AS GOOD A TIME AS ANY

STM speaks to Dave Noakes, co-founder and senior managing director at Prostar Capital, to discuss how the infrastructure investor views prospects for the storage terminal market

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Dave Noakes, co-founder and senior managing director of Prostar Capital

What opportunities remain for investment in infrastructure assets, particularly in midstream markets?

Dave Noakes. Right now, we see a variety of highly attractive opportunities right across the midstream. In fact, our deal flow pipeline is as strong as it's been at any time over the last decade. Considering the infrastructure asset class as a whole, the COVID-19 pandemic has mostly affected assets that are directly tied to the global mobility of people and goods, such as airports, ports and toll roads.

Assets such as those in midstream energy infrastructure have, to a large extent, been insulated from these shocks. The primary reason for this is due to the nature of the underlying contracts and revenue models of these assets.

Storage terminals are the perfect example. Cash flows are generally underpinned by strong take-or-pay contracts with good quality customers. In addition, the service is critical to the customer's operations and is also relatively cheap as a proportion of the value of the underlying product. We at Prostar believe that this dynamic, together with strong global demand, has made this a great time to own storage terminals.

More broadly, we expect that the movement towards a lower-carbon economy will provide huge opportunity for midstream. As the world moves away from petroleum and towards cleaner natural gas and electrification, the infrastructure required to facilitate this transition will play a critical role. This will require investment in large-scale LNG import facilities, gas gathering and distribution pipelines, in addition to solar panels and wind turbines. This energy transition is central to our investment thesis over the next decade.

Our expectation is that demand will recover gradually but remain constrained by the pandemic

Who are the likely sellers? Are there many smaller independent operators left willing to sell? And, what about major players? For example, wasn't the sale by NuStar of the St Eustatius terminal prompted in large part by the specific circumstances surrounding PdVSA as the major customer and the ongoing US sanctions against the company?

The transaction we completed last year with NuStar is a great example of where we see sellers. The PdVSA issue was unrelated (the US sanctions were only announced in the final stages of the transaction). Our view is that NuStar was strategically shifting away from non-US storage assets (they had sold their European terminals a year prior) towards US, and specifically gathering infrastructure in the Permian. These strategic shifts do not arise frequently; however, we see a variety of dynamics creating similar opportunities.

At the moment we are seeing good terminals available to acquire at attractive prices that in most cases have some operational upside that a value investor like Prostar looks for. The sellers are in some cases stressed, or distressed, due to other aspects of their business, and who are looking to offload assets that are performing well.

In some cases these are traders who don't necessarily see the need to own storage terminals, and in other cases it is large corporate entities for whom these assets are non-core.

In the past couple of years we have seen terminal assets acquired at as much as 13 times EBITDA. In the current climate are such prices sustainable? Or, as you indicate, are valuations likely to be depressed over the coming years due to liquidity limitations and pricing uncertainty?

We believe valuations are largely driven by the underlying quality of the asset – and high-quality asset valuations tend to remain fairly stable across the cycle. While top-tier assets in good locations tend to maintain their value, we do see more volatility in second-tier assets and locations. In particular, second-tier assets that may have gone for high multiples 12 months ago are not seeing the same level of interest from financial investors at this point in the cycle.

I could easily point to three or four auction processes in the past six months alone that have been delayed or shelved as a result. The direction of future average asset values is hard to predict, but we remain confident that well-located, well-operated terminals will continue to be highly sought after over the medium term.

INVESTMENT PROSPECTS

Which geographic regions look particularly promising over the next couple of years?

We believe global regions that are geared towards supporting growing energy trade flows to Asia are particularly attractive. The Caribbean is a good example. Over the medium term as growing US shale production increasingly targets Asian markets, the Caribbean offers an attractive make-bulk option for those trade flows.

Similarly, Fujairah presents a highly attractive growth opportunity. Well established as a global bunkering hub, Fujairah is poised to become a major crude oil port. Having completed VLCC access, there are now several refinery projects and storage expansion projects in varying stages of development, and we expect this trend to continue.

