Master Limited Partnerships
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MLP returns have the potential to be highly volatile; an MLP is also subject to liquidity risk, potential conflicts of interest as a result of the MLP ownership structure and the risks of the specific sector in which the MLP is concentrated.

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7. Glossary
1. Introduction

Master Limited Partnerships (MLPs) are a unique asset class in the investment landscape. They have historically generated competitive total returns (approximately 9.1% annually since 2006 as represented by the Alerian MLP Index) through a combination of current yield and growth in distributions, while also providing portfolio diversification and a potential hedge against inflation.1,2 Historically, MLPs have been primarily owned by high net worth and retail investors due in part to the tax complexities. However, MLPs have gained a wider acceptance amongst institutional investors in recent years as many MLP-focused vehicles (total return swaps, Exchange Traded Funds (ETFs), Exchange Traded Notes (ETNs), mutual funds, etc.) have been introduced to the marketplace which are designed to minimize the tax reporting issues that had previously hindered institutional ownership.

Higher Current Yields Compared to the Alternatives3

Perhaps the best known benchmark for MLPs is the Alerian MLP Index (AMZ), which formally launched in June 2006. As of December 31, 2016, the yield on the AMZ was 7.1%,4 which was greater than utilities, Real Estate Investment Trusts (REITs), the S&P 500, and Treasuries.5,6

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1. Alerian, as of 12/31/16. Past performance is not indicative of how the index will perform in the future. The index reflects the reinvestment of dividends and income and does not reflect deductions for fees, expenses, or taxes. The index is unmanaged and not available for direct investment.
2. The Federal Energy Regulatory Commission allows certain tariff-based MLPs to increase their pipeline fees according to the Producer Price Index (PPI), and many storage contracts adjust to the Consumer Price Index (CPI), so a rise in inflation may be partially offset by these pricing abilities.
3. Please see the Asset Class Yield Comparison chart for an illustration. MLP distributions are not guaranteed and subject to change based on market or other conditions. All or a portion of MLP distributions will be considered a return of capital.
4. Alerian, as of 12/31/16. The AMZ yield is calculated by income divided by current price. MLP distributions are not guaranteed and subject to change based on market or other conditions. All or a portion of MLP distributions will be considered a return of capital.
5. Bloomberg, as of 12/31/16
6. U.S. treasury bonds are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and guaranteed principal value. U.S. treasury bonds are issued and guaranteed as to the timely payment of principal and interest.

Please see the Glossary for a list of definitions.
Distribution Growth Has Historically Exceeded Inflation

Since 2006, distribution growth for MLPs has averaged 6.5%,\(^1\) which has been approximately 3.4x higher than the average rate of inflation (1.9%) as measured by the Consumer Price Index (CPI).\(^2\) Growth has come from a combination of organic growth and acquisitions, and recent shale discoveries have provided an additional avenue for growth. It is also worth mentioning that certain types of pipelines that are regulated by the FERC (Federal Energy Regulatory Commission)—particularly interstate crude and refined products pipelines—are able to increase their tariffs annually at Producer Price Index—Finished Goods (PPI-FG) +1.23% through 2020, which provides a potential inflation hedge for those businesses.\(^3\)

Correlations (or Lack Thereof)

MLPs may be valuable to the portfolio construction process since they typically do not exhibit high correlations with other asset classes. As shown in Figure 3, the highest correlation since June 2006 has been to high yield bonds (62%), while the correlation to the S&P 500 has been 54%.\(^6\)

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1. Alerian, as of 12/31/16. Average annual distribution growth rate is calculated by taking the total distribution growth per year and then calculating the weighted average of index constituents since June 2006. MLP distributions are not guaranteed and subject to change based on market or other conditions. All or a portion of MLP distributions will be considered a return of capital.
2. Bloomberg, as of 12/31/16
4. Alerian, as of 12/31/16. The MLP distribution growth rate is the rate at which an MLP grows its distribution. An individual MLP’s annual distribution growth rate is calculated by dividing its Year 1 distribution by its Year 0 distribution and subtracting 1 (dist yr 1/dist yr 0 - 1). The calculation universe is composed of constituents of the Alerian MLP Index. Constituents of the Alerian MLP Index are subject to change according to Alerian’s requirements for inclusion in the index.
5. Bloomberg, as of 12/31/16. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.
6. Bloomberg, as of 12/31/16
Over the long-term, the correlation versus crude oil has been relatively low at 51%. However, as seen in the rolling correlation graph below, there have been periods when the correlation has been negative (as recently as mid-2014) and also periods of time when correlations have spiked (particularly during the energy bear market that occurred from late 2014 through early 2016). As the graph illustrates, the 30-day correlation with oil reached approximately 80% several times during the 2014-2016 period before normalizing toward the end of 2016.\footnote{Bloomberg, as of 12/31/16}

In addition, many investors do not realize that the correlation of MLPs with rates (i.e. the 10-Year Treasury) is not only fairly low at 33%, but is positive. This means that, over time, rates and MLP prices have moved in the same direction. We believe this is due to the fact that higher rates typically imply stronger economic growth, which should imply increasing energy demand and, thus, growing volumes and cash flow for midstream assets.

