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Investing in MLPs - Dispelling Common Myths

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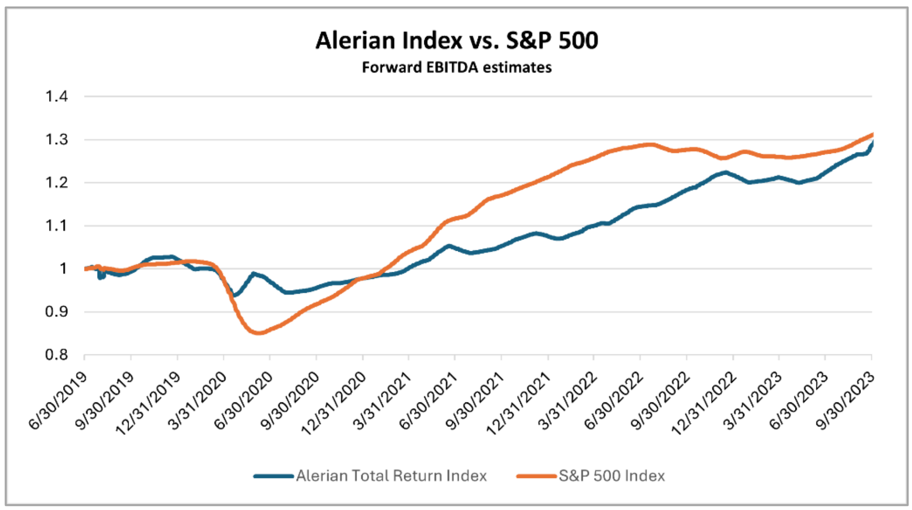
Master Limited Partnerships (MLPs) have long been subject to various myths and misconceptions that may deter investors from exploring this asset class. In this paper, we will delve into five prevalent myths surrounding MLP investing and provide evidence to debunk these misconceptions.

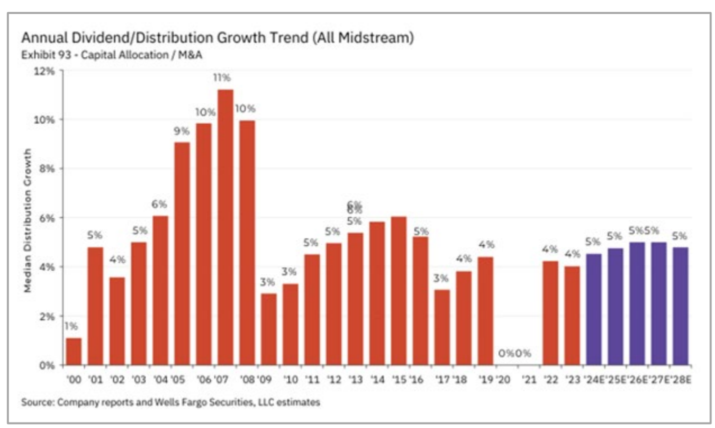
Myth 1 - MLPs Are Too Commodity Sensitive

One of the primary concerns investors often express about MLPs is their perceived vulnerability to commodity price fluctuations, particularly in oil and gas. However, historical data shows that oil and gas prices have a low correlation, indicating that the performance of MLPs is not solely dependent on these commodities. Moreover, MLPs have demonstrated resilient EBITDA growth even during periods of extreme commodity price volatility, as evidenced by their performance in 2020. Despite a dramatic decline in economic activity and falling oil prices, the cash flow for the Alerian Total Return Index went down less than the S&P 500, as seen in the chart to the right. This strong cash flow helped drive the Alerian Index up 88.61%, outperforming the S&P 500 return of 74.23% since the end of 2019 (before COVID-19) through the end of the first quarter of 2024. Additionally, MLPs usually operate on long-term, contracted fee-based revenues with inflation accelerators, which effectively mitigates direct commodity price risks.



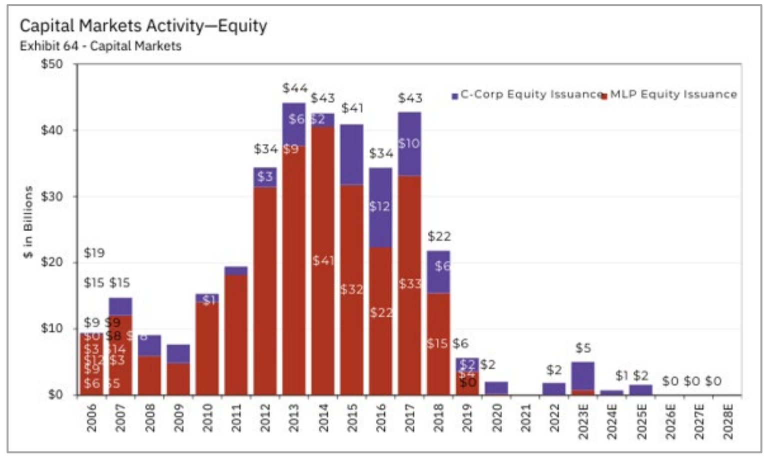
Myth 2 - MLP Distributions Are Fragile

Contrary to the myth, MLP distributions are not inherently fragile. The presence of durable long-term, contracted fee-based revenue streams strengthens the sustainability of distributions. Furthermore, near-record cash flow coverage of distributions, historically strong balance sheets and internal financing of equity capital needs contribute to the robustness of MLP distributions. Forecasted dividend/distribution growth of 5% per annum over the next five years reflects confidence in the stability of these payouts.



