

# Investment Bankers Are Not Helping MLPs

Several MLPs released earnings last week. Results were mixed. November is seasonally a weak month (see Why MLPs Make a Great Christmas Present), and many investors are weary of the sector after its second ever worst year. So reports below expectations resulted in steep drops, while good earnings caused modest ones.

Plains All America (PAA), which is in the crosshairs of the drop in U.S. crude oil production as the largest crude oil pipeline operator, met 3Q15 expectations but lowered 4Q15 guidance and didn't provide any for 2016 which drew a sharply negative reaction. Their current distribution of \$2.80 yields just under 10%. There's no plausible risk of it being cut and flat 2016 growth should be followed by a resumption of growth in 2017. Plains GP Holdings, PAA's GP, yields 7.2% having just increased its distribution 21% year on year. At \$12.82 PAGP is down almost 60% from its August 2014 high of \$31.55. What's probably not well understood is that PAGP has only \$559MM of debt. The \$10.2BN of long term debt they show on their consolidated balance sheet is mostly \$9.7BN at the PAA level. With \$617MM of distributions coming to PAGP from PAA, and a public float of only \$2.8BN (65% is already owned by management and entities with board representation), PAGP could easily take itself private through an LBO. They'd simply switch public equity holders for debt, increasing their upside exposure by 50% by using what the company would have paid in dividends to service the debt. This would not be a good outcome for public unitholders since the price is so low, but would represent an opportunistic roundtrip for the insiders who only took PAGP public two years ago at almost twice today's price.

NuStar (NS) lowered 2016 guidance due to reduced volumes out

of the Eagle Ford in Texas, and its price fell sharply as a result. Crude oil pipelines represent a quarter of NS's EBITDA and gasoline & distillate pipelines comprise 30% while Storage of refined products and crude oil represents just under half (they have a small marketing business). The Storage business did well; the silver lining of excess crude production is increased demand for places to put it. They are at capacity and are raising prices on renewals. Neither NS nor its GP, Nustar GP Holdings (NSH) are growing their distributions at present, although we believe that will eventually happen. Meanwhile, NS and NSH yield 9.6% and 8.9% respectively. Energy Transfer Equity's (ETE) three MLPs (Sunoco, Sunoco Logistics and Energy Transfer Partners) all had good quarters but nonetheless sold off.

Enlink Midstream Partners (ENLK) modestly exceeded expectations but its price fell nonetheless. Its GP, Enlink Midstream, LLC, yields 5% and reaffirmed its guidance for 15% distribution growth in 2016. ENLC purchased ENLK units recently alleviating all equity capital requirements in the near term.

The biggest shock of the week though was the announcement by Targa Resources that its GP (TRGP) will buy in its MLP (NGLS). While operationally Targa is well run, its strategic mis-steps are breathtaking. In the Summer of 2014, negotiations to sell itself to Energy Transfer Equity (ETE) broke down when TRGP was trading at \$150. At that time, management argued the stock was undervalued. Now, having lost fully two thirds of its value, they see fit to issue TRGP shares in order to buy in NGLS. The case in favor for NGLS investors is a lower cost of capital and modestly better distribution coverage (although they'll be receiving a lower distribution from TRGP than they were from NGLS). As with the Kinder Morgan transaction, the NGLS assets move to TRGP with a stepped up cost basis, eliminating TRGP's tax obligation for many years but at the expense of being a taxable transaction now for NGLS

unitholders. The 18% premium that TRGP is paying for NGLS is intended to compensate but in our view is needlessly generous. Most significantly for us, TRGP is foregoing the GP/MLP structure, which sacrifices valuable flexibility and is one of their most attractive features. The GP is also a prized acquisition target. The market reaction was swift, and by day's end investors in both securities were worse off than if the transaction hadn't been announced. We think management may be acting defensively to pre-empt a bid for TRGP in the same way that Williams Companies (WMB) sought to buy its MLP, Williams Partners (WPZ) before eventually agreeing to sell itself to ETE.

Leon Cooperman, whose fund Omega is a significant investor in TRGP, noted the 8% drop in the stock price and dryly asked on the conference call, "did the advisors that worked through this transaction with you expect this type of market reaction?" Since investors in both TRGP and NGLS saw a substantial loss in value on the announcement, and since TRGP management has shown themselves to be strategically inept, one would think that shareholder approval of the deal is by no means certain and perhaps even a hostile bid will appear to relieve TRGP of its burdensome stewards. We would be supportive of such. TRGP needs new leadership.

The deal hurt valuations of other GPs as investors considered where else investment bankers might show up. The MLP GP is the most attractive place to be in the MLP structure, and TRGP's apparent rejection of it has led to selling of other GPs and left investors puzzled. In recent weeks they've persuaded Kinder Morgan (KMI) to issue dilutive, poorly structured securities (see MLP Earnings Offer Scant Support for Bears and Rich Kinder Gets Outplayed) and now destroyed value for TRGP/NGLS. We'd all be better off if Wall Street bankers refrained from offering any more help, and let the industry just get on with its business.

We are invested in ENLC, ETE, KMI, NSH, PAGP, and TRGP.