**FIGURE 4**

30 Day Rolling Correlation Alerian MLP TR Index & Crude Oil

![Graph showing the correlation between Alerian MLP TR Index and Crude Oil from 2012 to 2016.](image)

Sources: Bloomberg and FactSet, as of 12/31/16

For illustrative purposes only. Past performance is not necessarily indicative of how the index will perform in the future. The index reflects the reinvestment of dividends and income and does not reflect deductions for fees, expenses, or taxes. The index is unmanaged and is not available for direct investment. Please see the Glossary for a list of definitions.

**FIGURE 5**

30 Day Rolling Correlation Alerian MLP TR Index & US Treasury Index

![Graph showing the correlation between Alerian MLP TR Index and US Treasury Index from 2012 to 2016.](image)

Sources: Bloomberg and FactSet, as of 12/31/16

For illustrative purposes only. Past performance is not necessarily indicative of how the index will perform in the future. The index reflects the reinvestment of dividends and income and does not reflect deductions for fees, expenses, or taxes. The index is unmanaged and is not available for direct investment. The Treasury Index is represented by the CBOE 10 Year Treasury Note Yield Index (TNX). Please see the Glossary for a list of definitions.
2. What is an MLP?

Section 7704 of the U.S. Tax Code

An MLP is a publicly-traded partnership that receives special treatment under the U.S. tax code. Specifically, MLPs do not have to pay income taxes at the corporate level if 90% or more of gross income is considered to be “qualifying.” Note that the 90% requirement for MLPs is related to income generation. Unlike REITs, there is not a requirement that MLPs pay out 90% of net income (or cash flow). In fact, MLPs are not required to pay out any distributions. This distinction is often misunderstood and/or misrepresented.

Section 7704 of the tax code defines qualifying income as “income and gains derived from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or similar products), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber).” As a result, the vast majority of MLPs are related to energy and natural resources.

The Internal Revenue Service (IRS) has been more accommodating in its definition of what constitutes “qualifying income” as demonstrated by a surge in the number of private letter rulings (PLRs) in recent years. Figure 6 shows the number of PLRs issued from 2004 through 2016. Note that the numbers increased meaningfully between 2012 and 2014 during the height of the U.S. energy boom as many companies sought to take advantage of the MLP structure.

The IRS has been back and forth recently regarding potential changes to Section 7704. In mid-2015, the agency proposed some changes that would exclude certain businesses from MLP eligibility. However, in the final regulations published in January 2017, the IRS announced that there would be no “exclusive list,” providing the agency with flexibility in evaluating activities that are not specifically included in the existing definition of “qualifying income.”

Ownership of an MLP consists of the general partner and the limited partners. The general partner manages the partnership and typically has unlimited liability in legal matters. The limited partners are the primary providers of capital and receive cash “distributions” (not “dividends”) from the partnership, but they are only liable to the extent of their investment as it relates to legal matters. The limited partners’ ownership is in the form of common “units” (not “shares”), which trade publicly on stock exchanges. In addition, several general partners are publicly-traded – some structured as MLPs and some as C-Corporations.

MLPs are designed to be a more tax efficient structure than the traditional corporation since they seek to avoid double taxation. In general, MLPs do not pay income tax at the corporate level. Instead, unit holders pay taxes at ordinary income tax rates on a portion of the distributions they receive. For more information on taxation, see page 17.

The Evolution and Size of the Space

Prior to 1997, the MLP space was primarily comprised of long haul pipeline and propane MLPs that generated stable cash flow but were generally not concerned about distribution growth. As a result, MLPs tended to trade like bond substitutes. In early 1997, Rich Kinder and Bill Morgan changed the game when they formed Kinder Morgan Energy Partners, L.P. (Kinder Morgan) after acquiring liquids pipeline assets from Enron Corporation.1 Kinder Morgan is often cited as the “original growth MLP”, as the partnership grew very rapidly by acquiring third-party midstream assets. We believe distribution growth is now one of the primary goals of many MLP management teams.

Historically, companies with predictable fee-based cash flow streams (such as pipelines) have been the norm in the MLP space. After all, the objective is to provide investors with steady (and potentially increasing) distributions. However, over the last ten years, a number of MLPs have come to market that have direct exposure to commodity prices including crude oil, natural gas, natural gas liquids (NGLs), and coal.

We believe that the ability of a partnership to hedge its commodity exposure has been a major contributor to more commodity sensitive businesses forming MLPs. Hedging essentially allows a partnership to turn a highly volatile cash flow stream into more predictable near term cash flows, which we think are essential in the MLP structure. However, even those businesses that have hedged their commodity exposure in the near-term face “rollover risk” in future years when those hedges expire. If commodity prices turn downward, those companies could have issues in the future. Case in point: almost every exploration & production (E&P) MLP eliminated their distributions during the 2014–2016 energy bear market due to declining cash flows and escalating leverage while several filed bankruptcy.2

As of December 31, 2016, there were approximately 111 publicly-traded energy MLPs with a total market capitalization of just over $400 billion. Note that this does not include the C-Corp general partners and midstream entities which account for another ~$300 billion of market cap.

