Midstream & MLPs: Bring on the Buybacks

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Summary

- With double-digit yields common across midstream, payouts feel largely underappreciated by the investment community, and those elevated yields make the case for stock repurchases all the more compelling.
- Third quarter earnings announcements saw five new buyback authorizations in the midstream space, bringing the total number of companies with buyback programs to 14.
- For midstream investors, the proliferation of buyback authorizations is a welcome development and provides tangible benefits of the anticipated free cash flow inflection in the space. Importantly, buybacks can help support midstream equity prices into a macro recovery.

The potential for midstream buybacks as free cash flow generation ramps has been a recurring comment in Alerian's research. With six repurchase authorizations announced since October, including five in the past week or so, buybacks are a timely topic to revisit. Today's note provides an update on buyback authorizations, amounts spent on repurchases through the third quarter for those with existing programs, and the competition between dividends and buybacks in capital allocation decisions.

Buybacks gaining traction.

Third quarter earnings announcements saw five new buyback authorizations in the midstream space – MPLX (MPLX), Plains All American (PAA), EnLink Midstream (ENLC), Rattler Midstream (RTLR), and Western Midstream (WES). With these additions, there are now 14 companies with buyback authorizations in the broad Alerian Midstream Energy Index (AMNA), which has 42 total constituents. The companies with buyback authorizations represent a diverse group in terms of size, structure, and sector classification. Of the 14, eight are structured as MLPs, and only one Canadian corporation has a buyback program. The table below includes the midstream companies with repurchase authorizations and their weightings in the AMNA Index, Alerian MLP Infrastructure Index (AMZI), and Alerian Midstream Energy Dividend Index (AEDW).

Company Name	Ticker	AMNA Weight	AMZI Weight	AEDW Weight	Total Authorization ($ millions)	Spent to Date Through 9/30 ($ millions)	Date Announced
Antero Midstream Corporation	AM	0.83%	--	2.26%	300	151	8/12/2019
Cheniere Energy	LNG	6.13%	--	--	1,000	404	6/3/2019
Energy Transfer LP	ET	6.28%	10.26%	10.25%	2,000	1,089	2/18/2015
EnLink Midstream LLC	ENLC	0.30%	2.51%	0.65%	100	-	11/4/2020
Enterprise Products Partners LP	EPD	9.59%	10.09%	10.15%	2,000	255	1/31/2019
Gibson Energy Inc[1]	GEI CN	1.19%	--	0.52%	208	-	8/27/2020
Kinder Morgan Inc	KMI	10.15%	--	8.45%	2,000	575	7/19/2017
Magellan Midstream Partners LP	MMP	3.75%	10.22%	3.25%	750	252	1/21/2020
MPLX LP	MPLX	3.10%	10.31%	9.86%	1,000	-	11/2/2020
NGL Energy Partners LP	NGL	0.21%	1.71%	0.35%	150	-	8/30/2019
Plains All American Pipeline LP[2]	PAA	1.83%	9.42%	2.40%	500	-	11/2/2020
Rattler Midstream LP	RTLR	0.12%	--	--	100	-	11/4/2020
Targa Resources Corp	TRGP	1.60%	--	0.33%	500	-	10/5/2020
Western Midstream Partners LP	WES	0.73%	6.04%	1.86%	250	-	11/9/2020
	Total	45.81%	60.55%	50.31%			

AMNA and AMZI weights as of September 25. AEDW weights as of October 16.
[1] GEI's authorization is to repurchase and cancel up to 10% of public float as of 8/24/20. Dollar amount shown reflects share price as of 11/6.
[2] PAA's weighting in AMNA and AEDW represents the combined weighting of PAA and Plains GP Holdings (PAGP).
Source: Alerian, Company Reports as of November 6, 2020

Buybacks vs. dividends.

With double-digit yields common across midstream, payouts feel largely underappreciated by the investment community, and those elevated yields make the case for stock repurchases all the more compelling. From a capital allocation standpoint, companies are weighing the best way to return cash to investors. As discussed in a note earlier this month, Kinder Morgan (KMI) signaled flexibility in its approach to returning excess cash flow to shareholders, mentioning dividend increases and/or share buybacks in its 3Q release and omitting the prior target of achieving an annualized dividend of $1.25 per share. Perhaps the best example of weighing dividends and buybacks is RTLR reducing its distribution by 31% while simultaneously announcing a $100 million repurchase authorization. As reflected in the quote below from the 3Q call, the decision to cut the distribution and deploy buybacks was an opportunistic move to reallocate capital in response to market conditions, and management believes the decision will ultimately reward RTLR unitholders.

> This quarter, the Board of Directors of Rattler's general partner elected to reduce the annual distribution by 31% from $1.16 to $0.80 per unit. While we believe the current outlook would have supported the distribution while keeping leverage around our 2x leverage target, the current distribution yield of our equity indicated that such a view was not supported by the market. Accordingly, we elected to reduce the distribution and offensively reallocate the retained cash flow to a common unit repurchase program with $100 million authorization through year-end 2021. To be clear, this is not a buy-in of Rattler by Diamondback, and Diamondback will not be selling its position as part of this program. This is instead a reallocation of capital to the best returning project in our portfolio, which is retiring units with an over 18% forward return.
>
> **Travis D. Stice, CEO & Director of Rattler Midstream, November 5, 2020**

Source: Refinitiv

While a case can be potentially made for reducing dividends to repurchase shares in some situations, it seems unlikely that many names would follow RTLR's example. For one, several midstream companies stand to generate meaningful free cash flow after dividends, supporting both steady dividends and opportunistic buybacks (read more). Additionally, many management teams are sensitive to investor desires or needs for the income these companies provide. Instead of cutting payouts to repurchase shares, midstream companies may continue to put dividend growth on hold until yields improve and prioritize buybacks over increases to dividends. In the wake of macro headwinds and elevated yields, dividend growth has already been widely suspended with only a few notable exceptions (read more). For those companies generating meaningful free cash flow with comfortable leverage positions, buybacks will likely represent a more compelling way to return cash to shareholders until equity values improve and yields return closer to historical averages.

What does this mean for investors?

For midstream investors, the proliferation of buyback programs is a welcome development and provides tangible benefits of the anticipated free cash flow inflection in the space. Buybacks represent a significant reversal from the old MLP model of issuing equity. Importantly, buybacks can help support midstream equity prices into a macro recovery, which is self-help that was not available coming out of past energy downturns.

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