Midstream/MLPs Reap Benefits from Selective Divestures

June 15, 2021

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Summary

- The Midstream/MLP space is leveraging a favorable energy environment to selectively divest assets with a view to improving financial flexibility, enhancing shareholder returns, and advancing long-term objectives.
- A more stable macro environment has paved the way for additional private equity involvement in midstream following the handful of transactions that took place earlier in the year, adding confidence to the multi-year outlook.
- Numerous midstream names are rationalizing their asset portfolios to focus on core fee-based midstream activities that generate sustainable cash flows and provide insulation from commodity price volatility.

Midstream MLPs and corporations are leveraging a markedly improved energy environment to sell non-core assets at attractive valuations, optimizing their asset portfolios to advance strategic initiatives while increasing their financial flexibility to pay down debt and enhance shareholder returns.

Midstream MLPs and corporations benefit from M&A

As the midstream/MLP space increasingly shifts to disciplined capital spending focused on free cash flow and sustainable returns, midstream MLPs and corporations are selectively rationalizing their asset portfolios through divestitures to help achieve their strategic objectives. For some names, the intent has been to take advantage of a favorable energy environment to increase financial flexibility and minimize risks by exiting non-core activities or business ventures.

Early this month Crestwood Equity Partners (CEQP) and Consolidated Edison (ED) announced the sale of Stagecoach Gas Services to Kinder Morgan (KMI) for $1.225 billion. The sale price represents a multiple of 10.0x 2020 EBITDA and 11.0x on 2021 estimated EBITDA based on CEQP's projections from April, which results in a premium relative to valuations across the Natural Gas Pipeline Transportation subsectors. For context, at the end of May, the equally-weighted average EV/EBITDA multiples for the Pipeline Transportation | Natural Gas sector of the Alerian MLP Infrastructure Index (AMZI) and Alerian Midstream Energy Select Index (AMEI) represented 8.8x and 10.2x multiple to 2022 EBITDA, respectively. CEQP intends to use proceeds to pay down debt—accelerating the MLP's plan to de-lever in 2021—and use free cash flow to opportunistically buyback shares under its current authorization of $175 million.

While the divestiture proved favorable from a seller perspective, it was also beneficial for KMI, particularly from a strategic perspective. From a purchase price perspective, the acquisition represented a largely neutral valuation for KMI, which was trading at 11x on 2022 EBITDA at the end of May. In addition, KMI is financially well-equipped to absorb the cost of the acquisition following a very strong 1Q21 set apart by a $1 billion EBITDA beat relative to consensus expectations. Notably, the Stagecoach assets will allow KMI to expand its vast natural gas footprint, and given the strategic fit with KMI's existing infrastructure, management believes they can extract synergies to drive the multiple to high-single digit levels.

Private equity activity picks up in 2021

Historically, private equity deals have served as a catalyst for the space, providing important valuation markers and validation for the multi-year outlook for the midstream business model. As previously noted (read more here), private equity involvement resurfaced early in the year when KMI and Brookfield Infrastructure Partners (BIP) announced in February that they had agreed to sell a 25% minority interest in Natural Gas Pipeline Company of America to ArcLight Capital Partners for $830 million. The stake sold at a multiple of 11.2x to 2020 EBITDA. Additionally, in April, Sempra Energy (SRE) announced the sale of its 20% interest in Sempra Infrastructure Partners to KKR for $3.37billion.

A more stable macro environment has paved the way for additional private equity involvement following the handful of transactions that took place earlier in the year. On June 7th Macquarie infrastructure Corporation (MIC) announced it had agreed to sell its Atlantic Aviation business to KKR for $4.5 billion. Roughly $3.3 billion of the sale proceeds will be available for distribution to unitholders. One day later, Plains All American (PAA) announced on June 8th it had agreed to divest its Pine Prairie and Southern Pines natural gas storage facilities to Hartree Partners for $850 Million. With the implied enterprise value representing a 11.0x multiple per 2020 EBITDA, PAA's largest divestiture since 2018 sold at a premium relative to its own 8.9x 2022 EBITDA multiple the day before announcing the agreement. While PAA benefits from an attractively valued sale, the MLP was also able to divest an asset that lacked integration with its broader system, marking a complete exit from the natural gas storage business. Including the $850 million from the sale, PAA's combined YTD transactions result in $870 million in sales proceeds, exceeding their 2021 asset sale guidance of $750 million and providing $120 million of additional cash flow that could be allocated towards buybacks in accordance with stated mandates. Since adopting the objective to optimize its asset portfolio in 2016, PAA has generated over $4.5 billion through strategic asset sales. Going forward, the MLP expects to continue evaluating potential opportunities that align with its efforts to reinforce its fee-based business and long-term positioning.

The same day of PAA's announcement, Enbridge (ENB) announced its plan to divest its non-operating 38.9% minority stake in Noverco Inc. for C$1.14 billion. While Noverco is a gas and power distribution business (i.e., not midstream assets), it does highlight ENB's ability to enhance financial flexibility as the focus remains on advancing multiple strategic initiatives. With a robust secured project backlog of $17 billion through 2023, ENB expects to generate EBITDA and cash flow growth from an array of projects across liquids pipelines, gas transmission, gas distribution and storage, and renewable power. Also this month, Magellan Midstream Partners (MMP) announced the sale of its independent refining terminals to Buckeye Partners for $435 million on June 10. MMP plans to use the proceeds in accordance with its capital allocation plans, namely free cash flow after distributions could be opportunistically used for buybacks as the company previously indicated.

Bottom Line:

Midstream MLPs and corporations are leveraging a favorable energy environment and increased private equity interest to pursue asset sales with the goal of improving financial flexibility, enhancing shareholder returns, and optimizing asset portfolios to maximize value to shareholders.

AMNA is the underlying index for the ETRACS Alerian Midstream Energy Index ETN (AMNA). AMZI is the underlying index for the Alerian MLP ETF (AMLP) and the ETRACS Alerian MLP Infrastructure Index ETN Series B (AMUB). AMEI is the underlying index for the Alerian Energy Infrastructure ETF (ENFR). 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).

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