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Midstream dividends earning trust again

Investors have long sought equities that pay healthy dividends as those reliable payouts can meaningfully aid long-term total returns. Not long ago, midstream equities were often considered an important part of that equity pool. Then, over several years of energy market and midstream sector turmoil where many midstream companies cut their dividends, some investors understandably lost trust in the sector's dividend attribute. However, healthy midstream equity performance in recent years, particularly over periods of broader energy volatility, suggest the sector has earned this trust back.

Why midstream lost its reliable dividend payer status

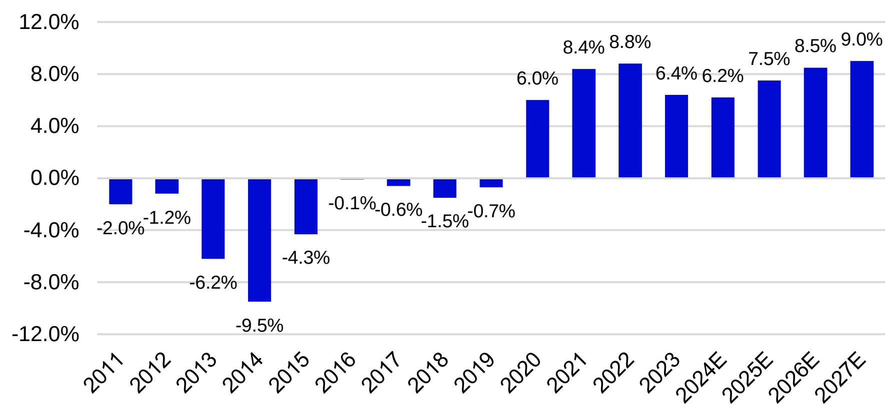
As shale production took off in the US, midstream energy companies invested hundreds of billions of dollars to meet the logistical demands of this new production. Raw production from far afield oil and gas wells had to be gathered, treated, processed, transported, and stored by new facilities to ultimately reach consumers of energy in the right quality and at the right time. Originally, midstream companies were executing on these enormous capital spending requirements while also maintaining their high distribution rates through issuing new equity to fund this investment.

But poor equity markets brought on by a series of commodity price cycles starting in late 2014 and capped off by the effect of the COVID induced lockdowns in 2020 made issuing new equity too costly. Without reasonably priced access to fresh equity capital, many midstream companies chose to cut their distribution payouts to self-fund capital programs or to right size borrowing levels from previous spending. This business model shift, from dependence on outside equity to self-funding, was unsettling for investors and made for poor price performance.

The return of the reliable dividend payer status

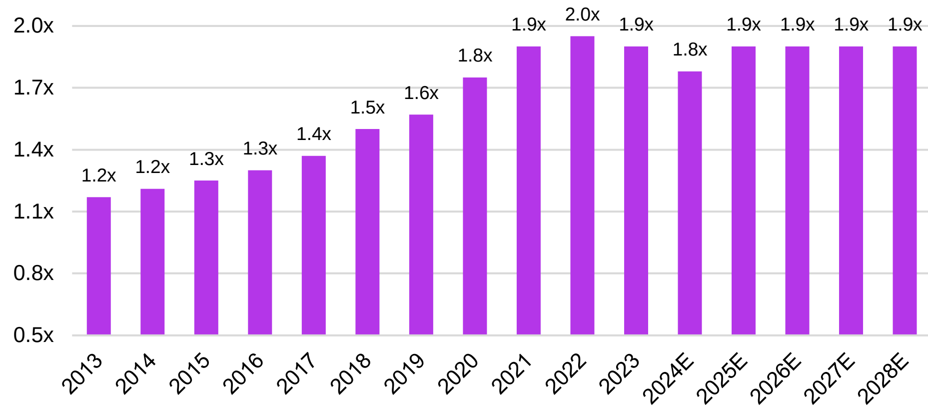
As seen in charts below, midstream free cash flow, distribution coverage, and leverage metrics have improved materially over recent years. As a result, we believe the sector has now largely completed this transformation and, in fact, has embarked on a new period of distribution and dividend growth.

Midstream market cap weighted free cash flow (FCF) yield



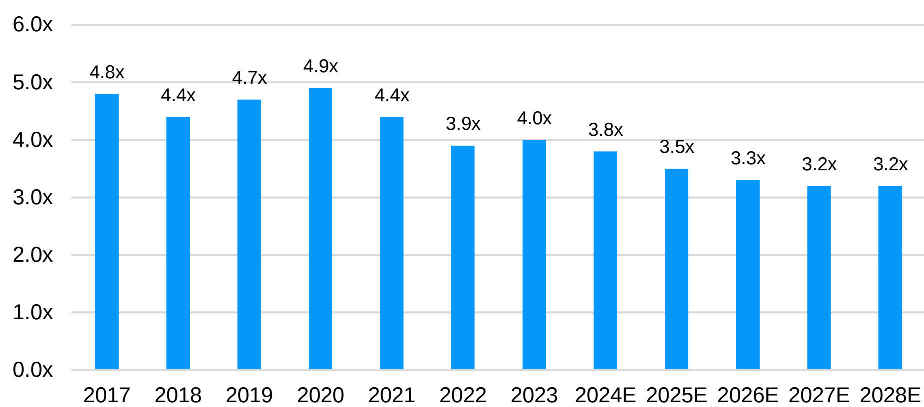
Source: Wells Fargo Research as of 3/31/24. Free cash flow represents cash flow from operations minus maintenance and growth capital expenditures. Free cash flow yield is a ratio that compares the free cash flow per share a company is expected to earn against its market value per share. "E" represents estimates. There is no guarantee that estimates will come to pass. Past performance is not indicative of future results.

