MIDSTREAM Monitor

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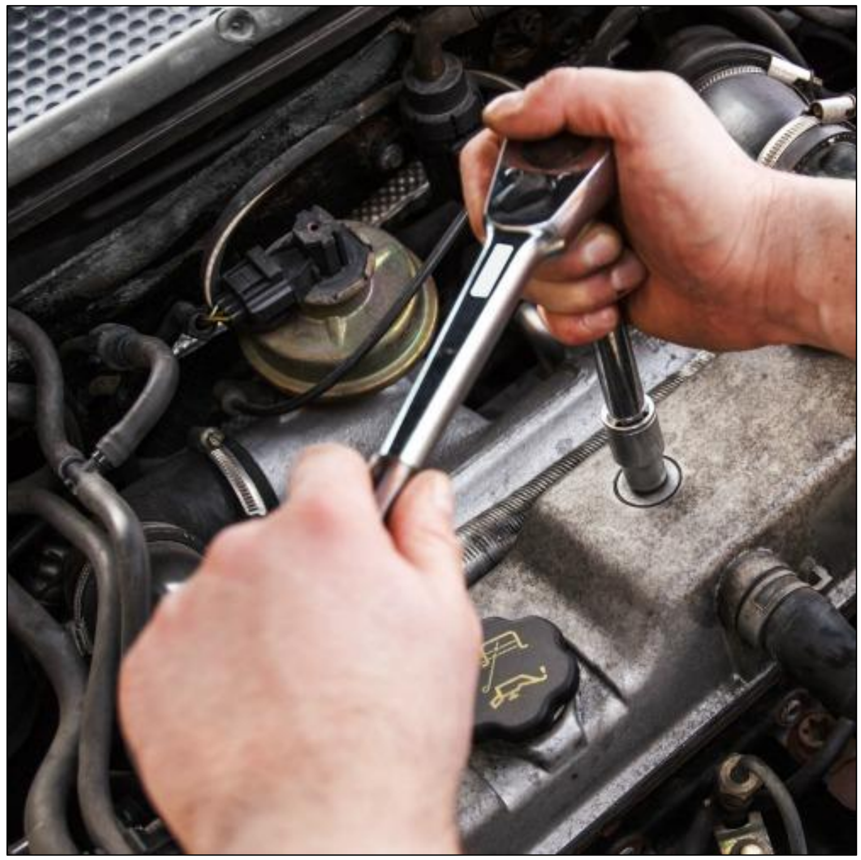
FEATURES

Are MLPs Dead? Hardly



MLP structure requires some tweaks, but it still works as an effective investment vehicle, experts at MLPA conference say.

By **PAUL HART**, Hart Energy

Mark Twain probably never heard of a master limited partnership but one of his most famous quotes may fit MLPs today: "The reports of my death have been greatly exaggerated."

That was the message in a lively panel discussion, entitled "The MLPs are Finished Myth: Why and How to Keep Investing," at the 15th annual Master Limited Partnership Association (MLPA) investor conference in Orlando. (MLPA formerly was known as the National Association of Publicly Traded Partnerships.)

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However, there will be tweaks in the MLP structure overall and there may be areas of the energy business that don't work well as an MLP, specifically upstream, production-focused firms, the panelists said. They agreed that the MLP concept is not broken and still provides a meaningful investment and operational vehicle. Growth is a key driver for investors, they noted.

Ed Russell, managing director at Tortoise Capital Advisors and panel moderator, opened the discussion by acknowledging the sector "came out of a really rough 2015 and a rough early 2016. But the fundamentals for MLPs are much better than the market reflected." He noted concerns in the second half of 2015 about distribution cuts by a handful of partnerships—concerns that many investors assumed would be the case for the entire sector.

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"For the first time right now, we are beginning to see evidence that people are recognizing the concerns of an individual company and not applying those concerns to the entire sector," he added. Some firms still have distribution-cut issues and investors will need to consider how they will handle investing in those partnerships.

The bottom in unit prices occurred in February, concurrent with crude oil prices, "and since that time we've seen a pretty dramatic improvement." Russell credited the upswing to, first, commodity price improvements, then by "data showing U.S. production coming down and that supply-demand can come in balance in the latter half of this year.

"But in general, the investor appetite appears to be strong" for MLPs, he emphasized.

