27 Oct 2014 | UK

Thomas Lane

Antin's CATS deal was de-risked and well delivered

It is no secret that competition for regulated assets amongst investors is fierce. The regulated energy transmission space is no exception. Direct institutional investors intent on acquiring these assets and wielding a lower cost of capital are pushing up prices. To match these prices infrastructure funds are having to increasingly rely on more aggressive business plans to bolster returns. For infrastructure fund managers targeting higher returns investment, opportunities in the regulated sector are few and far between. It is in this context that some infrastructure investors are turning to the unregulated midstream transmission sector for potential investment opportunities.

One investor which falls into this category is Antin Infrastructure Partners. Earlier this year the fund manager acquired a 62.77% stake in the Central Area Transmission System (CATS) in the UK's Continental Shelf (UKCS) in the North Sea from BG Group for GBP 523m including GBP 290m debt. CATS itself comprises a 404km gas pipeline and riser platform connecting over 30 North Sea gas fields to processing facilities (The CATS Terminal) in Teesside in northeast England. The asset has a capacity of 1,700 million cubic standard feet per day (MMSCFD) and is currently operating at between 50% and 75% capacity. The transmission of gas to the processing facilities constitutes the majority of CATS' income, with the processing facility accounting for just a fraction of the business' revenues.

The deal was supported by five-year acquisition financing arranged and later syndicated by RBC, giving the deal a conservative debt to equity ratio 55:45 - and the investment was made from Antin Infrastructure Partners II, which is targeting mid-to-high teen returns.

Antin appears well placed to manage an asset in the midstream energy sector given its in-house experience, not least the manager's two managing partners, Alain Rauscher and Mark Crosbie. Rauscher was former head of oil, gas and mining at BNP Paribas Corporate Finance, whilst Crosbie was director of corporate strategy, development and M&A at oil and gas giant Centrica. In addition, it is understood that Antin has hired the former manager of CATS from BG Group to continue to manage the asset, which has been in operation since 1993. Antin also has past experience in the energy midstream sector having acquired France's largest independent oil storage business Pisto SAS via its first fund in 2010. In addition, CATS is operated by BP (which is also a co-shareholder in the asset) which has extensive experience in the sector.

The risks

On the face of it, however, CATS is a risky business. It requires a high degree of expertise to manage, is exposed to volume risk and is not economically regulated. In addition, the exploration of new gas fields and their connection to the CATS requires a high degree of technical expertise to avoid potential incidents. All of these factors potentially stand in the way of Antin marking its high teen returns.

In truth, CATS' exposure to volume risk is, in fact, limited. Shippers - the developers and producers of the gas - pay a minimum tariff for access to CATS, which is contracted for the life of each field (known as send or pay contracts). These contracts provide CATS with minimum revenues over the life of each connected field.

Furthermore, if any additional volumes are shipped by the developers over a certain threshold then CATS receives additional income. These send or pay contracts provide CATS, and Antin, a certain level of income security. And, at least in the last year, CATS has operated at a solid profit producing profits of GBP 28.7m (attributable to the 62.77% stake) for the year ending 2013 on turnover of GBP 74.4m (based on the accounts of BG CATS Limited). So it would appear that Antin's income is at least protected to a certain level.

However, what about the potential risks involved in connecting new gas fields discovered in the future to the CATS? The answer here is simple: CATS does not bear this risk. Any risks involved in the connection of new gas fields to CATS will be borne by the exploration and development companies tapping the gas fields. CATS also has the capacity to keep operating whilst a new connection is being made. This avoids any outages or shortfalls in transmission capacity and any dint on revenues this might cause. In addition, CATS has an almost monopoly position for transmitting gas back onshore within its catchment area, known as the Central North Sea sector. The system is also in close proximity to a number of new fields in development, which could provide new opportunities for growth.

Growing gas volumes

But, for Antin, growing the business is paramount to it making its high return target. So, is this going to be possible?

