



AMNA: The Benchmark Index for North American Midstream

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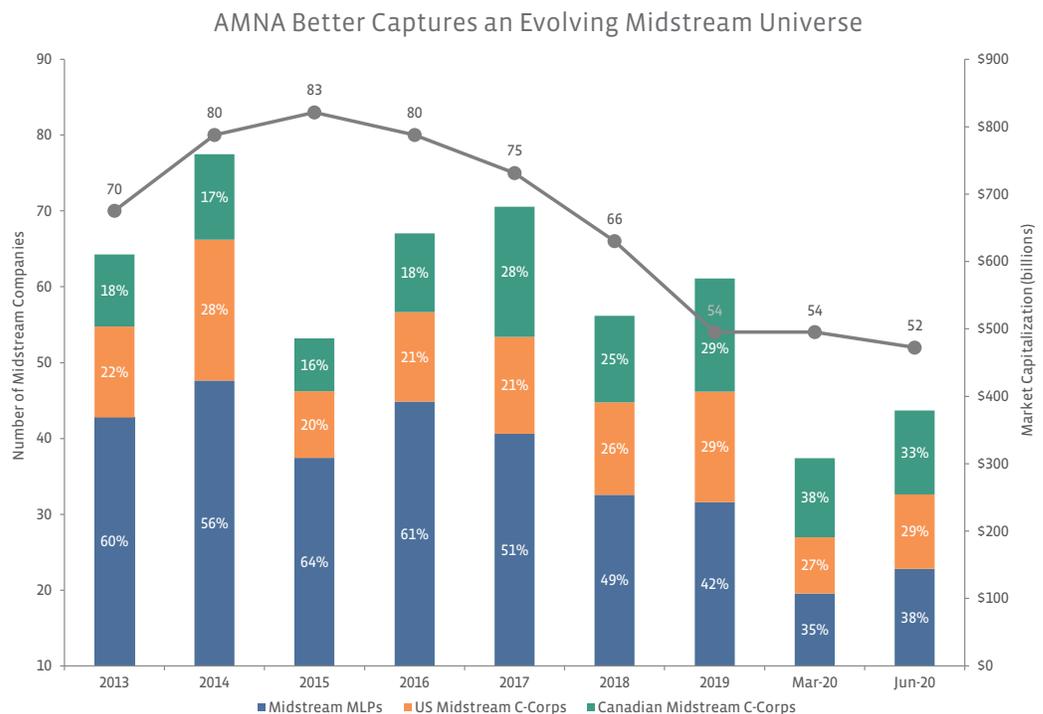
Summary

Several years ago, Master Limited Partnerships (MLPs) dominated the midstream universe, making MLP-only indexes a decent proxy for midstream broadly. Today, MLPs represent less than 40% of the North American midstream universe by market capitalization. An MLP-only index is ideal for benchmarking MLPs but is not sufficient for gauging North American midstream performance given the increased prevalence of US and Canadian corporations in the universe. In June 2018, Alerian launched the [Alerian Midstream Energy Index \(AMNA\)](#) to provide a sector benchmark for investors and industry stakeholders primarily concerned with representation. This piece discusses the superior representation of the AMNA Index and examines the benefits of a diversified energy infrastructure allocation as exemplified by the attributes of the index.

Several years ago, Master Limited Partnerships (MLPs) dominated the midstream universe, making MLP-only indexes a decent proxy for midstream broadly. After a series of consolidations, take-private deals, and other transactions in recent years, MLPs now represent less than 40% of the North American midstream universe by market capitalization. An MLP-only index is ideal for benchmarking MLPs, but it is not sufficient for gauging broad midstream performance given the increasing share of US and Canadian corporations in the universe. In June 2018, Alerian launched the [Alerian Midstream Energy Index \(AMNA\)](#) to provide a sector benchmark for investors and industry stakeholders primarily concerned with representation. This piece discusses the superior representation of the AMNA Index and examines the benefits of an energy infrastructure allocation as exemplified by the attributes of the index.

The evolution of the midstream landscape required a new benchmark.

