



Robust Free Cash Flow Generation Sets Midstream Apart

Date: November 2, 2021

Author: Stacey Morris, CFA

Summary

- For midstream, the combination of steady cash flows backed by long-term contracts and a significant decline in growth capital spending is leading to robust FCF generation.
- The absolute improvement and positive trend in FCF yield for midstream screens favorably when compared to the broader market and utilities.
- Several midstream companies are expected to generate positive free cash flow after dividends in 2021.

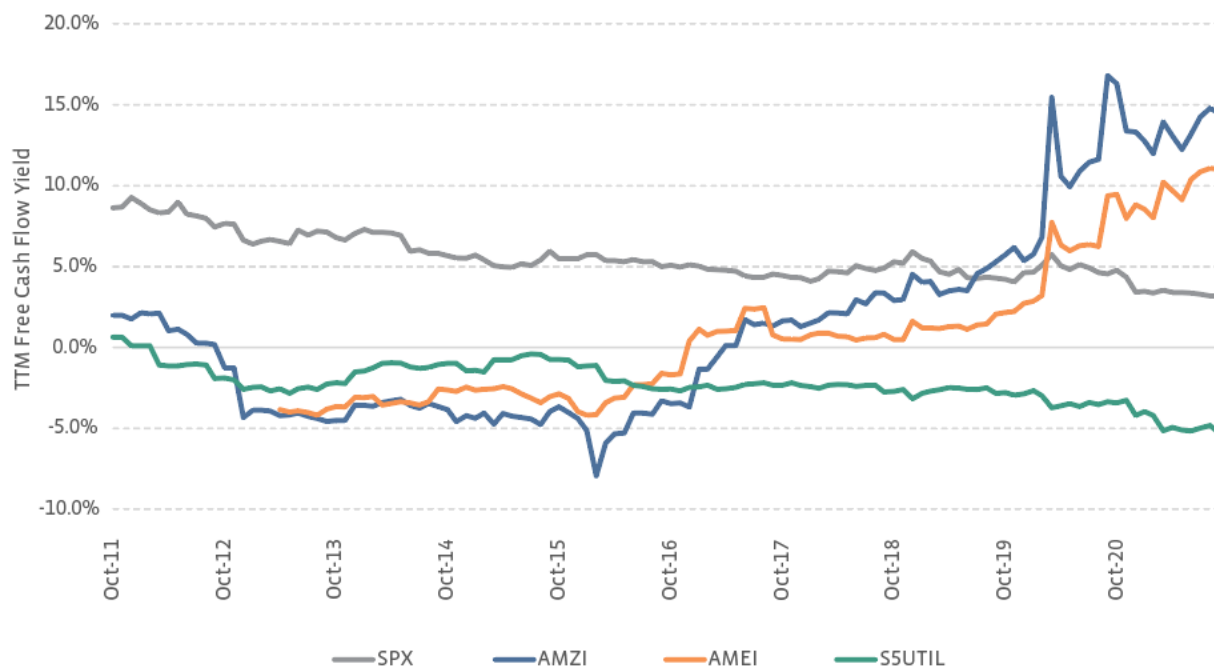
Across the energy sector, free cash flow (FCF) generation is a priority as companies look to lure back investors by enhancing shareholder returns through dividends and buybacks. For many companies, a past emphasis on growth has been replaced by a focus on capital discipline and efficiency. Specific to midstream, years of hefty investments to facilitate the boom in US energy production have largely given way to more modest spending plans, which is allowing for FCF generation even after accounting for generous dividends. Today's note looks at how FCF yields have trended over time relative to the broader market and utilities and estimated 2021 FCF for top constituents of the [Alerian MLP Infrastructure Index \(AMZI\)](#) and the [Alerian Midstream Energy Select Index \(AMEI\)](#).

Midstream FCF yields compare favorably to the broader market.

For midstream, the combination of steady cash flows backed by long-term contracts and a significant decline in growth capital spending is leading to robust FCF generation. Unlike other energy subsectors where the amount of FCF generated depends on commodity prices, there is better visibility to midstream FCF due to its fee-based business model, which drives steadier cash flows. From a spending perspective, instead of building massive new pipelines, companies are mostly pursuing bolt-on projects, joint ventures with modest capital requirements, and/or smaller expansions, which is more in line with what is needed today given the current [US production outlook](#). The absolute improvement and positive trend in FCF yield for midstream screens favorably when compared to the broader market and utilities.