The life expectancy of the existing gas fields connected to CATS (over 30) are not publicly available. So whilst owning CATS might come with certain income protection (in the form of send or pay contracts), it is difficult to tell how much longer volumes from these fields will last. This also raises the question of where new volumes are going to come from if Antin is going to achieve its high IRRs.

It is at this point that Antin's CATS deal becomes more complex. Ultimately Antin is taking a view that UKCS is going to continue to be developed and that additional volumes are going to come through the CATS. Whilst there are many UKCS oil and gas fields currently licensed (over 300) the new gas fields are becoming increasingly difficult to access. This has to do with the pressure and temperatures in the fields, which make the risks and costs associated with exploiting the them higher. However, technology is continually developing to counter these issues.

In addition, the costs of developing new fields has to also be juggled with gas prices. If gas prices fall too low then developers will have less incentive to tap new fields. Gas, like coal, nuclear or renewables is a primary energy source. Primary energy sources compete with one another in terms of price and are subject to the vagaries of the market. They are also impacted by political interventions and long term policy decisions. The UK government is known to be keen to push oil and gas production from the North Sea and is looking at new incentives including lower taxation to encourage development. Ultimately, Antin's buy-in to CATS is taking the view both on the UK's continued demand for gas and the UKCS as cost effective source of gas. But will the demand continue?

According to UK government statistics, the net demand for gas over the next 10 years, will remain relatively constant with a range of between 66-72 million tonnes of oil equivalent (the amount of energy produced from burning one barrel of oil) per annum. However, the UK's indigenous gas production is set to fall overall to a range of between 32-24 million tonnes of oil equivalent per annum over the same 10-year period as existing gas fields reach the end of their lives. This leaves a net deficit to be filled through imports of between 34-47 million tonnes of oil equivalent per annum over the period. So whilst domestic gas production is falling the demand will remain roughly the same. This is good news for CATS as the demand for gas will be there if new gas fields can be connected to the system.

New connections

But which projects could be connected to CATS?

It is understood that there are a number of new gas fields are being developed in the CATS catchment area in the Central North Sea. One of the fields is Culzean. The field is being developed by Danish firm Maersk Oil, with total investment for the project being GBP 3bn. Maersk is expecting to start drilling in 2016, with production from the field due to start in 2019. In addition, there is the Jackdaw gas field, again within the CATS catchment area. Jackdaw is being developed by BG Group and is one of the largest recent discoveries in the UKCS. If both fields are connected then they could result in an uptick in the volumes of gas CATS transports.

However, the extraction and production of gas from the North Sea fields is not without risk. BG Group confirmed to *InfraNews* that it has pushed back its final investment decision on the Jackdaw project to 2017. This is in order to look for a more cost effective way of accessing the field. It could take at least three years after the investment decision for BG Group to start producing gas from Jackdaw, before it is connected to CATS. Another risk for Antin is that CATS has no say over whether these projects do in fact go ahead or the time they take to execute. However, it is understood that multiple fields could be connected to CATS. So the business it is not overly reliant on one or two fields, such as Jackdaw or Culzean, to provide additional gas volumes.

Ultimately, Antin's investment has some income protection in the form of send or pay contracts, which lock in revenues for CATS over the long-term. However, the fund's investment is also reliant upon the growth of gas volumes through the connection to new gas fields. This in turn relies on the continual exploration and production of the UKCS. According to the UK's Department for Energy and Climate Change (DECC), the most significant undiscovered recoverable resources on the UKCS lay in the Central North Sea in the CATS catchment area (at an upper estimate of 337bn cubic metres). This opens up further scope for exploration in CATS' catchment area and the potential for further connections to CATS in the future. Whether Antin will make its mid-to-high teen returns from the business is unknown. However, with gas demand in the UK set to remain relatively stable and the UK government looking to maximise the recovery of oil and gas reserves from the UKCS, CATS looks like it might just be in a good position to benefit from evolving dynamics of the UK energy market.