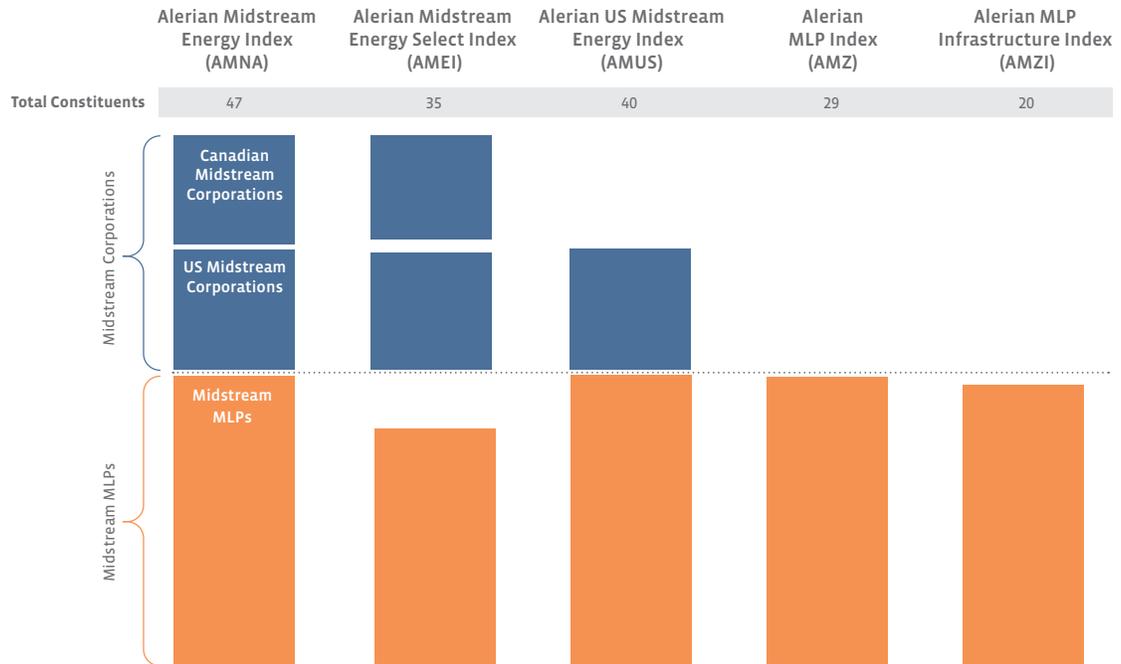
In years past, MLP-only indexes were fairly representative of the midstream universe given the prevalence of MLPs. Investors primarily looked to the [Alerian MLP Index \(AMZ\)](#) to assess midstream performance. However, MLPs have represented less than 50% of the midstream universe by market capitalization for a few years. MLP consolidations by parents structured as corporations, take-private deals, and other simplification transactions have driven this transition. The landmark transaction by Kinder Morgan (KMI) in 2014 is a prime example of this, with KMI acquiring two MLPs and an LLC to consolidate under one C-Corp. While there were additional consolidation transactions in the interim, the simplification trend accelerated notably in 2018 and 2019 for a variety of reasons. These included investor disdain for incentive distribution rights and a related desire to streamline structures, a FERC policy revision that made the C-Corp structure relatively more attractive for owning interstate natural gas pipelines, and challenged capital markets, which prohibited dropdown MLPs from serving their original purpose. As illustrated in the chart, the makeup of the North American midstream universe has changed significantly over the last few years, with MLPs seeing their share of the universe decline and the total number of companies falling by roughly a third since 2015.



Source: Alerian as of 6/30/2020

AMNA provides broad midstream representation.

With the shift in the makeup of the midstream universe, the Alerian Midstream Energy Index (AMNA) was launched in June 2018 to provide superior sector representation, as shown below. The index includes MLPs as well as midstream corporations with principal offices in the US and Canada and has a modest liquidity requirement. Constituents must earn the majority of cash flows from midstream activities, which include Gathering & Processing, Liquefaction, Pipeline Transportation, Rail Terminating, and Storage. As of June 30, 2020, AMNA had 47 constituents compared to 52 total companies in the universe. The index is weighted by float-adjusted market capitalization with a 10% cap.

