

# FUEL

*The Global Business of Fuels*

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■ **Naphtha's Advantage**  
*Coproducts key to value*

■ **Flying on Biofuels**  
*Industry awaits commercial volumes*



# LNG *on Land and Sea*

# contents

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HARTENERGY

## >> FEATURES

### I2 TRANSPORTATION Looking for Solutions

*Momentum is building among shipowners for the use of LNG bunker fuels.*

#### Distributed LNG

*LNG fuel suppliers find exciting new markets in stationary, industrial applications.*

## Q & A

### 22 Bracing for Change

*Mansfield Oil Co. president foresees a restructuring trend occurring in the downstream energy industry, and soon.*



### 48 FINANCE & INVESTMENT Forming Chemical Bonds

*Foreign companies are making multibillion-dollar bets on the Gulf Coast petrochemical corridor, where capital investment is surging because of cheap U.S. natural gas and existing industry infrastructure.*

## >> IN EVERY ISSUE

- I Publisher's Column
- 6 Editor's Column
- 8 FUEL Facts
- 10 Public Policy
- 76 Ad Index

# 12



# Q & A **Bracing for Change**

**Mansfield Oil Co. president foresees a restructuring trend occurring in the downstream energy industry, and soon.**

**By Bryan Sims, Associate Editor**

>>> Doug Haugh knows what it takes to adapt and evolve in the ever-changing downstream energy industry.

With 20 years' experience working in the energy and technology sector, Haugh began his career with Exxon, serving in marketing and business development. Previously, as co-founder and COO of FuelQuest, Haugh created supply chain management and tax automation solutions throughout the downstream

energy industry for clients like 7-Eleven, Chevron, Ryder, UPS and Walmart.

Today, Haugh serves as president of Gainesville, Ga.-based Mansfield Oil Co., one of the largest energy supply, logistics and services enterprises, and is the driving force behind the company's sales and marketing activities, including national account sales, channel sales, new business development, corporate marketing and field sales operations.

Mansfield Oil, an \$8-billion company, is focused on partnering with clients to provide innovative, technology-based solutions to support their energy supply chain needs. From traditional petroleum products to CNG, LNG, specialty chemicals and renewable fuels, Mansfield's expertise spans nearly all channels of transportation fuels and energy services.

The firm delivers over 3.5 billion gallons (gal) of petroleum products, ethanol, biodiesel and diesel exhaust fluid (DEF) annually to customers, one full tanker truck load every minute of every day.

Mansfield built its biofuels division into a billion-dollar plus business in less than 12 months and combined it into a joint venture with Noble Group. Haugh expects to see similar results with the new DEF industry and expects it to exceed \$1 billion in net new sales over the next five years with the new product.

The company also greatly expanded its power, natural gas and CNG business in the past three years, having constructed over 200 locations for CNG fueling.



Doug Haugh, president, Mansfield Oil Co.

In fact, last summer, Mansfield teamed with Clean Energy Fuels Corp. to form a new joint venture company—called Mansfield Clean Energy Partners—to provide natural gas fueling solutions to bulk fuel haulers in the U.S., a segment that consumes over 3 billion gal of fuel annually.

Speaking with *FUEL* recently, Haugh offered insights into trends driving change in fuels distribution and marketing and portends how those ill-equipped to adapt and evolve may be left behind.

**FUEL:** You've been involved in the downstream segment of the energy industry for quite some time. What overarching trends are you seeing that might be occurring currently that may not have been foreseen, say, 10 to 15 years ago? Specifically, what factors are the driving forces behind these changes today?

**HAUGH:** I think the biggest trend is the decline in demand for our primary product: gasoline. Forecasts now show demand declining by 30 billion gal over the next 25 years or so. While other refined products like diesel and jet fuel are going to continue to grow, there will be no escaping the decline in gasoline demand. Between the doubling of fuel economy in the automotive fleet, growing evidence that electric vehicles are for real and continued blending of renewables, our industry is going to need to restructure. Gasoline is 19 gal of every 42-gal barrel [of oil] we use, so the changes will be up and down the entire supply chain from production to end use.

**FUEL:** In your view, how has the business of fuel distribution and marketing and, to a larger extent, fuel retailing changed today compared to five to 10 years ago?



