Kayne Anderson

Midstream Market Update: Q1 2018

April 2018

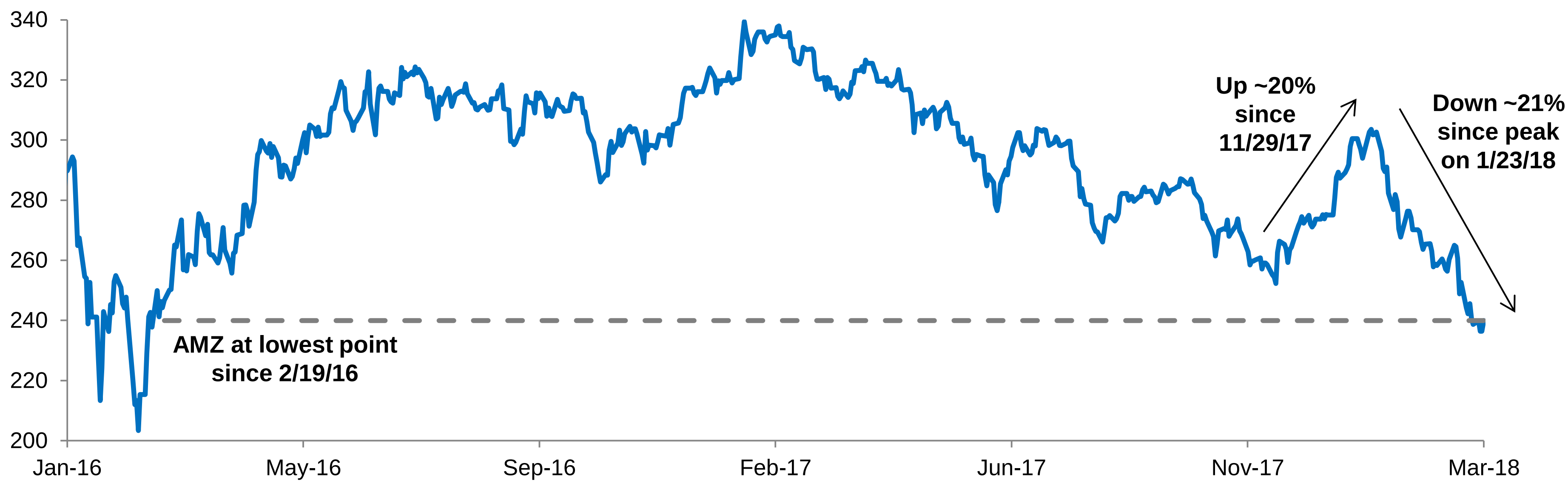
Topics Covered in Presentation

- Recent trading performance for MLPs and Midstream Companies
- Fourth quarter earnings and recent news flow for the sector
- FERC announcement regarding income tax allowance
- Update on fundamentals for energy industry
- Valuations and outlook for the MLP sector

MLP Market Update

- In December and January, we thought the sector had turned the corner…but performance since then has left investors extremely discouraged
- After nearly setting a 52-week low on November 29th, the AMZ rallied over 20% through January 23rd. Sentiment improved meaningfully during that two-month period
  - Then, the AMZ declined by 11% during February – the fifth worst month in the AMZ's history
  - FERC announcement in mid-March pushed AMZ below November 29th levels
- We continue to be hopeful that sentiment will improve throughout the year – the macro is very good – but the sector has to stop "shooting itself in the foot"

