

NOVEMBER 11, 2022

MIDSTREAM UPDATE

NOVEMBER 2022

Consistent Cash Flow Performance

Quarterly results were strong again as third quarter 2022 earnings season saw another “beat and raise” quarter. Companies within the Model Portfolio beat earnings before interest, taxes, depreciation and amortization (EBITDA) expectations by 2.2%, weighted average, while growing EBITDA 21% year over year (Y/Y)¹. For companies that provide guidance, expectations nudged towards the high end of public forecasts, and companies generally provided a positive outlook for 2023.

Looking ahead, we don’t believe “beat and raise” is required for Midstream companies to achieve strong total returns. One of the key concerns we observed for general equities coming out of the most recent reporting season is the potential for current earnings revisions downwards, and then how far lower might they fall in 2023? Midstream has demonstrated stable and growing cash flow throughout 2022, and consensus growth expectations for the Alerian MLP Index’s (AMZ) distributable cash flow per unit/share (DCF/u) in 2023e is 5.0%. Given that AMZ’s 2022e DCF/u expectations have increased from 4.4% at the start of the year to 13.4% currently, we believe 5.0% growth for 2023e could be conservative. Or maybe put more succinctly, Midstream continues to see growth where the rest of the market’s growth is in question.

Potentially most important to us is momentum in cash returns to investors is increasing. We estimate another record quarter of repurchase activity occurred in Q3:22 totaling over \$1.4 billion. Midstream is on pace to repurchase greater than \$4 billion this year, matching the expectations laid out by Wells Fargo earlier in the year². We also saw increased distributions during the quarter. Corporate expectations are they may consider raising distributions and dividends in 2023 to more closely reflect actual cash flow growth rates seen in 2022, and expectations for cash flow growth rates in 2023.

This is also a good time to consider the total return year-to-date (YTD) and the outlook for 2023. The Alerian MLP TR Index (AMZX) was up 35.1% through November 11th, and we estimate 6–7% of the total return is from distributions. With the stability of cash flow demonstrated in 2022, and conservatively forecasted growth for 2023 as we discussed above, the AMZX 7.0% estimated yield for 2023e³ is a solid foundation for thinking about total returns in 2023. It’s also worth mentioning this yield remains well covered at greater than 2.0x, or a 50% payout ratio.

Thinking about valuation as another component of total return, the price to DCF/u for the AMZ of 5.8x remains well below historic levels. We encourage investors to continue to “look in front” regarding how much further Midstream has the potential to add to total return, rather than “look behind” from where we have come.

(1) Weighted average EBITDA growth is not a forecast of the portfolio’s future performance. EBITDA growth rate for the portfolio’s holdings does not guarantee a corresponding increase in the market value of the holding or the portfolio. (2) Wells Fargo, “Weekender: If there’s a will (for buybacks), there’s a way”, April 1, 2022. Actual share/unit repurchases may vary significantly. (3) Bloomberg, LP as of 10/31/22.

INVESTMENT TEAM

Geoffrey P. Mavar – Principal

Matthew G. Mead – Principal

Robert M.T. Walker – Principal

Bryan F. Bulawa – Principal

Paul R. Jacob – Vice President

Scott B. Warren, CFA – Senior Analyst

Luke B. Davis, CFA – Senior Analyst

Chickasaw Capital Management, LLC gives no guarantees with respect to the success of its investment management services and has not authorized any person to represent or guarantee any particular investment results. Any historical data provided herein are solely for the purpose of illustrating past performance and not as a representation or prediction that such performance could or will be achieved in the future. Securities are subject to numerous risks, including market, currency, economic, political and business risks. Investments in securities will not always be profitable, and investors may lose money, including principal. Past performance is no guarantee of future results. This is not an offer or solicitation with respect to the purchase or sale of any security.

Chickasaw Capital Management, LLC does not provide legal, tax or accounting advice. Any statement contained in this communication concerning U.S. tax matters is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties imposed on the relevant taxpayer. Clients of Chickasaw Capital Management, LLC should obtain their own independent tax advice based on their particular circumstances. Opinions expressed are current opinions as of the date appearing in this material only. No part of this material may be copied, photocopied or duplicated in any form, by any means, or redistributed without the prior written consent of Chickasaw Capital Management, LLC.

References to market or composite indices, benchmarks or other measures of relative market performance over a specified period of time (each, an “index”) are provided for your information only. Reference to this index does not imply that the portfolio will achieve returns, volatility or other results similar to the index. The composition of the index may not reflect the manner in which a portfolio is constructed in relation to expected or achieved returns, portfolio guidelines, restrictions, sectors, correlations, concentrations, volatility or tracking error targets, all of which are subject to change over time. Indices are unmanaged. The figures for the indices do not reflect the deduction of any fees or expenses which would reduce returns. Investors cannot invest directly in indices.

