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'Midstream infrastructure is better placed than ever': Prostar Capital

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[1]

The three-pronged crisis of the oil price crash, LNG glut and energy demand destruction caused by the Covid-19 pandemic has, without question, created an extremely difficult, if not terrifying, environment for many in the LNG segment – especially those involved in liquefaction. But for midstream investors and operators – not to mention end-users – low gas and LNG prices have created an unmissable opportunity for growth, Steve Bickerton and Dave Noakes, co-founders and senior managing directors of Prostar Capital, an investment firm focused on midstream infrastructure globally, tell LNG Business Review.

Bickerton and Noakes founded Prostar Capital in 2012 having previously worked together at another infrastructure investment firm. At Prostar, their role involves leading all aspects of the investment process, including origination, acquisition and management of assets. The company's current investment portfolio comprises a total enterprise value of more than USD 3 billion and generated about USD 200 million of EBITDA in 2019. Its existing investments include Eureka Midstream, a gas gathering business in the US, and Kyungnam Energy, a gas distribution business in South Korea.



[2]

“Eureka Midstream is an investment we made in 2017 alongside SK Holdings of South Korea,” explains Noakes. “When we first formed Prostar, Steve and I took the view that partnering in investments alongside large energy players like SK Holdings gave us a unique insight into where they see opportunities and want to invest – it offers us access to opportunities other investment firms might not see.”

Through Eureka Midstream, SK Holdings is, essentially, “running the world’s longest virtual pipeline, getting gas out of the ground and out of the US, via the Freeport LNG plant, to South Korea, where they have their own import terminal. It’s part of the wider plan to broaden their involvement on all levels of the supply chain,” adds Noakes.



[3]

For both Bickerton and Noakes, their prior work at investment firms during the 2008 global financial crisis means they are well aware of the challenges that can result from a significant economic downturn. That experience has proved very helpful to Prostar in building an investment portfolio with significant downside protection in the face of a negative external environment – just as the one happening now, they say.

“Notwithstanding the challenges in early 2020 of Covid-19 and a low oil price, our current assets have proven to be extremely resilient,” says Bickerton. “Because our investment philosophy is focused on midstream infrastructure, with low or no commodity exposure, these businesses have performed well, and in some cases exceptionally well, due to increased demand. For example, our storage terminal assets are expected to outperform budget and our gas assets are either on or above budget for 2020.”

Crossroads locations

According to Bickerton and Noakes, Prostar’s business development is based on the underlying premise that the continued urbanisation of the developing world will drive increasing demand oil, gas and LNG for decades to come. Off the back of this expected growth in demand, they believe that there is substantial value investing in the infrastructure needed to move this oil and gas from the wellhead to the consumer.

“We like being in that midstream space,” says Bickerton. “We are a critical link in that supply chain, which may go all the way to the wellhead, or is firmly in the midstream, like the storage terminals we own globally.”

Recently, Prostar acquired GTI Statia, a crude and refined product storage terminal on Sint Eustatius in the Caribbean with a total storage capacity of 14 million barrels (2.3 million cm). This acquisition is an example of the company’s strategy to invest in strategically positioned infrastructure in the midstream supply chain, “so that we can be largely agnostic about movements in commodity prices,” explains Noakes.

Joining supply and demand – these two pieces of the puzzle – is especially crucial in a favourable price environment for end-users.

“Historically, GTI Statia has been a break-bulk terminal for high-sulphur Middle Eastern or Latin American crudes feeding US refineries. In the future we see it perfectly positioned as a make-bulk hub for US Permian exports to Asian markets. In addition, there are multiple other trade flows and markets the terminal can serve, by virtue of its crossroads location.”

In early June, Prostar Capital announced that GTI Statia had entered a long-term partnership with Vitol, which will involve the Dutch energy trader operating the marine bunker fuel supply business at the terminal for ten years. According to Bickerton, the deal is an example of Prostar’s approach to adding value to its investments and partnering with large corporates.

“Vitol has been a customer of Prostar’s storage terminal facilities for a long time and has an unparalleled global network and extensive experience across the market. It also has the expertise to continue to provide outstanding service to the terminal’s bunker customers,” he says.

GTI Statia’s bunkering business presented Prostar with a different risk-reward profile to its core storage operations, Noakes adds. “The storage business is underpinned by long-term take-or-pay capacity lease agreements and stable and attractive operating margins. Profitability of the bunkering business is based on the ability to realise economies of scale across a global marketing and sales network.”

Offering LNG as bunker fuel at GTI Statia could be “a possibility in the longer term,” says Bickerton. “For the medium term, over the next 5-7 years, we expect that LNG bunkering will be mostly focused on large container vessels moving from and between China, South Korea and Japan to Singapore, Dubai, Rotterdam and the US West Coast.” However, as the Caribbean is not a prime area for container shipping, there is relatively low LNG bunkering demand in the region, he adds.

Furthermore, “the LNG volumes from bunkering would be too small to allow the economics to work at a facility like GTI Statia, which doesn’t have a current regas storage terminal. It makes more sense to use a current regas storage terminal and add bunkering volumes rather than build a terminal solely for the purpose of bunkering,” Noakes points out.