January 2016 to Present

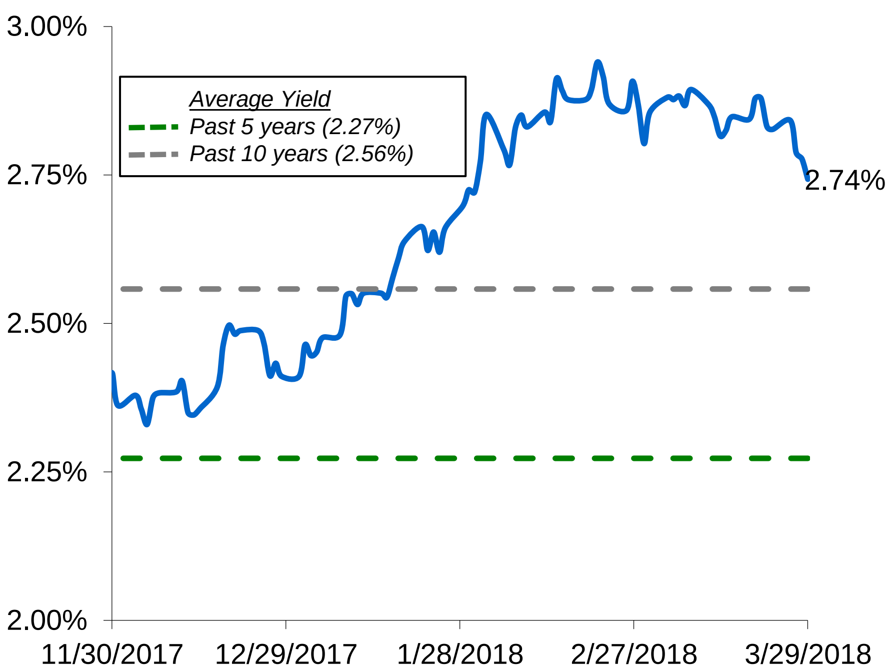


Note: Market data as of March 29, 2018.

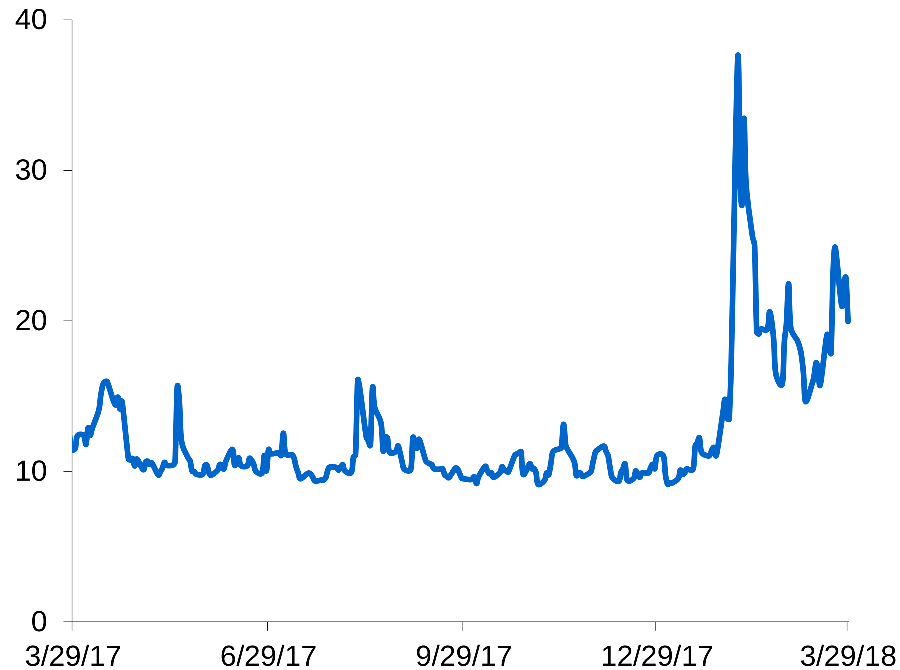
Jitters in the Broader Market Don't Help

- During the quarter, the S&P 500 had its first correction in 2 years – declining 9% over a two-week period in January and declining again in mid-March by 7%
- The January sell-off caused a spike in volatility, which jarred investors after enjoying a multi-year period of very tame volatility
- Rates on the 10-year UST, which had been below 2.5% for nearly all of 2017, started to rise in January
  - Yields peaked in February at nearly 3%, up over 50 bps since the beginning of the year and at the highest level since January 2014