Generally, MLPs fall in the small– to mid-cap category. As of December 31, 2016, only 10 MLPs had a market capitalization of greater than $10 billion, 28 MLPs fell between $2 and $10 billion, and the rest were below $2 billion. The average market cap as of that date was $3.6 billion, while the median market cap was only $1.1 billion.2

In general, MLPs can be categorized into ten different “subsectors” based on the type of assets owned and products transported:

- **Diversified.** Diversified MLPs are generally large cap in nature and operate in several of the subsectors listed below.
- **Natural Gas Pipelines & Storage.** MLPs in this subsector own both interstate and intrastate natural gas pipelines and/or natural gas storage. Historically, natural gas pipelines have generated stable cash flow due to long-term contracts with a large “take or pay” component. Natural gas storage has been a weak spot over the past several years due to a combination of lower natural gas prices, lower volatility in the natural

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2. Federal Energy Regulatory Commission (FERC). 04/12. The FERC resets this inflator every five years.

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**FIGURE 7**

MLPs: A Maturing Asset Class

For illustrative purposes only. Past performance does not guarantee future results. There are certain tax risks associated with an investment in MLP units and conflicts of interest exist between common unit holders and the general partner of the MLP.

Source: Salient Capital Advisors, LLC, as of 12/31/16
gas curve, and a lack of basis between hubs. The emergence of the Marcellus Shale in recent years has re-routed the historical flow of natural gas in the U.S. For decades, natural gas was produced in the Midwest and Gulf Coast and shipped via pipeline to the heavily populated northeastern states. However, Marcellus production has been so strong that the northeast only needs natural gas in the winter months when demand is highest and actually has a surplus of gas during the other months. As a result, we have witnessed a number of pipeline reversals and projects that deliver Marcellus natural gas to other regions.

- **Liquids Pipelines & Storage.** Crude oil and refined products pipelines and storage fall into this category. Revenues are largely fee-based, and for interstate pipelines, the FERC allows a PPI-FG + 1.23% tariff increase every year through 2020 which provides a potential inflation hedge. There have been a number of new crude pipelines constructed over the past five years due to new shale discoveries in areas such as the Bakken (ND), Eagle Ford (TX), and Niobrara (CO) as well as production growth in legacy basins like the Permian (TX).

- **Gathering & Processing (G&P).** G&P MLPs aggregate natural gas from multiple wells in a field and deliver it to a processing plant that removes NGLs. Historically, G&P has been one of the more commodity-sensitive subsectors due to keep-whole, percent-of-liquids (POL), and percent-of-proceeds (POP) contract structures through which the processors were long or short natural gas and/or NGLs. As natural gas prices have collapsed over the last several years, many of these contracts have shifted to fee-based arrangements as E&P companies need proceeds from their NGL production to increase returns. As a result, there has been some natural de-risking in this subsector. In fact, there are now several G&P MLPs that are entirely fee-based, though they still face volumetric risks should drilling decline in their areas of operation.

- **Propane.** Propane MLPs typically have both wholesale and retail distribution divisions that sell propane for heating, crop drying, and cooking purposes. Volumes are highly dependent on the winter weather, while margins can swing based on wholesale propane prices and the ability/inability to pass those price changes through to customers.

- **Exploration & Production (E&P).** E&P MLPs typically own long-lived reserves with low decline rates and focus more on production than exploration. Most hedge out a high percentage of expected production, but they are still highly exposed to commodity prices. Almost every E&P MLP eliminated their distribution during the energy bear market of 2014-2016, with several seeking Chapter 11 bankruptcy protection.

- **Shipping.** Currently, there are 10 shipping MLPs that transport products such as liquefied natural gas (LNG), refined products, crude oil, and dry bulk. In addition, some of these MLPs own floating storage and LNG regasification vessels. Typically, the shippers have long-term, fee-based charters, but could face issues if those charters are renewed at lower rates.

- **Coal.** Currently, there are five coal production MLPs and one that owns reserves that generate royalty revenues. In most cases, production is sold forward on multi-year contracts, but like E&P MLPs, coal MLPs face the risk of lower pricing once those contracts expire. Regulatory issues and escalating costs can also be a headwind for coal MLPs.

- **Refining & Marketing.** This subsector includes refineries that convert crude oil into refined products (such as gasoline, diesel, and jet fuel) as well as those that produce fertilizer. We also include wholesale marketers of crude and refined products as well as the “convenience store MLPs” in this subsector.

- **Oil Service and Other Specialty.** The “Oil Service” portion of this subsector includes compression MLPs, producers of sand used in the hydraulic fracturing process, and offshore drillers. The “Other” portion consists of MLPs that do not fit perfectly in any subsector like LNG plants, petroleum coking facilities, and other one-off MLPs.

Figure 8 on the following page touches on key characteristics inherent in some of the different types of businesses in the MLP structure.
Why Do Companies Put Assets into MLPs?

Early on, companies formed MLPs in order to divest assets and focus on core competencies. In the late 1980s, many large energy companies found that they had significant amounts of capital tied up in cash-generating assets such as pipelines. Since the income from those assets typically met the definition of qualifying income, energy companies sought to monetize those assets and create a more efficient capital structure for their ownership in these assets. Placing those assets into a publicly-traded partnership structure enabled many owners to be compensated for those assets and focus on their core competencies.