Investors spooked

Mike Clarfeld, portfolio manager for Clearbridge Investments, pointed to "commodity price headlines" that spooked many investors, many of whom failed to realize the limited commodity price exposure of most midstream MLPs. But he focused most of his presentation on simplification trends, "something that has been a part of the MLP life-cycle. They are nothing new and nothing to be afraid of."

Clarfeld said structural changes to MLPs include the elimination of general partners or the elimination of general partners' incentive distribution rights (IDR). He added many of the largest midstream MLPs, which typically are popular now with investors, went through structural simplification in the 2008-2009 downturn. "And in general, simplifications only happen when times are tough" because they require a general partner to give up often-lucrative IDRs.

Simplification can be done in different ways and for different reasons to avoid over-leverage after the deal or the avoidance of tax obligations. Clarfeld said the sector is becoming more diverse with varying partnership structures and distribution models.

> "So what can we learn as a sector from the past 18 months? First, don't bite off more than you can chew."
>
> **—Kevin McCarthy, managing partner of public funds for Kayne Anderson Capital Advisors**

'Member of the mafia'

The panel's third member, Kevin McCarthy, managing partner of public funds for Kayne Anderson Capital Advisors, admitted to "being a member of the MLP mafia for 32 years now" and noted he has heard the question about a broken MLP model multiple times. While the model hasn't been wrecked and totaled, MLPs "probably deserved a speeding ticket in 2014," McCarthy said. Problems came from the way MLPs finance themselves "and in terms of [a lack of] structural protection for investors."

He emphasized financing of growth must come from outside the company. "This instills discipline, it has to be a good deal," McCarthy said. Also, MLPs must have a predominantly fee-based revenue structure.

"So what can we learn as a sector from the past 18 months?" he asked. "First, don't bite off more than you can chew." He recommended big projects start at the general partner level, to be dropped down after completion and cash flow begins. "And if you have large equity commitments, you can't always count on the equity markets being open. You have to be under your target ratios, not over them."

McCarthy emphasized that "the MLP model just does not work for upstream companies" due to inherent commodity and volume risks.

"We went through this before in the late 1980s and it blew up again this time for many of the same reasons. And just like last time, it was too easy to underestimate the capital required to maintain production," he said.

He also focused on the role of IDRs, adding they can be valuable for an enterprise but can become unwieldy as it grows and payments to the general partner grow disproportionately.

How The Abnormal Oil Price Became The Norm

By **JOSEPH MARKMAN**, Hart Energy

Oil futures pioneer explains how crude price paradigms have changed in a world beset by a long-term glut.

Three prominent economists, armed with reams of data and decades of observations, assessed the causes and outlook for crude price volatility before a packed house at the recent KPMG Global Energy Conference.

Conclusion: "Oil has become the new corn."

Not what you were expecting? Hey, the Saudis don't care for it either, but the data provide strong support.

"Oil is going to be much more like an agricultural product, meaning when there are disruptions to supply like the fires in Alberta, or the MEND [Movement for the Emancipation of the Niger Delta] attacks in Nigeria, supplies will get cut, prices will go up," said Philip K. Verleger Jr., who served in the Ford and Carter administrations and later played a key role in creating oil futures markets. "But then there will be periods when there are huge crops and you'll see prices go down."

To the contrary

If that appears to contradict what has long been accepted about the economic fundamentals of the oil business, that's because it does.

The mindset was defined by Harold Hotelling, an economist whose paper, "The Economics of Exhaustible Resources," was published by the University of Chicago Press in 1931. Hotelling's theory was that producers of nonrenewable resources like oil will only produce a limited supply of their product if it generates more profit than bonds or interest-bearing financial instruments.

Therefore, long-term prices will rise year after year at the prevailing interest rate—in theory.

But two years ago, the leaders of Saudi Arabia found themselves in an existential crisis. They looked at the steps being taken to combat global warming. They saw the success of unconventional techniques in the U.S. like horizontal drilling and hydraulic fracturing, and concluded that, long term, *their* oil was going to be left in the ground, Verleger said.

"What this does for those of us who study resources was essentially turning Hotelling upside down," he said.

"The most dangerous assumption in economics is when people come to believe this time is different. It isn't."

—Mustafa Mohatarem, chief economist for General Motors Co.

A finite resource

So much for "peak oil." In this situation, oil as a natural resource is no longer finite, and it put the Saudis in a race with other producers, particularly Venezuela, to pump as much as possible for as long as possible until the market disappeared.

