



# What's Working for Midstream/MLPs, and Can It Continue?

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## Summary

- Recent commodity price improvement has not been limited to oil as liquefied natural gas (LNG) and natural gas liquids (NGLs) have also seen significant gains.
- Aside from commodity price improvements, the reflation trade has also provided a boost to energy and supported interest and money flows into the sector.
- The recent strong gains across energy have some investors wondering if they have missed the rally, but for midstream, there seems to be plenty of potential upside.

Since November, things have started to look up for energy, including midstream, as oil prices have gained over 40% initially on positive vaccine news and more recently on the heels of the announcement of further production cuts by Saudi Arabia with some help from dollar weakness as well. Recent commodity price improvement has not been limited to oil as liquefied natural gas (LNG) and natural gas liquids (NGLs) have also seen significant gains. From an equity perspective, a growing reflation trade following the Georgia election results has also benefitted energy, including midstream. Today's note discusses the recent strength in midstream and the reasons why the current upward momentum could continue.

## What's Worked for Energy and Midstream/MLPs?

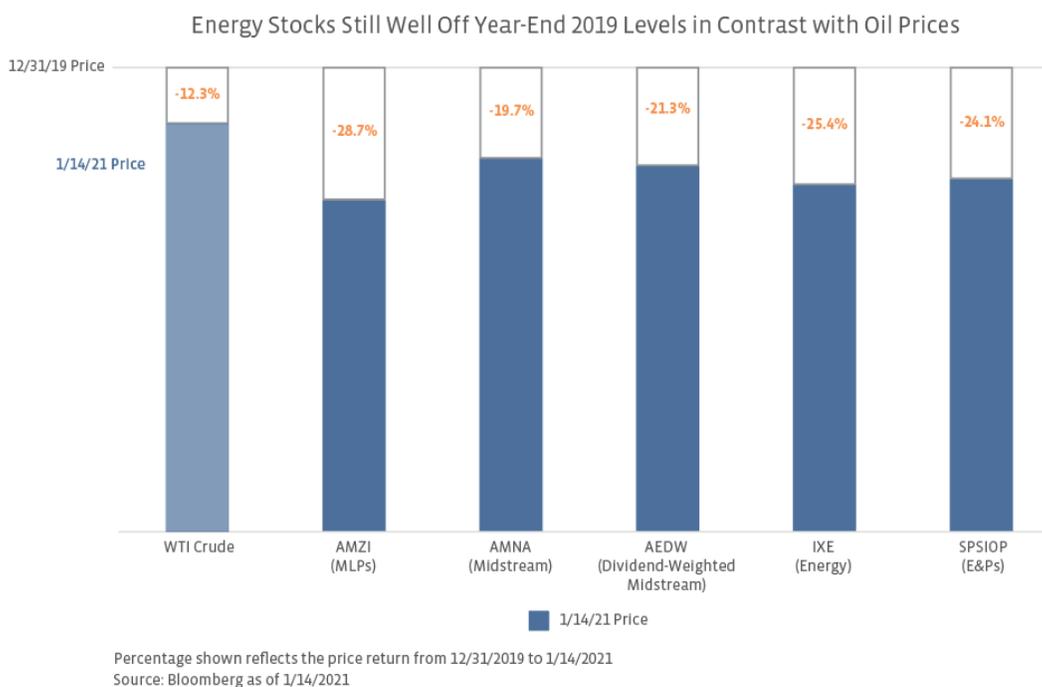
Even though midstream is unique from the rest of energy in its fee-based business model and more stable cash flows, oil prices tend to drive sentiment across the energy space. The recovery in oil prices has been constructive for the sector, but gains in other hydrocarbons have also contributed to the buzz around energy. LNG prices in Asia reached a record high earlier this month on cold weather, lower supply from outages, and shipping bottlenecks at the Panama Canal. In Europe, the Dutch price marker for LNG reached three-year highs. [Cheniere](#) (LNG) has gained 19.4% through January 14 since the November 19 relative low seen in global LNG prices. Closer to home, the NGL basket price at Mont Belvieu has gained 48.4% from December 8 to January 14, with outsized gains in propane (+66.9%) driven by seasonality and solid export demand as cold weather has driven heightened heating demand in Asia. Gathering and processing names, which process natural gas and NGLs and tend to have greater commodity price sensitivity due to their proximity to the wellhead, have outperformed the [Alerian Midstream Energy Index](#) (AMNA) by 400 basis points over that timeframe.

Aside from commodity price improvements, the reflation trade has also provided a boost to energy and supported [inflows](#). The outcome of the Georgia run-off results has paved the way for hefty stimulus spending from the incoming Biden administration and raised concerns around inflation. As highlighted in our [real assets](#) white paper, oil prices tend to do well during periods of inflation and benefit from dollar weakness. As also noted in the piece, midstream contracts often include provisions for inflation providing added protection in an inflationary environment. Finally, years of underperformance have left energy deeply discounted with value rotation poised to provide another potential tailwind.

All in all, from November 1, 2020 through January 14, 2021 on a price-return basis, AMNA and the [Alerian MLP Infrastructure Index](#) (AMZI) are up 34.8% and 45.8%, respectively, compared to oil price gains of 49.7% and gains in broader energy of 55.4%, as represented by the [Energy Select Sector Index](#) (IXE). While the percentages sound high, keep in mind that these gains are off a low base. For midstream, particularly AMNA, muted gains should be put in the context of resilient performance amid the challenging market environment of 2020, as shown in the next section.