While that is still a motivation for many companies, we believe several issuers are now simply exploiting the valuation gap. Because of their tax structure and yield-oriented nature, MLPs have a lower cost of capital which typically leads to higher market valuations (and vice versa). For instance, let’s say that a traditional E&P company that also owns high quality pipeline assets trades at an EBITDA (earnings before interest, taxes, depreciation, and amortization) multiple of 6x, while MLPs with similar assets trade at 12x. Given the major difference in valuation, the company would be highly motivated to either form its own MLP or sell the assets to an existing MLP to maximize shareholder value. This valuation discrepancy has been the motivation behind the formation of MLPs such as Williams Partners, L.P. (natural gas pipelines), Western Gas Partners, L.P. (gathering & processing), Phillips 66 Partners, L.P. (liquids transportation & storage), and Shell Midstream Partners, L.P. (liquids transportation & storage).

By spinning out qualifying assets, the parent company is typically able to receive cash upfront while maintaining operational control and a meaningful financial stake in the assets through ownership of common units, the general partner interest, and incentive distribution rights.

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**FIGURE 8**

Characteristics of Businesses in the MLP Structure

<table>
<thead>
<tr>
<th>Cash Flow Stability</th>
<th>Type of Business</th>
<th>Contract Length</th>
<th>Revenue Type</th>
<th>Exposure to Commodity Prices</th>
<th>Types of Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very High</td>
<td>Natural gas pipelines</td>
<td>10+ Yrs</td>
<td>Rental fee / “Ship-or-pay”</td>
<td>Little</td>
<td>Gas distributors, Utilities, Producers, Marketers and other gas pipelines</td>
</tr>
<tr>
<td></td>
<td>Crude oil pipelines</td>
<td>5-10+ Yrs</td>
<td>Rental fee / Volume</td>
<td>Littie</td>
<td>Refiners, Producers, Financials</td>
</tr>
<tr>
<td></td>
<td>Storage</td>
<td>3-5 Yrs</td>
<td>Rental fee / Volume</td>
<td>Little (forward curve, contango)</td>
<td>Utilities, Marketers, Financials</td>
</tr>
<tr>
<td></td>
<td>Refined prod. Pipelines</td>
<td>1-5 Yrs</td>
<td>Rental fee / Volume</td>
<td>Littie</td>
<td>Refiners, Marketers</td>
</tr>
<tr>
<td></td>
<td>NGL pipelines</td>
<td>1-5 Yrs</td>
<td>Rental fee / Volume</td>
<td>Little</td>
<td>Petrochemical plants, Producers</td>
</tr>
<tr>
<td>Gathering</td>
<td>Ranging from month-to-month to life of lease dedications</td>
<td>Rental fee / Volume</td>
<td>Littie</td>
<td>Producers</td>
<td></td>
</tr>
<tr>
<td>Fractionation</td>
<td>Typically short-term contracts but trending more long-term</td>
<td>Fee-based / “Frac-or-Pay”</td>
<td>Littie</td>
<td>Producers</td>
<td></td>
</tr>
<tr>
<td>Terminals</td>
<td>1-3 Yrs</td>
<td>Volume / Ancillary services</td>
<td>Littie (contango)</td>
<td>Refiners, Financials</td>
<td></td>
</tr>
<tr>
<td>Processing</td>
<td>Month-to-month to life of lease dedications</td>
<td>Fee-based / Volume</td>
<td>More (NGL prices, contract mix)</td>
<td>Producers</td>
<td></td>
</tr>
<tr>
<td>Marine shipping</td>
<td>1-3 Yrs</td>
<td>Fee-based / Indexed charter rates</td>
<td>Littie</td>
<td>Refiners, Petrochemical companies, Integrated companies, Marketers</td>
<td></td>
</tr>
<tr>
<td>E&amp;P</td>
<td>–</td>
<td>Market rates / Hedging</td>
<td>Significant</td>
<td>Midstream operators</td>
<td></td>
</tr>
</tbody>
</table>

For illustrative purposes only.
Source: Morgan Stanley, March 2015.
3. The MLP Value Proposition

Over the past several years, MLPs have generated attractive total returns through a combination of high current yield and growth in distributions, as represented by the returns of the constituents within the AMZ. In fact this yield plus growth equation has explained 78.4% over the past three years, 59.7% over the past five years, and 78.7% of the MLP total returns over the past seven years (with the remainder due to changes in yield/valuation).

Potential Opportunities for Growth

Historically, MLPs have typically increased their cash flow through a combination of organic growth projects and acquisitions. Over the last decade, one of the key drivers of growth for MLPs has been the need for infrastructure resulting from the discovery of numerous shale plays (both crude oil and natural gas). The graphic below shows the major producing basins, including recent shale discoveries.

