The New Private Finance Approach

My Windsor Briefing, Part II

The second of the two briefings I provided on March 4 at the annual Windsor Castle energy consultation created a major reaction among both the experts and policy makers in the audience. It presented my estimates on financial flows for the energy sector in 2017.

The main interest involved my discussion of a major new initiative unfolding over the past several years in international energy finance. I had introduced the subject two weeks earlier when I addressed the Iranian Natural Gas and LNG Summit meeting in Frankfurt.

Officials attending that session specifically requested that I consider the matter at Windsor where they would also be in attendance. I had intended to do that in any event, but the advance mention merely accentuated the interest and allowed me to provide a more extended discussion.

This ECRG Intel will consider only this aspect of my presentations at both Frankfurt and Windsor and will provide a few of the slides from the Windsor briefing. This results from seven meetings of major private investment representatives I have advised over the past 16 months: two apiece in Abu Dhabi and Paris, and one each in Algiers, London, and at my compound in South Florida. It has been during this period of about a year and a half that the amount of funding and the number of projects to which such funding has been targeted have been increasing markedly.

The less than two dozen individuals I advise control the bulk of these funds.

A Private Opportunity

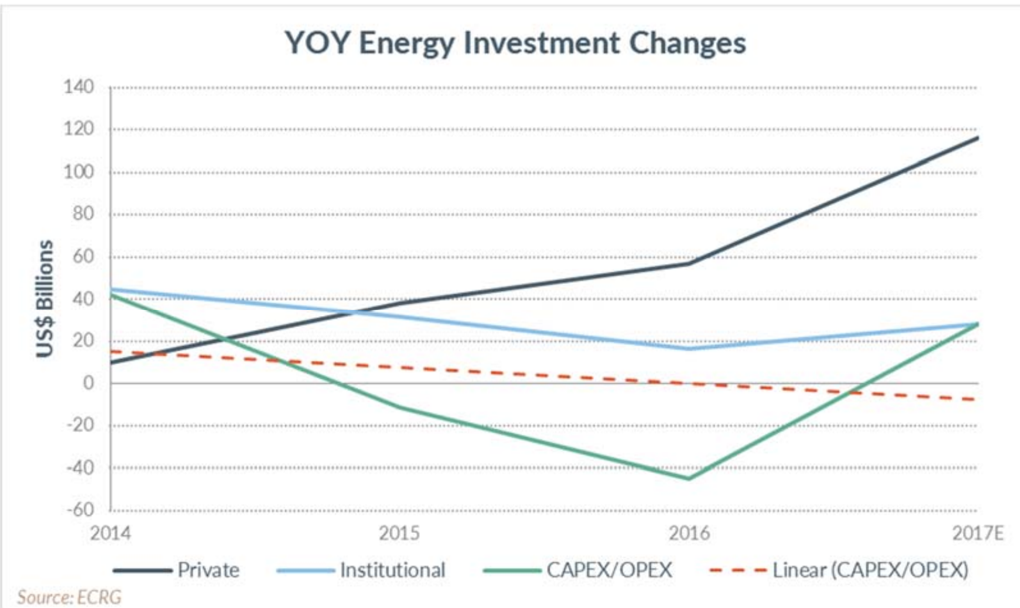
Until this recent ramp up, such finance has been largely folded into the broader "alternative investment market" category. Yet the funding to which I refer has rather specific sourcing and, as I shall discuss in a moment, very different objectives from more traditionally-defined private finance.

The sourcing of the funding I address comprises a complex of individual investment, private and family trusts, limited access fund portfolios, structured and special investment vehicles, asset holdings, and the like. In aggregate, the raw dollar value has risen at least 117% in one year and no less than 225% since 2014.

At least $93 billion has already been earmarked for the "cherry picking" of crude oil and natural gas assets in the beaten down U.S. market. Other initiatives in renewable energy, technology, and efficiency rollouts are also booked.

