

May 2, 2016

## Market Capitalization's Impact on MLP Yields and Multiples

Investors and valuation experts have long debated the general magnitude (and even the existence) of a “small stock risk premium” and its effect on market values. Small stock risk implies simply that investors expect a higher rate of return for investments in smaller companies (given a higher perceived level of risk).

A recent research report on Master Limited Partnership (“MLP”) values illustrates this concept and how it plays out in two groups of MLP’s with different size market capitalizations. The “Large Cap MLP Group” reflects companies with market capitalization of more than \$3.5 billion. For this group, shown below, their current yield has a median value of 15.1% and the enterprise values are trading at a median of 13.5 times their estimated 2016 EBITDA.

Large Cap MLP Group				
Ticker	Company	Market Cap (\$MM)	Current Yield	EV / 2016 EBITDA
BPL	Buckeye Partners, L.P.	\$8,968	6.9%	12.0 x
BWP	Boardwalk Pipeline Partners, LP	\$3,817	2.6%	10.3 x
EEP	Enbridge Energy Partners, L.P.	\$8,234	11.9%	9.9 x
EPD	Enterprise Products Partners L.P.	\$49,238	6.5%	13.0 x
ETP	Energy Transfer Partners, L.P.	\$19,611	12.7%	14.4 x
MMP	Magellan Midstream Partners LP	\$15,373	4.7%	15.3 x
MPLX	MPLX LP	\$8,901	6.7%	14.6 x
NS	NuStar Energy L.P.	\$3,445	9.9%	12.8 x
OKS	ONEOK Partners, L.P.	\$9,375	9.8%	13.5 x
PAA	Plains All American Pipeline, L.P.	\$9,207	12.2%	15.5 x
SEP	Spectra Energy Partners, LP	\$13,713	5.3%	14.8 x
SXL	Sunoco Logistics Partners L.P.	\$7,063	7.3%	17.5 x
WPZ	Williams Partners L.P.	\$14,221	14.0%	12.4 x
<b>Median</b>		<b>\$9,207</b>	<b>7.3%</b>	<b>13.5 x</b>

The “Small and Mid-Cap MLP Group” reflects companies with market capitalization less than \$3.5 billion. For this group, shown below, their current yield has a median value of 7.3% and the enterprise values are trading at a median of 9.6 times their estimated 2016 EBITDA.

Small and Mid-Cap MLP Group				
Ticker	Company	Market Cap (\$MM)	Current Yield	EV / 2016 EBITDA
APLP	Archrock Partners, L.P.	\$664	20.7%	7.4 x
ARCX	Arc Logistics Partners LP	\$200	16.3%	7.6 x
BKEP	Blueknight Energy Partners, L.P.	\$159	11.7%	6.8 x
CAPL	CrossAmerica Partners LP	\$707	9.7%	12.3 x
CCLP	CSI Compresso LP	\$227	22.6%	8.3 x
CEQP	Crestwood Equity Partners LP	\$849	44.7%	7.9 x
DM	Dominion Midstream Partners, LP	\$2,410	2.8%	28.4 x
GEL	Genesis Energy LP	\$3,511	8.5%	10.4 x
GLP	Global Partners LP	\$445	14.1%	8.3 x
MMLP	Martin Midstream Partners LP	\$722	16.0%	12.8 x
NGL	NGL Energy Partners LP	\$967	30.3%	8.8 x
RRMS	Rose Rock Midstream, L.P.	\$552	18.4%	9.6 x
SUN	Sunoco LP	\$3,202	9.5%	11.8 x
TEP	Tallgrass Energy Partners, LP	\$2,604	7.3%	15.2 x
USAC	USA Compression Partners, LP	\$680	16.2%	9.6 x
VTTI	VTTI Energy Partners LP	\$775	6.3%	9.6 x
<b>Median</b>		<b>\$714</b>	<b>15.1%</b>	<b>9.6 x</b>

