EAGLE GLOBAL ADVISORS

Quarterly Commentary
Q1 2019

EGA Energy MLPs and Midstream Companies

From the EGA Portfolio Management Team

Winter Is Ending! Or Is It? Stay Tuned...

On April 14, HBO's Game of Thrones will begin its final season. For years, we endured King Joffrey, a Red Wedding, and a multitude of other epic journeys. We have been unable to secure the final script despite our New York office being only a block away from HBO's headquarters. However, if history is an indicator we know that winter will finally end for this legendary show. There will likely be a scene celebrating spring, new partnerships, and opportunities for HBO to grow the franchise further. Of course, the show on multiple occasions has soothed the audience into relative calm only to hammer them with a twist so outrageous as to defy Hollywood precedent. It's this reason people tune in to watch. Nobody really knows who is going to win. And we certainly cannot say that winter is, finally, ending.

The Midstream market has also experienced winter unlike any other in its history. Having now put together its best performing first quarter in years, you'd think MLP watchers would be rejoicing the end of winter. You'd be wrong. The popular topic these days is the lack of retail fund flows with resulting angst over where the sector will get its next dollar of investor capital. Some management teams are recreating their presentations to cater to generalist investors, while investors pepper sell-side analysts and management teams with questions on generalists' interest and whether MLP-to-C-Corp conversions will help. While we warmly welcome generalist capital into the sector, we believe operational consistency with a focus on returns will drive performance that both generalists and retail want.

If You Build It, They Will Come (Back)

There is no magical presentation that can convince investors to invest in a specific sector. A sector needs to provide a compelling investment case – its emerging growth, driven by a paradigm shift in the world energy economy, or led by experienced managers that are good stewards of capital. Prior to 2014, generalist investors avoided MLPs due to discomfort with the sector's reliance on equity capital markets and incentive distribution rights to support growth. In some instances, there was also an aversion to K-1s. The consensus was generalists would eventually overcome their K-1 aversion in a desire to capture outperformance, a trend that started to occur before oil prices collapsed in the second half of 2014.

When OPEC embarked on a market share strategy (as opposed to a price stabilization strategy of years past), commodity prices collapsed and energy equity values (including MLPs) plummeted. Retail investors fled and the following four years exposed shortcomings with the old Midstream model. Fast forward to today and Midstream 2.0, the new business model is better positioned for long-term success. So why haven't generalists and retail investors returned? We believe the Midstream sector needs time to prove operational consistency and rebuild management credibility. Multiple quarters of strong operational performance are helping. Investors love a good story, but nobody wants to be early and wrong.

Now the exciting part. The first quarter of 2019 was the best performing first quarter since 2013, the second best first quarter in 20 years, and the fifth best stand-alone quarter in 20 years. In years the first quarter finished positive, the full year performance closed positive 92% of the time. Finally, in years where both first quarter and full year performance was positive, the full year advanced beyond the first quarter an additional 20% on average. These are not insignificant numbers, though we agree you can prove anything with statistics.

Quarter	Performance
1Q13	19.7%
2Q16	19.7%
2Q09	19.3%
3Q00	17.3%
1Q19	**16.8%**
4Q09	16.6%
4Q11	16.3%
2Q03	15.7%
1Q01	15.5%
2Q14	14.2%
10yr avg	2.9%
20yr avg	3.2%

	Performance		Post 1Q
Year	First Quarter	Full Year	Upside
2000	7%	46%	38%
2001	15%	44%	28%
2003	7%	45%	37%
2004	3%	17%	14%
2005	2%	6%	4%
2006	6%	26%	20%
2007	13%	13%	0%
2009	11%	76%	65%
2010	8%	36%	28%
2011	6%	14%	8%
2012	2%	5%	3%
2013	20%	28%	8%
2014	2%	5%	3%
2019	17%	??	–
average	*9%*	*28%*	*20%*