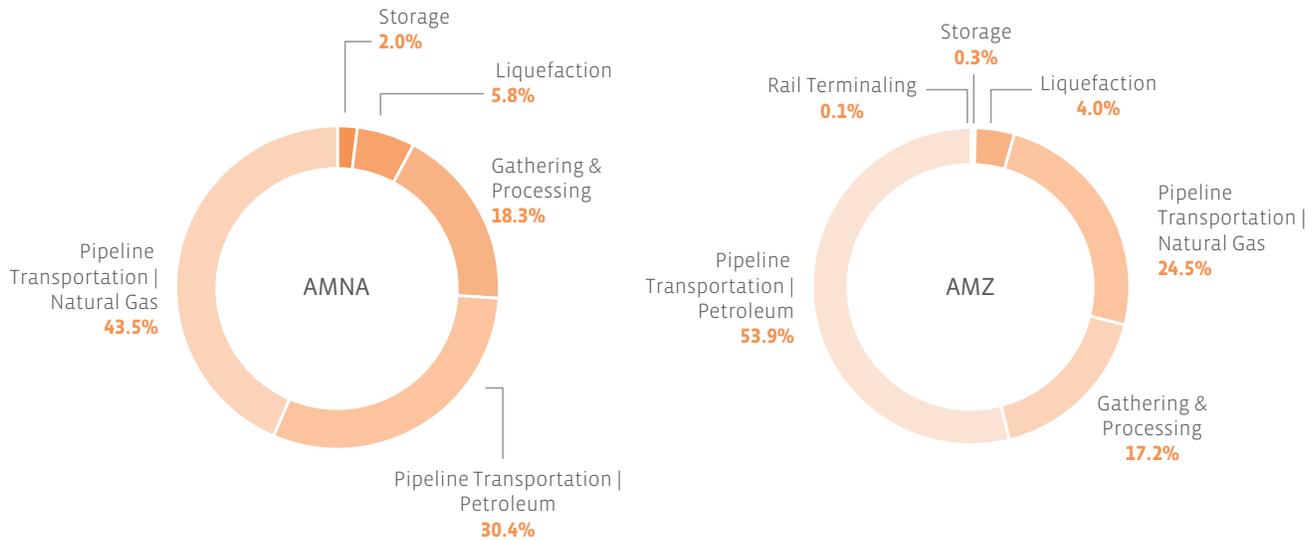


For illustrative purposes only
Source: Alerian as of 6/30/2020

While there is a 10% cap on individual constituents, the AMNA Index does not have limitations on the portion of the index allocated to MLPs. This differentiates AMNA and its US subset, the [Alerian US Midstream Energy Index \(AMUS\)](#), from other Alerian indexes, which cap MLPs at 25% or 20%. If an investment vehicle such as a mutual fund or exchange-traded fund owns more than 25% MLPs, the fund will be taxed as a corporation. Given these tax considerations, benchmark indexes intended for these funds limited MLP exposure at the cost of more accurate sector representation. The weightings for AMNA are not constrained by fund-related tax considerations.

In addition to superior representation in terms of included companies, AMNA also provides more comprehensive exposure to the full spectrum of midstream assets. As noted above, a FERC policy revision in March 2018 made the C-Corp structure relatively more attractive for owning interstate natural gas pipeline assets. Multiple MLPs with these assets were consolidated by midstream C-Corp parents. As a result, MLP-only indexes tend to be lacking in exposure to interstate natural gas pipelines and have a greater exposure to companies involved in the pipeline transportation of petroleum as shown in the comparison of sector weightings for AMNA and AMZ on the following page.

Sector Weightings for AMNA More Accurately Reflect the Full Spectrum of Midstream Assets



Source: Alerian as of 6/30/2020

Canadian midstream companies should not be overlooked.

