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In Pursuit of Value

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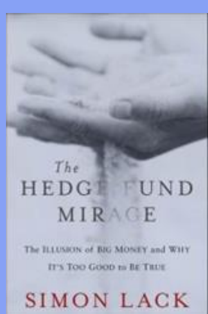


Straight Answers From Tough Questions

The UK House of Commons has long maintained the tradition of Prime Minister's Question Time, a weekly event in which the Prime Minister (PM) stands before all the other Members of Parliament (MPs) and responds to all manner of pointed, often disrespectful questions. The PM has no warning of what questions will fly his way, although the news cycle provides a strong clue. And he has to think on his feet, literally, since custom requires whoever's addressing the House to stand. It's now televised, making it one of the more gripping shows on C-Span (although the competition is weak). The sight of the country's leader answering for his government's actions to other elected officials is one of the purest forms of democracy anywhere in the world. Former PM Tony Blair confessed to frequent nervousness prior to what was often the most stressful point of the week, although his performances (and there is an element of theatre) rarely betrayed him. There is no equivalent in the U.S. Presidents face sometimes hostile questioning from journalists at press conferences arranged as they see fit. U.S. democracy would be better if it adopted this single feature from the UK.

There have been some memorable quotes over the years. For example, in 1995 PM John Major suffered what he conceded was the best one-liner ever delivered, when Tony Blair (then Leader of the Opposition Labour Party) noted Major's splintered support over Europe from his Conservative Party by stating that, "I lead my party while he follows his." The live audience, which is to say the MPs sitting in the House of Commons, erupted in jeers and laughter. As in America, such soundbites can define the subsequent election.

Every quarter, most public companies hold a conference call following their earnings during which the CEO or perhaps CFO answers questions and provides some additional color on the earnings report just released. We listen to lots of them from companies we're following. While not in the same league as PM's Question Time, these events also occasionally throw up memorable exchanges. Most of the questions come from sycophantic sell-side analysts who lob softball questions to CEOs for fear of causing offense and missing out on future banking business. However, sometimes a real investor gets on the call, and then the dialogue becomes both more interesting and meaningful.

Kinder Morgan's (KMI) CEO Rich Kinder is rarely afraid to speak his mind. Although he's made himself a billionaire, his most famous quote is probably from January 15, 2014 when the company reported earnings from the prior quarter. Kinder took personally the criticism of one bearish analyst by saying, "…you sell, I'll buy and we'll see who comes out the best in the long run." KMI was at the time trading around $35 which Kinder felt was not reflective of the value in his company. Two years later KMI trades at half this, and if Kinder was running for elected office this single quote would be indelibly linked with his candidacy. However, his protagonist had been bearish on KMI for several months and the stock subsequently traded above $44 before the collapse in crude oil ultimately bailed out that view. It's invariably easier to hold opinions unburdened by the need to apply them to actual investment decisions, and while the quote was memorable, there was little else for either side to recall fondly in this episode.

More recently, on the January 2016 earnings call, a KMI investor who had evidently invested a couple of years earlier based on the $2 dividend and its projected 10% growth sought clarification on what he might now expect with a $0.50 dividend and no forecast growth. KMI management was audibly discomfited by the question, and while there is a positive response that far exceeds a soundbite, the exchange between an investor who feels completely betrayed and the people he holds responsible was a form of shareholder democracy in action.

For those wondering where crude oil prices are headed, Plains All American (PAA) CEO Greg Armstrong offered this, "Without question the entire energy sector is facing a challenging period with future visibility to somewhat upside down. By that, I mean the long-term view is clearer than the short-term. Over the intermediate to long-term, it is very clear that the industry cannot replace production declines or make projected crude oil demand with oil at $30 per barrel and that the world will need US production growth to balance the market."

ADT, the alarm company recently acquired by Apollo Global Management, provided an amusing exchange between CEO Nareen Gursahaney and Omega Management's founder Leon Cooperman in April

2014. Gursahaney inspired me to write about *ADT and the Ham Sandwich Test* after Corvex (a hedge fund run by Keith Meister) negotiated a private sale of its large investment back to ADT by utilizing the very stock buyback program Meister had successfully urged the company to adopt. Untroubled by this sudden about-face from the buyback proponent, Gursahaney later defended the purchase as a good opportunity to acquire a large block of shares. The subsequent fall in the stock price reflected the more insightful view that Meister had played him for a fool. So it was that Leon Cooperman, noting that stock buybacks represented the company's biggest investment, challenged ADT to expand on what type of analysis they were doing: "I'd like to know how much thought is going into your biggest investment." A question that fairly demands a quantitative response of course drew nothing of the kind, further demonstrating ADT's weak command of their capital deployment. It's the kind of question that should be asked more frequently. Two years later, ADT's sale of itself to Apollo took place at a lower price than its share buyback from Corvex. We should all hope that Gursahaney never runs another public company.