10 Year Treasury Yield



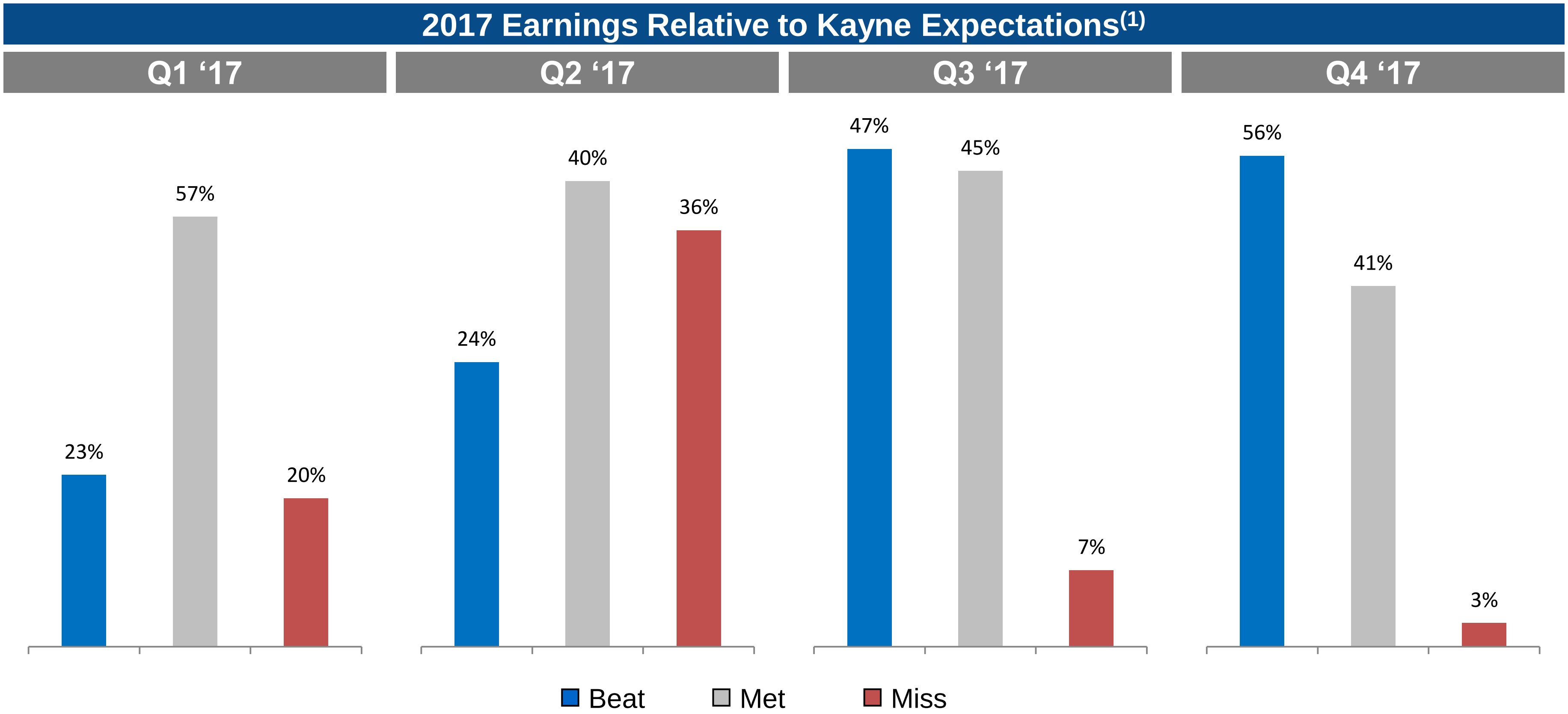
VIX Index (Last Twelve Months)



Note: Market data as of March 29, 2018.

Earnings Improved During 2017…

- Fourth quarter earnings were the best they have been in the last few years
  - Very few missed expectations, and the outlooks were generally good
- The path of earnings during 2017 was also consistent with the expected lag between drilling activity ramping and volumes showing up, so we expect good results in Q1 as well