The chart below shows trailing twelve-months FCF yield for the S&P 500 (SPX), S&P 500 Utilities Index (S5UTIL), AMZI, and AMEI over the past decade. The negative FCF yield for utilities is worsening, and the FCF yield for the SPX has gradually declined to less than 5% currently. In contrast, the AMZI and AMEI have seen a clear step-change in FCF yields in recent years to about 10-15% as midstream reached an inflection point in capital spending. This is a significant improvement from the negative FCF yields of years past. Notably, the TTM FCF yield is slightly higher for the MLP-focused AMZI relative to the AMEI, which is 25% MLPs and 75% US and Canadian C-Corps.

Midstream FCF Yields Trending Higher; Compare Favorably to Broader Market and Utilities



Source: Bloomberg, Alerian and S-Network Global Indexes as of 10/22/2021

Several midstream companies generating FCF after dividends.

To further contextualize the index-level data, it is helpful to look at estimated free cash flow before and after dividends for top constituents in the AMZI and AMEI by weighting. All nine companies – Enterprise Products Partners (EPD) is a top five constituent in both indexes – are expected to generate positive free cash flow in 2021 based on consensus estimates as shown below. Seven of the nine are expected to generate free cash flow in excess of dividend payments, including all of the top five constituents in the AMZI. Excess cash flow after dividend payments allows for added financial flexibility to reduce debt or return cash to shareholders. The top five names in the AMZI also have [buyback authorizations](#) in place, and in AMEI, Targa Resources (TRGP) also has a buyback authorization. The Canadian C-Corps Enbridge (ENB) and TC Energy (TRP) stand out from the rest of the group for their sizable project backlogs and higher capital spending estimates, which result in negative free cash flow after dividends.

Top AMZI and AMEI Constituents Expected to Generate Meaningful Free Cash Flow in 2021

Name	Ticker	Index Weight	2021 Estimates (\$ millions)					Free Cash Flow After Dividends	Free Cash Flow Yield	FCF Yield After Dividends
			Operating Cash Flow	Capital Spending	Dividend Payments	Free Cash Flow	Free Cash Flow After Dividends			
Top 5 AMZI Constituents										
Plains All American Pipeline LP	PAA	10.2%	1,867	480	600	1,387	787	17.7%	10.0%	
Western Midstream Partners LP	WES	10.1%	1,516	375	533	1,141	608	12.1%	6.5%	
Enterprise Products Partners LP	EPD	9.8%	7,114	2,140	3,938	4,974	1,036	9.3%	1.9%	
MPLX LP	MPLX	9.7%	4,496	838	2,855	3,658	803	11.6%	2.5%	
Energy Transfer LP	ET	9.5%	10,666	2,150	1,867	8,516	6,649	31.9%	24.9%	
Top 5 AMEI Constituents										
Enbridge Inc	ENB CN	9.6%	9,442	7,208	6,297	2,234	(4,063)	2.1%	-3.8%	
Enterprise Products Partners LP	EPD	8.3%	7,114	2,140	3,938	4,974	1,036	9.3%	1.9%	
TC Energy Corporation	TRP CN	8.2%	6,901	6,586	3,477	315	(3,162)	0.5%	-4.7%	
Targa Resources Corp	TRGP	5.7%	1,980	520	167	1,460	1,293	11.4%	10.1%	
ONEOK Inc	OKE	5.6%	2,993	620	1,702	2,373	671	8.2%	2.3%	

All index weightings are as of 10/22/21.
 FCF Yield is based off of market pricing as of 10/22/21.
 Amounts for the Canadian names are in CAD.
 Operating cash flow and dividend payments based on consensus estimates.
 Company guidance for capital spending used instead of consensus estimates where applicable.
 Source: Bloomberg, Refinitiv Eikon, Company Reports, Alerian and S-Network Global Indexes as of 10/22/21

Bottom Line:

The expectation for significant free cash flow generation is one of the key pillars to the midstream investment case today. Midstream's evolution from negative FCF yields to now generating FCF in excess of dividends marks a positive transformation for the space, and midstream FCF yields compare favorably with broader equities and utilities. While midstream income remains attractive with the AMZI and AMEI yielding 7.40% and 5.87%, respectively, as of October 29, FCF generation supports increased financial flexibility and buyback programs, adding to the potential for attractive total return.

