowing into the natural resources marketplace, first-time fund managers have still secured notable amounts of capital recently. In 2012, Kerogen Capital held a final close on its maiden vehicle, Kerogen Energy Fund, raising just over \$1bn for investment in oil and gas companies in emerging markets. Elsewhere, UK-based private equity firm Blue Water Energy is currently targeting \$750mn in capital commitments for its natural resources fund and has already managed to hold two interim closes within a year of fundraising, securing two-thirds of its target so far.

Natural Resources Funds in Market

As of the start of April 2013, there are 30 natural resources funds in market seeking an aggregate \$28.6bn in capital commitments, the top 10 of which are shown in Fig. 7. North America-focused funds continue to dominate the natural resources fundraising environment and are seeking to raise 75% of aggregate target capital, an increase compared to the 69% of the aggregate capital targeted by natural resources funds they represented at the start of 2012.

Historically, primarily Europe-focused natural resources funds have accounted for a very small proportion of fundraising activity; however, the region currently accounts for 7% of the total capital sought by natural resources funds in market, up from 2% in Q1 2012. There are currently two Asia-focused funds in market, seeking to collect a combined \$160m in capital commitments, while predominantly Rest of World-focused natural resources funds account for 17% of the total capital sought, with eight funds seeking to collect an aggregate \$4.5bn.

Outlook

Investment in natural resources has gained considerable momentum over the past 12 months, with LPs seeking to increase their exposure to natural resources funds and establish separate allocations to the industry. The past performance of natural resources funds is likely to continue to drive investor interest in the future. A significant amount of capital was raised by natural resources funds that closed in 2012, and fundraising in 2013 began strongly, which is encouraging for fund managers currently on the road with vehicles focused on



investment in natural resources.

North America-based GPs led the fundraising efforts for this type of investment last year, with favourable regulation relating to fracking in the region aiding domestic investment. Although established natural resources fund managers are still likely to attract the most capital, buyout fund managers entering this space, along with first-time fund managers experiencing fundraising success in 2012, may mean that competition within the industry could intensify in the future.

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