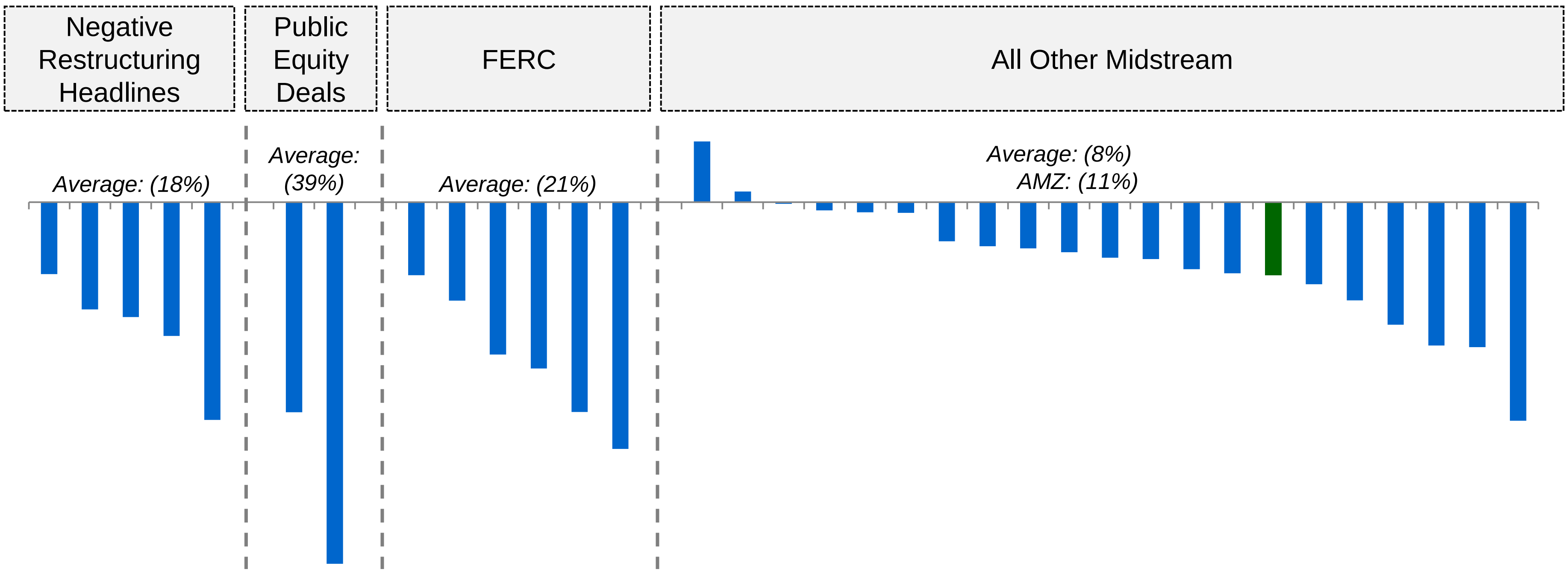


(1) Based on the portfolio of Kayne's largest CEF (at the beginning of each earnings season).

… But Were Overwhelmed by Negative Headlines

- Although the sector remains down on the year, there has been a wide disparity in performance
- MLPs that either had unfavorable announcements or became targeted as potentially next in line for a restructuring, significantly underperformed
- Two MLPs issued equity during the quarter, and the market clearly did not like the deals

Midstream AMZ Constituents: Q1 2018 Total Return(1)



Note: Green bar represents AMZ.
(1) Market data as of March 29, 2018.

Still Many More Restructurings to Work Through

- Though many large cap MLPs and Midstream Companies have addressed their IDRs and/or simplified their structure, there are still many more to come
- The recent FERC policy change appears to create a potential incentive to be organized as a corporation, and we could see certain Midstream C-corps roll up their MLPs as a result
- We believe this is another reason non-dedicated investors are just steering clear of the sector

Midstream Restructuring Candidates		
Announced(1)	Expected: Super Drop(2)	Expected: FERC / Other(2)
ENERGY TRANSFER	Phillips 66 Partners	Williams PARTNERS L.P.
RMP RICE MIDSTREAM PARTNERS	VALERO ENERGY PARTNERS LP	ENBRIDGE Enbridge Energy Partners, L.P.
TALLGRASS ENERGY PARTNERS	Shell Midstream Partners	TC PipeLines, LP
EQT Midstream PARTNERS, LP		Western Gas Partners, LP
Antero Midstream Partners LP		Dominion MIDSTREAM PARTNERS

(1) Companies that have announced they are considering alternatives.
(2) Kayne Anderson expectation.

