



Midstream/MLPs: Leverage Reductions Paying Off in 2020

December 22, 2020

Author: Michael Laitkep

Summary

- The average leverage ratio for the AMZI dropped from 4.35x in 2016 to 4.03x in 3Q20 and from 4.24x to 3.91x for AMNA during the same period.
- Leverage has trended down in 2020 as company actions prioritizing financial discipline and resilient earnings drove balance sheet improvements.
- In addition to improving flexibility during volatile periods, reducing leverage is a prerequisite to shareholder-friendly returns of capital such as buybacks and will likely remain an area for continued progress for many names going forward.

The macro headwinds that have accompanied the COVID-19 pandemic have undoubtedly made 2020 a challenging year for midstream, though midstream has been better positioned for these challenges than other energy sectors that are more dependent on commodity prices. As midstream contended with significant market volatility that acted as a real-life stress test on businesses earlier this year, the sector's financial positioning has been in focus. Today's note examines how leverage metrics have evolved in the midstream space and discusses how leverage improvements have laid the groundwork for buybacks as means of returning excess cash to shareholders. Importantly, though investors and midstream companies alike have begun to optimistically look forward to a post-pandemic world, leverage is likely to remain a focus area for midstream.

Midstream positioning into 2020 helped insulate the space from macro headwinds.

From 2016 to the present, midstream company leverage ratios have come down broadly. The tables below show how leverage has eased since 2016 at the index level for both the MLPs of the [Alerian MLP Infrastructure Index](#) (AMZI) and the broader midstream universe represented by the [Alerian Midstream Energy Index](#) (AMNA). Leverage was calculated by dividing long-term debt by adjusted EBITDA on an annual basis from 2016 to 2019 and on a trailing twelve-month (TTM) basis for 1Q20 and 3Q20. Notably, average leverage has dropped from 4.35x in 2016 to 4.03x in 3Q20 for the AMZI and from 4.24x to 3.91x for AMNA during the same period. Looking solely at 2020, average leverage for the AMZI decreased from 4.16x as of the first quarter, an elevated level relative to prior years, to 4.03x as of 3Q20. For AMNA, average leverage was basically flat, increasing slightly from 3.85x in 1Q20 to 3.91x in 3Q20.

AMZI Leverage in Context: 3Q20 Shows Improvement as Financial Flexibility Emphasized

	2016	2017	2018	2019	1Q20 (TTM)	3Q20 (TTM)
Median	4.29x	4.06x	3.94x	4.17x	4.23x	3.90x
Average	4.35x	4.28x	3.85x	4.11x	4.16x	4.03x

CQP was excluded from the average as an outlier.
Source: Company Reports, Alerian as of December 17, 2020

AMNA Leverage in Context: Recent Years Reflect Stability

	2016	2017	2018	2019	1Q20 (TTM)	3Q20 (TTM)
Median	4.31x	4.28x	4.09x	4.05x	4.18x	3.92x
Average	4.24x	4.21x	3.84x	3.88x	3.85x	3.91x

CQP and LNG were excluded from the average as outliers.
Source: Company Reports, Alerian as of December 17, 2020

Following challenged oil prices from 2014 to 2016, many midstream companies placed more emphasis on reducing debt to improve financial flexibility. Unlike prior downturns, most midstream companies were thus better prepared to weather this year's challenges given steps taken to reduce leverage, improve distribution coverage, and ease capital spending. In general, leverage rose broadly for the space earlier this year but has since moved closer to prior levels. In addition to resilient earnings due to fee-based business models, company actions prioritizing cost reductions and capital discipline have contributed to leverage improvements this year. Beyond these improvements, some companies are pursuing asset sales to accelerate deleveraging, but it has been difficult to solidify asset sale agreements in the current environment. As markets stabilize, the environment for asset sales may become more favorable in the coming months.

Leverage is best viewed at the individual company level.

While index-level leverage metrics provide a sense of how leverage is changing broadly, examining leverage at the company level can provide greater context. The table in the Appendix shows leverage metrics and sector classifications for the constituents of the AMNA Index. With 2020 presenting new challenges, the importance of balance sheet strength was fully realized and resulted in another push to reduce leverage for some names. This was especially true for some gathering and processing MLPs with greater commodity price exposure or more concentrated counterparty risk that entered 2020 in a weaker financial position in terms of leverage and distribution coverage. Of note, leverage was elevated for some of these names due to recent dropdown and simplification transactions resulting in higher debt levels. Positively, several of these MLPs took difficult but necessary steps to reduce leverage this year. [Western Midstream Partners](#) (WES), [DCP Midstream](#) (DCP), and [EnLink Midstream](#) (ENLC) each cut their distributions by 50% or more this year and used the extra cash to prioritize balance sheet improvements in conjunction with other cost cutting measures and reductions in capital spending. The leverage reductions for these MLPs have been notable as detailed in the Appendix.

