Chickasaw Capital Management

NOVEMBER 11, 2022

MIDSTREAM UPDATE

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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 year[2]. 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 2023e[3] 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

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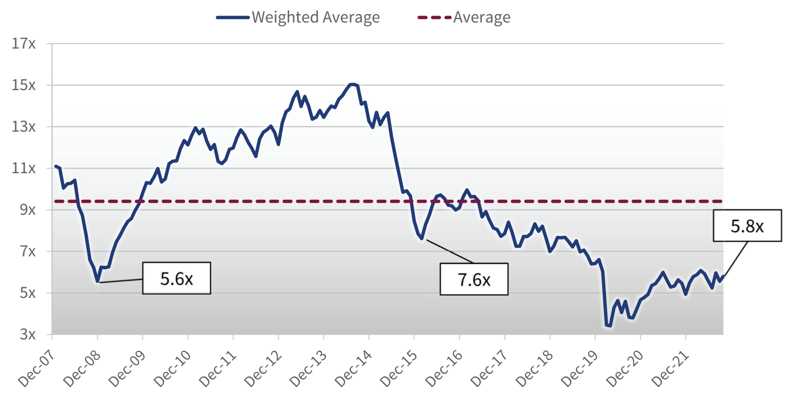
Alerian Weighted P/DCF



Average = 9.4x | Current = 5.8x | Minimum = 3.4x

Source: Bloomberg LP, CCM

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 (CO_2) transportation service with the economics being consistent with traditional tolling arrangements for natural gas transportation. With the expanded tax credits for CO_2 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.