Alerian

The Evolution of MLP and Energy Infrastructure Products

March 2018

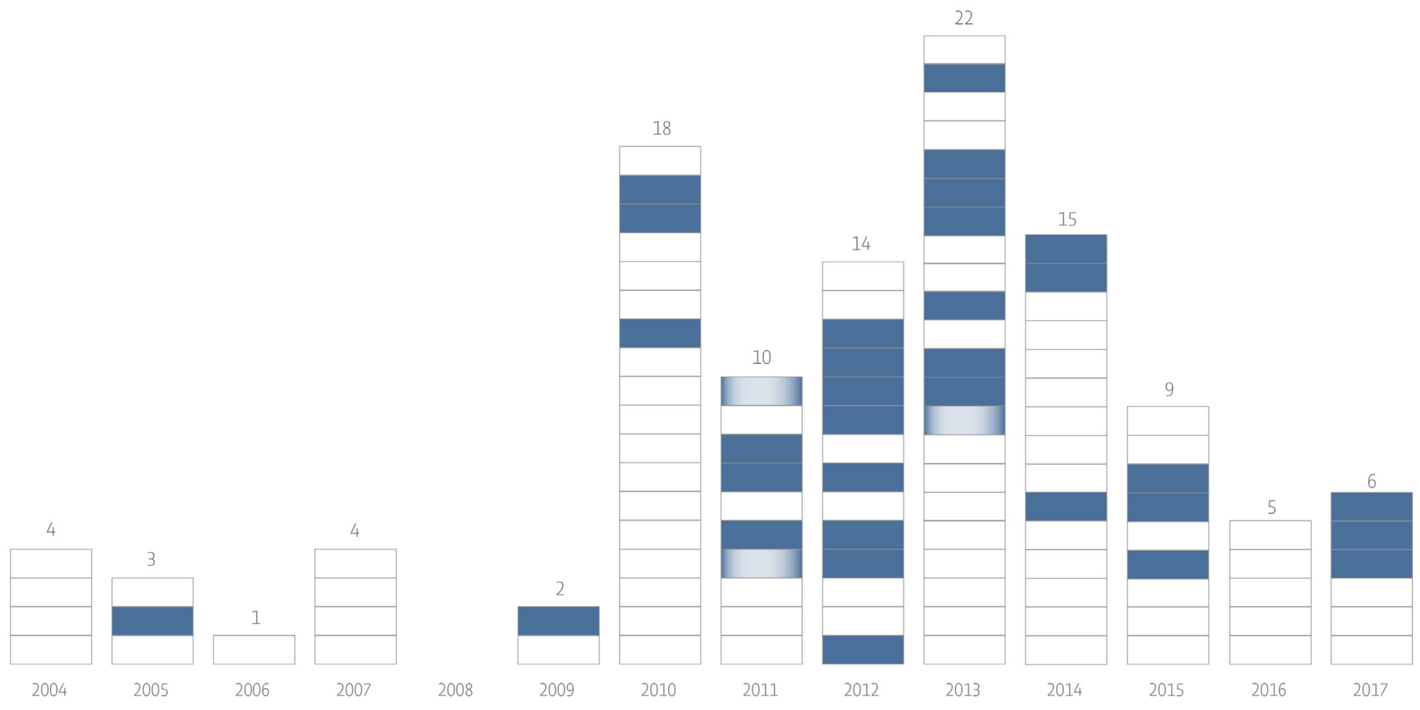
Since 2004, when the first MLP closed-end fund launched, there have been 112 MLP products issued in the form of ETFs, ETNs, mutual funds, and closed-end funds. The MLP product landscape continues to evolve and today, there are 94 MLP products remaining. This whitepaper walks through this evolution and provides context for where the market may be shifting to next.

Not All MLP Products Own 100% MLPs

The first generation of MLP products focused primarily on providing diversified access to MLPs in a simplified way. Simplified, meaning that investors do not have to deal with K-1s or the hassle of multiple state tax filings; instead, investors receive one Form 1099. While these funds provide 100% exposure to MLPs, the funds are not RIC-compliant, must pay taxes at the fund level, and therefore fund performance is reduced by federal and state taxes that must be accrued. We'll refer to 100% MLP funds as C-Corp funds. For more detail on C-Corp fund taxation and RIC-compliance, please visit Applied MLPs on the Alerian website.

During the "early years" of the energy renaissance (around 2010), MLP performance was strong and investors began to prefer growth over income. RIC-compliant products began to come to market, which limited MLP ownership to 25%, but the other 75% consisted of higher growth MLP general partners[1] or exposure to energy companies (E&P, power, utilities, energy infrastructure). Because RIC-compliant funds are not subject to tax at the fund level, investors focused on total return are able to capture the full performance upside.

