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By

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After promoting a wave of oil-and-gas asset sales in the Permian Basin, private-equity firms are just as eagerly redeploying capital in the still-challenged U.S. energy sector.

Private equity-backed companies have sold at least $16.48 billion in Permian Basin assets since August, according to global consulting firm Wood Mackenzie Ltd., taking advantage of soaring land prices in what is today the most economically attractive oil exploration region in the U.S.

Some of the biggest U.S. private-equity firms that invest in energy took part in the exit spree, including Apollo Global Management LLC, EnCap Investments, Pine Brook, Post Oak Energy Capital, Quantum Energy Partners and Riverstone Holdings.

The buyers were publicly traded companies such as Callon Petroleum Co., Diamondback Energy Inc., Parsley Energy Inc. and WPX Energy

Inc. Boosted by strong stock valuations, those producers agreed to pay top dollar to private equity for the opportunity to expand their operations in the Permian Basin, a vast region covering parts of West Texas and southern New Mexico. These producers are seeking greater access to the Permian because it is the only U.S. region where oil can be produced profitably even at lower prices—as low as $23 a barrel in the best wells of some core areas, according to industry data provider DrillingInfo Inc.

“We’ve been beneficiaries of the market being extremely hot for our Permian Basin assets,” said Post Oak Managing Director Frost Cochran. The Houston firm and Apollo last year formed Double Eagle Energy Permian LLC, which in early February agreed to sell an array of Permian assets to Parsley for around $2.8 billion.

Now, having received an infusion of capital from the exits, private equity already is doubling down on its energy bets. During the past few months, the same firms that earlier sold Permian assets have announced a series of new investments in the sector. Post Oak in February led investments of $200 million and $100 million, respectively, in Moriah Henry Partners LLC and Saxet II Minerals LLC, two Texas-based oil-and-gas producers. Pine Brook and Riverstone Holdings in early March co-led a $600 million investment to form Permian-focused Admiral Permian Resources LLC, just a week after Pine Brook closed the sale of Brigham Resources LLC to Diamondback for $2.55 billion.

Other firms are raising new energy funds. EnCap is targeting $6.5 billion for its EnCap Energy Capital Fund XI LP, according to an investor presentation reviewed by Private Equity Analyst, while Quantum plans to gather nearly $4.3 billion for Quantum Energy Partners VII LP, PEA reported in March.

Private equity’s renewed optimism about the energy sector comes amid continuing uncertainty in the industry overall. After a three-month period of relative stability, oil prices dipped again below $50 a barrel in early March, raising doubts about how far the U.S. production recovery led by the Permian can go. The big questions, experts said, are how much growth, if any, worldwide demand for oil will experience this year and what will happen to oil prices when the Organization of the Petroleum Exporting Countries' six-month agreement to cut production expires in June.

With higher land prices making it more difficult for private equity to generate attractive returns on new investments in the Permian, some firms have begun looking at other regions, from the Scoop/Stack basin in Oklahoma and the Eagle Ford shale in South Texas all the way to California.

"Private equity has clearly been rotating out of the Permian because prices has gotten very high in terms of what buyers are willing to pay," said Wil VanLoh, Quantum's founder and chief executive. He added that Quantum is present in several other U.S. basins and highlighted the recent acquisition made by one of its portfolio companies, Sentinel Peak Resources LLC, of onshore California assets from Freeport-McMoRan Inc.

In any case, the Permian Basin—with its so-called stacked plays, which enable energy companies to tap several shale zones at different depths—will still serve a critical role in private equity's energy strategy, Mr. VanLoh and executives from several other firms said. Some of the newly announced businesses, such as Admiral, are focused on the region, and many private-equity firms have kept a sizable presence there even after the recent asset sales.
If oil prices do go up, other regions will become more attractive, but then the superior economics of the Permian will generate even higher profits. If oil prices drop further, the Permian may once again become the only place to be.

"We are continuing to look at the Permian and to put capital to work there in both acquisitions and drilling," said Nick Chew, vice president on the energy investment team of Pine Brook.