Twenty years ago, Venezuela had the upper hand and sought to push Saudi Arabia out of the market. Times have changed and now the Saudis are trying to return the favor.

"They are pushing for maximum production," Verleger said. "I think they'll probably try to go for 13 million or 14 million barrels per day [bbl/d] and I don't think that they will ease off."

But it's not just Saudi production that is fueling glum times. Global energy companies have issued about $400 billion a year of debt since 2014, despite falling prices.

"One thing we know from economics is that when you have oversupply of something and you have leverage on the back end that is linked to that oversupply, your trough tends to be longer," said Constance Hunter, KPMG's chief U.S. economist. "It's a situation where it's possible—now, of course oil prices are notoriously difficult to predict—it's possible that this downturn could be a little lower and a little longer than a lot of people have anticipated. And yet, for non-economists looking at this, look at the open interest in the oil contracts. It still remains pretty high."

The more things change…

On June 7, oil closed at $50.41 a barrel on the New York Mercantile Exchange. That's good, right?

"The most dangerous assumption in economics is when people come to believe this time is different," said Mustafa Mohatarem, chief economist for General Motors Co. "It isn't. So it's a question of, where will the new demand come from that absorbs the new capacity that we've brought to the market?"

Mohatarem acknowledged how the current relatively high prices may distort this view, but he noted that in previous eras, oil price stability were maintained first by the Texas Railroad Commission beginning in the 1930s and later by OPEC in the 1970s.

"Absent the cartel, absent the price regulation, you will always have a price crash coming," he said. "The problem is, that in itself sets in motion the process of people seeking new resources or new technologies and that again brings the price down."

Global Gas Demand Growth Expected To Slow

By **JOSEPH MARKMAN**, Hart Energy

Cheaper coal and a strong uptick in renewable fuels will hinder global demand growth for natural gas, the International Energy Agency (IEA) said June 8 in its annual "Medium Term Gas Market Report."

The LNG tanker *Arctic Princess* calls on the Baltic Sea port of Klaipeda, Lithuania, in July 2015.

While natural gas is the only fossil fuel that will not experience a decline in its share of the energy mix, its expansion will slow and a glut is possible, the agency reported. The forecast for 2015 to 2021 is 1.5% annual growth, compared to average annual increases of 2.5% from 2009 to 2015. Forecast growth is lower than the 2% seen in last year's report.

Also hampering demand is an expected decrease in imports by Japan and South Korea, the world's leading importers of LNG. This comes about just as LNG export capacity ramps up significantly between now and 2021, mostly in the U.S. and Australia.

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"Developments are pointing to a period of oversupply," Fatih Birol, the IEA's executive director, said the report. "The next five years will witness a reshaping of the global gas trade."

The oversupply will maintain downward pressure on global spot natural gas prices, with Europe as the preferred destination for "unwanted" LNG because of the economics of its spot markets and flexibility of its distribution system. Birol expects intense competition among producers to hold onto European customers.

"We are at the start of a new chapter in European gas markets," he said.

The IEA anticipates that weaker demand in Asia will leave LNG buyers in that region over-contracted, which it expects to accelerate a movement toward more flexible contract structures. Oil markets are expected to rebalance before gas markets, which will encourage the trend toward hub pricing and reduce oil exposure in long-term contracts.

The report highlights the danger of reducing LNG capacity, citing numerous events from terrorist attacks and sabotage in Africa to natural disasters like hurricanes Katrina and Rita in the United States that have knocked LNG facilities out of service. The collapse in investment (no final investment decisions made on liquefaction plants in 2016) also raises concerns about the security of natural gas supplies and the potential for tighter markets in the next decade.

Why A DUC?

Abundance of drilled but uncompleted oil wells will play key role when producers are ready.

By **PAUL HART,** Hart Energy

In a classic scene from the Marx Brothers' "The Cocoanuts," Groucho befuddles Chico during a fast-talking hustle for a swampy Florida real estate development around a "viaduct."

Befuddled and confused, Chico finally blurts out, "Why a duck? Why not a chicken?"

The oil and gas industry might be equally befuddled and confused right now by an abundance of drilled but uncompleted (DUC) wells. When commodity prices more fully recover, completion crews could move in, do their work and those DUCs will take flight. That could bring a quick uptick in output, according to an S&P Global Platts analyst.

Jenna Delaney, senior energy analyst-oil, told a crowd at the firm's annual Midstream Energy & MLP Breakfast Briefing in Houston on June 7 that "there is a historic backlog" of such wells now. She added the buildup isn't necessarily due to the price downturn.