RIC-Compliant MLP & Energy Infrastructure Products



Note: Faded colors represent funds that are now delisted.
As of March 27, 2018

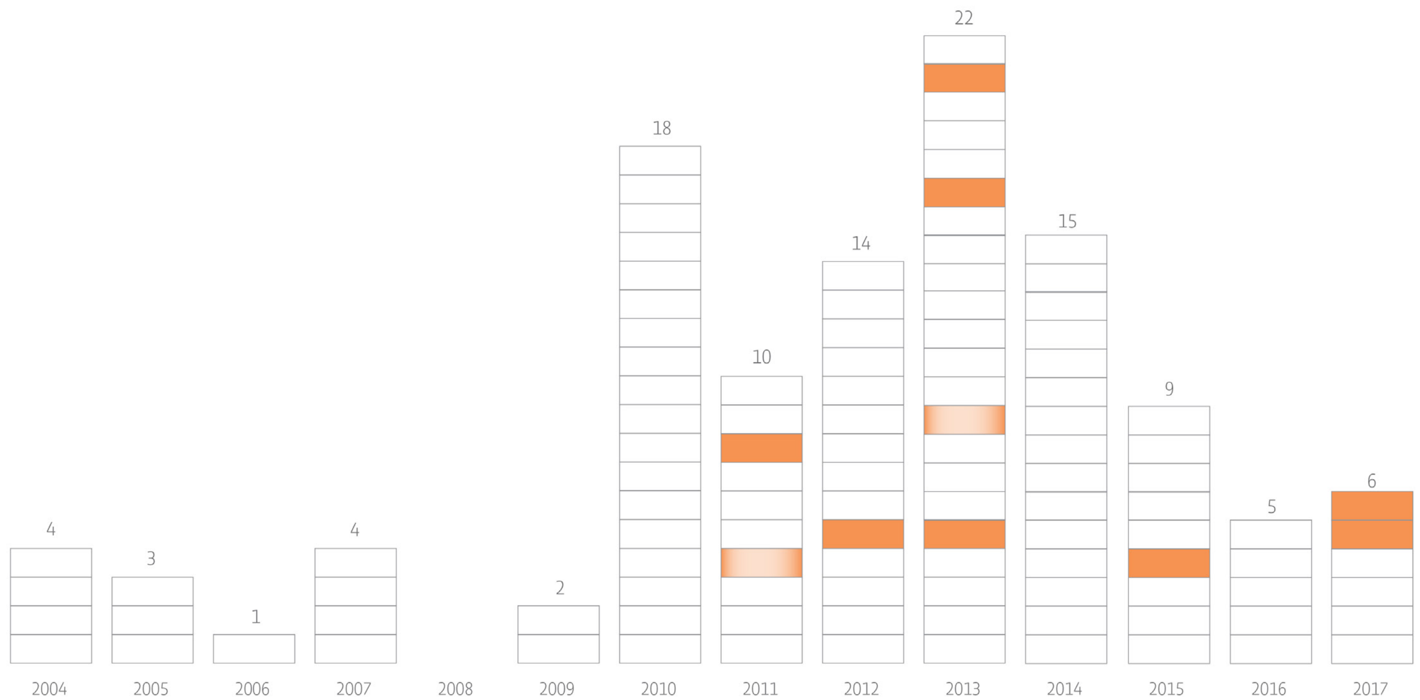
In the past few years, MLPs have simplified their structures and a handful have become C-corporations. Previously household MLP names such as Kinder Morgan (KMI) and ONEOK (OKE) are no longer MLPs, yet their business assets are still the same. Alerian, and even the Master Limited Partnership Association, has begun to redefine the space as "MLPs and energy infrastructure." While RIC-compliant MLP funds initially came to the market as a structure allowing investors to capture total return, it seems that they will be here to stay to capture a representative piece of the energy infrastructure story.

1 // The ones structured or taxed as corporations

Canadian Infrastructure Feeling the Love Now, Eh?

The Canadian-equivalent version of the MLP structure, the income trust, was already in play long before MLPs were even mainstream in the US. In the Halloween Massacre of October 2006, however, it was announced that all Canadian income trusts would be taxed like corporations. Initially, the Canadian energy industry took a major hit, and companies eventually converted to corporations. Despite the structural difference, Canadian energy infrastructure companies own the same types of assets as their US MLP counterparts – pipelines, storage facilities, processing plants, etc. Not to mention, many energy infrastructure assets cross borders to keep supply and demand balanced, and US and Canadian energy markets have become increasingly integrated. It was only a matter of time before Canadian energy infrastructure companies became part of the portfolios of MLP and energy infrastructure products.