[FIGURE 9: Yield and Growth Historically Drives Returns]

For illustrative purposes only. Past performance is not indicative of how the index may perform in the future. The index reflects the reinvestment of dividends and income and does not reflect deductions for fees, expenses, or taxes. The index is unmanaged and not available for direct investment.
Sources: Alerian and Salient Capital Advisors LLC, as of 12/31/16
Please see the Glossary for a list of definitions.

[FIGURE 10: Lower 48 States Shale Plays]

For illustrative purposes only. Source: Energy Information Administration based on data from various published studies. Updated April 2015.

Past performance does not guarantee future results.
To put some numbers to the growth potential, ICF International (on behalf of the Interstate Natural Gas Association) published an updated report on future North American energy infrastructure needs and capital spending in April 2016. In its report, ICF estimates that infrastructure expenditures will total between $471 billion and $621 billion over the next 20 years. On average, annual natural gas capital expenditures (capex) are expected to be $14.8 billion over the next 20 years ($309.5 billion in total at the mid-point), with crude oil expected to average $7.8 billion ($163.7 billion in total at the mid-point), and NGL capex expected to average $2.4 billion ($49.0 billion in total at the mid-point). The table below summarizes the findings of the study.

### FIGURE 11

**Estimated Midstream Infrastructure Expenditures Through 2035**

<table>
<thead>
<tr>
<th></th>
<th>Total Expenditures in Billions</th>
<th>Average Annual in Billions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Low</td>
<td>Mid</td>
</tr>
<tr>
<td>Natural Gas</td>
<td>266.6</td>
<td>309.5</td>
</tr>
<tr>
<td>Crude Oil</td>
<td>137.5</td>
<td>163.7</td>
</tr>
<tr>
<td>NGLs</td>
<td>43.3</td>
<td>49.0</td>
</tr>
<tr>
<td>Incremental Integrity Management &amp; Emissions Control</td>
<td>24.0</td>
<td>24.0</td>
</tr>
<tr>
<td>Total</td>
<td>471.4</td>
<td>546.1</td>
</tr>
</tbody>
</table>

For illustrative purposes only. Estimates provided are subject to change without notice. Actual results may materially differ from those provided. Source: “North American Midstream Infrastructure Through 2035 – Leaning into the Headwinds” by ICF International, April 2016.
**Relative Performance vs. Alternative Yield Investments**

MLPs have outperformed the S&P 500 and other yield-based investments on a total return basis since the inception of the AMZ in June 2006. As shown in the graph below, the Alerian MLP Index has returned 9.1% annually since 2006 as compared to the S&P 500 annual return of 8.8%, albeit with a higher standard deviation than the S&P 500 (18.7% vs. 14.0% for the S&P 500). The Alpha (4.9%), Beta (0.67), and Sharpe Ratio (0.41) metrics also compare favorably to the S&P 500.

**FIGURE 12**

**Index Risk/Return**

*June 2006 – December 2016*

<table>
<thead>
<tr>
<th>Index</th>
<th>Compound ROR</th>
<th>Cumulative Return</th>
<th>Standard Deviation</th>
<th>Max Drawdown</th>
<th>Sharpe Ratio (2.941%)</th>
<th>Sortino Ratio (10%)</th>
<th>Up Capture Ratio</th>
<th>Down Capture Ratio</th>
<th>Alpha</th>
<th>Beta</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alerian MLP TR</td>
<td>9.1%</td>
<td>151.2%</td>
<td>18.7%</td>
<td>-48.5%</td>
<td>0.41</td>
<td>-0.06</td>
<td>70.0%</td>
<td>87.5%</td>
<td>4.9%</td>
<td>0.67</td>
</tr>
<tr>
<td>S&amp;P MLP TR</td>
<td>9.2%</td>
<td>154.2%</td>
<td>19.4%</td>
<td>-51.3%</td>
<td>0.40</td>
<td>-0.05</td>
<td>74.6%</td>
<td>89.1%</td>
<td>5.1%</td>
<td>0.67</td>
</tr>
<tr>
<td>Dow Jones Utilities Total Return</td>
<td>8.8%</td>
<td>144.0%</td>
<td>14.0%</td>
<td>-36.4%</td>
<td>0.47</td>
<td>-0.10</td>
<td>29.9%</td>
<td>54.4%</td>
<td>5.7%</td>
<td>0.45</td>
</tr>
<tr>
<td>Barclays High Yield Credit Bond Index</td>
<td>7.8%</td>
<td>121.7%</td>
<td>10.5%</td>
<td>-33.3%</td>
<td>0.50</td>
<td>-0.25</td>
<td>30.6%</td>
<td>61.4%</td>
<td>3.8%</td>
<td>0.51</td>
</tr>
<tr>
<td>MSCI REIT Index</td>
<td>7.0%</td>
<td>104.7%</td>
<td>25.5%</td>
<td>-69.2%</td>
<td>0.28</td>
<td>-0.15</td>
<td>144.8%</td>
<td>107.5%</td>
<td>-0.8%</td>
<td>1.26</td>
</tr>
<tr>
<td>Barclays Aggregate Bond Index</td>
<td>4.6%</td>
<td>61.1%</td>
<td>3.3%</td>
<td>-3.8%</td>
<td>0.51</td>
<td>-1.58</td>
<td>3.0%</td>
<td>-24.6%</td>
<td>4.6%</td>
<td>0.01</td>
</tr>
<tr>
<td>S&amp;P 500 TR</td>
<td>7.8%</td>
<td>120.9%</td>
<td>14.9%</td>
<td>-50.9%</td>
<td>0.38</td>
<td>-0.18</td>
<td>100.0%</td>
<td>100.0%</td>
<td>0.0%</td>
<td>1.00</td>
</tr>
</tbody>
</table>

For illustrative purposes only. Past performance is not indicative of how the indices may perform in the future. Indices are unmanaged, and investors cannot invest directly in an index. Index performance does not reflect the deductions of fees, expenses or taxes.