In addition to crude oil storage, do you see particular interest in other types of storage, e.g. chemicals, LNG, NGLs, bitumen?

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We think LNG is the growth engine for the future of midstream. As global economies and particularly those of developed Asian countries trend towards a lower-carbon footprint in order to meet emissions targets, Prostar believes that LNG is the fuel that will support this transition.

Over the past decade there has been significant investment in converting refinery sites to storage? Has this segment still got legs, or do you think the prime is past?

In our experience refinery conversions are highly complex and must be undertaken with a clear view of the risks involved. Again, our view is that location is critical. Assets that are well located with respect to their customers' trade flows are well placed to provide resilient cash flows over the cycle. If a refinery conversion meets that criteria then, provided the technical challenges are addressed, past successes could be replicated.

In addition to acquiring existing facilities, what are the prospects for institutional investment in new terminal developments?

Prospects for greenfield are reasonably strong at this time, however institutional investment has tended to have a bias towards brownfield developments. Prostar believes that this will lead to a crowded buyer market, forcing up prices paid and ultimately reducing returns for these investments. This should lead to a movement back to the higher risk/reward opportunity of new terminal developments.

Prostar also sees opportunity in brownfield development of existing assets. Each of our existing assets benefits from available land for capacity expansion and we continually evaluate these opportunities alongside key customers.

Misconceptions persist that the entire energy industry is as a homogeneous sector, when in fact there is significant outperformance in some sectors of the market, including bunkering and storage. Is it not surprising that this view still seems to prevail, and that many investors fail to grasp the toll-road model of midstream energy?

We agree that the market tends to conflate 'midstream' with US oil & gas gathering infrastructure. However, this fails to recognise the difference in risk between gathering or upstream assets, and midstream assets. Assets closer to the upstream are typically based on actual throughput volume which, in turn, is dependent on market prices and production economics. In contrast midstream assets are more of a toll-road model, such as storage assets with take-or-pay lease contracts, or regulated pipeline distribution assets that provide stable, guaranteed return on capital.

Knowing when to sell is just as valuable as knowing when to buy. Do you build a solid exit strategy into your business model?

Flexibility and optionality are key when considering the exit strategy. We have built our portfolio of storage terminals under a single holding entity, called Global Terminal Investments that is one of the largest financial investor-owned storage terminal companies in

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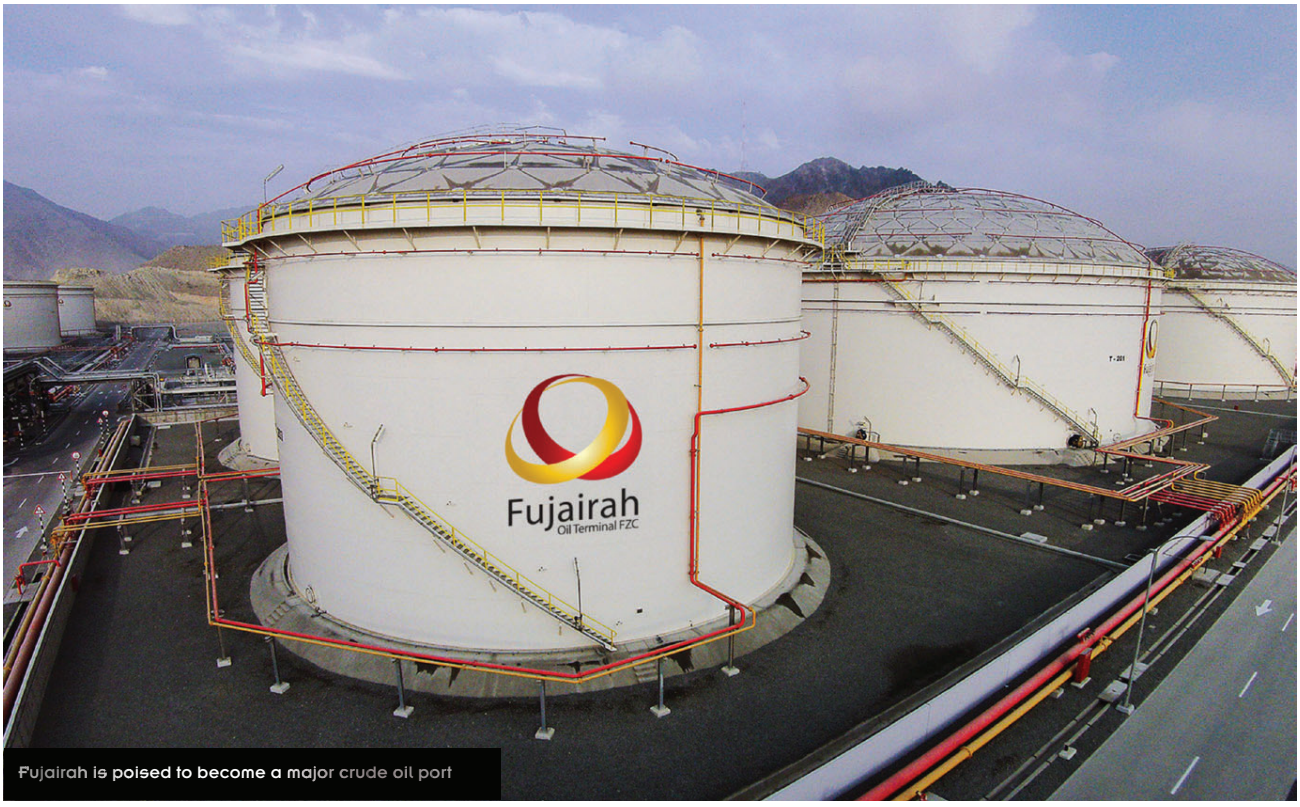

