MIDSTREAM Monitor

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VIDEO ARTICLE

Taking Stock ... Or Not

Has debt surpassed equity as an energy investing strategy?

JOSEPH MARKMAN | HART ENERGY

Something was off.

The BlackGold Capital Management LP team was analyzing the capital structure of SemGroup Corp. (NYSE: **SEMG**) in the wake of the company's $2.1 billion deal to purchase the Houston Fuel Oil Terminal Co. from Alinda Capital.

Investors had their reservations, evidenced by the more than 20% drop in SemGroup's stock price in the two weeks following **announcement of the acquisition** June 6. But that wasn't what caught the **BlackGold** team's attention.

SemGroup's debt was yielding more than its equity, contrary to how investments typically work.

"Given that the bonds higher up in the capital structure have better asset protection, their higher yield than the common equity meant something is off and misaligned," Shalin Patel, BlackGold's director of research, told Hart Energy. "We think there is an opportunity for the bonds to move up or compress the yield, which should be the natural relationship between bonds and equities or units."

SemGroup is not an isolated case. BlackGold, based in Houston, believes that with commodity prices stuck in a lower-for-longer mode, the rapid growth the sector experienced during the shale boom won't return any time soon. Investors, they believe, should consider a shift in strategy to adjust to the times.

See **INVEST** on Page 3.

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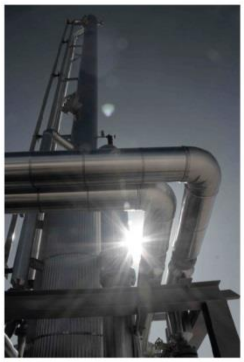 

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"Ultimately, if your viewpoint or an investor's viewpoint is that commodity prices are going to be much higher and volumes are going to be growing substantially from current levels, then you probably are going to get a better return profile from MLPs because they are equities," Sharam Honari, partner, told Hart Energy. "But I think for those investors who are looking for yields, our viewpoint would be that you're better off in terms of risk/reward total returns perspective being in the credit."

Faith In Equities

Jim Hanson, Houston-based managing director of **Duff & Phelps**, said he can see that perspective, though he still has faith in equities.

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"The nice thing about MLP debt or midstream debt in general is that you likely won't get your yield cut," he told Hart Energy. "It's fixed unless something drastic happens like a bankruptcy or a restructuring. Whereas eventually, as you continue to move into a more mature MLP that eventually needs to do something with its incentive distribution rights [IDR], you could potentially see an effective distribution cut as part of the simplification transaction."

The maturity issue has been a concern for investors in MLPs. The IDR structure at some point will hamper the ability of an MLP to grow. When that happens, Hanson said, the cost of capital for equity increases, making it difficult to make acquisitions that are accretive or attractive.

"It makes it harder to continue growth on a balanced basis by issuing equity and debt," he said. "That's one of those things that people have always known about. However, if the MLP eventually gets into those high levels of the IDR, that's one of those 'good' problems for the MLP investor because it also means that you've enjoyed a run-up in your own distribution."

To Power Islands, Sun May Be LNG's Best Friend

Plunging costs for solar photovoltaic power have lifted it to the level of an economically viable source of electricity.

For some 3,600 island nations across the globe looking for a cheaper alternative to imported oil, that's a promising development, Wood Mackenzie said in a new report, except for the inconvenience of non-daylight hours. The solution may be a combination of solar and imported LNG, the consultancy said, especially for those island nations able to handle the relatively high upfront capex.

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Wood Mac analysts focused on three solutions:

- Solar and oil;
- Solar and LNG; and
- Solar and lithium-ion (Li-ion) battery storage.

"Clearly, the economics and viability of different options depends on many factors, including market size, location, solar irradiation and the cost of capital," Wood Mac said in its report.

The analysts based their findings on the assumption of a $50 per barrel cost of oil and an upfront investment of $80 million to build a 100-megawatt (MW) combined cycle gas turbine. The LNG investment also includes a $75 million regasification infrastructure that includes a terminal with a 10,000 cubic-meter storage tank. Shipping cost is estimated at $2.50 per million Btu.

With a 74% utilization rate for the regasification plant, the levelized cost of energy (LCOE) for an island nation to **use LNG alone** would be 34% below the cost of oil in the short run, even with the expense of building the regasification infrastructure. **—JOSEPH MARKMAN** | HART ENERGY

FRAC SPREAD

NGL 'Barrel' Soars To Three-Year High

JOSEPH MARKMAN | HART ENERGY

NGL prices reached a three-year high last week, propelled by sharp rises from propane and natural gasoline.

The hypothetical NGL barrel at Mont Belvieu, Texas, recorded a spread of $5.50 as the price of natural gas slipped by 3.2% at the Houston Ship Channel and the barrel climbed to just shy of $33. The barrel's margin grew by almost 10%, led by a 24.1% expansion in the margin for ethane.