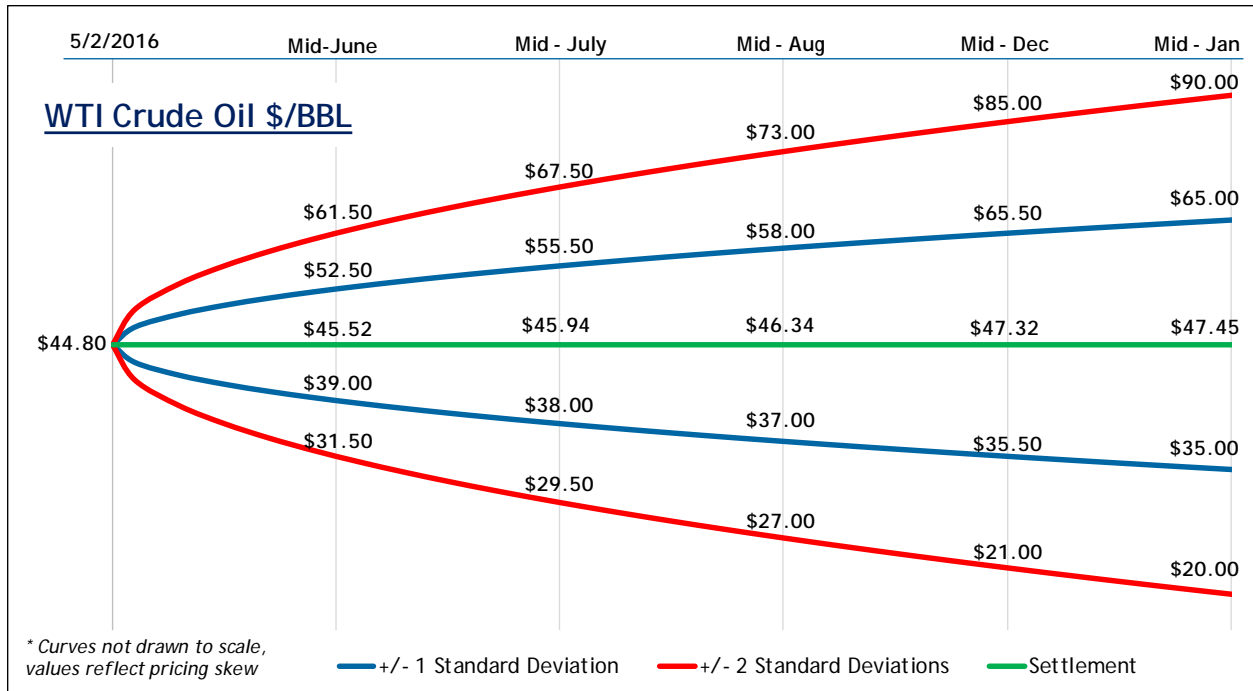
As shown above, the market has priced these securities so that the median yield for the Small and Mid-Cap Group is almost 8% higher than that of the larger group. All else equal, an 8% higher distribution rate would imply a higher cost of equity required by the market, which results in lower values. This concept is further supported by the 2016 EBITDA multiple effect shown in the data above. The EBITDA multiples show that investors are willing to pay \$13.60 for a single dollar of EBITDA from a large MLP, but only \$9.60 for a single dollar of EBITDA from a smaller MLP.

Although the data set above is not robust enough to pass an academic peer review, it does illustrate the market's perception that *bigger is better*.

### **Crude Oil Outlook**

While futures markets aren't a crystal ball, their price levels and related options are useful for estimating future price ranges or "confidence intervals" for crude oil and natural gas.

The graphic below shows the crude oil price on May 2, 2016 and predicted crude oil prices based on options on oil futures contracts (ticker /CL). The blue lines are within one standard deviation ( $\sigma$ ) of the settlement price (green line) and the red lines are within two standard deviations for each month (for a refresher on standard deviations, see the January 2016 blog).



Based on the May 2, 2016 prices, the markets indicate that in mid-June, there is about a 68% chance that oil prices will be between \$39.00 and \$52.50 per barrel. Likewise, there is about a 95% chance that prices will be between \$31.50 and \$61.50. For a longer-term view, I am also showing the year end ranges, which indicates that by mid-December 2016, the +/- 1σ price range is \$35.50 to \$64.00 per barrel. This upward skew in the price ranges also drives the expected midpoint of \$47.30 per barrel at year end. All in all, it was a great month for oil investors with average futures prices going up around \$8.00 per BBL.

### Natural Gas Outlook

We can do the same thing for natural gas futures, currently trading at about \$2.00 per MMBTU on the Henry Hub (ticker /NG). Although more affected by seasonal factors than crude oil, in mid-December 2016, the +/- 1σ price range is \$1.70 to \$3.20 per MMBTU and the 2σ range is \$1.25 to \$4.05 per MMBTU. The expected midpoint of natural gas prices is \$3.10 at year end.

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