ENERGY INFRASTRUCTURE ROILED BY COVID-19, SUSTAINABILITY

An interview with Jamie Storrow, who co-leads infrastructure investment at Northleaf Capital Partners. Storrow discusses the steep drop in demand for fossil fuels amid the COVID crisis, the motivated selling among big energy companies, the greening of industrial activity, and the mixed future of coal.

Privcap: The COVID crisis has dramatically changed the use of energy around the world. How has that impacted the infrastructure investment opportunity?

Jamie Storrow, Northleaf Capital Partners: When we think of energy infrastructure, we are referring predominantly to midstream investments—gathering and processing for liquids and gases, pipelines, and tank storage.

What's happened with COVID is that, almost overnight in some jurisdictions, the demand for fossil fuel products has dropped extensively. That led to a commodity price war. Many investors have curtailed investing in energy infrastructure because of the significantly increased level of volatility in the energy sector. In some cases there's a reassessment of risk/return. I think we will see an acceleration of investors moving away from certain energy investments and into different types of ESG investing on the back of this very unique time.

Jamie Storrow
Managing Director
Co-Head, Infrastructure Investment Program
Northleaf Capital Partners

There was trouble in the oil and gas industry even before the COVID pandemic. The business models of many of these upstream companies were not working. Are you seeing seller motivations in the current market because of the increase in distress?

Storrow: We're probably seeing the most opportunities for new investment in the energy sector because of exactly that. Big international, multi-product energy companies might have some fixed assets that are either "non-core" or that can be sold and leased back. And so we're seeing some of these companies looking to sell pipelines, storage terminals and processing units so they can use the proceeds to de-lever their balance sheets, or in some cases they'll put the proceeds into higher returning product lines or business activities. But overall, we're seeing a lot of caution in the industry right now in the energy infrastructure sector.

What do you view as the major categories of energy infrastructure?

Storrow: Energy infrastructure is very country-specific. In the U.S.—which we view as the largest energy infrastructure market—there are substantial gathering and processing assets. These assets process gas and liquids that cover a certain acreage. Pipelines also are quite large in the U.S., as is tank storage. The market differs as you move to Canada, Western Europe, and Australia. There's gathering and processing in Canada, there's a bit

↓ CONTINUES ON NEXT PAGE

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of tank storage, but there's far less in the pipeline space with a lot of the pipelines being owned by large public companies. In Western Europe, there are pipeline and tank storage opportunities, but there's little in gathering and processing because they don't have the resource bodies that you see in the U.S. and Canada.

There's a growing trend in the energy space called electrification. What does this mean?

Storrow: Electrification from an infrastructure investment perspective is referring tomoving away from using fossil fuels for transport and industrial equipment and moving towards using renewable electricity to power these activities. For example, moving a country towards electric vehicles of various types would be electrification, with the end goal being to lower carbon emissions.

How about the trends in industrial activity?

Storrow: Industrial facilities are large users of different types of energy. Over time, converting to electric boilers and pumps, along with electric industrial vehicles will help move away from industrial fossil fuel usage.

We've also seen some industrial companies investing in renewable power to provide some direct ownership of renewable electricity. In addition, certain facilities can introduce carbon capture technology to effectively sequester carbon dioxide.

Speaking of fossil fuels, the use of coal has been in steep decline. What do you think will be the impact as coal continues to fall out of favor as a source of energy?

Storrow: The impact of the decline in coal use depends on the country, and in some cases the region, in question.

Europe has been moving away from coal for quite a while and there's relatively little coal left there—only 10-15% of electricity across the EU is generated from coal. The U.S. is catching up to Europe in this regard.

In the U.S., about 20-25% of electricity is produced by burning coal, and on a declining basis. Canada is currently less than 10%. Coal is being replaced with a mix of natural gas and renewable power. Natural gas is relatively cheap and generation equipment is well understood. Renewable technology improving and becoming more cost effective. Battery technology is catching up—it's expensive, but better understood than in the past.

But then, in parts of Asia, coal is highly prevalent. That prevalence is underpinning a lot of the global coal map. In Australia, well over half of the electricity generation is coal based, which is very different from Western Europe. That's changing, but it's expensive to change.

Setting aside the COVID crisis, what are you most excited about as a long-term investor in energy infrastructure?

Storrow: We are a mid-market manager, so we're investing in sub-billion dollar enterprise value investments, mostly in the U.S., Canada, Australia and a few European countries. We invest in processing and gathering units. We see a lot of opportunities in tank storage in part because tanks can hold a variety of products which provides future optionality.

They can hold traditional fuels but they can also hold chemicals in some cases, which are used for all sorts of industrial purposes. Tanks can hold edible oils and can move into growth products such as biofuels.

In addition, renewable power is absolutely active—renewables are not going anywhere. They're getting cheaper. They're better understood. They're getting better integrated into transmission systems. And the move to couple renewable power with batteries is progressing. Batteries are still expensive and are at an early stage, but they aren't a dream anymore, they're a reality. So renewables combined with battery storage are areas that we're going to continue to spend a lot of time in. ■