CHICKASAW
CAPITAL MANAGEMENT

AUGUST 22, 2022

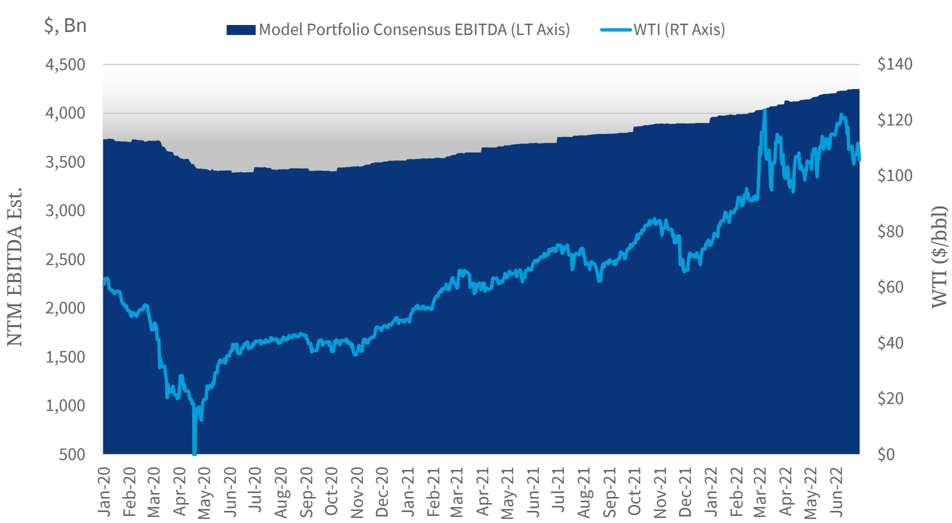
MIDSTREAM UPDATE

AUGUST 2022

Beat, Raise & Buyback

With the most recent quarterly earnings reporting season now complete, we believe the Alerian MLP Total Return Index's (AMZX) 19.0% quarter-to-date (QTD) total return through August 18th is reflective of very positive fundamental results. It should also be mentioned the strong total return has occurred while West Texas Intermediate (WTI) crude oil has decreased (14.4%) QTD. As a reminder, commodity prices are likely to remain unpredictable, but Midstream cashflows exhibit strong resiliency due to the fee-based nature of their cash flows.

NTM EBITDA vs. WTI Evolution



Source: Bloomberg, LP at 6/30/22. All figures shown for current model portfolio weights and holdings. EBITDA is the consensus estimate at each point in time for the weighted sum of each portfolio holding for the next twelve months (NTM).

The hallmarks of equity outperformance this quarter were companies which beat consensus expectations, raised forward guidance, consistently repurchased equity, and maintained moderate growth capital expenditure budgets and/or kept future capital expenditure expectations modest. Our portfolio holdings beat EBITDA estimates by 4.3%, and grew distributable cash flow per unit (DCF/u) by 9.7% quarter over quarter (Q/Q) and 30.4% year over year (Y/Y), all on weighted average metrics. This compares to the AMZX whose holdings beat consensus expectations by 2.9% weighted average. Importantly, we saw dramatically increased buyback activity in the quarter as companies used free cash flow to repurchase a record $1 billion of common equity, a majority of which we believe occurred during June's weakness. This compares to ~$350 million in the first quarter, and is greater than the previous quarterly high of $800 million in Q3 2021.

INVESTMENT TEAM

Geoffrey P. Mavar – Principal
Matthew G. Mead – Principal
Robert M.T. Walker – Principal
Bryan F. Bulawa – Principal

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As we look forward, we are seeing increased DCF/u estimates for 2022 and 2023, which generates a higher amount of discretionary free cash flow and more flexibility for companies as overall valuation remains inexpensive compared to historical levels. While only one month removed from when we last provided key statistics, there has been meaningful improvement. As of 7/31/22, the DCF/u growth rate for the portfolio increased to 19.8% from 14.9% month over month (M/M), and is up ~15% absolutely since 12/31/21[1] driven predominantly by fee-based volumetric gains, modest net inflation benefits from existing contracts, increased export activity, and accretion from merger and acquisition activity — notably not from outsized commodity price gains. We expect the growth rate to continue to increase later this quarter as sell-side models are fully updated. Higher estimates also lead to a lower valuation as the Price to DCF (P/DCF) for the AMZX registered at 5.2x as of 7/31/22, representing a (7%) decrease Q/Q even as the AMZX delivered a +12.5% return in July, i.e. the denominator (DCF/u) grew at a greater rate than the numerator (AMZX).

We just returned from a conference meeting with 17 companies, and most of the discussions focused on our longstanding rhetorical question, "what are you going to do with all the excess cash flow?". Operations and cash flow generation continue to reflect the positive fundamental drivers discussed above, and several companies noted this environment is creating as strong of an outlook for fee-based growth as they've ever seen. Notably, if cash flow growth is mostly occurring through increased asset utilization with only modest growth capital needs, this increases the prospect for increasing return on invested capital (ROIC) across many companies, a topic we introduced in our April 2022 newsletter. We believe we are seeing the early innings of this virtuous cycle as increased returns may accrue to equity holders.

Conclusion

We hope you are enjoying your end of summer days, and have found the intra-quarter update of use. From our conversations, we believe many market participants plan to use the upcoming months to consider their asset allocations heading into 2023. We believe the fundamental set up and low valuation will continue to present Midstream in a positive light. Please continue to reach out with any questions you may have as you are considering your own goals.

Geoffrey Mavar Matt Mead Robert Walker Bryan Bulawa

(1) DCF/u growth rate refers to the estimated 2022 weighted average Distributable Cash Flow (DCF) growth rate. This is not a forecast of the portfolio's future performance. DCF growth rate for the portfolio's holdings does not guarantee a corresponding increase in the market value of the holding or the portfolio.

Distributable Cash Flow (DCF) is calculated as net income plus depreciation and other noncash items, less maintenance capital expenditure requirements. Distributable cash flow (DCF) data is CCM calculated consensus of Wall Street estimates. The estimated consensus weighted average distributable cash flow (DCF) per unit growth rate for the AMZ and our Model Portfolio incorporates market expectations by using the average annual growth rate using rolling-forward 24-month data. DCF growth rate is not a forecast of the portfolio's future performance. DCF growth rate for the portfolio's holdings does not guarantee a corresponding increase in the market value of the holding or the portfolio.

Free Cash Flow (FCF) is a measure of financial performance calculated as operating cash flow minus capital expenditures.

EBITDA is earnings before interest rates taxes depreciation and amortization.

Growth CapEx or **Growth Capital Expenditures** refers to the aggregate of all capital expenditures undertaken to further growth prospects and/or expand operations and excludes any maintenance and regulatory capital expenditures.

West Texas Intermediate (WTI), also known as Texas light sweet, is a grade of crude oil used as a benchmark in oil pricing. This grade is described as light because of its relatively low density, and sweet because of its low sulfur content. It is the underlying commodity of Chicago Mercantile Exchange's oil futures contracts.