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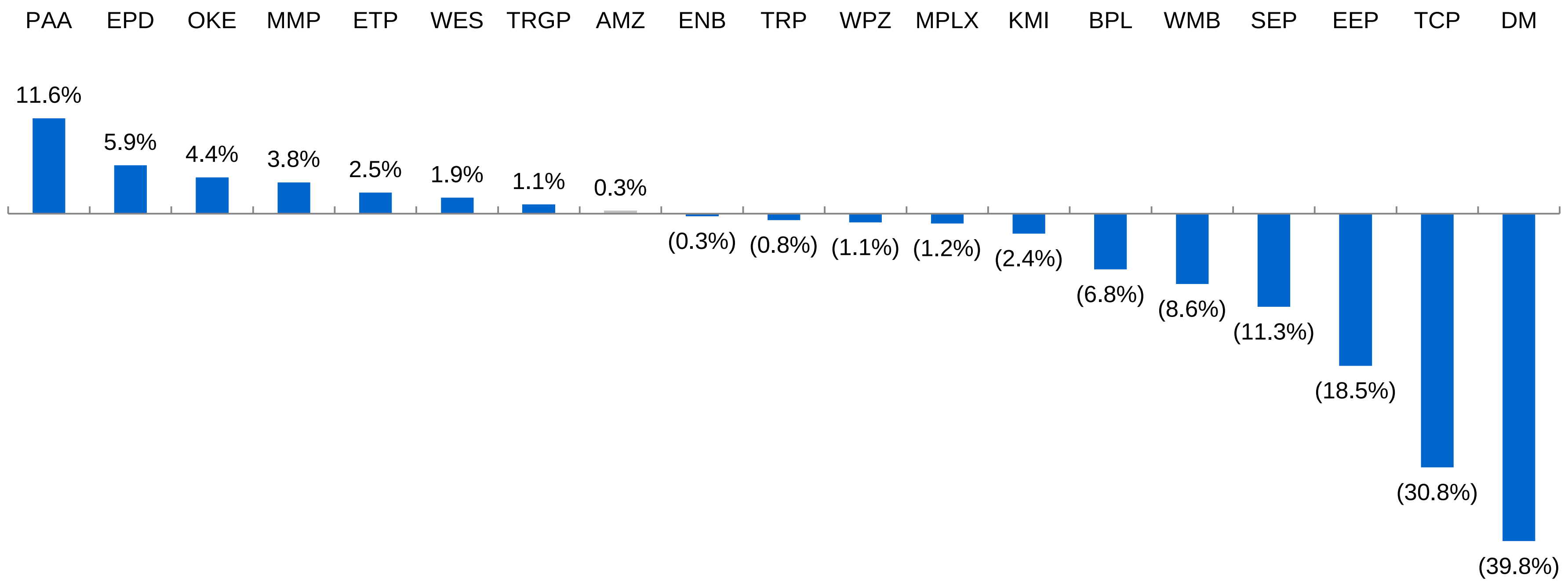
Background on the FERC Announcement

- On March 15th, the FERC announced it had revised its policy and will no longer allow an income tax allowance (ITA) in cost-of-service rates for MLPs
  - ITA is one of the basic components used in determining a pipeline's cost of service
  - Methodology allowing MLPs to include an ITA had been in place since 2005
- Looking back at the regulatory history, the treatment of income tax allowances for MLPs has varied, and it is a topic that has been heavily litigated
  - **Pre 1995:** All pipelines were entitled to an income tax allowance regardless of their form of business organization
  - **1995-2005:** Pipelines that are owned by partnerships are allowed an income tax allowance only to the extent they are owned by corporate partners (Lakehead policy)
  - **2005-2018:** FERC returned to its pre-Lakehead policy of permitting an income tax allowance for all pipelines
- The FERC's recent announcement is in response to a 2016 federal court of appeals ruling (United Airlines v. FERC), which remanded the issue back to the FERC
  - The court found that the FERC had *"failed to demonstrate that there is no double-recovery of taxes for a partnership"* and therefore had not shown a *"reasonable basis"* for allowing an ITA for partnerships

Market Reaction to the FERC Announcement

- At its intraday low, the MLP market was down over 9% in the first hour after the FERC announcement on March 15th
- MLPs recovered after the initial selloff (press releases indicating no material impact helped calm nerves), but selling pressure resumed in the days that followed
  - Weakness in broader markets and concerns about longer term impacts of new FERC rules
  - AMZ is now slightly up since announcement

Performance for Select Midstream Companies since March 14th (1)



(1) Performance through April 17th. Kayne's largest CEF's top 10 holdings plus DM, EEP, ENB, KMI, SEP, TCP, TRP and WMB.