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"It's not all economics," Delaney explained. "They can be drilled faster than they can be completed" thanks to rapid advancements in drilling technology. The high DUC inventory means domestic production could come back more quickly than many expect—adding to the U.S. role as a major swing producer on the world market.

"The U.S. can respond faster now," she added.

Her presentation featured a graphic that projects crude oil prices will be in the breakeven range of $50-$60 per barrel range through the end of 2017. However, "We don't forecast prices because we could be wrong," quipped Michael Grande, S&P Global director, during a question-and-answer session following Delaney's presentation.

Delaney said S&P projects crude will come into a supply-demand balance in the next year, first in the U.S. in late-2016 and worldwide in 2017. Balance will happen in part due to a decline in U.S. production. Her presentation projected domestic oil output will hover just above 8.5 million barrels per day (bbl/d) the rest of this year and into 2017. Domestic output peaked above 9.5 million bbl/d in second-quarter 2015.

"U.S. production has declined but not as sharply as many had expected," she added. Abroad, non-OPEC and non-U.S./Canada production will decline as lingering low prices make marginal fields economic, forcing producers to shut-in money-losing wells.

Source: Navigator Energy Services LLC

Construction of crude oil storage tanks in the Permian Basin.

Crude Storage, Ethane Price Both On Rise

By **JOSEPH MARKMAN**, Hart Energy

U.S. working crude oil storage capacity rose by 34 million barrels (MMbbl) between last September and March 2016, the largest expansion in a six-month block ever recorded by the U.S. Energy Information Administration (EIA) since it began tracking the segment in 2011.

And just in time: storage utilization set a record of 74% in the week ended June 3. The largest expansions were in the Midwest (PADD 2) with 19 MMbbl, a 13% increase, and the Gulf Coast (PADD 3) which added 13 MMbbl, or 4%). The two regions combined represent 82% of total U.S. storage capacity.

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The large increase in capacity comes as global crude oil supply has exceeded demand for the last two years. With near-term deliveries cheaper than long-term—a spread of $7.25, the EIA reported—now is the time to store.

The EIA's weekly natural gas storage report for the week ended June 3 showed an increase of 65 billion cubic feet (Bcf), below the Bloomberg consensus prediction of a 77 Bcf rise. The new total of 2.972 Tcf was 28.5% above the level of 2.195 Tcf last year at this time and 32.1% over the five-year average of 2.25 Tcf for 2011 to 2015.

U.S. propane stocks increased by 1.9 MMbbl to 77.3 MMbbl as of June 3, though that level is still 1.5 MMbbl, or 1.9%, lower than a year ago.

CURRENT FRAC SPREAD (CENTS/GAL)				
JUNE 10, 2016	**Conway**	**Change from Start of Week**	**Mont Belvieu**	**Last Week**
Ethane	17.17		21.12	
Shrink	14.72		14.85	
Margin	2.45	-16.58%	6.27	-16.49%
Propane	46.13		49.08	
Shrink	20.34		20.52	
Margin	25.79	-17.54%	28.56	-18.33%
Normal Butane	60.80		61.08	
Shrink	23.02		23.23	
Margin	37.78	-15.39%	37.85	-14.04%
Isobutane	73.35		65.33	
Shrink	22.11		22.31	
Margin	51.24	-5.05%	43.02	-12.02%
Pentane+	104.40		101.66	
Shrink	24.62		24.84	
Margin	79.78	-4.40%	76.82	-4.18%
NGL $/Bbl	20.54	-3.65%	20.95	-3.43%
Shrink	8.11		8.18	
Margin	12.44	-10.12%	12.76	-11.49%
Gas ($/mmBtu)	2.22	8.29%	2.24	12.56%
Gross Bbl Margin (in cents/gal)	27.91	-10.82%	29.26	-12.10%
NGL Value in $/mmBtu (Basket Value)				
Ethane	0.95	3.87%	1.16	2.03%
Propane	1.60	-7.85%	1.70	-7.74%
Normal Butane	0.66	-7.75%	0.66	-5.55%
Isobutane	0.46	-1.38%	0.41	-4.93%
Pentane+	1.35	-1.69%	1.31	-0.57%
Total Barrel Value in $/mmbtu	5.01	-3.58%	5.24	-3.45%
Margin	2.79	-11.33%	3.00	-12.71%

Price, Shrink of 42-gal NGL barrel based on following: Ethane, 36.5%; Propane, 31.8%; Normal Butane, 11.2%; Isobutane, 6.2%; Pentane+, 14.3%, Fuel, frac, transport costs not included. Conway gas based on Midwest region, Mont Belvieu based on Houston region. Shrink is defined as Btus that are removed from natural gas through the gathering and processing operation.