Fujairah is poised to become a major crude oil port

the world. Part of the strategy behind this approach is to provide optionality to exit the entire platform in one transaction, such as a private sale or an IPO, as well as retaining the ability to sell single assets.

MARKET STRUCTURE

Obviously no-one can tell when a contango will unwind, but with storage assets in high demand at the moment, do you have any predictions as to how the market structure might evolve over, say, the coming year.

Prostar's view is that the current themes are likely to continue. Our expectation is that demand will recover gradually but remain constrained by the pandemic, OPEC-plus will ease supply restraints in response to demand growth, and prices should remain in the US$40-50 range in the near term. We think this suggests a narrow but persistent contango for at least the first half of 2021.

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> Midstream energy infrastructure has, to a large extent, been insulated from the pandemic shock

NEW FUNDING FOR GTI STATIA

Prostar Capital recently secured US$15 million in co-investment capital from an institutional infrastructure investor, building on a previous commitment from the investor.

The funding will support ongoing efforts to expand and upgrade operations at Prostar's GTI Statia storage terminal, which the company bought from NuStar and is located on the Dutch Caribbean island of St Eustatius. As a result, the investor is acquiring a minority stake in GTIS.

Prostar believes that the capital will help accelerate the $100 million investment programme, first announced in March, to improve the GTIS facility over the next two years. The improvements planned include tank refurbishments, marine infrastructure upgrades, and other terminal improvements. Prostar believes these developments will allow GTIS to continue to operate at the highest safety standards while providing superior service for new and existing customers. Prostar and GTI Statia intend to increase the in-service capacity at the terminal to attract several new customers.

The plan aims to improve the facility's flexibility by enabling the transition to low-sulphur marine fuel as dictated by IMO 2020 regulations. The investment is also expected to increase the demand for local skilled labour and to attract a key workforce to the island in order to optimise the terminal.

"We're excited to receive this ongoing support from our investors as we embark on a shared vision to enhance the performance of GTI Statia's existing infrastructure and attract new, global long-term customers that recognise the strategic value of this terminal in the global energy trading value chain," said Steve Bickerton, senior managing director of Prostar Capital.

"This is a continuation of the capital improvement plan we put in place earlier this year," added John Roller, president and CEO of GTI Statia. "We are incredibly proud of the work we are doing with Prostar and our investors to add value to this terminal and transform it into an unparalleled facility to better serve the industry, our customers and the Statia community."

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