In general, capital expenditures [decreased significantly](#) this year across midstream as many projects were deferred or canceled, but some companies saw their leverage ratios stay about the same or increase slightly as a result of continued spending on capital-intensive growth projects funded in part by debt. [Equitrans Midstream's](#) (ETRN) leverage ratio increased as a result of its [merger](#) with EQM Midstream in June as well as ongoing construction of the Mountain Valley interstate natural gas pipeline, which has seen its estimated total cost creep up to [\\$5.9 billion](#). Large Canadian corporations [Enbridge](#) (ENB CN) and [TC Energy](#) (TRP CN) have significant growth project backlogs that require higher levels of debt. Other midstream companies have made progress in lowering elevated leverage ratios but still have further to go. Reducing leverage will likely remain a priority for these companies.

Reducing leverage is a prerequisite for other means of capital return.

In addition to improving flexibility during volatile periods, reducing leverage is arguably a prerequisite to shareholder-friendly returns of capital. As midstream companies generate more [free cash flow](#) as spending falls, there will likely be greater opportunity to further reduce leverage, repurchase shares, or increase dividend payouts. With valuations remaining discounted relative to history, several companies have announced opportunistic buyback authorizations recently ([read more](#)), including notable leverage reducers [Plains All American](#) (PAA), [ENLC](#), and [WES](#), in conjunction with 3Q20 results. ENLC noted in the release that it continues to emphasize leverage reductions, but the partnership's recent execution allows it to utilize unit repurchases as one way to generate returns for investors.

Bottom Line

Leverage metrics for midstream have broadly improved since 2016, marking a meaningful step in increasing financial flexibility and opening doors in terms of returning capital to shareholders in new ways through buybacks. Although midstream's progress in reducing leverage to this point is encouraging, it is likely to remain an area for continued improvement for many names going forward.