****Performance as measured by the Alerian MLP Total Return Index (AMZX)***

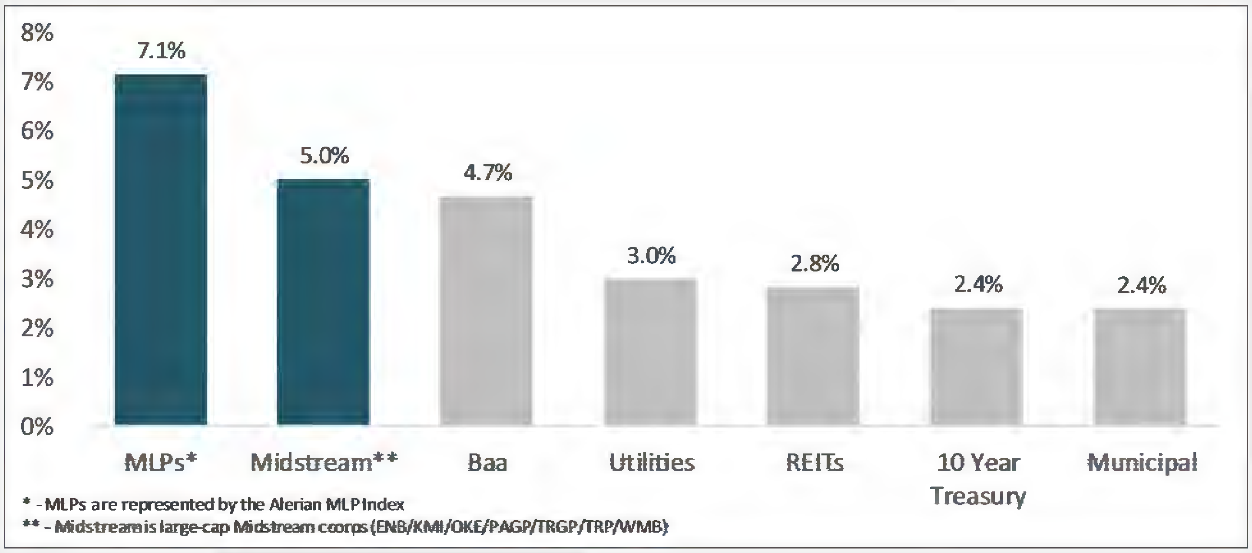
Sources: Bloomberg

The KISS (Keep It Simple, Stupid) Method Applies Yet Again

An attractive yield supported by stable cash flows as a result of rising domestic crude oil and natural gas production. Remember "Yield + Growth"? It's still there, and it still comes with a large dose of tax efficiency. Keep in mind global investors and an aging domestic population are starved for yield. This is the pitch that made a juggernaut of Midstream for well over a decade. It is also the pitch that has gotten better with the advent of Midstream 2.0.

For those interested in a more in-depth analysis of the Midstream infrastructure opportunity set, please read or ask your client representative for a copy of our 4Q18 Quarterly Commentary titled "This Isn't Your Father's MLP".

Whether MLPs Or Midstream C-Corps, The Sector Pays A Generous Yield



Sources: Bloomberg

Overcoming The Hurdle Of Relevance

In our eyes, the key for Midstream to transition from a short-term rally to a multi-year bull market is more about investor psychology. Put plainly, the broader market views crude oil and natural gas as relics of the past. A 20th century fuel in a 21st century world that is being taken over by renewable energy. We believe this perception is the result of a misconception of renewable energy's current role in the world. We're not refuting the idea that renewable energy is growing in relevance, only that dreams of what renewable energy can do are drastically at odds with reality. As an example, we're hard pressed to believe the general public comprehends the following statistics provided in a recent Manhattan Institute report titled "The 'New Energy Economy': An Exercise In Magical Thinking." A few examples:

"Today's reality: hydrocarbons - oil, natural gas, and coal - supply 84% of global energy, a share that has decreased only modestly from 87% two decades ago. Over those two decades, total world energy use rose by 50%, an amount equal to adding two entire United States' worth of demand."