CURRENT FRAC SPREAD (CENTS/GAL)

NOVEMBER 3, 2017	Conway	Change from Start of Week	Mont Belvieu	Last Week
Ethane	16.20		26.50	
Shrink	19.20		18.80	
Margin	-3.00	65.45%	7.70	24.07%
Propane	92.27		97.78	
Shrink	26.53		25.97	
Margin	65.74	7.91%	71.81	11.70%
Normal Butane	102.18		105.18	
Shrink	30.03		29.40	
Margin	72.15	-0.92%	75.78	3.08%
Isobutane	106.08		105.50	
Shrink	28.84		28.24	
Margin	77.24	-1.26%	77.26	3.03%
Pentane+	117.30		130.62	
Shrink	32.12		31.44	
Margin	85.18	-2.50%	99.18	9.19%
NGL $/Bbl	29.79	1.65%	32.92	4.88%
Shrink	10.58		10.36	
Margin	19.21	0.93%	22.56	9.04%
Gas ($/mmBtu)	2.90	2.99%	2.84	-3.16%
Gross Bbl Margin (in cents/gal)	44.86	1.47%	53.11	9.31%
NGL Value in $/mmBtu (Basket Value)				
1.04	0.89	-3.74%	1.46	3.43%
3.12	3.20	6.45%	3.39	7.32%
1.16	1.10	0.20%	1.14	1.25%
0.69	0.66	-0.14%	0.66	1.30%
1.53	1.51	-1.05%	1.68	5.94%
7.54	7.37	2.00%	8.33	5.00%
4.61	4.48	1.37%	5.50	9.78%

Price, Shrink of 42-gal NGL barrel based on following: Ethane, 36.5%; Propane, 31.8%; Normal Butane, 11.2%; Isobutane, 6.2%; Pentane+, 14.3%, Fuel, frac, transport costs not included. Conway gas based on Midwest region, Mont Belvieu based on Houston region. Shrink is defined as Btus that are removed from natural gas through the gathering and processing operation.

Propane rose 7.3% at Mont Belvieu and 6.4% at the Conway, Kan., hub with **En*Vantage Inc.** determining "there is a real potential of breaking $1 per gallon [gal] by early November." Margins widened by 11.7% at Mont Belvieu and 7.9% at Conway.

With winter fuel demand still to come, En*Vantage did not expect a leap over the mid-90 cents/gal. The recent chill across much of the U.S. pulled prices up, with prices easing on Halloween along with temperatures. Exports, at or above the 900,000 barrel per day (bbl/d) also support the higher price and the analysts picked up on little discussion of cargo cancellations in November.

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"Overall, the propane markets are in a period where a number of demand factors are beginning to converge and we are going to find out how much the 'propane airplane' has been overbooked," En*Vantage said.

Among the factors:

- Enterprise Products Partners LP's (NYSE: **EPD**) propane dehydrogenation plant in Mont Belvieu will continue to ramp up, consuming about 30,000 to 35,000 bbl/d;
- Lower temperatures will likely push some farmers to turn to propane drying from field drying for their crops; and
- The colder weather will pit consumers needing propane as a space heating fuel against exporters.

En*Vantage is also bullish about the export outlook for butane, based on the spread between Brent and West Texas Intermediate crude oil and continuing refining issues in Mexico, Venezuela and Europe.

American Midstream Expands Eagle Ford Presence

American Midstream Partners LP (NYSE: **AMID**), betting on the expected natural gas and NGL growth from the rebounding Eagle Ford Shale, said Nov. 1 it agreed to acquire Southcross Energy Partners LP (NYSE: **SXE**) and assets from Southcross Holdings LP in two transactions totaling $815 million.

American Midstream billed the deal as a partnership and said that Southcross would add about $900 million in enterprise value to create a $3 billion company. The midstream company expects the combined company to generate annualized 2018 adjusted EBITDA of more than $300 million.

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In the next 10 years, American Midstream expects an upsurge along the Texas Gulf Coast with NGL demand up about 75% and natural gas demand growth increasing by 30%. The company cites petrochemical and industrial use, LNG export projects, exports to Mexico and global LPG demand that is anticipated to grow by about 500 billion cubic feet (Bcf) per year through 2020.

"The addition of the Southcross assets allows us to capture the full midstream value chain in the very prolific Eagle Ford basin," Lynn L. Bourdon III, American Midstream's chairman, president and CEO said. "The transaction represents a unique opportunity to expand our onshore gathering, processing and transmission services, linking supplies from the economically attractive Eagle Ford Shale to high demand growth markets along the Gulf Coast." **—DARREN BARBEE | HART ENERGY**

Capline Reversal Gauges Demand For Southbound Line

Not quite two weeks into the open season on the possible reversal of the Capline pipeline, the rationale for the move is clear. The question is whether shippers will support it.

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The answer will come by Nov. 17, when the season closes for the northbound pipeline, which currently runs from Louisiana to Illinois. Shipper support will be part of the answer to whether the long-contemplated move is a savvy and efficient redevelopment of a major asset, or just a last-ditch effort to salvage some value for a line that has seen dwindling shipments.

Marathon Pipe Line LLC, operator of the 40-inch, 1.2 million-barrel-per-day Capline, announced a non-binding open season Oct. 17 to gauge shipper interest in a proposed reversal. The plan is to flip the line and ship from Patoka, Ill. to St. James, La., and then to either Gulf Coast refineries or waterborne export markets. If the owners—Plains All American Pipeline (NYSE: **PAA**) (54%), Marathon Petroleum (33%) and BP Oil Pipeline Co. (13%)—decide to proceed, southbound flow could be operational by second-half 2022.**—GREGORY DL MORRIS | CONTRIBUTOR**

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