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

Appendix

AMNA Constituents Reduced Average Leverage From 2016 to 2020

Company Name	Ticker	Sector Classification	2016	2017	2018	2019	1Q20 (TTM)	3Q20 (TTM)
Antero Midstream Corporation	AM	Gathering & Processing	2.10x	2.26x	2.28x	3.49x	3.43x	3.67x
BP Midstream Partners LP	BPMP	Pipeline Transportation Petroleum	-	-	2.39x	2.38x	2.34x	2.20x
Crestwood Equity Partners LP*	CEQP	Gathering & Processing	3.27x	3.77x	4.17x	4.42x	4.19x	4.52x
Cheniere Energy Partners LP*	CQP	Liquefaction	38.93x	10.61x	6.38x	7.01x	5.79x	6.38x
DCP Midstream LP*	DCP	Gathering & Processing	4.77x	4.63x	4.38x	4.43x	4.95x	4.17x
Delek Logistics Partners LP	DKL	Pipeline Transportation Petroleum	4.04x	3.67x	4.27x	4.66x	4.99x	4.48x
Enbridge Inc	ENB CN	Pipeline Transportation Petroleum	5.29x	5.90x	4.70x	4.50x	4.78x	4.75x
Enable Midstream Partners LP*	ENBL	Gathering & Processing	3.43x	2.81x	2.91x	3.46x	3.76x	3.90x
EnLink Midstream LLC*	ENLC	Gathering & Processing	4.25x	4.06x	3.87x	4.41x	4.63x	4.27x
Enterprise Products Partners LP*	EPD	Pipeline Transportation Natural Gas	4.02x	3.87x	3.42x	3.16x	3.43x	3.56x
Energy Transfer LP*	ET	Pipeline Transportation Natural Gas	6.95x	5.97x	4.56x	4.55x	4.53x	4.78x
Equitrans Midstream Corp	ETRN	Pipeline Transportation Natural Gas	1.72x	2.11x	4.09x	3.63x	3.50x	5.07x
Gibson Energy Inc	GEI CN	Storage	5.21x	4.27x	2.27x	2.50x	2.43x	2.51x
Genesis Energy LP*	GEL	Pipeline Transportation Petroleum	5.81x	6.49x	4.85x	5.17x	5.19x	5.47x
Holly Energy Partners LP*	HEP	Pipeline Transportation Petroleum	4.48x	4.37x	4.09x	4.07x	4.21x	4.18x
Hess Midstream LP	HESM	Gathering & Processing	-	-	-	3.18x	2.94x	2.68x
Inter Pipeline Ltd	IPL CN	Pipeline Transportation Petroleum	3.91x	3.43x	3.53x	4.06x	4.13x	5.56x
Keyera Corp	KEY CN	Gathering & Processing	2.38x	2.91x	2.62x	2.70x	2.34x	3.06x
Kinder Morgan Inc	KMI	Pipeline Transportation Natural Gas	5.00x	4.74x	4.39x	4.05x	4.18x	4.38x
Cheniere Energy Inc	LNG	Liquefaction	139.92x	13.89x	10.67x	10.45x	8.68x	7.94x
Macquarie Infrastructure Corp	MIC	Storage	3.56x	4.10x	4.66x	4.39x	5.88x	3.92x
Martin Midstream Partners LP	MMLP	Storage	4.78x	5.40x	5.36x	5.26x	1.46x	4.79x
Magellan Midstream Partners LP*	MMP	Pipeline Transportation Petroleum	3.37x	3.28x	3.02x	2.98x	2.64x	3.40x
MPLX LP*	MPLX	Gathering & Processing	3.12x	3.47x	3.85x	3.86x	3.99x	3.89x
Noble Midstream Partners LP*	NBLX	Gathering & Processing	-	0.39x	1.71x	5.87x	5.52x	3.08x
NGL Energy Partners LP*	NGL	Pipeline Transportation Petroleum	6.86x	7.77x	6.56x	5.48x	5.43x	5.54x
NuStar Energy LP*	NS	Pipeline Transportation Petroleum	5.83x	5.48x	4.67x	4.17x	4.45x	4.87x
ONEOK Inc	OKE	Gathering & Processing	4.28x	4.07x	3.62x	4.84x	5.35x	5.39x
Oasis Midstream Partners LP	OMP	Gathering & Processing	-	5.69x	4.62x	2.88x	2.80x	2.60x
Plains All American Pipeline LP*	PAA	Pipeline Transportation Petroleum	4.67x	4.41x	3.41x	2.84x	2.97x	3.28x
Plains GP Holdings LP	PAGP	Pipeline Transportation Petroleum	4.67x	4.42x	3.41x	2.84x	2.97x	3.28x
PBF Logistics LP	PBFX	Pipeline Transportation Petroleum	4.36x	3.47x	4.18x	3.99x	4.18x	3.15x
Pembina Pipeline Corp	PPL CN	Pipeline Transportation Petroleum	3.52x	4.44x	2.67x	3.29x	3.32x	3.35x
Phillips 66 Partners LP*	PSXP	Pipeline Transportation Petroleum	4.29x	3.87x	2.64x	2.75x	2.67x	2.76x
Rattler Midstream LP	RTLX	Gathering & Processing	-	-	-	1.60x	1.58x	2.08x
Shell Midstream Partners LP*	SHLX	Pipeline Transportation Petroleum	1.51x	3.83x	3.29x	3.69x	3.56x	3.51x
TC PipeLines LP*	TCP	Pipeline Transportation Natural Gas	4.29x	5.29x	3.94x	4.09x	4.23x	3.65x
Tellurian Inc	TELL	Liquefaction	-	-	-	-	-	-
Targa Resources Corp	TRGP	Gathering & Processing	4.33x	4.29x	4.36x	5.18x	4.90x	4.60x
TC Energy Corp	TRP CN	Pipeline Transportation Natural Gas	6.04x	4.71x	4.67x	3.95x	3.66x	3.95x
Western Midstream Partners LP*	WES	Gathering & Processing	3.03x	3.29x	3.97x	4.63x	4.48x	3.73x
The Williams Companies Inc	WMB	Gathering & Processing	5.11x	4.51x	4.82x	4.02x	4.32x	4.34x
Median			4.31x	4.28x	4.09x	4.05x	4.18x	3.92x
Average			4.24x	4.21x	3.84x	3.88x	3.85x	3.91x

* Also a constituent of the Alerian MLP Infrastructure Index (AMZI)

CQP and LNG were excluded from the average as outliers. Recent IPOs include NBLX in 2016; BPMP, HESM, and OMP in 2017; and RTLX in 2019.