MLP & Energy Infrastructure Products with Canadian Exposure



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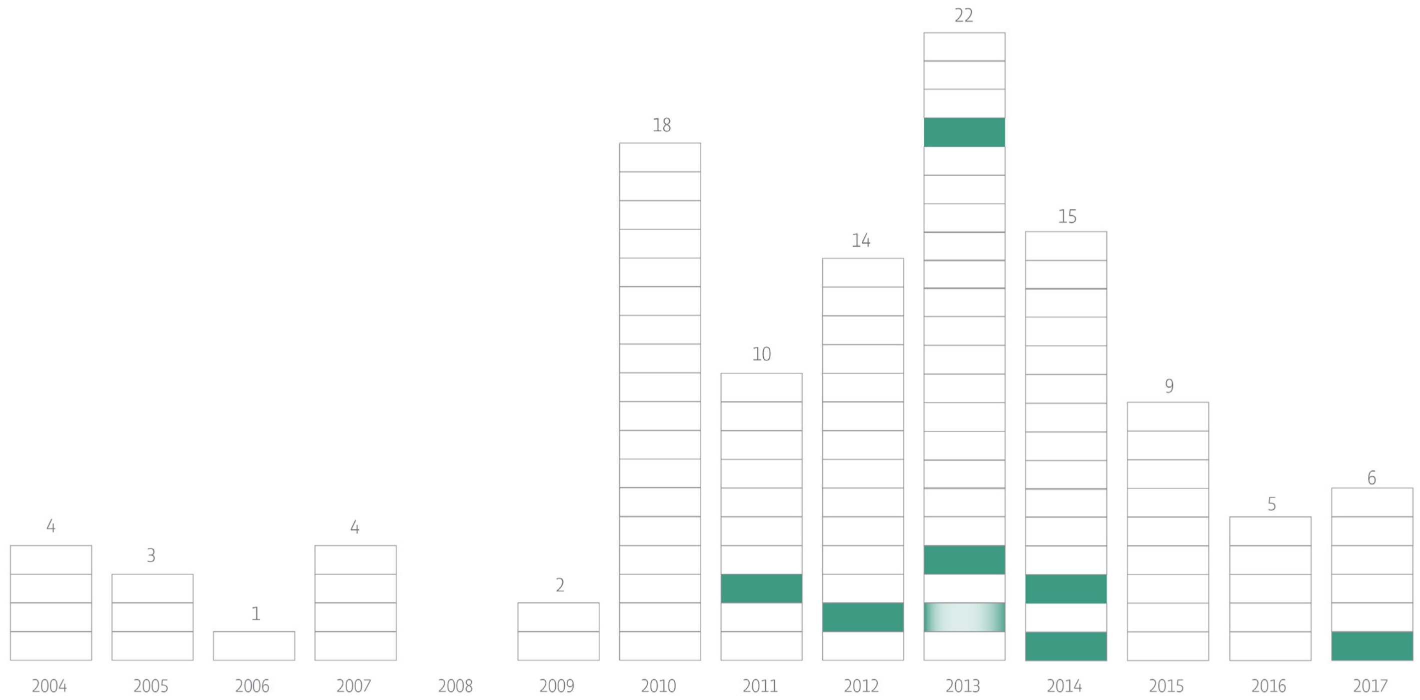
Notably, in the chart above, aside from a small allocation to TransCanada (TRP) or Enbridge Inc (ENB), many of the highlighted products above—namely the active products—did not own many other Canadian names at product launch. This has changed as the energy infrastructure space continues to be redefined—that is, to "North American energy infrastructure." With increased development, and many MLPs taking part in its energy infrastructure build-out, could Mexican companies be included next?

High-Yield and Small Cap Products – Timing is Everything

From 2010 to 2014, the MLP space saw a wave of IPOs, with the total number of MLPs increasing from 72 to 124. The passage of the JOBS Act and expanded interpretations of qualifying income from the IRS resulted in an increased number of non-traditional businesses monetizing their assets into the MLP structure, including frac sand, fertilizer, and mineral interest companies. As mentioned previously, during this time, investors desired growth and/or something more than the "traditional 6-7% yielding MLP". And so enters the high-income and/or small-capitalization-focused MLP products.

