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We Have A Disconnect: Public vs. Private MLP Valuations

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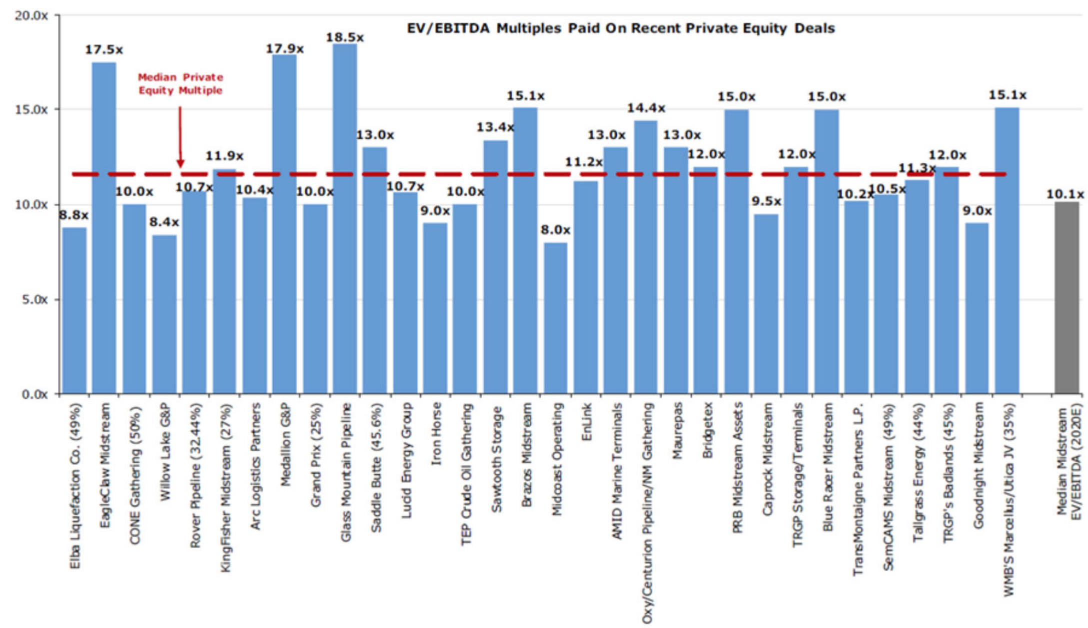
Historically, public market assets have traded at premium valuations to private equity (PE) assets due to a variety of reasons including increased transparency, liquidity and support from public fund flows. Since 2017, the tide has shifted with PE investors now paying an average premium multiple of 12x for midstream assets or companies. This compares to public midstream trading at an average 2020E EV/EBITDA of 10.1x relative to C-Corps at 11.1x, pipeline MLPs at 10.9x and G&P MLPs at 9.2x.

Exhibit 1. EV/EBITDA Multiples Paid By PE (Since January 2017)



Source: Wells Fargo Securities, LLC.