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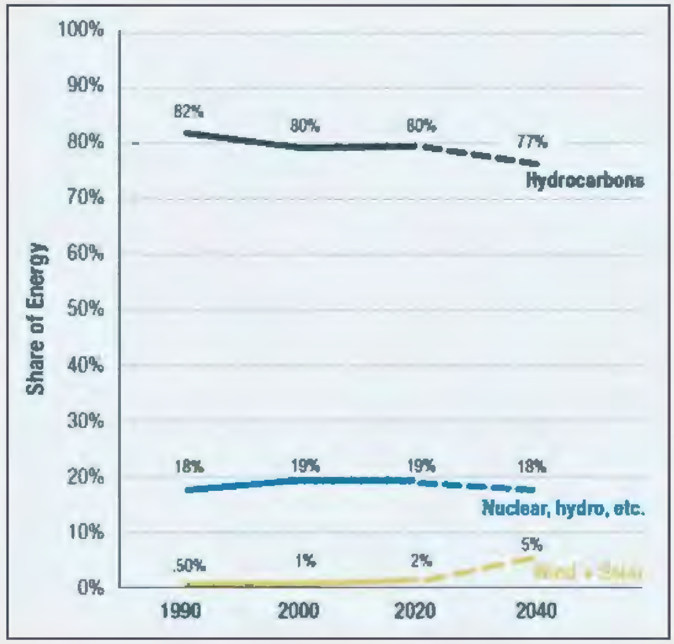
“The small percentage-point decline in the hydrocarbon share of world energy use required over $2 trillion in cumulative global spending on alternatives over that period. Popular visuals of fields festooned with windmills and rooftops laden with solar cells don’t change the fact that these two energy sources today provide less than 2% of the global energy supply and 3% of the U.S. energy supply.”



Sources: Manhattan Institute, ExxonMobil, EIA

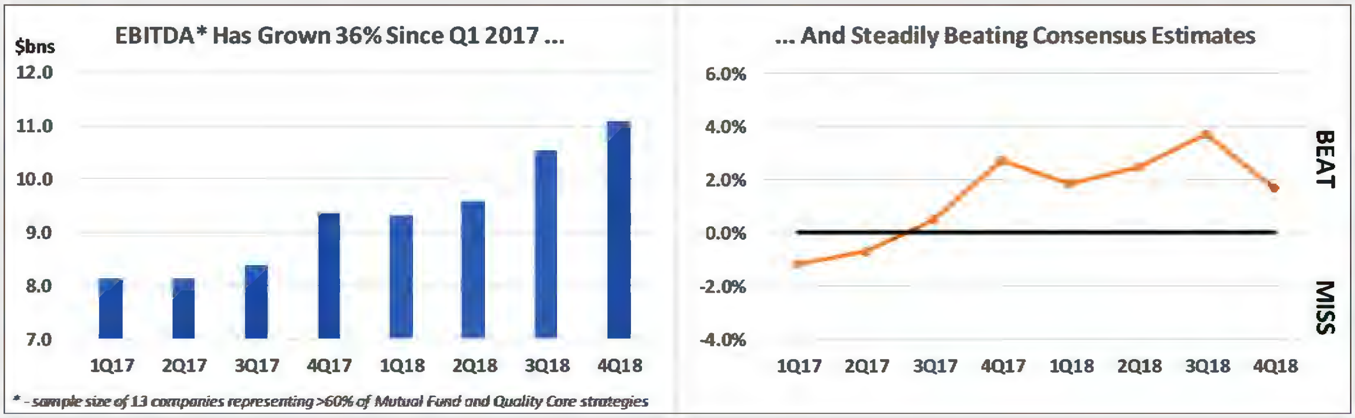
“To completely replace hydrocarbons over the next 20 years, global renewable energy production would have to increase by at least 90-fold. For context: it took a half-century for global oil and gas production to expand by 10-fold.”