**HAUGH:** Let's take the commercial and retail topics separately as they are undergoing different dynamics.

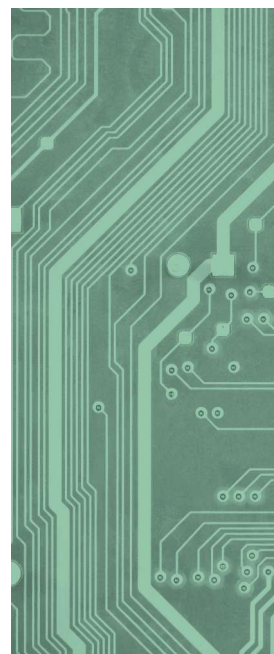
In retail gasoline we have seen the rise of high volume retailers [HVRs] continue, which we all saw even 10 years ago, but what has changed—more pronounced in past years—is that the penetration of that model has continued to increase to include many more grocery chains. What I don't think we fully appreciated, even five years ago, was the rapid growth of the private brands like Quik-Trip, Sheetz and Wawa, to name a few, that are as driven by food as they are fuel.

These players are taking a larger share from the typical branded outlet flying a major oil company brand. For every one of these locations that open the equivalent of six to seven traditional outlets needs to close. If you combine that trend with ongoing increases in grocery and HVR outlets and layer on declining demand, you quickly see that everything is going to need to change.

I believe that there will be a small group of publicly traded MLP consolidators who roll up large numbers of traditional outlets in a last-man-standing dynamic that will be driven by huge economies of scale, plentiful low-cost capital and an advantaged tax structure. You are seeing the beginnings of this now with CST [Valero Energy's convenience store spin-off], SUSP [Susser Petroleum Partners] and LGP [Lehigh Gas Partners, now known as CrossAmerica Partners] already trading well and looking

to deploy more capital each quarter so they can grow distributions to their unitholders.

There is room for a few more of these consolidators since there are



over 100,000 locations to work with, but I do not see a future with the thousands of independent distributors in the retail part of our industry like we have had in the past.

Ultimately, if we go from filling up once a week to once or twice a month, all the dynamics driving the traditional fuel-centric convenience store change. The players that feature gasoline as an important and convenient category, but not their reason to exist, will come to dominate much more completely than we see today. I think most industry leaders see this all coming, and that is one of the reasons why the pace of deal-making is going to be furious for the next five years.

On the commercial fuel side of things, meaning mainly diesel fuel, the news is much better on the demand front and the shape of that demand is also driving changes. Setting aside the other distillates for a moment and just focusing on diesel fuel, we expect demand to grow from 48 billion gal today to nearly 65 billion over the next 25 to 30 years. An important trend shaping that demand is the consolidation happening in nearly every other industry.

If you look at the largest end users of diesel fuels, most of those industries are consolidating even faster than our industry. Across every sector—waste, parcel, food, raw materials, for-hire trucking—the big are getting bigger and more spread out geographically. These same customers are becoming much more sophisticated about their fuel-buying and supply-chain strategies as they grow.

This has been a primary success factor for Mansfield. We have benefited from customers' needs becoming more dispersed geographically and their increased focus on simple, reliable and more competitive fuel supply everywhere they do business. Local relationships still matter, but when a company spends \$50 million to \$100 million a year on anything, it's going to be systematized and commoditized. Responding to those customer demands requires that our industry lower costs, improve transparency and offer supply solutions in a much broader geography.

**FUEL:** Consolidation has been a key theme in the downstream industry for many years, with an increased specialization of petroleum marketing companies coming onto the scene. Can you briefly explain why we might potentially see more of these types of enterprises, and what factors might make these types of companies more equipped than others to thrive?

**HAUGH:** When I entered the business 20 years ago with Exxon, we figured there were around 14,000 distributors in the downstream industry. We had almost 700 just for lubricants alone back then. Of course, we also had a much larger number of integrated refiners back then, all of whom needed a channel to get product to market. Exxon needed a channel, but so did Mobil; Chevron needed a channel, but also Texaco. So, much of the consolidation

that has been with us for these past 20 years was largely driven by moves and changes upstream of the distribution business. What we are seeing now is different. This wave of consolidation is about efficiency and better scale, but it is also about increased specialization.