CEOs cannot always be relied upon to be completely frank. A real doozy was Devon's (DVN) CEO David Hager when asked if they'd be issuing additional equity, "We've already issued the equity associated with those transactions, the $1.35 billion… As far as additional equity beyond that, we are focused on our cost reductions. We're focused on the asset sales, on the dividend reduction. I'm not going take anything off the table as far as a possibility, but we think we've taken some very significant steps to really increase the financial strength of the company with the actions we talked about today." Although this sounds a lot like "No", DVN later that day announced a secondary offering of equity. If Hager tells you it's sunny outside, you'd better check for yourself. This did at least further strengthen DVN's balance sheet, to the benefit of their creditors and suppliers including EnLink Midstream (ENLC).

Many questions are being asked about contract enforceability between an MLP and a struggling E&P customer who might file for bankruptcy protection. When Williams Companies (WMB) CEO Alan Armstrong was asked about this with respect to Chesapeake Energy (CHK), for whom they provide gathering and processing services, he responded like this, "I think if there was a reason for us to negotiate, then, yes, that could be part of a settlement. But the decision really is to accept or reject. And really, our point is if the contract is rejected, then we no longer have an obligation to provide service. And because these assets are built uniquely for these reserves, the ability to duplicate these assets would be, from our vantage point anyway, in most of these cases just would not be feasible to build or duplicate all these facilities in these very heavily – particularly places like the Barnett where it's very heavily populated and very expensive to build in, especially when you've got less reserves than you started with to build the assets in the first place.

"So, anyway, it could come down to a negotiation if there was value to be shared between the parties in a better contract, but our point is just that there isn't any ability to just separate. If somebody accepts the contract, they accept the contract in its whole. And if they reject it, then they take the risk of not being able to get their product moved out of the basin."

Recently David Dehaemers, the CEO of Tallgrass Energy GP, LP (TEGP) has offered up a few gems. He promised to conclude an earnings call by 5pm, …"so that those of you who rely on Jim Cramer and his lightning round for your MLP advice can make sure to watch him tonight." Dehaemers later characterized "take-or-pay" contracts under which Master Limited Partnerships get paid whether the pipeline capacity is utilized or not: "Our Pony Express contracts are take-or-pay period. We get paid the same amount every month whether the pipeline moves one barrel of oil or moves 300,000 a day. So we get the same amount of money. And so we already have the cash in our pockets at the end of every month. And so what happens is, it just like signing a year lease on an apartment with a little bit of difference right. So if we signed a lease for an apartment for two years and someone paid us every month, but they didn't move in there, we wouldn't really care, we have an apartment it's not been lived in, but we are getting paid anyway." And on valuations in the MLP sector, "Are we undervalued today? Unequivocally, has the market overcooked itself on the downside in my humble opinion? Absolutely."

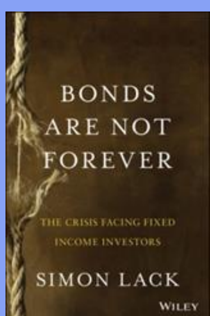
Dehaemers sounds a bit like JPMorgan's CEO Jamie Dimon, whose public comments are refreshingly clear. On the "London Whale", a credit derivatives trade that went badly wrong in 2012 and ultimately cost over $6BN, Dimon said at the time, "Just because we're stupid doesn't mean everybody else was."

Winston Churchill provided us with many great quotes, none of which related to Finance but are fun nonetheless. One of my favorites is, "There's nothing more exhilarating than to be shot at and missed." Assuming MLPs eventually return to delivering positive results, the MLP investor who dodged the understandable impulse to sell at various moments of deep depression may well feel like quoting Churchill, one of history's greatest defenders of democracy.

We are invested in ENLC, KMI, TEGP and WMB

Upcoming *Wall Street Potholes* Presentations

SL Advisors, LLC focuses on investment strategies that provide income without relying on fixed income securities.



On Monday, March 14th at 6:15pm, at the Hilton Hasbrouck Heights, Hasbrouck Heights, NJ, I'll be giving a presentation on my new book to the American Association of Independent Investors, Northern New Jersey Chapter. There is a modest entry fee. I'll also be giving a similar presentation on Wednesday, March 23rd at 7pm at the Westfield Memorial Library, Westfield, NJ. Attendance is free