“If the initial goal were more modest - say, to replace hydrocarbons only in the U.S. and only those used in electricity generation - the project would require an industrial effort greater than a World War II–level of mobilization. A transition to 100% non-hydrocarbon electricity by 2050 would require a U.S. grid construction program 14-fold bigger than the grid build-out rate that has taken place over the past half-century. Then, to finish the transformation, this Promethean effort would need to be more than doubled to tackle nonelectric sectors, where 70% of U.S. hydrocarbons are consumed. And all that would affect a mere 16% of world energy use, America’s share.”

The belle is simply not ready for the ball. For those interested in a cleaner future, we highlight the growth in natural gas usage supplied by the shale revolution is responsible for a 12% reduction in U.S. greenhouse gas (GHG) emissions since 2011 (source: U.S. Environmental Protection Agency) and the U.S. has boasted the world’s largest emissions reductions nine times this century (source: American Enterprise Institute). It’s true that renewable energy is playing a role in these reductions, but a major driver of these reductions is natural gas replacing coal.

A Few Final Thoughts...

Midstream EBITDA continues to deliver solid growth and consensus beats. We reviewed 13 companies not impacted by the ongoing structural shifts (i.e., simplifications, etc.) that represent a majority of our portfolio strategies. Over the last eight quarters EBITDA has grown 36% while beating Street's consensus estimates for 6 consecutive quarters (see below charts). We believe the analysts that comprise consensus estimates will start raising the bar and making it harder for Midstream companies to "beat and raise", but if for nothing else we are encouraged by management teams' ability to deliver and generate EBITDA growth. We highlight the combination of debt paydowns and EBITDA growth will allow companies to de-lever faster, a prominent trend in today's Midstream sector.



Sources: Bloomberg, Company Data

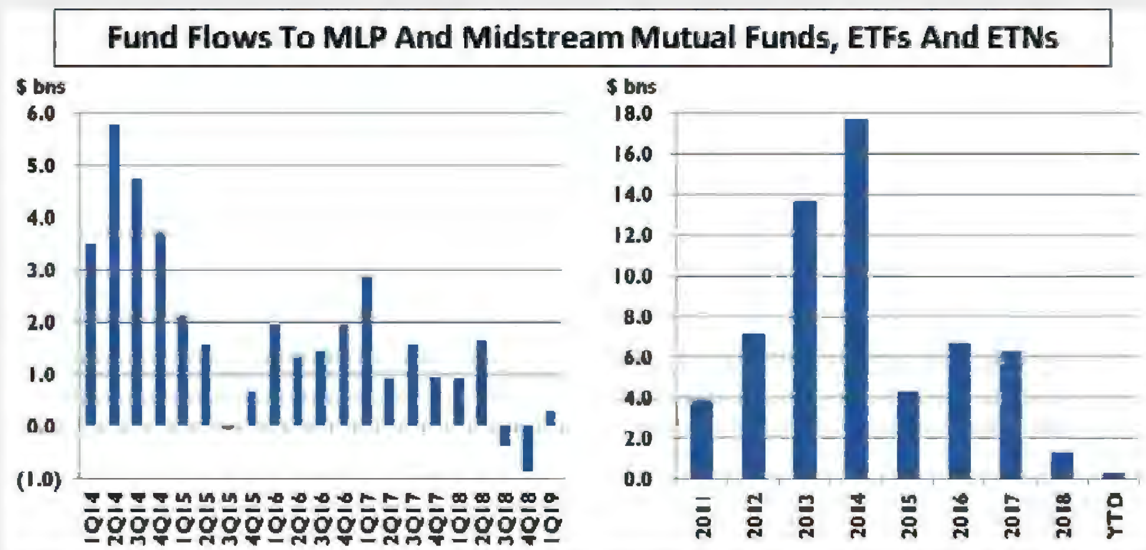
MMP cancels Permian Gulf Coast (PGC) Pipeline. On March 25, Magellan Midstream (MMP) indicated it is unlikely its PGC Pipeline project will proceed as initially announced. As highlighted earlier, investors looking at a more traditional sector like Midstream want confidence that company managers will be good stewards of capital. As MMP is a market leader in capital discipline, we're encouraged they're not moving forward with a project that doesn't meet their return hurdles. It also reduces concern that Midstream developers will overbuild Permian takeaway capacity, which has been a question of late. It is headlines like this that investors look for when evaluating individual companies and entire sectors. We hope to see more of these types of return-focused decisions in the future.