High Yielding And/Or Small Cap MLP & Energy Infrastructure Products



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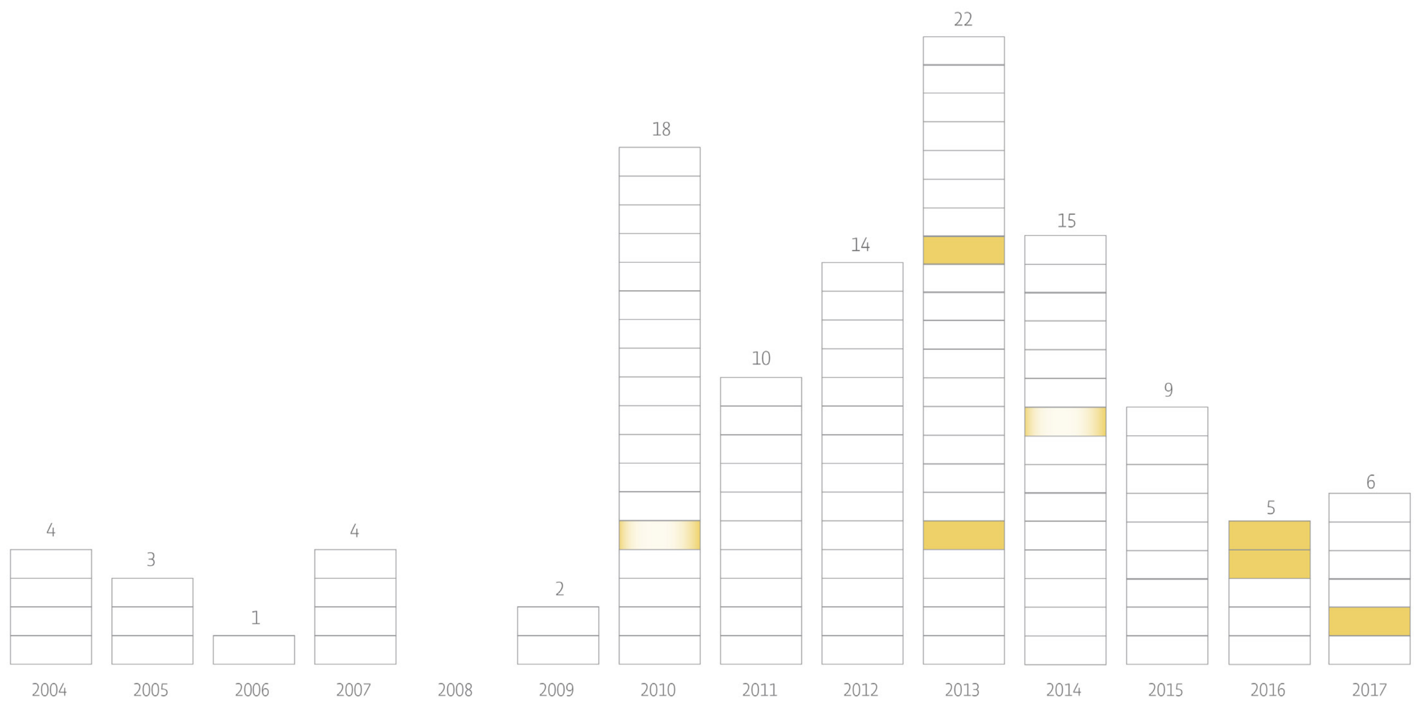
While these products were launched to quench investor's desires for something more, most never gathered a sizable amount of assets. Not to mention, these funds were impacted the most during the energy downturn. Trading liquidity is typically an issue for smaller-cap, higher-yielding companies – an impact even more magnified in the MLP space. Liquidity will likely need to improve materially before such funds gather steam in the future.

Dabbling in Smart Beta?

As the broader ETF land has evolved with the rise of smart-beta ETFs, the MLP and energy infrastructure space has seen a few smart-beta products itself. Smart beta refers to a passive (index) product that is not weighted by market capitalization. The weighting scheme of the portfolio could be something as simple as equal-weighting, or it could involve multiple layers of fundamental screening and weighting. The seven highlighted products below are ventures between passive product issuers and active MLP managers that have created rules-based proprietary indices, screening various factors such as distribution growth, coverage, and growth capital expenditures.

Smart Beta MLP & Energy Infrastructure Products



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In the broader ETF space, while there are many smart-beta products, the education behind how such products should fit within a portfolio is still limited. For smart-beta MLP funds, we expect these products may be targeted more towards investors that have a deeper understanding of MLPs and their nuances.

Depending on what happens in the broader market as well as the energy space, investor preferences for MLP and energy infrastructure products will continue to change. While there is no crystal ball of what types of products will come to market next, we wouldn't be surprised to see more energy infrastructure C-corporations as well as Canadian and Mexican companies show up in MLP and energy infrastructure product market.

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