Source: Company Reports, Alerian as of December 17, 2020

// Disclaimers

This Document Is Impersonal and Not a Solicitation. In jurisdictions where Alerian, S-Network Global Indexes, or their affiliates do not have the necessary licenses, this document does not constitute an offering of any security, product, or service. Alerian and S-Network Global Indexes receive compensation in connection with licensing its indices to third parties. All information provided by Alerian and S-Network Global Indexes in this document is impersonal and not customized to the specific needs of any entity, person, or group of persons. Alerian, S-Network Global Indexes, and their affiliates do not endorse, manage, promote, sell, or sponsor any investment fund or other vehicle that is offered by third parties and that seeks to provide an investment return linked to or based on the returns of any Alerian or S-Network Global Indexes index.

No Advisory Relationship. Alerian and S-Network Global Indexes are not investment advisors, and Alerian, S-Network Global Indexes, and their affiliates make no representation regarding the advisability of investing in any investment fund or other vehicle. This document should not be construed to provide advice of any kind, including, but not limited to, tax and legal.

You Must Make Your Own Investment Decision. It is not possible to invest directly in an index. Index performance does not reflect the deduction of any fees or expenses. Past performance is not a guarantee of future returns. You should not make a decision to invest in any investment fund or other vehicle based on the statements set forth in this document, and are advised to make an investment in any investment fund or other vehicle only after carefully evaluating the risks associated with investment in the investment fund, as detailed in the offering memorandum or similar document prepared by or on behalf of the issuer. This document does not contain, and does not purport to contain, the level of detail necessary to give sufficient basis to an investment decision. The addition, removal, or inclusion of a security in any Alerian or S-Network Global Indexes index is not a recommendation to buy, sell, or hold that security, nor is it investment advice.

No Warranties. The accuracy and/or completeness of any Alerian or S-Network Global Indexes index, any data included therein, or any data from which it is based is not guaranteed by Alerian or S-Network Global Indexes, and it shall have no liability for any errors, omissions, or interruptions therein. Alerian and S-Network Global Indexes make no warranties, express or implied, as to results to be obtained from use of information provided by Alerian and S-Network Global Indexes and used in this service, and Alerian and S-Network Global Indexes expressly disclaim all warranties of suitability with respect thereto.

Limitation of Liability. While Alerian and S-Network Global Indexes believe that the information provided in this document is reliable, Alerian and S-Network Global Indexes shall not be liable for any claims or losses of any nature in connection with the use of the information in this document, including but not limited to, lost profits or punitive or consequential damages, even if Alerian and S-Network Global Indexes have been advised of the possibility of same.

Research May Not Be Current. This document has been prepared solely for informational purposes based on information generally available to the public from sources believed to be reliable. Alerian and S-Network Global Indexes make no representation as to the accuracy or completeness of this document, the content of which may change without notice. Alerian and S-Network Global Indexes expressly disclaim any obligation to update the contents of this document to reflect developments in the energy Master Limited Partnership sector. The methodology involves rebalancings and maintenance of indices that are made periodically throughout the year and may not, therefore, reflect real-time information.

Linked Products. Alerian and S-Network Global Indexes licenses its indexes to third parties for the creation of investment funds or other vehicles. Alerian and S-Network Global Indexes are not responsible for the information on these websites or for anything that they provide.

Policies and Procedures. Analytic services and products provided by Alerian and S-Network Global Indexes are the result of separate activities designed to preserve the independence and objectivity of each analytic process. Alerian and S-Network Global Indexes have established policies and procedures to maintain the confidentiality of material non-public information received during each analytic process. Alerian, S-Network Global Indexes, and their affiliates provide a wide range of services to, or relating to, many organizations, and may receive fees or other economic benefits from these organizations.

Copyright. No Unauthorized Redistribution. Alerian and S-Network Global Indexes © 2020. All rights reserved. This document, in whole or in part, may not be redistributed, reproduced, and/or photocopied without prior written permission.

Alerian
alerman.com
info@alerman.com // 972.957.7700
3625 N. Hall St., Suite 1200, Dallas, TX 75219

S-Network Global Indexes
snetworkglobalindexes.com
info@snetworkinc.com // 646.467.7928
267 Fifth Avenue, Suite 508, New York, NY, 10016