Regas is key

Returning on how rapid urbanisation around the world is a key driver for Prostar’s business, Bickerton notes that with it also comes a strong desire for cleaner skies, especially in highly polluted cities in Asia, which has increased demand for more environmentally friendly fuels like LNG.

“These are the markets where we see most opportunities. The question for us is: how can we be the critical link to join supply and demand – these two pieces of the puzzle together?” he asks. Answering this question is especially crucial at a time of low gas and LNG prices, which has made it a favourable environment for end-users.

“Big users, such as power plants, are taking advantage of the lower gas prices and trying to switch more generation capacity from coal-fired generation to gas-fired generation. This behaviour is expected to increase the medium to long-term demand of LNG,” says Noakes.

The natural response right now is that the energy market is terrible. But if we anticipate a period of low costs because of gas oversupply, that’s good for demand.

“Furthermore, the push for companies to switch from coal to gas coming from governments around the world, particularly in Asia and Europe, is accelerating in this low gas and LNG price environment.”

However, while the current narrative in the gas and LNG segment is, understandably, dominated by its unprecedented, negative fundamentals, the positives are being lost in the “noise”, Bickerton stresses.

“The natural response right now is that the energy market is terrible. It’s not. People are queueing up for access to our storage facilities. If we anticipate a period of low costs because of gas oversupply, that’s good for demand. The low-price environment is very good for infrastructure – we’re better placed than ever.”

For Bickerton and Noakes, regas is key in relieving the pressure the oversupplied LNG segment is facing at the moment. While the opening of new markets has slowed down in the past couple of years, they believe that more new markets can be developed, and are already in the process of being developed, around the world.

“The main push for this is two-fold,” explains Noakes. “Firstly, governments are asking for and pushing for higher usage of cleaner gas/LNG versus dirty coal. Secondly, power generators and industrial users are looking actively for more and new economical solutions whereby they would like to use more gas/LNG. These are the markets and opportunities we focus on. We believe that our experience owning and developing critical energy infrastructure globally will help unlock these markets.”

Small-scale will also play a role, Bickerton says – especially as commoditisation and the growth of spot trading leads to more LNG volumes becoming available to smaller and/or new players.

“Historically, LNG was driven by large-scale, long-term bilateral agreements that left no room for anybody else. But the oversupply and commoditisation within LNG is driving many smaller scale opportunities. For example, we looked at Kalimantan, Indonesia, where you have cities with 2-3 million inhabitants where only half of the city gets electricity at any point in time in the day. They just don’t have enough capacity. But small-scale LNG-to-power opportunities can help these cities address this issue.”

Currently, Prostar is looking at about a half dozen potential investments into import and storage terminals in key OECD markets and energy hubs. They comprise both onshore and floating storage and regasification unit (FSRU) investments, “depending on the market and opportunity,” says Noakes.

Alternative fuels

While it is hard for many LNG industry participants to be upbeat in the current environment, for Bickerton and Noakes the segment’s prospects remain positive.

“As mentioned earlier, commoditisation and the rise of a spot LNG market, coupled with the downward pressure on prices, are all part of the trend we see towards increasing medium to long-term demand for LNG,” says Bickerton.

“Whilst this presents some challenges now, this is challenging principally for upstream companies who get less for their gas. The current market also makes it difficult for liquefaction projects, which require huge upfront capital investments and therefore are not viable in this environment or, if already operating, may not run at full capacity while demand is too low.”

Given the potential size of the market opportunity, liquid hydrogen is definitely one we are following.

However, says Noakes, with the structural lower gas and LNG prices, Prostar is seeing increasing demand and utilisation rates for midstream facilities. Noakes believes that investing into such facilities “is a compelling opportunity as the current environment is asking for more, and the medium to long-term demand is also there.”

Looking further into the future, though biomethane and hydrogen are emerging new fuels that are in the very early stages of their development, Bickerton and Noakes say that Prostar is monitoring their growth as potential investment opportunities.

“We have been directly involved in biofuels for some time via our storage terminal investments, though we remain unconvinced of their long-term role in the energy mix – particularly as advancements in electronic vehicles appear to provide lower cost and more sustainable alternatives for transportation,” says Bickerton.

In the hydrogen space, Prostar is reviewing various opportunities, and considering that South Korea is

one country with strong interest in hydrogen technology, this does not come as a surprise.

“As the owner of the largest independent distributor of natural gas in South Korea, we are closely exploring the development of hydrogen fuel cell technology for power generation and its progress to industrial scale,” Noakes explains.

“Similarly, the liquid hydrogen, or LH2, industry is a very interesting and rapidly developing area of the market. Last December we saw the launch of the world’s first LH2 carrier by Japan to import hydrogen produced from Australian brown coal. And Japan has indicated a need for 900,000 tonnes/day of LH2 imports by 2030 – about 3 times current global production capacity. Given the potential size of the market opportunity, it is definitely one we are following,” Bickerton concludes. - KT



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