Please see the Glossary for a list of definitions.

Source: PerTrac, Data from June 2006 – December 2016
**Risk-Adjusted Returns vs. Other Energy Sectors**

In addition, MLPs have also generated the highest risk-adjusted returns among other energy sectors. The annualized return of the AMZ (9.1%) has been higher than utilities, E&P, oil service, and refining, as defined by the indices in Figure 13. While utilities did exhibit lower volatility than the AMZ, we would note that the standard deviation of the AMZ has been much lower than those of the more commodity-sensitive, cyclical sectors.

**FIGURE 13**

*Index Risk/Return Energy*

*June 2006 – December 2016*

For illustrative purposes only. Past performance is not indicative of how the indices may perform in the future. Indices are unmanaged, and investors cannot invest directly in an index. Index performance does not reflect the deductions of fees, expenses or taxes.

Please see the Glossary for a list of definitions.

Source: PerTrac, Data from June 2006 – December 2016.
4. Partnership Structure

MLP ownership is comprised of the general partner (GP) and the limited partners (LP). The general partner manages the partnership and typically owns some common units, the 2% general partner interest, and the incentive distribution rights. The limited partners are the primary providers of equity capital and typically receive quarterly cash distributions from the partnership. The limited partners’ ownership is in the form of publicly-traded common units and several general partners are publicly-traded as well (some structured as MLPs and some as C-Corporations). Figure 14 below shows a typical MLP organizational structure.

**FIGURE 14**

**MLP Organizational Structure**

For illustrative purposes only.

Source: Salient Capital Advisors, LLC, as of 12/31/16

**Governance: The “Limited” in Limited Partner**

MLPs are managed by the general partner, and in most cases, limited partners have limited voting rights regarding partnership matters such as acquisitions and electing the board of directors. Further, removing the general partner can be very difficult and often requires a 66 2/3% majority vote of the common unit holders, sometimes including the common units owned by the general partner. That said, major stock exchanges typically require at least three independent members on the general partner’s board of directors and the general partner does have certain fiduciary duties to the limited partners.

**The Mechanics of Incentive Distribution Rights (IDRs)**

MLP management teams are strongly incentivized to increase quarterly distributions to unit holders. Under the MLP structure, management is represented by the general partner, which typically has a 2% cash flow interest. Even though the equity stake of the GP is small, IDRs provide substantial upside and encourage the GP to grow distributions to unit holders as quickly as possible. As distributions increase and certain targets are met, the general partner receives a larger percentage of the incremental distributions.

In general, the tiers are set at 15.0%, 25.0%, and 50.0% above the minimum quarterly distribution (some cap the IDRs at 25.0%, some don’t have IDRs at all). Perhaps not coincidentally, the general partner receives that same percentage of incremental distributions once the tier is surpassed. In other words, if distributions were increased by 15.0%, the general partner would receive 15.0% of the incremental distributions above that level.

Let’s assume that “MLP” went public in January 2005 with a minimum quarterly distribution (MQD) of $0.35 per unit. At the MQD level, the MLP unit holders receive a quarterly distribution of $0.35 per unit, while the general partner receives $0.0071 per unit, or 2% of the total distribution.

From the MQD to the top-end of the first tier of distributions ($0.4025 per unit), the general partner receives 2% of the total distribution, for a total quarterly distribution between MLP unit holders and the general partner of $0.4107 per unit.

At the high end of the second tier, the MLP limited partners will receive $0.4375 per unit ($1.75 annually). This represents 98% of the tier one distribution and 85% of the distributions beyond that amount. The general partner will receive a total of $0.0144 per unit, for a total distribution between the LP and GP of $0.4519 per unit.

At distribution levels above $0.525 per unit, the MLP limited partners and the general partner will each receive 50% of the incremental distributions. For example, if the quarterly distribution was increased to $0.55 per unit, both the limited partners and the general partner would receive an additional $0.025 per unit as shown in Figure 15 on the following page.
Impact of IDRs on MLP Cost of Equity

To put it simply, IDRs increase a partnership’s cost of equity capital. As shown in the example above, the general partner receives an increasing portion of the distributions as the distribution to limited partners grows over time. Once a partnership reaches the 50% splits (Tier 4 in Figure 15), it has to increase distributable cash flow by $0.02 per unit in order to increase distributions to limited partners by $0.01 (since the general partner receives $0.01 as well).