## Why Can Midstream/MLPs Keep Working for Investors?

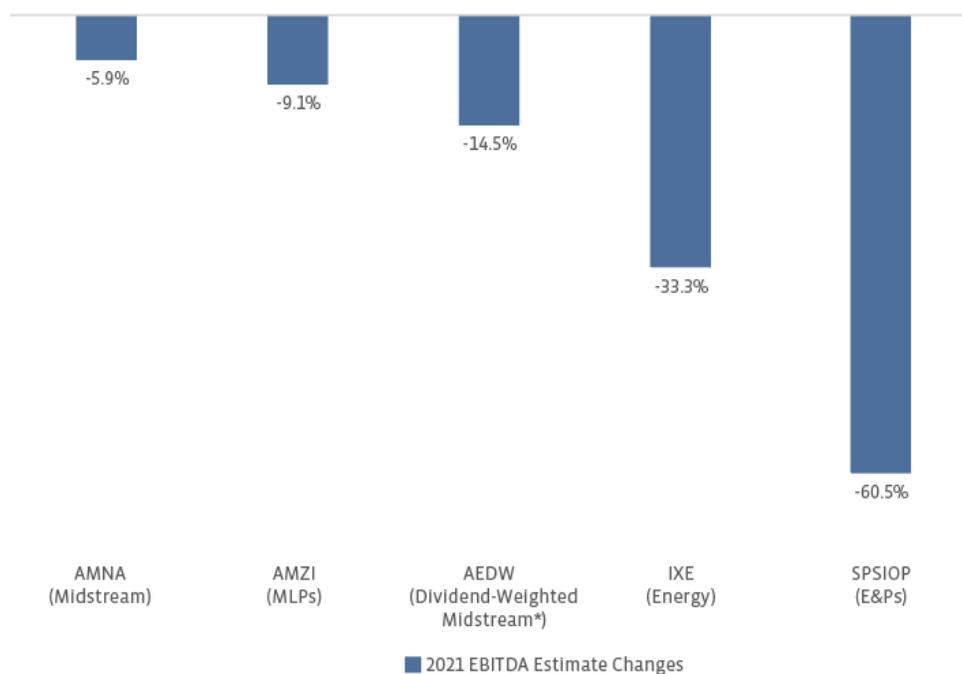
The recent strong gains across energy have some investors wondering if they have missed the rally or if it is too late to go shopping for energy stocks. For energy and midstream, there seems to be plenty of potential upside, though the focus of this note is primarily midstream. As shown in the chart below, oil prices have recovered to levels not far from their price at year-end 2019. However, relative to oil's recovery, the rest of energy is lagging and trading approximately 20% or more below year-end 2019 prices. MLPs stand out for a greater price decline from year-end 2019 compared to broader energy and exploration and production (E&P) companies. MLPs were particularly impacted by closed-end fund deleveraging in March 2020 as forced selling exacerbated pressure in the space, resulting in more ground to make up in a recovery. Meanwhile, AMNA benefitted from the defensive performance of Canadian names included in the index and was the most resilient of the indexes below.



As shown in the chart on the following page, 2021 EBITDA estimates for midstream have fallen modestly over the last year, particularly relative to significant negative revisions for broader energy and E&Ps. Despite resilient estimates, the space has largely traded in line with the broader sector. Given steady EBITDA estimates and lower equity prices, midstream is trading at noticeable discounts to history. As of January 14, the AMZI was trading 1.3 turns below its five-year average on a forward EV/EBITDA basis using 2022 estimates, while the [Alerian Midstream Energy Select Index \(AMEI\)](#) was trading 1.4 turns below its five-year average.<sup>1</sup>

1// The AMEI Index is used here instead of AMNA or AEDW given the greater index history for AMEI.

## Midstream and MLP 2021 EBITDA Estimates Resilient Over the Last Year



\* AEDW reflects available data from 1/27/20 to 1/14/21.

Data reflects the percentage change in 2021 index-level EBITDA estimates from 1/14/20 to 1/14/21. Estimates from 1/14/20 used for comparison were based on estimates for index constituents at that time.

Source: Alerian, Bloomberg as of 1/15/21

Relative to the rest of energy, the price gains for oil have little direct tangible benefit for midstream at this point. Of course, higher oil prices make for stronger producer customers and improve overall energy sentiment, but oil prices have yet to sustain a price level to incentivize US production growth, which would have more meaningful implications for midstream. As discussed in the past, midstream is a volume-driven business, but in practice, oil prices and sentiment have tended to dominate midstream equity performance – not US production volumes ([read more](#)). Acknowledging that US producers are likely to be more disciplined going forward, WTI crude likely needs to sustain \$55-60 per barrel or higher to incentivize production growth. All this to say, continued oil price improvement could have more direct benefits for midstream than the gains seen so far.

Finally, midstream has several tailwinds in this energy recovery that were not in place in the past. Midstream stands to generate meaningful free cash flow this year, which can be used to reduce leverage or return capital to shareholders. To that end, more than 50% of AMNA by weighting and more than 60% of the AMZI by weighting have buyback authorizations in place ([learn more](#)). These tailwinds could help enhance the benefits from an ongoing reflation trade or continued improvements in oil prices.

*AMZI is the underlying index for the Alerian MLP ETF (AMLP) and the ETRACS Alerian MLP Infrastructure Index ETN Series B (MLPB). AEDW is the underlying index for the ETRACS Alerian Midstream Energy High Dividend Index ETN (AMND) and the Alerian Midstream Energy Dividend UCITS ETF (MMLP). AMNA serves as the underlying index for the ETRACS Alerian Midstream Energy Index ETN (AMNA). AMEI is the underlying index for the Alerian Energy Infrastructure ETF (ENFR).*

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