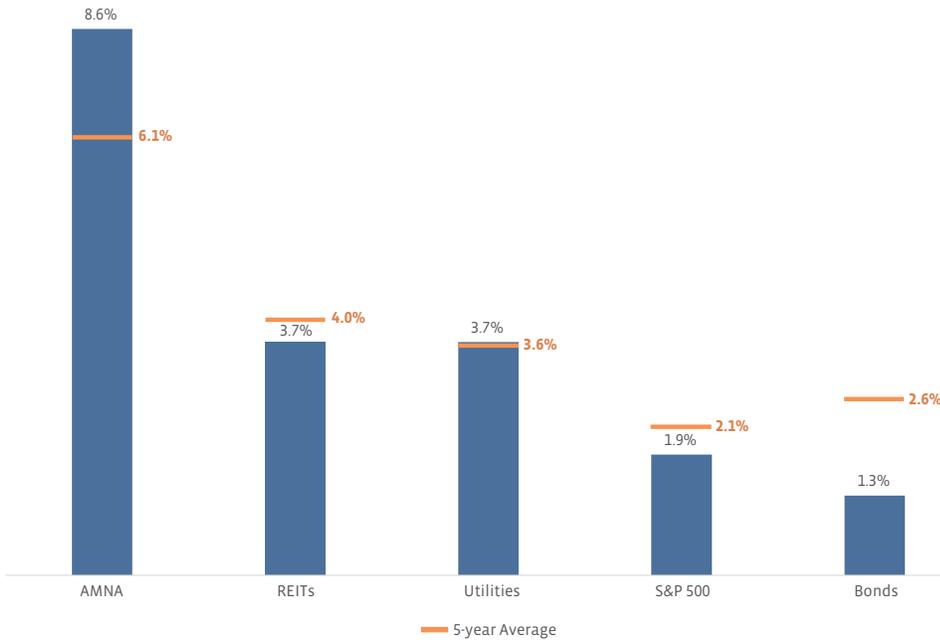
The US and Canadian energy markets have become increasingly intertwined. Canada is the biggest provider of energy imports to the US, and Canada is the second-largest customer for US energy exports after Mexico. At the company level, Canadian midstream companies own significant assets in the US. For example, at the end of 2018, Enbridge (ENB) acquired its related US MLPs, Enbridge Energy Partners and Spectra Energy Partners. TC Energy (TRP) also owns significant assets in the US in addition to the infrastructure owned by its related MLP, TC PipeLines (TCP). On the other hand, US midstream companies may also own assets in Canada, with MLP Plains All American (PAA) serving as an example of a US company with a Canadian asset base.

Setting aside the integration between the US and Canada, Canadian midstream corporations are a significant portion of the midstream universe. After the severe volatility in energy stocks earlier this year, Canadian corporations represented 38% of the North American midstream universe by market cap at the end of March 2020 – the first time that Canadian corporations had accounted for the greatest share of the universe. While MLPs have since overtaken Canadian corporations in terms of market cap share, ENB and TRP are the largest midstream companies by market cap at the time of writing. Clearly, Canadian midstream corporations should not be overlooked. However, for those investors limited to owning US companies, the Alerian US Midstream Energy Index (AMUS) represents the US subset of AMNA and would provide a more relevant benchmark.

AMNA exemplifies the benefits of an allocation to midstream.

Given its broad representation, the AMNA Index can be useful for evaluating the benefits of a diversified allocation to energy infrastructure. Investors have historically been drawn to midstream for generous income with yields exceeding those of other income-oriented investments, as shown below. Despite elevated yields, it is important to note that companies rated investment grade represented 83.0% of the AMNA index by weighting as of June 30, 2020. Current yields are well above the five-year average given weak performance in the wake of COVID-19 macro energy headwinds.

AMNA's Yield Compares Favorably to Other Sectors



Correlations to AMNA

| | 3-year | 5-year |
|-----------|--------|--------|
| REITs | 0.83 | 0.68 |
| Utilities | 0.53 | 0.37 |
| S&P 500 | 0.83 | 0.78 |
| Bonds | 0.20 | 0.15 |
| WTI Crude | 0.50 | 0.52 |