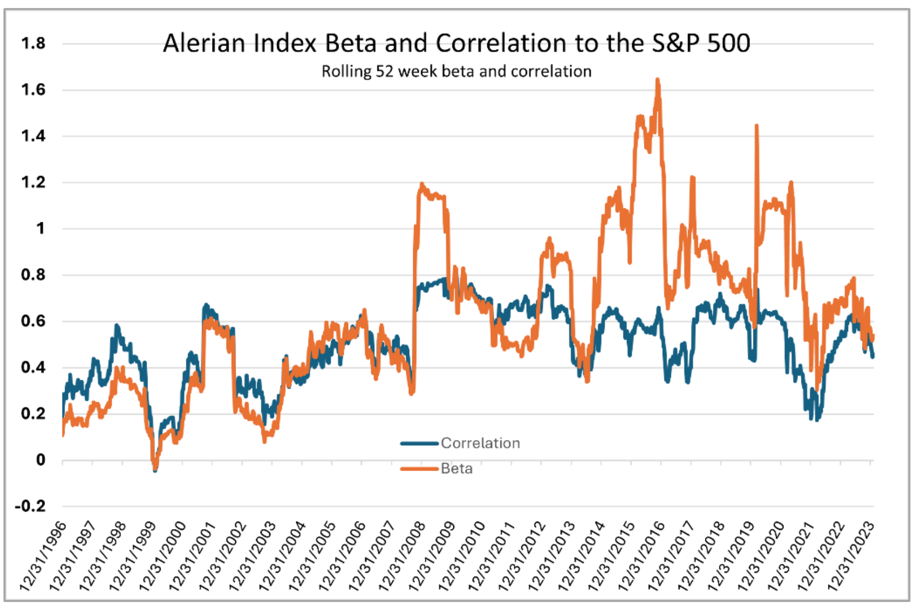
Myth 3 - MLPs Are Capital Market Dependent

While MLPs may have been perceived as reliant on capital markets in the past, recent trends indicate a shift towards self-financing equity capital needs. Total MLP capital expenditures have significantly decreased and there is strong demand for bond issuance at attractive rates. The median cost of debt capital for MLPs is currently at a historically low level of 5.8%. Lastly, equity issuance has dropped close to zero as companies are more likely to buy back stock than issue new equity.



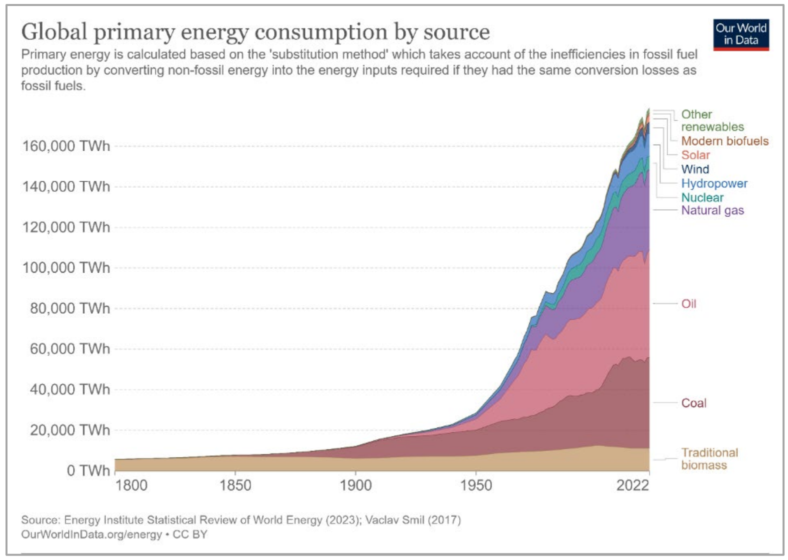
Myth 4 - MLPs Are Too Volatile

Volatility (relative to the S&P 500) is another concern often associated with MLP investments. However, data shows that both absolute and relative MLP stock price volatility have declined significantly in recent years to its long- term normal range, as seen in the chart. This can be attributed to renewed investor understanding of the long-term, contracted fee-based revenue model, as well as capital discipline within the industry. Additionally, MLPs have focused on high-grading capital investments, prioritizing dividend growth and deleveraging balance sheets which have contributed to reduced business financial risk.



Myth 5 - MLPs Face Terminal Value Risk Due To Energy Transition

With the global shift towards alternative energy sources, some investors worry about the prospects of carbon-based energy-related assets such as MLPs. However, the reality is that carbon-based energy demand, including coal, continues to grow despite efforts towards energy transition as seen in the chart to the right. Strong and growing demand for natural gas, particularly in electricity generation, positions MLPs favorably for the long-term. As MLPs primarily engage in natural gas transport, storage, processing, and export activities, they are well-aligned with the evolving energy landscape. Additionally, increased incentives for Carbon Capture, Utilization and Sequestration (CCUS) creates another market opportunity for the world to move towards cleaner use of hydrocarbons.



Wrapping up the Myths

In conclusion, MLPs defy common myths with their resilient business models, stable distributions, reduced capital market dependency, decreased volatility, and alignment with evolving energy demands. While MLPs have been inexistence for over 20 years, a period of high capital deployment created some of these myths. A new era of more disciplined capital deployment has the market returning to this industry and driving strong returns. As always, thorough research and a long-term perspective are key when considering MLP investments.

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