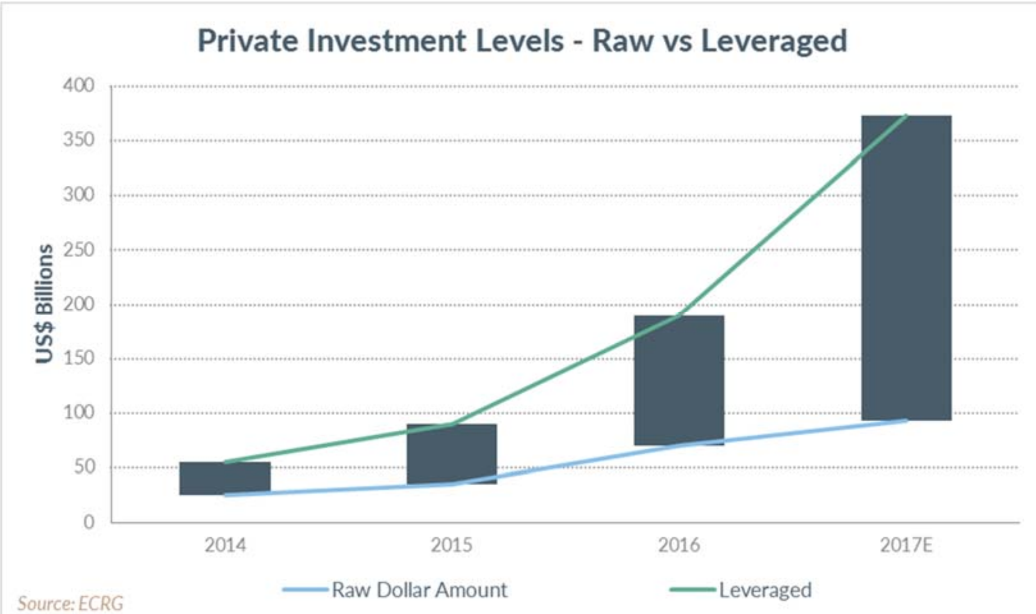
This total comprises a significant divergence from the overall trends of either institutional or project capex/opex investments since 2014. As shown in the Windsor briefing slide below, the private investment has been trending steadily upward in year-on-year percentage terms while institutional investment moved in the opposite direction.

Y-O-Y Energy Investment Change by Source



However, the raw dollar total hardly tells the tale. This private funding is being increasingly leveraged, as indicated by this slide (which provide an admittedly conservative estimate of that leveraging).

Private Investment Levels (US$B) – Raw vs Leveraged



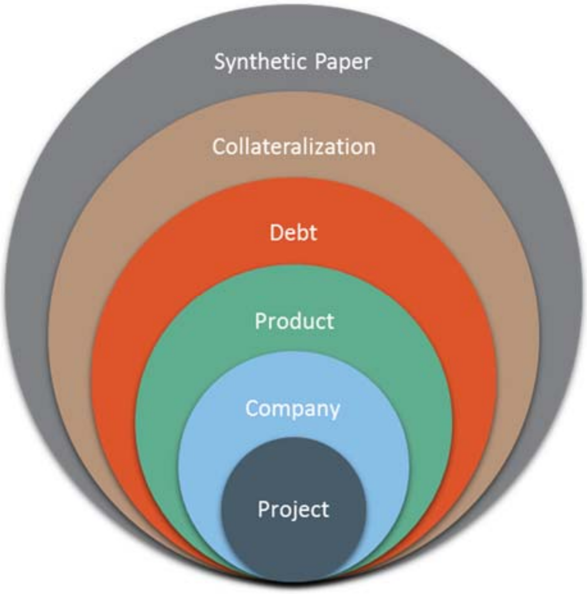
The departure in this private investment from more traditional approaches is graphically illustrated once the scope of the investment is considered. Whereas conventional investment would focus upon a project, a company, or perhaps product, this new investment strategy emphasizes at least six targets pursued simultaneously.