Propane's surge took a detour, falling 7.8% at Mont Belvieu, Texas, and 7.9% at Conway, Kan., to below 50 cents a gallon (cents/gal) at both hubs for the first time in a month. The price is still up 26.9% for the year at Mont Belvieu and 17.2% at Conway.

NGL barrel

The hypothetical NGL barrel slipped 3.4% during the week to $20.95, but remained over $20 for the fourth straight week and fifth week in the last six. NGL are separated, or fractionated, for various market purposes. Hart Energy rejoins them in a 42-gallon spreadsheet "barrel" to illustrate the overall performance of the sector.

The barrel is up 6.2% at Mont Belvieu compared with the same week last year, and up 18.8% since the start of the year.

At Conway, the barrel is up 12.4% over a year ago and 20.6% since the beginning of this

NGL PRICES						
Mont Belvieu	**Eth**	**Pro**	**Norm**	**Iso**	**Pen+**	**NGL Bbl**
June 1 - June 7, '16	21.12	49.08	61.08	65.33	101.66	**$20.95**
May 25 - May 31, '16	20.70	53.20	64.67	68.72	102.24	**$21.69**
May 18 - May 24, '16	20.45	54.03	65.48	69.50	101.18	**$21.74**
May 11 - May 17, '16	20.33	53.80	64.89	68.23	98.34	**$21.44**
May '16	19.63	52.11	63.15	66.67	97.15	**$21.11**
April '16	19.18	45.59	55.10	57.43	92.03	**$19.05**
1st Qtr '16	15.90	39.03	52.22	52.84	76.84	**$16.46**
4th Qtr '15	17.50	42.15	60.09	60.57	97.59	**$19.11**
3rd Qtr '15	18.26	40.99	54.16	55.19	100.10	**$18.80**
2nd Qtr '15	17.93	46.30	58.11	59.66	126.14	**$21.48**
June 3- June 9, '15	17.57	36.98	52.38	53.76	124.18	**$19.73**
Conway, Group 140	**Eth**	**Pro**	**Norm**	**Iso**	**Pen+**	**NGL Bbl**
June 1 - June 7, '16	17.17	46.13	60.80	73.35	104.40	**$20.54**
May 25 - May 31, '16	16.53	50.06	65.91	74.38	106.19	**$21.32**
May 18 - May 24, '16	16.40	50.70	66.40	72.80	105.45	**$21.31**
May 11 - May 17, '16	16.28	51.18	64.85	72.10	103.05	**$21.09**
May '16	16.14	49.34	63.42	71.60	101.55	**$20.65**
April '16	15.57	42.79	53.34	64.69	93.42	**$18.52**
1st Qtr '16	13.45	35.23	48.14	57.05	76.01	**$15.61**
4th Qtr '15	14.90	38.06	57.31	64.04	95.84	**$18.20**
3rd Qtr '15	15.47	36.28	48.59	54.34	99.10	**$17.59**
2nd Qtr '15	15.50	40.55	52.40	56.80	121.50	**$19.89**
June 3- June 9, '15	15.23	31.70	46.22	49.92	121.50	**$18.28**

Data Provided by Bloomberg. Individual product prices in cents per gallon. NGL barrel in $/42 gallons.

year. The only component of the barrel to enjoy a good week was ethane, which cracked 21 cents/gal at Mont Belvieu for the first time since the middle of last November, and which has increased 38.6% since the start of the year. At Conway, the price passed 17 cents/gal for the first time since March 2015 and is up 18.8% for the year.

Ethane et al

Ethane has now stayed above 20 cents/gal at Mont Belvieu for seven of the last eight weeks, the first time it has been able to sustain that price level since mid-November 2014. It is 49.9% above its low point of 14.09 cents/gal in mid-January.

Butane at Mont Belvieu decreased by 5.6% during the week but stayed above 60 cents/gal for the fourth straight week for the first time since December. At Conway, butane was down 7.8%, but its fourth straight week over 60 cents/gal marked the first time of sustaining that level since March 2015.

