

# Escaping Valuation Purgatory

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## Executive Summary

Reflecting on the market for midstream infrastructure equities, the following are our key takeaways:

- **Exceptional MLP returns in spite of investor indifference**
- **MLPs have quietly joined the ESG conversation**
- **MLPs are ripe for a valuation upgrade**

Today's midstream infrastructure equities, many of them based in the MLP corporate structure, are nearing their fourth anniversary of exceptional total return performance. Over this period, they have trounced both public equity and fixed income performance. Paradoxically, they attract little investor interest. MLP's relationship to carbon forms of energy in a world of ESG popularity partly explains this lack of interest, and the industry's lack of capital discipline in the 2015 to 2019 period.

Recent underwhelming stock market investment returns for wind and solar investments, combined with the growing realization that no matter how rapid the transition to green energy becomes, carbon-based energy sources are likely to be essential to global economies for decades to come. Surprisingly to some, midstream energy infrastructure companies have become an important part of the energy transition as they bring their core competencies of transport and storage to carbon capture initiatives.

A large swath of investors are at a Hobson's choice moment<sup>1</sup>.

Carbon-based energy companies are going to exist and grow for years if not decades to come as global energy demand cannot be sated exclusively by green sources. Midstream energy infrastructure will benefit from these long-term tailwinds and will further benefit from their new role of providing transport and storage solutions for carbon capture and sequestration. We believe the future for midstream energy infrastructure is bright. Valuations and growth prospects are about to be recognized by new investor entrants who have been unwittingly boycotting the sector. The nine-year odyssey of midstream infrastructure (MLPs) is captured by the tables below.

<b>Three Important Moments in Time</b>			
	12/31/14 "Peak Times"	3/27/20 "The Brutal Button"	11/10/23 "The Skeptical Present"
<b>Median Yields</b>	7.2%	24.7%	6.9%
<b>Median EV/EBITDA</b>	12.2x	7.1x	8.8x
<b>Estimated Distribution Growth</b>	7.7%	0.0%	4.5%
<b>Distribution Coverage</b>	1.1x	1.5x	1.9x
<b>Debt/EBITDA</b>	3.7x	4.4x	3.6x
<b>Fee Based Cash Flow (%)</b>	87%	98%	92%
<b>43 Months of Exceptional Returns (3/31/20-10/31/23)</b>			
	<b>MLPs<sup>2</sup></b>	270.78%	
	<b>S&amp;P 500</b>	71.80%	
	<b>Bonds<sup>3</sup></b>	-13.20%	

In conclusion, the bull market in MLPs has been driven by distributions, EBITDA growth, and share repurchases. Valuation expansion has been very modest. We say modest as it's barely off the bottom and inadequately reflects the distinct improvements in balance sheets, distribution coverage, and distribution growth prospects.

<sup>1</sup> The necessity of accepting an objectionable alternative.

<sup>2</sup> Alerian Total Return Index (MLPs)

<sup>3</sup> Bloomberg Aggregate Index (Bonds)



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