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Private Equity Turns Cautiously to Liquefied Natural Gas

By Luis Garcia

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Energy-focused private-equity firms have found many investment opportunities in all the main outcomes of the so-called U.S. shale revolution—including soaring production of natural gas, higher demand for pipelines and a petrochemical boom.

Now, these firms are looking to benefit from the latest impact of the shale revolution—an increase in the number of projects for exporting liquefied natural gas—even though they see challenges in the LNG sector.

Private-equity firms such as Blackstone Group LP, EIG Global Energy Partners and IFM Investors already have poured billions of dollars to help fund the construction of LNG export terminals along the Gulf Coast. Dozens more are being built or are under different stages of "preconstruction development," according to a September article published by law firm Skadden Arps Slate Meagher & Flom LLP.

The developers of those facilities plan to capitalize on a vast supply of cheap natural gas in the U.S. by liquefying and exporting more of it. They are turning to private-equity investors not only to help finance their expensive projects but to lend those projects more credibility, which makes it more likely for them to secure contracts with buyers in an increasingly competitive environment, said Skadden Partner David Armstrong, who co-wrote the article and specializes in energy-infrastructure transactions.

"There's a desire from some of the developers to get private equity, at least in name, into the project at an earlier stage," he said. "That name and that potential source of funding can help in a significant way to get better contract terms because the off-taker is more inclined to go with that project."

But some private-equity firms are reluctant to invest in LNG projects, especially at earlier stages, given the high volumes of capital they demand and the uncertainties that cloud the still-fledgling market, such as evolving pricing structures, said energy consultants and deal lawyers.

In addition, as LNG facilities proliferate in the U.S. and other countries such as Australia and Qatar, buyers are in a stronger position to negotiate contracts.

“The market has changed a lot,” said Wil VanLoh, chief executive of Houston firm Quantum Energy Partners. “Today, the global buyers for LNG are, for the most part, not willing to enter into long-term, 20-year fixed contracts. So, it’s a little more challenging to make the numbers work today.”

Still, with global demand for LNG expected to increase substantially in the coming decades, today’s investments in LNG potentially could produce attractive returns down the road. Meanwhile, private-equity firms should find opportunities to deploy capital along the entire LNG value chain, including the infrastructure needed to take gas to the liquefaction terminals.

“We’re looking at it,” Mr. VanLoh said of the sector. “It certainly is an area that will consume quite a bit of capital in the next five years, as these LNG export facilities get built out.”

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