MLP Quarterly Update for 1Q 2020

April 29, 2020

Price and Fundamental Performance

At the end of the first quarter, the MLP Index had a year-to-date total return of -58.12% while energy stocks were down 64.86%, oil prices were down 67.14% and the S&P was down 19.43%[1]. Since the Russia-Saudi Arabia oil price war in the beginning of March, MLP stocks significantly underperformed the market while outperforming oil prices. As of April 29, 2020, the MLP Index was down 38.37% for the year, while energy stocks were down 45.17%, oil prices were down 82.55% and the S&P closed down 8.54%.[2]

On average, MLPs reduced distributions sequentially by -5.33% weighted by market capitalization. The average sequential distribution for transportation and storage companies was -9.64%. The average sequential distribution cut for gathering and processing companies was -48.44%

The large capitalization integrated pipelines and storage companies have generally seen smaller sequential decreases, as BPMP, ET, EPD, KMI, MMP, MPLX, OKE, PSXP, SHLX and WMB maintained fourth quarter 2019 distribution levels.

Outlook

The Covid-19 pandemic has caused Midstream MLP stock prices to crash despite having relatively stable businesses, particularly relative to more impacted sectors such as airlines, hotels, and restaurants. We favor the large capitalization integrated transportation and storage companies as these companies have investment-grade credit ratings, diversified asset bases and less exposure to commodity prices relative to gathering and processing companies. We believe that the recent OPEC agreement and a gradual return to normal business activity is likely to drive oil prices higher and support MLP stock prices. We expect low gasoline prices to stimulate incremental demand in the US, resulting in reduced inventories of oil and refined products.

We continue to believe that global monetary policy will support our higher oil price view. The Federal Reserve has taken numerous actions since its March 3, 2020 meeting, where it made an emergency interest rate cut of 0.50%. On March 15, the Fed cut rates another 1.0%, taking the benchmark Fed funds rate to near zero for short-term lending. In addition, it is pursuing an extremely aggressive quantitative easing program.

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[1] Compiled using Bloomberg data as of 03/31/2020. “MLP”, “Energy stocks”, and “Oil prices” refer to the Alerian MLP Infrastructure Index (AMZI), S&P Oil and Gas Exploration and Production (XOP), and the United States Oil Fund LP (USO), respectively.
[2] S&P refers to the S&P 500 Index (SPX).
[3] Compiled with Bloomberg consensus data.
[4] 10-year Treasury data is from U.S Department of the Treasury website.
[5] Compiled with Bloomberg consensus data, Alerian.

Portfolio Strategies:

We continue to focus on investing in large capitalization integrated pipelines and storage companies. We believe these companies are best positioned to take advantage of contango opportunities in the commodity market while investing in projects supported by high quality counterparties under long-term fee-based contracts. We are less concentrated on gathering and processing companies with struggling counterparties and challenged balance sheets.

2021 EBITDA estimates for AMZI companies have only been reduced by 8% since the end of January. Estimates for E&P companies are down 45% and for more broad energy companies down 35%.[5] Relative to other energy industry segments, the midstream is showing the resilience of its businesses.

MLP stock prices have outperformed oil prices year-to-date by 44.18% but underperformed the S&P by 29.83% as of April 29, 2020. In addition, the pipeline and storage group is trading at an average yield of 10.3%, an EBITDA (cash flow) multiple of 9.8x, average dividend coverage of 1.67x and leverage of 4.3x. The gathering and processing group is trading at an average yield of 16.5%, an EBITDA (cash flow) multiple of 7.0x, average dividend coverage of 2.14x and leverage of 4.2x. In our perspective, this is deep discount pricing by historical standards.

We continue to believe that there will be significant asset sales and acquisitions of entire companies over the next year as private equity firms and strategic acquirors take advantage of these historically low valuations of midstream assets. With the 10-year treasury[4] trading at a yield near 0.60% and utilities and REITs yielding 3%[3], we believe that MLPs are dramatically undervalued and that the valuation gap will be closed as more asset sales and acquisitions of whole companies are announced over the next few quarters.

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