In the example on the previous page, the partnership has to generate almost $0.62 per unit of cash flow to pay a $0.55 distribution to limited partners, and that is based on a partnership being only slightly ($0.025 per unit) into the high splits. If the distribution to limited partners were to increase to $3.00 per unit ($0.75 per quarter) in the example above, the partnership would have to generate cash flow of almost $1.02 per quarter after accounting for the general partner. Clearly, the general partner IDRs come at a cost to an MLP’s limited partners. The IDRs are also the reason that publicly-traded general partners may be such powerful growth stocks.

Due to the impact on an MLP’s cost of equity, several MLPs have bought out their general partner IDRs in recent years by issuing additional limited partner units to the general partner in lieu of the IDRs. For the most part, distribution growth rates have increased over time for those MLPs subsequent to the IDR buyout.

Investing in General Partners

We believe the same IDR dynamic that creates a headwind for MLP distribution growth also provides the potential for publicly-traded general partners to generate higher distribution (or dividend) growth. Not all general partners are publicly-traded, but there are currently several trading in both C-Corp form and MLP form. Note that the GPs that are structured as corporations may have to pay corporate level income tax.

Typically, general partners have lower yields but tend to grow their dividends or distributions at a faster rate than their underlying MLPs. The reason is fairly straightforward: operating leverage. General partners, in most cases, have very little general and administrative (G&A), interest, and other expenses. As the IDRs to the general partner increase, expenses typically do not increase by the same magnitude (if at all). Therefore, distributable cash flow and dividends/distributions to shareholders may grow at a faster rate.¹

### FIGURE 15

Typical MLP Incentive Distribution Rights Structure

<table>
<thead>
<tr>
<th>Distribution Schedule</th>
<th>Quarterly</th>
<th>Annually</th>
<th>Tier 1</th>
<th>Tier 2</th>
<th>Tier 3</th>
<th>Tier 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>MQD of $0.35</td>
<td>MQD</td>
<td>$0.3500</td>
<td>$0.3500</td>
<td>$0.3500</td>
<td>$0.3500</td>
<td>$0.3571</td>
</tr>
<tr>
<td>up to $0.4025</td>
<td>$0.0525</td>
<td>$0.0082</td>
<td>$0.4025</td>
<td>$0.4025</td>
<td>$0.4025</td>
<td>$0.4107</td>
</tr>
<tr>
<td>above $0.4025 to $0.4375</td>
<td>$0.0350</td>
<td>$0.0062</td>
<td>$0.4375</td>
<td>$0.4375</td>
<td>$0.4375</td>
<td>$0.4519</td>
</tr>
<tr>
<td>above $0.4375 to $0.5250</td>
<td>$0.0875</td>
<td>$0.0292</td>
<td>$0.5250</td>
<td>$0.5250</td>
<td>$0.5250</td>
<td>$0.5686</td>
</tr>
<tr>
<td>above $0.5250</td>
<td>$0.0250</td>
<td>$0.0250</td>
<td>$0.5500</td>
<td>$0.5500</td>
<td>$0.5500</td>
<td>$0.6186</td>
</tr>
<tr>
<td>% of Total Distribution</td>
<td>88.9%</td>
<td>11.1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For illustrative purposes only.
Source: SEC Filings; Tier 4 assumes $2.20 annual distribution to limited partners, as of 12/31/2016.
Please see the Glossary for a list of definitions.

¹. Salient Capital Advisors, LLC, as of 03/15.
5. Tax Basics

MLPs pay distributions to unit holders in cash. However, since MLPs are pass-through entities, each limited partner unit is entitled to its share of the non-cash deductions (such as depreciation and amortization) associated with the business. The portion of these non-cash expenses allocated to the limited partners reduces taxable income on the distribution by an equal amount. However, the passive loss limitations under Section 469(k) of the Internal Revenue Code of 1986, as amended (“IRC”) may affect the timing of when the deductions may be taken. In many cases, a new MLP may have a tax deferral of greater than 80%. In other words, for every dollar of cash received, only 20 cents is taxed at the unit holder’s ordinary income rate in the year it is received.

It is important that investors understand that, in general, ordinary deductions allocated to the investor will be recaptured as ordinary income when the units are sold.¹ Taxes on the deferred portion of the distribution will be “recaptured” when the units are sold rather than in the year in which the distribution is received up to the amount previously recognized as depletion. In addition to the recapture of distributions, unit holders will be subject to capital gains taxes when the units are sold at a gain for the portion above the initial cost.

For example, assume an individual buys an MLP unit for $20.00 which is yielding 10% and has a tax deferral of 80%. Each year, the unit holder receives a $2.00 distribution, of which $1.60 is deferred (80% x $2.00). The remaining $0.40 of the distribution is subject to ordinary income tax in the year received. At the end of year three, suppose the unit holder sells the unit for $23.00. The capital gain would be $3.00 ($23.00 minus $20.00), and the amount of recapture allocated to the unit holder’s ordinary income would be $4.80 ($1.60 per year times three years). Please see Figure 16.

Like inherited stock, inherited MLP units receive a “step-up” in basis upon the death of the owner.² For estate tax purposes, the value of the unit is its fair market value, and that becomes the new basis for the heir going forward. Any capital gains or recapture of ordinary income is eliminated, which typically makes MLP units a viable option for estate tax management.