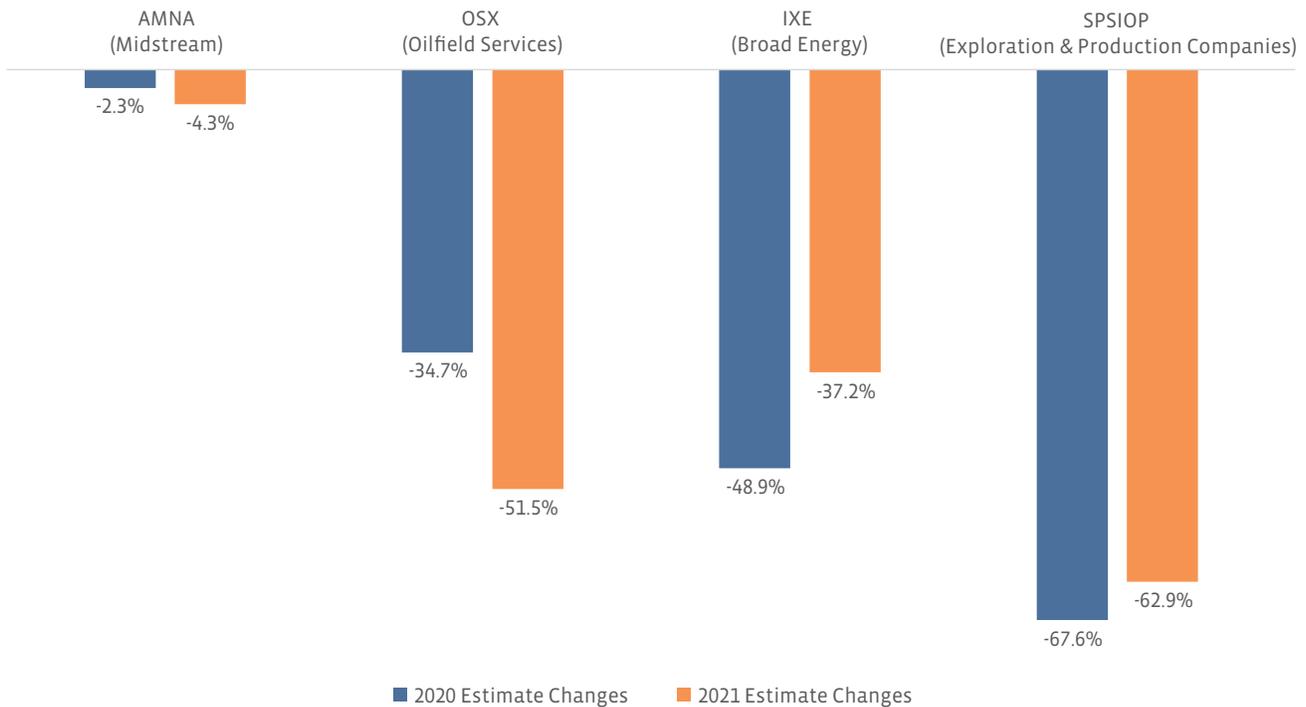
REITs are represented by the FTSE NAREIT Real Estate 50 Index. Utilities are represented by the S&P 500 Utilities Index. Bonds are represented by the Barclays US Aggregate Bond Index. Source: Alerian, Bloomberg as of 6/30/2020

Additional benefits of an energy infrastructure allocation include real asset exposure, more defensive energy exposure given the fee-based nature of the midstream business model, and diversification. An allocation to midstream can enhance an income portfolio by increasing yield while further diversifying the portfolio. Midstream tends to have modest correlations with income-focused assets like utilities and bonds, as shown above. Additionally, MLPs are not included in broader market indexes, which can provide another element of diversification.

In addition to the evolution of the midstream universe discussed previously, there have been a number of positive changes at the company level across the space in recent years. Midstream has reduced its dependence on equity capital markets and shifted towards self-funding equity growth capital. The vast majority of MLPs have eliminated incentive distribution rights from their structures, simplifying their businesses, lowering their cost of capital, and improving corporate governance. The energy infrastructure space has also taken steps to improve Environment, Social and Governance (ESG) reporting, with several companies providing annual sustainability reports.

Despite macro headwinds related to the impacts of COVID-19 countermeasures on energy demand, North American midstream companies are well positioned to withstand market volatility. Companies have responded by prioritizing financial flexibility and balance sheets, which has led to widespread reductions in growth capital spending plans and dividend cuts for smaller names. Specifically for AMNA, 20 of 48 constituents as of April cut their payouts for 1Q20, but this represented only 10.3% of the index by weighting as of April 17. While cuts to payouts are frustrating for investors, they leave the space better positioned to weather current challenges. Furthermore, the fee-based nature of midstream insulates the sector's cash flows from commodity price volatility, particularly relative to other sectors of energy as shown in the chart below.