Alerian Weighted P/DCF



Source: Bloomberg LP, CCM

The **Alerian MLP Index** is a composite of the most prominent energy Master Limited Partnerships that provides investors with an unbiased, comprehensive benchmark for this emerging asset class. The index, which is calculated using a float-adjusted, capitalization-weighted methodology, is disseminated real-time on a price-return basis (NYSE: AMZ), and the corresponding total-return index is disseminated daily (NYSE: AMZX). Relevant data points such as dividend yield are also published daily. For index values, constituents, and announcements regarding constituent changes, please visit www.alerian.com.

“**Alerian MLP Index**”, “**Alerian MLP Total Return Index**”, “**AMZ**” and “**AMZX**” are service marks of GKD Index Partners, LLC d/b/a Alerian (“Alerian”) and their use is granted under a license from Alerian. Alerian does not guarantee the accuracy and/or completeness of the Alerian MLP Index or any data included therein and Alerian shall have no liability for any errors, omissions, interruptions or defects therein. Alerian makes no warranty, express or implied, representations or promises, as to results to be obtained by Licensee, or any other person or entity from the use of the Alerian MLP Index or any data included therein. Alerian makes no express or implied warranties, representations or promises, regarding the originality, merchantability, suitability, non-infringement, or fitness for a particular purpose or use with respect to the Alerian MLP Index or any data included therein. Without limiting any of the foregoing, in no event shall Alerian have any liability for any indirect, special, incidental, or consequential damages (including lost profits), arising out of the Alerian MLP Index or any data included therein, even if notified of the possibility of such damages.

The **Energy MLP Classification Standard (“EMCS”)** was developed by and is the exclusive property (and a service mark) of GKD Index Partners, LLC d/b/a Alerian (“Alerian”) and its use is granted under a license from Alerian. Alerian makes no warranties, express or implied, or representations with respect to such standard or classification (or the results to be obtained by the use thereof), and hereby expressly disclaims all warranties of originality, accuracy, completeness, merchantability, suitability, non-infringement, or fitness for a particular purpose with respect to any such standard or classification. No warranty is given that the standard or classification will conform to any description thereof or be free of omissions, errors, interruptions, or defects. Without limiting any of the foregoing, in no event shall Alerian have any liability for any indirect, special, incidental, or consequential damages (including lost profits), arising out of any such standard or classification, even if notified of the possibility of such damages.

This material is provided for informational and educational purposes only and should not be construed as investment advice or an offer or solicitation to buy or sell any security, product or service.

PAST PERFORMANCE DOES NOT GUARANTEE FUTURE RESULTS.

Midstream and the Energy Transition Takes Further Shape

We have been writing for nearly 18 months regarding the important role Midstream should play in the energy transition. In our last quarterly newsletter, we discussed the important announcement between EnLink Midstream LLC (ENLC, \$12.02) and Exxon Mobil Corp (XOM, \$113.04) where ENLC will convert an existing natural gas line to carbon (CO₂) transportation service with the economics being consistent with traditional tolling arrangements for natural gas transportation. With the expanded tax credits for CO₂ sequestration in the recently passed Inflation Reduction Act (IRA) increasing from \$50/ton to \$75/ton, we believe this will stimulate more commercial agreements and companies may give more concrete terms that will allow investors to factor this with greater certainty into the models and valuation frameworks.

There were two such “soft” announcements made to this effect during quarterly earnings calls. Targa Resources Corp (TRGP, \$72.64) mentioned they are seeking permits that would allow them to start receiving tax credits beginning in Q423 at certain of their processing plants in West Texas. Also, Williams Companies Inc (WMB, \$34.08) announced their Louisiana Energy Gateway (LEG) pipeline will be able to transport carbon and natural gas in one stream that can be separated at the end of the pipeline. From there, high quality natural gas will be delivered for liquefied natural gas (LNG) export, and the carbon will be sequestered. The increased economics, the new and existing assets, and the industrial knowhow are just now beginning to come into play, showing the important role Midstream could play in the energy transition. We believe this is the “tip of the iceberg”.

Geoffrey Mavar

Matt Mead

Robert Walker

Bryan Bulawa

Distributable Cash Flow (DCF) is calculated as net income plus depreciation and other noncash items, less maintenance capital expenditure requirements. DCF data are CCM-calculated consensus of Wall Street estimates.

Distributions are quarterly payments, similar to dividends, made to Limited Partner (LP) and General Partner (GP) investors. These amounts are set by the GP and are supported by an MLP’s operating cash flows.

Free Cash Flow (FCF) is a measure of financial performance calculated as operating cash flow minus capital expenditures.

EBITDA is earnings before interest, taxes, depreciation and amortization.

Growth CapEx or Growth Capital Expenditures refers to the aggregate of all capital expenditures undertaken to further growth prospects and/or expand operations and excludes any maintenance and regulatory capital expenditures.

West Texas Intermediate (WTI), also known as Texas light sweet, is a grade of crude oil used as a benchmark in oil pricing. This grade is described as light because of its relatively low density, and sweet because of its low sulfur content. It is the underlying commodity of Chicago Mercantile Exchange’s oil futures contracts.

Yield refers to the cash dividend or distribution divided by the unit price at a particular point in time.