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Energy Fundamentals Update

- The outlook for domestic production remains robust:
  - Domestic crude oil production is approximately 10 million b/d, up over 1 million b/d since last year. We are forecasting exiting 2018 at over 11 million b/d
  - Domestic natural gas production is approximately 84 Bcf/d, up 8 Bcf/d since last year. We are forecasting exiting 2018 at 92 Bcf/d
- At the same time, the commodity price outlook continues to be supportive of the growth outlook
  - WTI has traded in the low to mid $60s for most of 2018
  - Market is expecting natural gas prices to remain low, but most seem prepared to adapt to a lower gas price world
- While these growth trends should continue into 2019, the industry is becoming less concerned that the US will “flood” the global market with too much crude supply
- Many producers have “committed” to balancing growth and shareholder returns, promising to restrain additional capital spending if cash flows prove to be greater than budget
  - We think this trend makes a real difference in 2018 and 2019
  - Expectation that the rate of domestic growth will moderate

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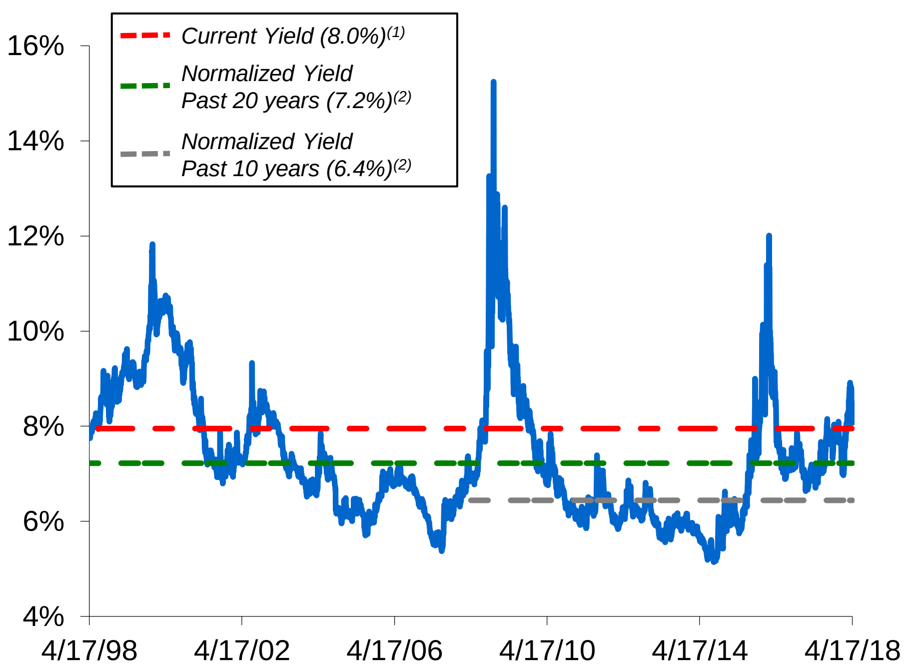
MLP Valuations: Yields

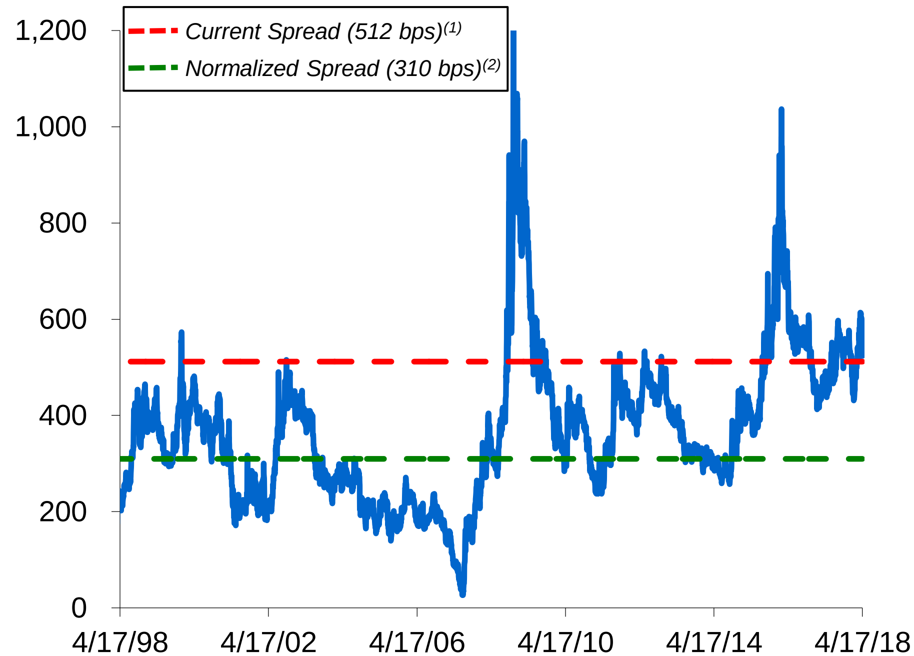
- Absolute yields remain attractive relative to historical levels, with the AMZ currently yielding 8.0%
  - Prior to the downturn and not including the financial crisis, the past 10 years have seen yields closer to the 6.4% area on average
- While investors pay attention to yields (and yield plus growth), trading multiples are increasingly being viewed as the key valuation metric for the sector