Layers Within Layers

The objects of interest here include at least these: projects; companies; production volume (e.g., swaps, futures contracts, arbitrage, hedges); debt; collateralization; and new generations of synthetic paper and derivatives

As illustrated by this slide, I refer to this as investment “layering”:

Private Investment Layering

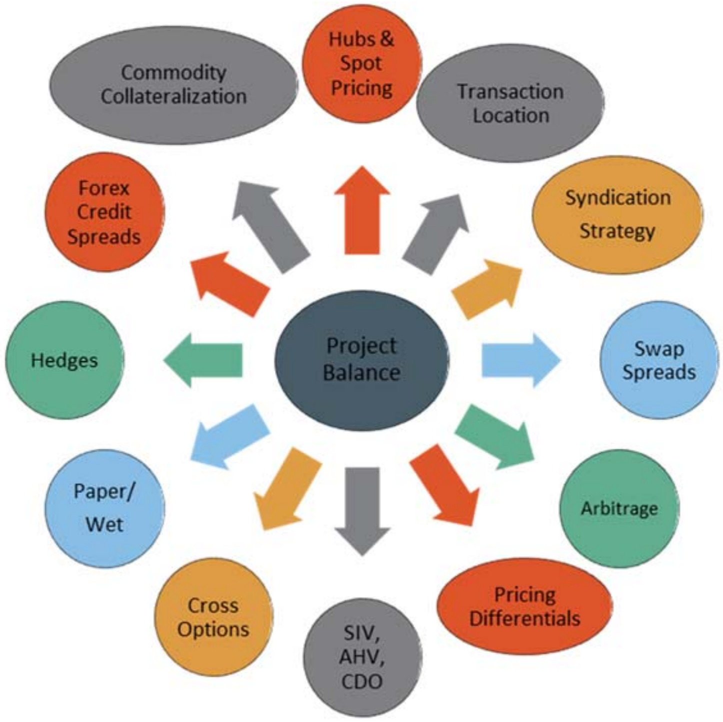


In this approach, investors are attempting to control both market and trading forces coming to bear on a single series of ongoing transactions. Traditionally, an investment in a project would await return from the sale of production. Now, the project, the company operating the project, the control over what volume flow results, debt incurred and the credit swaps resulting, the use of assets (including volume still in the ground), and an array of new derivative paper resulting from the interchange among these elements, are all wrapped into the same investment instrument.

Aside from the fiduciary dimensions addressed by this new way of looking at the energy sector, the approach also introduces a new range of risk management and analysis needs. At the request of policy leaders attending the Iranian summit in Frankfurt, I had sketched an initial radial diagram for assessing risk when applying such private investment to Iranian LNG trade.

The 12 categories resulting involve the initial aspects to be analyzed and structured. The real challenge emerges when the cross-risk factors emerge. Charts can provide the identification of separate elements (such as the representation below) but actual events require that the interchange among them be calculated and handicapped.

Radial Diagram - Adjusting Private Sector Financial Risk



The “project balance” sought requires a series of flexible algorithms to allow for the risk calculations. Those, in turn, will oblige that differing moves be made among distinct objects influencing an ongoing project-market-product process.

That is now the next matter on my agenda.

Before the end of the year, a widening portion of energy investment is going to look very different with most of this emanating from European bases of operation.

This is going to be very interesting.

About the Author

Dr. Kent Moors is an internationally recognized expert in oil and natural gas policy, risk management, emerging market economic development, and market risk assessment.

He serves as an advisor to the highest levels of 27 countries, including the U.S., Russian, Kazakh, Chinese, Iraqi, and Kurdish governments, to the governors of several U.S. states, and to the premiers of two Canadian provinces. He's served as a consultant to private companies, financial institutions and law firms in 29 countries, and has appeared more than 2,300 times as a featured radio-and-television commentator. He appears regularly on ABC, BBC, Bloomberg TV, CBS, CNBC, CNN, NBC, Russian RTV, and the Fox Business Network.

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