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As an investment advisor, you have been subscribed to the MLP Newsletter so that you and your clients can stay abreast of this powerful income-generating sector. Published quarterly, the MLP Newsletter includes valuable information and expert opinion about MLPs that you cannot get anywhere else.

The Master Limited Partnership Association (MLPA) is a trade association representing the publicly traded limited partnerships (PTPs) that are commonly known as master limited partnerships (MLPs), and those who work with them.

Tortoise Capital Advisors

Tortoise Capital Advisors invests in assets and services that serve essential needs in society, such as diversification and income. Tortoise's expertise spans energy investing across the entire value chain.

Advisor Access spoke with Brian Kessens, CFA, Tortoise's Managing Director and Portfolio Manager - Energy.

Advisor Access: ***While MLP performance is positive in 2018, the increase lags that of the broader market. Why have MLPs underperformed this year and over the last several years?***

Brian Kessens: MLPs performed relatively well for the decade prior to 2014, aided by both the shale revolution in the U.S. and open equity capital markets. Investors embraced the MLP business model of paying out cash flow and financing growth with new capital. Since 2014, several things have changed. Crude oil has fallen from over $100 per barrel to under $30 per barrel in 2016. Investor sentiment toward all energy soured. Equity capital markets were no longer reliable to finance growth. And growth in MLP distributions over the previous decade left many paying 50% of all incremental cash flow to the general partner through incentive distribution rights. This raised the cost of capital, reducing the ability for MLPs to earn excess returns. MLPs began evolving in this new environment, yet investors have not returned to embrace the sector in the same way.

AA: ***How have MLPs evolved?***

BK: MLPs are looking more like C corporations. Reducing the cost of capital, self-funding the equity portion of new projects and improving management and unitholder alignment are the primary aims of the evolution. Many MLPs reduced the amount distributed to unitholders through consolidation, elimination of the incentive distribution rights, or through outright lower distribution payouts. The effect of these efforts is a lower cost of capital and more retained cash flow. Use of this excess cash flow is typically project financing or debt reduction. The ability for self-funding is much improved. Further, the elimination of the incentive distribution rights, and in some cases a consolidation of the limited and general partner, is leading to improved alignment between managers and owners. Broadly, MLPs have simplified. For investors looking at the sector for the first time, MLPs are structurally easier to assess.

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AA: ***How much more evolution do you expect, or is the evolution over?***

BK: The majority of MLPs as measured by the Tortoise MLP Index® no longer have incentive distribution rights (IDRs). In fact, six of the seven largest MLPs do not have IDRs and with the recent announcement by Energy Transfer to consolidate, we expect the seven largest MLPs will not have them by year-end 2018. By the end of 2019, we expect over 80% of the sector to be IDR-free.

MLPs in the News	
Enterprise Products Enterprise Products Partners L.P.	**Enterprise Products Partners** (NYSE: EPD) Reports Record Results for Second Quarter 2018
HOLLY ENERGY PARTNERS	**Holly Energy Partners** (NYSE: HEP) Reports Second Quarter Results
MAGELLAN MIDSTREAM PARTNERS, L.P.	**Magellan Midstream Partners** (NYSE: MMP) Reports Higher Second-Quarter Financial Results
NRP	**Natural Resource Partners** (NYSE: NRP) Reports Second Quarter 2018 Results
NuStar	**NuStar Energy** (NYSE: NS) and NuStar GP Holdings, LLC Announces 12% Increase in Second Quarter 2018 Net Income
PBF Logistics	**PBF Logistics** (NYSE: PBFX) Highlights Growth in Second Quarter Earnings Release
TC PipeLines, LP	**TC PipeLines, LP** (NYSE: TCP) Announces 2018 Second Quarter Financial Results
Westlake Chemical Partners	Westlake Announces Increase in Target Distribution Thresholds for Incentive Distribution Rights (IDRs) of **Westlake Chemical Partners LP** (NYSE: WLKP)

The ability to self-fund is now real, as companies routinely have distribution coverage in excess of 1.3x versus historical coverage closer to 1.1x. The acute need for new common equity to finance growth projects no longer holds. If there is a need for financing beyond self-funding, there are several avenues accessible, including public investment in private equity deals (PIPEs), joint venture, and private equity.