Midstream distribution coverage



Source: Wells Fargo Research as of 3/31/24. [4]Distribution coverage ratio is defined as distributable cash flow divided by distributions paid to shareholders. Distributable cash flow is defined as cash flow from operations minus maintenance capital expenditures. "E" represents estimates. There is no guarantee that estimates will come to pass. Past performance is not indicative of future results.

Midstream median debt-to-EBITDA

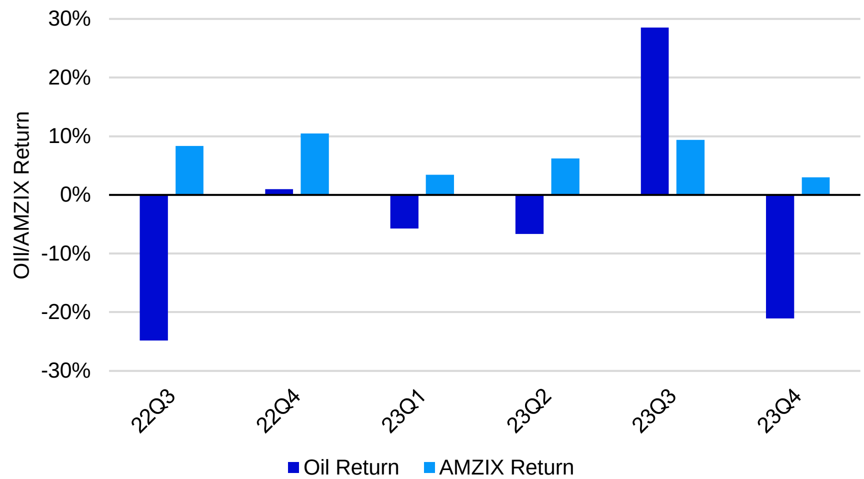


Source: Wells Fargo Research as of 3/31/24. EBITDA is earnings before interest, taxes, depreciation, and amortization. Debt-to-EBITDA is defined as total company debt divided by trailing twelve-month EBITDA. "E" represents estimates. There is no guarantee that estimates will come to pass. Past performance is not indicative of future results.

Over half of the midstream sector has grown their dividends since COVID and the median of those increases has been approximately 15%.[1] Notably, a number of large cap midstream companies grew their payout by more than 10% annually in 2023 including Energy Transfer LP, NYSE: ET (24%), Targa Resources Corp, NYSE: TRGP (42%), Plains All American Pipeline LP, NYSE: PAA (21%), and Western Midstream Partners LP, NYSE: WES (28%). We believe over the coming quarters and years, additional midstream operators will begin to grow their dividends as well.

Importantly, it appears that investors have finally begun to trust the midstream sector dividend as well. The Alerian MLP Index (AMZ) has generated an annual total return of 32% since the beginning of 2021 through 2023. Further, the sector has been able to perform with relative resilience over periods of broader energy market volatility, an attribute that was also noticeable over the sector's original phase of dividend trust. In fact, quarterly correlation between crude oil and the AMZIX from 2Q22 – 4Q23 was negative four of the six quarters (below).[2] Further since the beginning of 2014, the Alerian MLP Infrastructure Index (AMZIX) has outperformed oil every quarter that oil has had a negative return. The average outperformance during those periods has been 12.3%.[2]

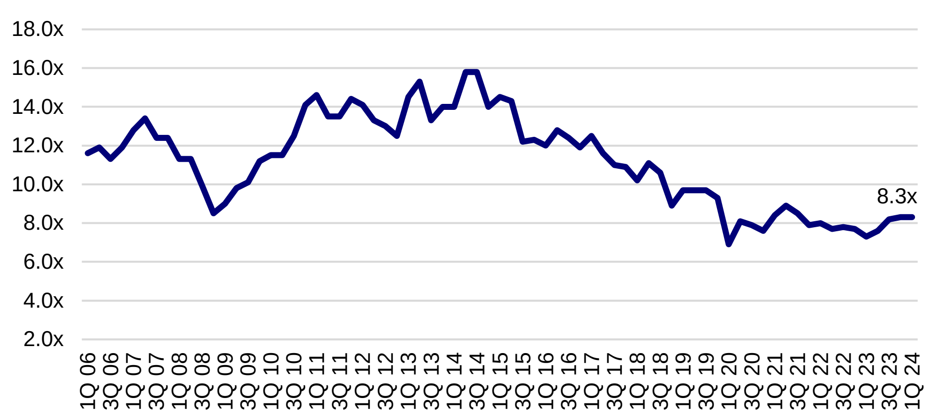
Oil/Alerian MLP Infrastructure Index (AMZIX) quarterly returns