AMZ Yield



AMZ Spread to 10-Year U.S. Treasury

(basis points)



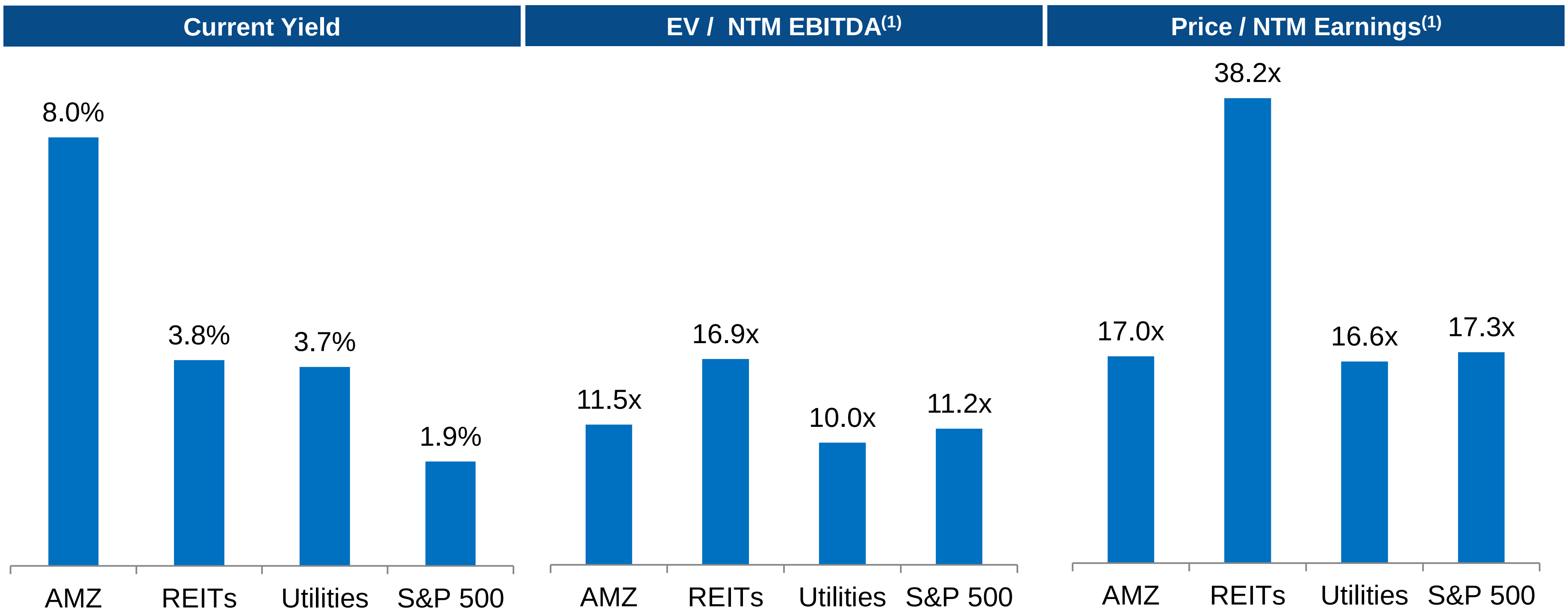
Note: Market data as of April 17, 2018.

(1) Pro forma for NuStar's announced distribution cut.

(2) Excludes yields and spreads during the depths of the 2008-2009 financial crisis and the recent energy market downturn (spreads in excess of 500 bps).