AA: ***How is the fundamental backdrop for the sector playing out?***

BK: In our view, the fundamentals for MLPs, specifically midstream MLPs, are terrific. The expectations are that U.S. production growth for all three of the drill-bit commodities will continue over the next five years. Crude oil production may near 13 million barrels per day in 2022, versus about 10 million in 2017. Natural gas production may eclipse 90 billion cubic feet per day in 2022, versus about 75 billion in 2017. Producing companies have continued to improve their drilling and completion techniques by drilling further horizontally and using more sand. These gains are resulting in improved returns and lower breakeven prices. For crude oil, breakeven prices are now below $40 per barrel, and even lower in the Permian Basin, where the majority of new drilling is taking place. For midstream companies tasked to transport energy commodities, we expect U.S. production growth to result in greater cash flow.

AA: ***Are MLPs keeping up with this production growth? How much of an opportunity does that represent?***

BK: To transport ever increasing volumes, the U.S. needs more pipeline takeaway capacity. The price for crude oil in the Permian Basin in west Texas is more than $10 per barrel below the price received on the Gulf Coast because the marginal barrel must be shipped on a truck or via rail, both more expensive and less efficient modes of transportation versus pipelines. Natural gas prices show the same phenomenon. Help is on the way with new pipeline announcements, commitments by producers, and construction. Significant new pipeline takeaway capacity is expected to come online in the second half of 2019. Until then, expect price differentials to remain wide. The Permian, in particular, remains a great opportunity for midstream companies to construct additional infrastructure.

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Export infrastructure is also necessary. We expect nearly all marginal production in the U.S. to be exported. Many MLPs are developing crude oil export infrastructure along the Gulf Coast. The key is finding berths deep enough, or building new ones, to support the largest crude oil marine vessels. And for natural gas, many liquified natural gas (LNG) export terminals are expected to come online through 2020, with several others seeking long-term shipper commitments and regulatory approvals to make final investment decisions.

We estimate about $150 billion in capital is needed for new projects over the 2018-20 period—a fairly significant sum. Further, the Interstate Natural Gas Association of America (INGAA) forecasts capital investment for new projects to average $44 billion per year from 2018 to 2035. The need for more energy infrastructure will continue.

AA: ***Are the regulators in favor of approving all of these new projects?***

BK: Generally, yes. Regulators recognize the need for more pipeline and energy infrastructure and are approving projects that have merit. But scrutiny on new projects has never been higher. Environmental concerns are at the heart of the matter; companies need to show the detailed environmental impact of a new pipeline, particularly around water crossings. A lot of time and effort is put into finding the most efficient route around preserved areas, Native American grounds, urban communities, etc. Midstream companies are engaging in more community outreach and remediation work post-construction than ever before. Regulatory approvals are forthcoming, yet the lead time from project ideation to completion is longer. In some cases, years longer.

AA: ***Any concluding thoughts?***

BK: The fundamentals for the sector are strong. MLPs have made great strides over the past several years, reducing costs of capital and improving alignment with unitholders. While the broad market trades at valuations above historical levels, MLPs trade at valuations more than 20% below those levels. We think, as investors increasingly no longer need to understand the structural dynamics of MLPs and can isolate the fundamentals, investors will recognize the sector's value. We are long-term investors and really like what we see in front of us.

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AA: ***Thank you, Brian.***

The Tortoise MLP Index® is a float-adjusted, capitalization weighted index of energy master limited partnerships (MLPs). The index is comprised of publicly traded companies organized in the form of limited partnerships or limited liability companies engaged in transportation, production, processing and/or storage of energy commodities.

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