PE Hub
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Adam Waterous outlines approach to investing in oil amid volatility

"During a period of very volatile prices, our investing strategy works when prices are high or when they are low," Waterous said.

Over the last five years, many private equity firms have distanced themselves from investing in traditional energ sources, such as oil, favoring more ESGfriendly sources. Now that oil supplies have been squeezed and prices are soaring in the wake of Russia's invasion of Ukraine, at PE Hub we're wondering if there will be a resurgence of PE interest in oil and gas.

We'll be talking to many sources on the topic in the coming weeks and months. We turned to Adam Waterous, CEO Waterous Energy Fund, to discuss the sector. In January, the Calgary, Canadabased firm closed its fourth fund and earlier in March its portfolio company Strathcona Resources completed its acquisitions of Caltex Resources and the Tucker thermal oil property.

Oil prices jumped to near record highs as Western nations slapped Russia, a key global supplier, with sanctions and threats to boycott its oil and gas in response to its war in Ukraine. This raised concerns in the market and triggered anxiety about global supply.

But Waterous said the extraordinary market volatility will not last for long. "There has been dislocation in distribution and of course there has been widening differentials against Russian production, but there has been no destruction of oil and gas producing facilities," he said.

"As a consequence, over a relatively short period of time, these Russian oil barrels will find customers likely in Asia and that will help to bring down prices. It can be high for a short period of time but ultimately these prices should come down."

In the long run, Waterous said the prices will rise again because Russia will be forced to cut down production, especially in the absence of Western capital and technology – a situation similar to that in Venezuela, which is under US sanctions.

Waterous claimed his value investing strategy is designed to work with extreme price fluctuations, unlike the growth equity model that other energy PE firms focus on. He said there has been a structural change in the sector that many investors misinterpreted when prices dropped to $50 and below per barrel in 2016.

The former banker described the growth investing model that some PE firms used as "broken" and not suitable for the energy sector. Instead of a growth equity model, he said that his firm "used a value investing approach, where we set up to build a single-scale operating business that has complementary assets. That is what we have done since our founding in 2017."

New investments in fossil fuels have taken a global hit over the years as countries focus on relatively cheaper clean green energy. Operating fossil fuels is capital intensive and implementation of ESG strategies may prove to be problematic for some smaller companies. Coupled with price volatility, these factors have deterred many PE firms from joining or continuing business in the energy sector.

Waterous however said he managed to grow his energy portfolio out of the value investing model which is designed to withstand extreme price volatility. "Prices are very high right now," he said. "Conversely if you look back two years ago, prices were very low. In the last two years we roughly quadrupled the size of our business." Waterous raised production from about less than 30,000 barrels per day two years ago to more than 110,000 barrels today. "During a period of very volatile prices, our investing strategy works when prices are high or when they are low."

At the time of acquisition in November last year, Caltex produced approximately 13,000 barrels of oil while Tucker, acquired in January, produced approximately 19,000.

On the ESG front, Waterous said he is investing in carbon capture and sequestration technology to address climate change concerns but noted that there must be a balance between energy sustainability and carbon emission concerns.

He said the biggest lesson from the invasion of Ukraine, especially for countries that rely heavily on Russia's oil and gas, is to invest in becoming energy self-sufficient. The dependence on Russia, he said, has emboldened Putin to wage his war against Ukraine.