Midstream/MLP Earnings So Far: M&A, Dividends, Buyback & ESG

November 3, 2020

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Summary

- Midstream companies have largely been positive on upstream consolidations as the combined entities result in stronger customers, but management commentary on midstream consolidation has varied.
- As of the end of October, 34 of the 39 dividend-paying names in the Alerian Midstream Energy Index (AMNA) have declared their 3Q payouts, with 29 maintaining, 3 growing, and 2 cutting sequentially.
- Discussion of the energy transition and opportunities in renewables have shifted from the Q&A portion of 2Q20 calls to the prepared remarks for 3Q20.

Despite broader market headwinds and oil price weakness weighing on recent performance, midstream earnings season has been mostly positive thus far with only a few negative headlines, namely in the form of two MLP distribution cuts. Results have largely exceeded consensus expectations. Aside from operational updates, performance during the quarter, and comments on recovering demand and production trends, company earnings calls have typically included discussions of consolidation and opportunities around renewables and the energy transition. Capital allocation has also been in focus, including the high hurdle rates for investing growth capital in the current environment and thoughts around returning excess cash to shareholders for those not needing to reduce leverage. This note highlights some of the key takeaways from earnings calls and summarizes distribution/dividend announcements so far.

Consolidation: Does upstream merger mania have readthrough for midstream?

An M&A frenzy has been underway lately for upstream companies, with a laundry list of deals announced recently – Canadian companies Cenovus (CVE) and Husky (HSE CN), ConocoPhillips (COP) and Concho (CXO), Pioneer (PXD) and Parsley Energy (PE), Devon (DVN) and WPX Energy (WPX), as well as the Chevron (CVX) acquisition of Noble Energy announced earlier. What do upstream mergers imply for midstream, and will the consolidation wave reach the midstream space?

Midstream management teams have largely been positive on upstream consolidations as the combined entities result in stronger customers with better financial positioning. Kinder Morgan (KMI) noted on their call that acquirers are not overpaying, which is positive for the forward outlook of the combined companies. Crestwood Equity Partners (CEQP) was particularly positive on the DVN/WPX and COP/CXO combinations within its customer base.

When asked about whether consolidation could reach midstream, commentary was more varied. The Chairman and CEO of Magellan Midstream Partners (MMP) pointed out that he does not anticipate any correlation between upstream consolidation and midstream consolidation, noting that midstream consolidation would likely have a slower pace. He noted that midstream may not see meaningful consolidation at all. CEQP's management acknowledged that consolidation in midstream makes sense over time and could lead to healthier companies. Management of Phillips 66 Partners (PSXP) believes consolidation is needed in midstream, noting bigger is better for scale and commercial efficiencies, and they saw midstream consolidation as likely. ONEOK (OKE) alluded to long-running expectations for consolidation, which has not materialized to this point. For Enterprise Products Partners (EPD), their size and footprint would limit their ability to consolidate given potential antitrust issues with any transaction per management. A repeated comment on multiple calls was that a strong balance sheet would be required of any acquisition target.

Buybacks in focus.

With midstream yields elevated and free cash flow generation gaining traction (read more), buybacks have been a common topic on earnings calls, particularly for those midstream companies with existing repurchase authorizations. In its 3Q release, KMI notably omitted past commentary around targeting a $1.25 per share dividend and instead mentioned dividend increases and/or share buybacks. Management explained on the call that they are looking at the best way to return excess cash to investors and want to retain flexibility. EPD's management noted the compelling return on buybacks in the current environment, and the partnership has repurchased $174 million or 8.3 million units this year. This represents roughly 4% of cash flow from operations (CFFO) so far this year or a doubling from initial plans to spend 2% of CFFO on buyback. Magellan Midstream Partners (MMP) repurchased 1.4 million units for $50 million in 3Q20, bringing 2020 repurchases to 5.0 million units for $252 million. Finally, MPLX (MPLX) announced the authorization of a $1 billion unit repurchase program alongside its 3Q20 earnings report, joining the handful of other midstream companies with buyback programs in place.

3Q distributions and dividends so far.

As of October 30, of the 39 dividend-paying names in the Alerian Midstream Energy Index (AMNA), 34 have declared their 3Q payouts, which will be paid in 4Q. Of those, 29 have maintained, 3 have grown, and 2 names have cut their distributions sequentially. Energy Transfer (ET) announced a 50% distribution cut on October 26, and NGL Energy Partners (NGL) also announced a further 50% distribution cut, having previously cut in April. Stay tuned for our comprehensive 3Q dividend and distribution recap in the coming weeks once all constituents have announced their payouts.

The energy transition and renewables garner more discussion.

The energy transition, renewables, and ESG-related commentary were commonly discussed on 2Q20 earnings calls, but for 3Q calls, there has been a noticeable difference. Instead of being a one-off in the Q&A segment, the discussion of the energy transition (or evolution) and renewables has largely shifted to management's prepared remarks. Most management teams have highlighted the long-term need for fossil fuels and the critical role midstream assets play in facilitating our everyday lives. (Please see our recent white paper on the energy transition for more on this topic.) However, there has also been commentary around opportunities related to renewables (transporting hydrogen, carbon capture, etc.) and examples provided of current renewables exposure in the power mix as companies work to lower emissions. As discussed in the past, ESG continues to gain traction in midstream, with MMP issuing its first sustainability report last week and ET releasing its first Community Engagement Report.

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