Colorado legislation focused on the oil and gas industry moves forward. SB 19-181 has already cleared Colorado's Senate and is steadily moving through Colorado's House on its way to the governor's desk. The bill says cities and counties can use their planning and land-use powers to regulate oil and gas, thereby providing more local control on development. In theory, this should eliminate industry headaches such as the recent referendum on setbacks during the 2018 election cycle. However, the bill also directs state regulators to prioritize protecting public health, safety, and the environment. Therefore, we remain concerned that state agencies in Colorado can still hinder oil and gas development in the state. While this would be negative for a handful of Midstream companies with Colorado exposure (NBLX, WES, DCP), restriction of supply would be supportive of energy prices long-term.

New York and the environment. We expect deep-pocketed environmentalists using regulatory and legal means to thwart new energy infrastructure projects to continue. That said, we are starting to see the downside of such activism. In Westchester County (suburbs immediately north of NYC), the local gas distribution company has placed a moratorium on new hookups of natural gas. According to the company, there isn't enough natural gas supply coming into this high demand market and the system's integrity is therefore at stake. The irony is one of the largest, most prolific natural gas fields in perhaps North America is less than 150 miles away in Pennsylvania (Marcellus Shale). Unfortunately, a lack of infrastructure means customers willing to convert to cleaner natural gas are unable to do so. It is our view when customers feel an issue hit their wallets they're more likely to demand a solution, which in this case would be the construction of new pipelines to meet demand.

Capital Flows And Access To Capital

January and February posted capital inflows of $225 million and $190 million respectively, though March saw a capital outflow of nearly $80 million. Capital inflows of $300 million for the quarter was the most benign positive capital flow quarter in our data set. There seems to be a divergence in logic, in that marginally positive capital flows contrasted with the impressive strength of the sector's stock prices. We think there is actually a simple explanation for this. With capital formation at all-time lows thanks to Midstream 2.0 and the self-funding model, it just doesn't take as much buying power to move stocks as it used to.



As of 3/31/2019 Sources: US Capital Advisors

It was only a few years ago our write-ups on "access to capital" ranked among the most compelling sections in our Quarterly Commentary. That was then, and this is now. Today this section is almost completely irrelevant given the lack of equity offerings and transition of the sector to self-funding (Midstream 2.0). We observed only three offerings in the first quarter. Tortoise Acquisition Corp (SHLL.U) raised $225 million in an initial public offering as a blank check company, formed for the purpose of effecting a merger, capital stock exchange, asset acquisition, stock purchase, reorganization or similar business combination. Viper Energy Partners (VNOM) raised $350 million in a follow-on offering. VNOM is not a traditional Midstream MLP, but rather owns mineral interests in oil and natural gas properties in the Permian Basin in West Texas. Finally, it was reported that private equity firm Arclight sold $350 million of Enable Midstream (ENBL) units in a secondary offering. ENBL received no proceeds from the transaction.

MLP Team Update

In January one of our research analysts left the firm to pursue an opportunity at a hedge fund. We reallocated his responsibilities to other various members of the MLP team and have begun a search to replace him.

Separately, we attended several major conferences throughout the first quarter, where we found investor sentiment had improved from the weak levels communicated in the 4Q18 Quarterly Commentary. This improvement was partially offset by volatility in energy prices and lower-than-expected flows into the sector given stock price appreciation and reversals of tax loss harvesting ("January effect"). We continue to utilize our networks to better understand what's happening in the fields in order to better inform our Midstream investing decisions. We are cautiously optimistic on 2019 as the sector's structural upgrades position it to benefit from the world's increasing appetite for energy infrastructure.

We thank you for your continued patronage of Eagle Global Advisors. We believe the long-term return outlook for Midstream remains attractive, and we look forward to communicating the results of your investment in an Eagle managed account next quarter.

- The Eagle MLP Team