MLP Valuations: Attractive vs. Other Yield Products

- MLP valuations look attractive relative to other yield products (and the broader markets)
  - MLPs look fairly valued on a multiple basis relative to Utilities and the S&P, but have a much higher yield
  - MLPs look attractive compared to REITs on all measures

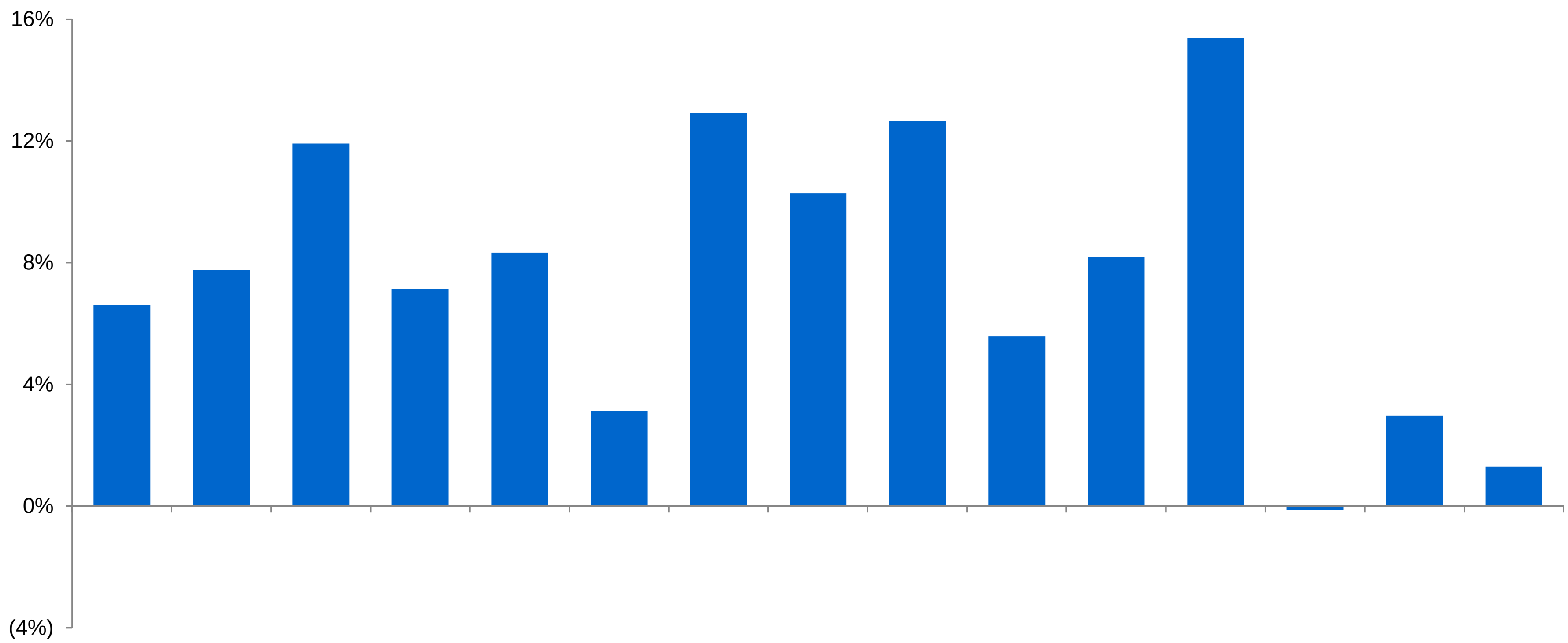


Note: Market data as of April 17, 2018.
(1) Source: FactSet, Bloomberg. AMZ data is an average of the top 15 index constituents by weight.

Midstream Valuations: Attractive Cash Flow Growth

- Growth in distributable cash flow (DCF) per unit over the next few years is expected to be quite strong
  - We project annual DCF/unit growth of ~8% for our top 15 holdings[1]
  - While this isn't getting much attention right now, we expect the market to increasingly focus on growth

2017 – 2020E DCF/Unit Outlook: Top 15 Holdings[1]



(1) Top 15 holdings of Kayne Anderson's largest closed end fund. Estimates per Kayne Research.

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Outlook

- The benefits of the MLP structure are undeniable, and it has survived much over the years
  - We believe that MLPs will continue to play a critical role in the development of midstream infrastructure
- Outlook for growth in domestic production and exports creates need for additional infrastructure
  - This growth will lead to higher cash flows for the sector
- The sector (and the MLP structure) continues to evolve. As more restructurings occur, we expect companies with simple structures to be rewarded by investors
  - Corporate governance will be another key point of differentiation by investors
- Although the bad news is currently “winning,” over time, we expect the favorable macro and attractive valuations to drive a recovery in equity prices for MLPs and Midstream C-Corps
  - We are bullish on the sector’s outlook over the next 3-5 years
  - Believe our funds are well positioned

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