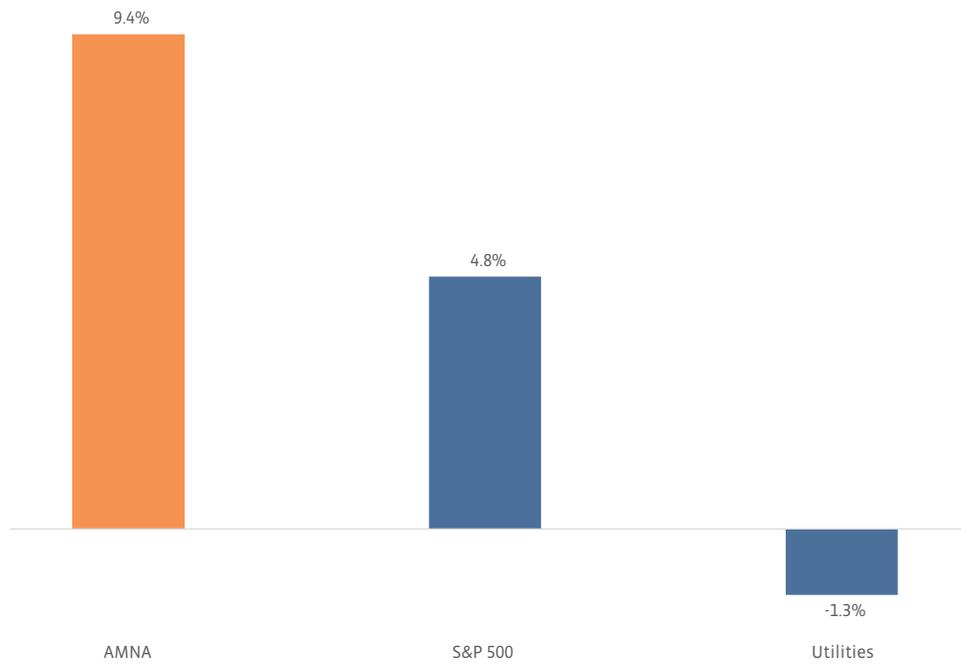
Revisions to EBITDA Estimates Reflect the Stability of Midstream Relative to Other Sectors of Energy



Oilfield service companies are represented by the PHLX Oil Service Index (OSX). Broad energy is represented by the Energy Select Sector Index (IXE). Exploration & production companies are represented by the S&P Oil & Gas Exploration & Production Select Industry Index (SPSIOP). Data reflects the percentage change in 2020 and 2021 index-level EBITDA estimates from 1/31/2020 to 6/30/2020. Estimates from 1/31/2020 used for comparison were based on estimates for index constituents at that time. Source: Bloomberg as of 6/30/2020.

Entering 2020, the midstream space was nearing a free cash flow inflection point as growth capital spending was moderating from peak levels in recent years. Several companies had free cash flow generation after dividends in their sights for 2020 or 2021. Despite current macro challenges, midstream has the potential to generate meaningful free cash flow in the coming years, as shown in the chart on the following page. In the near term, excess cash flow will likely be used to reduce leverage and shore up financial positioning. However, as demand recovers and energy markets stabilize, midstream could be well positioned to direct excess cash flow to shareholder-friendly returns, including buybacks and dividend increases.

AMNA Free Cash Flow Yield Compares Favorably to the Broader Market and Utilities



Utilities are represented by the S&P 500 Utilities Index.
Free cash flow yields are based on index-level Bloomberg estimates for 2021 free cash flow.
Source: Bloomberg as of 6/30/2020

Conclusion

Changes in the midstream landscape have necessitated a more comprehensive benchmark with MLPs and corporations. The Alerian Midstream Energy Index (AMNA) fulfills stakeholders' needs for a representative sector benchmark for the North American midstream universe.

AMNA: The Benchmark Index for North American Midstream

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