Isobutane was down 4.9% at Mont Belvieu and 1.4% at Conway. The sixth straight week above 60 cents at Mont Belvieu matched the six-week streak set last December. At Conway, the price of 73.35 cents/gal was the second-highest of the year and the second-highest price since March 2015.

TOP STORIES

Source: Kinder Morgan Inc.

Kinder Morgan's Elba Island facility.

Elba Island Gets FERC Approval

Kinder Morgan Inc. received FERC approval for a $2-billion project to build 10 liquefaction units at its Elba Island, Ga., LNG terminal to export volumes from the facility beginning in second-quarter 2018. The remaining nine units are scheduled to be added by the end of 2018.

The 2.5-million-metric-tons-per-year project is backed by a 20-year contract with Royal Dutch Shell plc, which was an original partner in the project before having its 49% interest bought out by Kinder Morgan. The project will use Shell's small-scale liquefaction unit technology to complete construction faster, while still maintaining the capacity of larger-scale units.

—FRANK NIETO

RESIN PRICES – MARKET UPDATE – JUNE 10, 2016

TOTAL OFFERS: 20,763,784 lbs		SPOT		CONTRACT	
Resin	Total lbs	Low	High	Bid	Offer
PP Homopolymer - Inj	6,709,660	0.495	0.6	0.48	0.52
PP Copolymer - Inj	3,903,532	0.53	0.645	0.5	0.54
HDPE - Blow Mold	2,130,048	0.53	0.58	0.495	0.535
LDPE - Film	2,020,668	0.555	0.69	0.6	0.64
LLDPE - Film	2,009,104	0.46	0.59	0.53	0.57
LLDPE - Inj	1,377,380	0.545	0.64	0.58	0.62
HDPE - Inj	1,064,000	0.53	0.59	0.505	0.545
HMWPE - Film	837,748	0.475	0.6	0.52	0.56
LDPE - Inj	711,644	0.48	0.635	0.59	0.63

Source: Plastics Exchange – www.theplasticsexchange.com

C_{5+} was off slightly at both hubs but remained above $1/gal for the third straight week at Mont Belvieu and the fourth straight week at Conway. It is 12% higher than it was at the start of the year at Mont Belvieu, and is 16.7% higher at Conway.

At Mont Belvieu, C_{5+} is down 18.1% from the same week a year ago. At Conway, the downward change is 14.1%.

Cheap Canadian Gas Imports May Prolong US Energy Industry's Rout

U.S. utilities and merchants are embarking on their biggest buying spree for Canadian natural gas since the start of the U.S. shale boom, taking advantage of record low prices and raising concerns about the U.S. industry's deepening crisis.

Traders have been scooping up more gas from Canada, the world's fifth-largest producer, in recent months after prices at the AECO hub in Alberta sank to a big discount to the U.S. benchmark.

With some analysts expecting the arbitrage to remain in place through the summer and traders having booked long-term pipeline deals, the shipments could last longer than previously expected, experts warn.

The deals will feed growing consumption from power generators after a record number of coal plants retired last year. In addition, gas demand is rising as the U.S. exports more gas to Mexico via pipeline and ramps up exports of LNG to the world, traders said.

The scramble has also offered loss-making Canadian drillers a chance to continue pumping out product as domestic tanks continue to fill up and prices languish near record lows.

But market experts worry the surprisingly strong imports could prolong the U.S. market's biggest rout in a generation, adding to the ballooning glut after a warm winter left Canadian and U.S. storage facilities at record highs.

"We're still pulling too much supply out of the field," said Martin King, an analyst at Alberta energy advisory FirstEnergy Capital.

Now analysts expect Canadian imports to the U.S. to rise this year for the first time since 2007 when growing output from U.S. shale fields like the Marcellus in Pennsylvania started to displace Canadian fuel.

—REUTERS

Longhorn To Ship Condensate in 3Q

Magellan Midstream Partners LP will begin shipping condensate on its Longhorn Pipeline in the third quarter, and could add condensate shipments to its Bridgetex Pipeline, a senior executive said at the Argus conference in Houston on June 7.

The 275,000 barrel per day (Mbbl/d) Longhorn Pipeline currently moves West Texas Intermediate (WTI) and West Texas Sour (WTS) crudes from Crane, Texas, to Houston.

The 300 Mbbl/d Bridgetex Pipeline ships WTI and WTS from Colorado City, Texas, to Houston.

—REUTERS

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