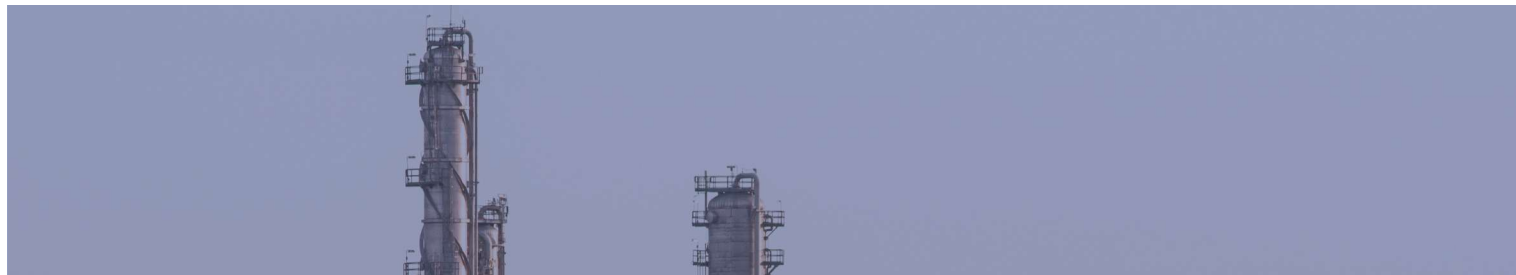
If we take the last-man-standing MLP strategy that I mentioned in retail, we see firms aggregating substantial amounts of the gasoline business in companies that are not built to service end users with a broad range of products like the traditional local distributor was in the past. We still see most distributors today offering lubricants, diesel and gasoline across every sector of demand. Essentially, anything they can reach locally they are trying to service with refined products, and many are also still trying to work in the propane and chemicals sectors as well.

I believe that in much of the U.S., this strategy “to be all things to all customers in a local market,” will be untenable. The primary reason is that gasoline has always been the lynchpin product for most of these local distribution companies; you pull that pin and the rest falls apart. There are going to be exceptions, for sure. In the West where you have isolated markets and not enough demand for any one product family to support a distribution business, then I think you'll still see successful companies offering everything a refinery produces, as well as several other products.

**FUEL:** As you know, North America is experiencing a boom in oil and natural gas thanks to advancements in hydraulic fracturing technology operating in prominent shale plays. How do you see the upstream side of the industry impacting the downstream side as more and more oil and natural gas continue to flood an already constrained refining fleet? How do you see it affecting downstream companies like Mansfield involved in the distribution and marketing of refined fuels?

**HAUGH:** There are a couple pieces to that. It's been great from a demand standpoint because they're using a lot of fuels to get the oil and gas out, so that's actually been a very positive direct impact on diesel demand. It used to be highly concentrated for just the Marcellus [Shale] and Barnett around Fort Worth, Texas, but now it's obviously all over the Dakotas, spreading to Ohio and Pennsylvania. The Rockies are forever sold out of diesel fuel.

The biggest impact it's having so far is actually on exports and not on domestic downstream. There's tremendous market share capture really in the whole Western Hemisphere. If you go down the coasts of South America like Chile, Ecuador, Peru and around to Argentina and Brazil and then up through the Caribbean, a tremendous amount of that product now is U.S.-produced refined products. As an industry, we're currently exporting between 1.2 million to 1.4 million barrels per day (bbl/d) of distillates. We're really just taking the Western Hemisphere as a U.S. market, and that's what is keeping refiner cracks healthy.



If it wasn't for that export capacity, you'd see refining cracks in the low single digits—the break-even for most refiners is about \$7 per bbl. With that said, as volumes build even

further, we are seeing investments in U.S. refining capacity. In many ways, the explosion in upstream domestically is key to growing the economy. As the economy grows, the energy demand grows for fuels out of the downstream. That gives us bigger, healthier growing customers, which is very positive.

The wild card that we don't yet know is—since the pressure hasn't come yet because exports have been so healthy—refiners have been able to remain disconnected from customers. They basically just refine the oil and get it to the head of the pipe and then they're done. Companies like us have increasingly just done the rest, as they've continued to kind of retreat into more of the manufacturing business than the marketing and distribution business.

That's the wild card we're watching: How is that going to evolve? If the market becomes so oversupplied and exports can't soak up the length of that additional supply and cracks come under significant pressure—or even if refineries have to dial back utilization—then I think you're going to see some of those guys [refiners] change their attitude and potentially reinvest in downstream because they can't be long.

Historically, as the majors divested the vast majority of their downstream assets—because they had such confidence that the U.S. market was short, we were importing crude oil and refined products—they didn't need to be in the marketing and distribution business. The market took care of it and it was efficient. They were in fact sold out every day so they never worried about knocking out a run at 100% efficiency.

Now, I don't know. That hasn't been the case now for the past two or three years, but they've turned that product to exports and captured other markets. Again,



they've been able to solve the problem in a different way. If you look at the demand balance and the ability of those export markets to continue to absorb U.S. barrels, we could be getting close, and when that happens, I think it could change.