Source: Bloomberg L.P. as of 12/31/2023. Oil represented by West Texas Intermediate (WTI) crude oil. WTI is a light, sweet crude oil that serves as one of the main global oil benchmarks. AMZIX is the Alerian MLP Infrastructure Index total return.

While the midstream sector has performed well over the last few years, midstream continues to trade at a historically low multiples (below). We are hopeful that as more yield-oriented investors begin to trust and add to midstream, the sector can also begin to improve the multiple at which it trades. Given a midstream sector yield of 7.04% relative to 4.08% for Utilities, we believe midstream's payouts may continue to earn investor consideration.[3] We believe that continued dividend growth may help to gain further investor interest as well.

Midstream median EV-to-EBITDA



Source: Wells Fargo Research as of 3/31/24. EV-to-EBITDA is defined as enterprise value divided by earnings before interest, taxes, depreciation and amortization (EBITDA). Enterprise value is defined as market capitalization of equity plus total debt minus cash and cash equivalents. **Past performance is not indicative of future results.**

Important information

1. Energy Transfer LP, NYSE: ET; Enterprise Products Partners LP, NYSE: EPD; Sunoco LP, NYSE: SUN; Global Partners LP, NYSE: GLP; KinderMorgan Inc, NYSE: KMI; Alliance Resource Partners LP, NYSE: ARLP; MPLX LP, NYSE: MPLX; Targa Resources Corp, NYSE: TRGP; Williams Companies Inc, NYSE: WMB; ONEOK Inc, NYSE: OKE; Archrock Inc, NYSE: AROC; Western Midstream Partners LP, NYSE: WES; Enbridge Inc, NYSE: ENB; TC Pipelines LP, NYSE: TRP; Suburban Propane Partners LP, NYSE: SPH; Hess Midstream Partners LP, NYSE: HESM; Plains All American Pipeline LP, NYSE: PAA; Plains GP Holdings LP, NYSE: PAGP; EnLink Midstream LLC, NYSE: ELNC; Delek Logistics Partners LP, NYSE: DKL; Cheniere Energy Partners LP, NYSE: CQP.
2. Bloomberg as of 12/31/2023. Analyzed quarterly from 1/1/14-12/31/23. During periods that oil, based on WTI performance, had a negative return, the AMZIX returned, on average, 12.3%.
3. Bloomberg as of 3/31/2024. Midstream represented by Alerian MLP Index. Utilities represented by Dow Jones Utilities Index.

The Alerian MLP Index is a capped, float-adjusted, capitalization-weighted index, whose constituents earn the majority of their cash flow from midstream activities involving energy commodities.
The Alerian MLP Infrastructure Index is a capped, float-adjusted, capitalization-weighted index, whose constituents earn the majority of their cash flow from midstream activities involving energy commodities.
The Dow Jones Utility Average is a stock index from S&P Dow Jones Indices that tracks the performance of 15 prominent utility companies traded in the United States.
An investment cannot be made into an index. Past performance does not guarantee future results.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions, there can be no assurance that actual results will not differ materially from expectations.

Most MLPs operate in the energy sector and are subject to the risks generally applicable to companies in that sector, including commodity pricing risk, supply and demand risk, depletion risk and exploration risk. MLPs are also subject the risk that regulatory or legislative changes could eliminate the tax benefits enjoyed by MLPs which could have a negative impact on the after-tax income available for distribution by the MLPs and/or the value of the portfolio's investments. Although the characteristics of MLPs closely resemble a traditional limited partnership, a major difference is that MLPs may trade on a public exchange or in the over-the-counter market. Although this provides a certain amount of liquidity, MLP interests may be less liquid and subject to more abrupt or erratic price movements than conventional publicly traded securities. The risks of investing in an MLP are similar to those of investing in a partnership and include more flexible governance structures, which could result in less protection for investors than investments in a corporation. MLPs are generally considered interest-rate sensitive investments. During periods of interest rate volatility, these investments may not provide attractive returns.

Energy infrastructure MLPs are subject to a variety of industry specific risk factors that may adversely affect their business or operations, including those due to commodity production, volumes, commodity prices, weather conditions, terrorist attacks, etc. They are also subject to significant federal, state and local government regulation.

The opinions referenced above are those of the author as of April 5, 2024. These comments should not be construed as recommendations, but as an illustration of broader themes. The opinions are based on current market conditions and are subject to change. They may differ from these of other Invesco investment professionals.

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