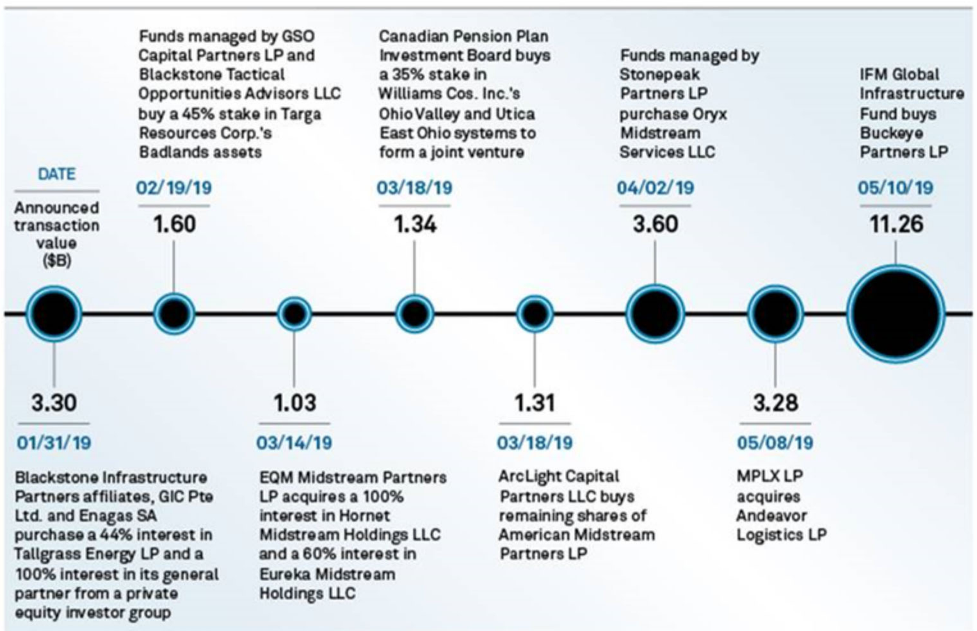
Bain & Company's 2019 Private Equity Report suggests the increasing level of capital moving toward private assets in ALL sectors may be indicative of long-term change in how the market values assets. Midstream investors previously evaluated absolute/relative yield and value of the GP. Today, the focus is on EV/EBITDA and FCF yield. This transition indicates investors now want to enjoy the yield, but also favor total return.

Why the disconnect?

The valuation disconnect for public vs. private MLPs has its roots in the stress witnessed by the asset class beginning in 2014. Oil prices slumped, volumes and cash dropped and the bulk of the companies in the MLP universe cut their distributions. The retail investor who bought MLPs for income became skeptical and eventually voted with their feet out of midstream investments.

PE players entered stage right with piles of institutional investor cash looking for a home in cheap, cash flow generating assets. Midstream fit the bill with both cash flow and attractive valuation versus history, particularly relative to infrastructure plays like toll roads, utilities and REITS. Eighty deals targeting U.S. pipeline companies were completed in 2018. Transaction activity continues in 2019. Most recently, Blackstone Infrastructure Partners' made a bid to acquire the remaining public shares of TallGrass Energy (TGE) shares at a 35.9% premium.

Select midstream M&A deals worth over $1B announced in 2019



As of June 30, 2019.
Credit: Cat Weeks
Source: S&P Global Market Intelligence

What is the impact to the public market? Recent transactions by PE investors have highlighted the opportunity to acquire premium midstream assets at attractive valuations. PE participation provides a cushion under public valuations because their capital contribution can be viewed as filling some of the void left by the retail investor. A secondary benefit to public MLPs results from index rebalancing as the departing company index weight is reallocated to existing holdings resulting in fund flows from both ETFs and active managers.

Finally, while the number of midstream companies greater than $2 billion is smaller today versus 2014, this could be an advantage for active midstream managers depending on the outcome of private market exit strategies. For managers who invest across midstream structures, the opportunity set remains healthy, despite the number of companies taken private to date.

Midstream Universe Comparison

	As of 10/31/2014 Midstream MLPs, Corps. & Canada	As 8/22/2019 Midstream MLPs, Corps. & Canada
Number of MLPs/Companies	94	56
Number with >$2Bn Market Cap.	62	34
Market Capitalization ($Bn)	$802.60	$541.60
Top 5 Market Capitalization ($Bn)	$230.10	$257.70

Source: Company reports and Bloomberg

Friend or Foe?

PE players in midstream can be viewed as friends of the public market because they are capital providers through outright purchases or JV arrangements. On the flip side, PE's war chest of cash and desire to generate yield for their investors gives them an advantage in the bid for projects.

Outlook

It appears the midstream privatization trend will continue as long as PE investors offer cash and premium valuations. Private market exit strategies are not clear at this point, but could include re-financings, IPOs, energy focused SPAC's, etc. We expect many midstream assets will be recycled back to the public market over time creating a robust opportunity set for midstream investors.

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