We could be at an inflection point in those trends where now integration between the upstream and downstream industries becomes more interesting and more valuable because, in an oversupplied market, the ability to maximize every dollar on every barrel you produce through your own system all of a sudden becomes pretty important.

**FUEL:** With gasoline demand projected to fall in the coming years—due to increased corporate average fuel economy standards, more fuel-efficient powertrains, lightweighting and a healthy export market for refined fuels—how do you see other alternative fuels, like CNG, perhaps gaining more traction in the North American on-road transport market?

**HAUGH:** I think there is tremendous potential for CNG; it's just very specific. For a whole host of on-road transportation needs, it's not a perfect fit. It's not just because there is not a CNG station on every corner. Even if there was, it's not necessarily a good fit and it's because of the engines that are available right now, the fuel economy of those engines and basically the returns [or payback] potential. If you don't burn at least 10,000 gal per year per vehicle then it doesn't pay

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itself back, which isn't a compelling economic case to convert to CNG.

We're eating our own dog food here at Mansfield, so to speak. We converted our own truck fleet to CNG. We think there are big opportunities in the bulk petroleum business itself whether that's us distributing gasoline and diesel. The irony is that we're hauling gasoline and diesel around Atlanta with trucks using natural gas [CNG]. The reason for that is that our trucks burn 20,000 gal of diesel per year per truck. We can get the CNG trucks for maybe \$40,000 more. At 20,000 gal per year at \$2 cheaper than diesel that's \$40,000, which equals a one-year payback. That payback is pretty attractive.

We're building CNG stations, having launched a joint venture with Clean Energy Fuels this year. A couple of years ago, when we got into the business, we actually were building CNG fueling stations directly. We built about 50 in about 24 months, mostly for our customers, but also for retail facilities as well.

But, as we did that, we found that our core strength is in distributing commodities. We don't like necessarily "turning the wrenches." So, we sold the business to Clean Energy Fuels last summer. So, we're working hard with them on the commodity supply side, and they're working hard on the infrastructure, retailing and with us on our customers on truck configurations and lease/buying.

I also think we're seeing tremendous interest in natural gas to displace diesel fuel consumption in high-horsepower applications in oil and gas production. It's all about picking the right tool for the right situation, and we think that in the right situation, natural gas is a great answer.

I think in a number of sectors natural gas will continue to advance. I don't see it destroying a material amount of diesel demand, but it could be similar to renewables where you could see about a 5% to 10% penetration over the next 20 years. I think we can make it a nice business both in terms of using it but also supply the natural gas because our customers are increasingly starting to see it together as energy.

**FUEL: Given regulatory uncertainty with respect to the Renewable Fuel Standard [RFS-2], what is the company's general view on biofuels today compared to, say, a decade ago? Is it still a viable business?**

**HAUGH:** If you think about it, in eight years we created 1 million bbl of renewable supply. That's 1 million bbl/d we're not

importing. [The RFS] is just poor governance; not necessarily bad policy. Renewables have helped in a very material way, but I do think anything pushed to extremes can be unhelpful.

There's some value in the Renewable Identification Numbers [RINs], but those have come back to reality. And, if the EPA [Environmental Protection Agency] would run the program with some reasonable schedule, then you wouldn't see these blowouts in RIN values. It's just an unnecessary market dislocation when you have lack of transparency and no predictability.

**FUEL: What is Mansfield doing today to adapt/evolve in the downstream industry?**

**HAUGH:** I think the biggest thing is investing in technology. Surprisingly for us, because we're in distribution and marketing and not production, we're asset-light. The pipeline is a common carrier so we ship on 16 pipelines and product in 900 terminals, but we don't have to own any of it. What we do own and what we continue to invest in is technology; to just do things at greater scale, faster, cheaper, more efficiently.

We spend tens of millions of dollars per year on information technology, software development and technology development—everything from rolling out mobile apps to collaboration platforms with our transportation partners so we can take freight costs and inefficiencies out of the system.

People talk about value-added services and all this stuff that you add on to a commodity to have the customer basically pay more for it. We're the opposite. If I'm at the same price as everybody else and you get ancillary services at the commodity price for no added cost, why wouldn't you give me all of your business vs. a piece of your business? That's our strategic approach for the future.

That model is what has driven our market share in diesel and commercial gasoline. We're continuing to take costs out of the business so we can be more competitive every day, and then we're continuing to layer solutions to create value for the customer in other ways so they save costs either in accounting, environmental, reporting or commodity expenses. If we can do that consistently everywhere in the country every day, we believe we can continue to take market share for a long, long time. ■

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