AMZI is the underlying index for the Alerian MLP ETF (AMLP) and the ETRACS Alerian MLP Infrastructure Index ETN Series B (MLPB). AMEI is the underlying index for the Alerian Energy Infrastructure ETF (ENFR).

Disclaimers

This Document Is Impersonal and Not a Solicitation. In jurisdictions where Alerian, S-Network Global Indexes, or their affiliates do not have the necessary licenses, this document does not constitute an offering of any security, product, or service. Alerian and S-Network Global Indexes receive compensation in connection with licensing its indices to third parties. All information provided by Alerian and S-Network Global Indexes in this document is impersonal and not customized to the specific needs of any entity, person, or group of persons. Alerian, S-Network Global Indexes, and their affiliates do not endorse, manage, promote, sell, or sponsor any investment fund or other vehicle that is offered by third parties and that seeks to provide an investment return linked to or based on the returns of any Alerian or S-Network Global Indexes index.

No Advisory Relationship. Alerian and S-Network Global Indexes are not investment advisors, and Alerian, S-Network Global Indexes, and their affiliates make no representation regarding the advisability of investing in any investment fund or other vehicle. This document should not be construed to provide advice of any kind, including, but not limited to, tax and legal.

You Must Make Your Own Investment Decision. It is not possible to invest directly in an index. Index performance does not reflect the deduction of any fees or expenses. Past performance is not a guarantee of future returns. You should not make a decision to invest in any investment fund or other vehicle based on the statements set forth in this document, and are advised to make an investment in any investment fund or other vehicle only after carefully evaluating the risks associated with investment in the investment fund, as detailed in the offering memorandum or similar document prepared by or on behalf of the issuer. This document does not contain, and does not purport to contain, the level of detail necessary to give sufficient basis to an investment decision. The addition, removal, or inclusion of a security in any Alerian or S-Network Global Indexes index is not a recommendation to buy, sell, or hold that security, nor is it investment advice.

No Warranties. The accuracy and/or completeness of any Alerian or S-Network Global Indexes index, any data included therein, or any data from which it is based is not guaranteed by Alerian or S-Network Global Indexes, and it shall have no liability for any errors, omissions, or interruptions therein. Alerian and S-Network Global Indexes make no warranties, express or implied, as to results to be obtained from use of information provided by Alerian and S-Network Global Indexes and used in this service, and Alerian and S-Network Global Indexes expressly disclaim all warranties of suitability with respect thereto.

Limitation of Liability. While Alerian and S-Network Global Indexes believe that the information provided in this document is reliable, Alerian and S-Network Global Indexes shall not be liable for any claims or losses of any nature in connection with the use of the information in this document, including but not limited to, lost profits or punitive or consequential damages, even if Alerian and S-Network Global Indexes have been advised of the possibility of same.

Research May Not Be Current. This document has been prepared solely for informational purposes based on information generally available to the public from sources believed to be reliable. Alerian and S-Network Global Indexes make no representation as to the accuracy or completeness of this document, the content of which may change without notice. Alerian and S-Network Global Indexes expressly disclaim any obligation to update the contents of this document to reflect developments in the energy Master Limited Partnership sector. The methodology involves rebalancings and maintenance of indices that are made periodically throughout the year and may not, therefore, reflect real-time information.

Linked Products. Alerian and S-Network Global Indexes licenses its indexes to third parties for the creation of investment funds or other vehicles. Alerian and S-Network Global Indexes are not responsible for the information on these websites or for anything that they provide.

Policies and Procedures. Analytic services and products provided by Alerian and S-Network Global Indexes are the result of separate activities designed to preserve the independence and objectivity of each analytic process. Alerian and S-Network Global Indexes have established policies and procedures to maintain the confidentiality of material non-public information received during each analytic process. Alerian, S-Network Global Indexes, and their affiliates provide a wide range of services to, or relating to, many organizations, and may receive fees or other economic benefits from these organizations.

Copyright. No Unauthorized Redistribution. Alerian and S-Network Global Indexes © 2021. All rights reserved. This document, in whole or in part, may not be redistributed, reproduced, and/or photocopied without prior written permission.

Alerian
alerialian.com
info@alerialian.com | 972.957.7700
3625 N. Hall St., Suite 1200, Dallas, TX 75219

S-Network Global Indexes
snetworkglobalindexes.com
info@snetworkinc.com | 972.957.7700
267 Fifth Avenue, Suite 508, New York, NY 10016