Unrelated Business Taxable Income (UBTI)

Many tax-exempt investors are apprehensive about investing in MLPs due to Unrelated Business Taxable Income³, which is typically generated from any activity engaged in by a tax-exempt organization that is not related to the purpose of that organization.

In general, a business activity is an unrelated business (and generates unrelated business income subject to taxation) if it meets three requirements:⁴

1. It is a trade or business.
2. It is regularly carried on, and
3. It is not substantially related to furthering the exempt purpose of the organization.

Since MLPs are publicly-traded partnerships which pass income and cash flow through to unit holders.

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¹ As pursuant to IRC §§ 751 and 1245.
² As pursuant to IRC §§ 754 and 1014.
³ As defined by IRC § 512.
⁴ As pursuant to IRC §513.
FIGURE 16
Hypothetical Example of MLP Taxation

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase Price</td>
<td>$20.00</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Sale Price</td>
<td>-</td>
<td>-</td>
<td>$23.00</td>
</tr>
<tr>
<td>Capital Gain</td>
<td>-</td>
<td>-</td>
<td>$3.00</td>
</tr>
<tr>
<td>Distribution per Unit</td>
<td>$2.00</td>
<td>$2.00</td>
<td>$2.00</td>
</tr>
<tr>
<td>Distribution Subject to Tax (20%)</td>
<td>$0.40</td>
<td>$0.40</td>
<td>$0.40</td>
</tr>
<tr>
<td>Deferred Distributions (cumulative)</td>
<td>$1.60</td>
<td>$3.20</td>
<td>$4.80</td>
</tr>
<tr>
<td>Taxation:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Year Distribution</td>
<td>$0.12</td>
<td>$0.12</td>
<td>$0.12</td>
</tr>
<tr>
<td>Deferred Distributions (30% tax rate)</td>
<td>-</td>
<td>-</td>
<td>$1.44</td>
</tr>
<tr>
<td>Capital Gains (15% tax rate)</td>
<td>-</td>
<td>-</td>
<td>$0.45</td>
</tr>
<tr>
<td>Total Tax</td>
<td>$0.12</td>
<td>$0.12</td>
<td>$2.01</td>
</tr>
</tbody>
</table>

Total Holding Period Return, Net of Taxes: 33.80%

For illustrative purposes only. Salient does not provide tax advice. Please contact your tax professional to determine how the information contained in this presentation may apply to your situation.

Source: Salient Capital Advisors, LLC, as of 12/31/2016.

Public unit holders are therefore considered to be “partners” in the business. Said another way, a unit holder in a natural gas pipeline MLP is considered to be in the natural gas pipeline business. For a tax-exempt institution, the natural gas pipeline business would likely violate all three of the requirements above and income generated by the partnership would therefore be subject to taxation.

Alternative Means of Investing in MLPs

For many individual investors, the administrative burden of receiving a Schedule K-1 is reason enough not to invest in MLPs. Likewise, tax-exempt investors have sometimes avoided investing in MLPs due to potential UBTI issues. Since necessity is the mother of invention, several structures have been created that attempt to address the K-1 and UBTI concerns including closed-end funds, open-end funds, exchange traded funds, and exchange traded notes. However, each of these structures has potential drawbacks.

Closed-end funds (CEFs) provide investors with a 1099 instead of a K-1, which eases the tax filing process for most investors. Further, CEFs do not generate UBTI, thus alleviating the concerns of tax-exempt investors and Individual Retirement Accounts (IRAs). Distributions received from CEFs typically are treated as some mix of return of capital, dividends, and capital
gains for income tax purposes. However, many CEFs are structured as C-Corporations since traditional Registered Investment Company (RIC) structures have limitations on owning MLPs. This can be a headwind to net asset value (NAV) growth in upward trending markets since the funds must accrue a tax liability at corporate tax rates. Further, since they trade like equity securities on an exchange, CEFs may trade at a discount or premium to the underlying NAV.

Open-end funds also provide a 1099 and avoid UBTI, and alleviate the premium/discount issues of CEFs since subscriptions and redemptions are done at NAV. However, many open-end funds currently on the market are also structured as C-Corporations and must accrue a tax liability, which serves to reduce NAV.

Exchange traded funds (ETFs) are passive vehicles that are typically based on an MLP index, provide a 1099, avoid UBTI, and trade freely on a stock exchange. However, many of the current ETFs are structured as C-Corporations and have the same inherent tax liability impact on NAV as CEFs and open-end funds.

Like ETFs, exchange traded notes (ETNs) are passive vehicles that are typically based on an MLP index, provide investors with a 1099, avoid UBTI, and trade freely on a stock exchange. However, strictly speaking, ETN investors are exposed to the full faith and credit of the institution that issues the note. In addition, since they are structured as notes, distributions from ETNs are considered interest income (not dividend income). Further, fees for some ETNs are similar to actively managed strategies.

As an additional alternative to investing directly in MLP units, some U.S tax-exempt institutions will invest in MLPs utilizing total return swaps. In a total return swap, an outside counterparty – typically an investment bank – utilizes its own balance sheet to purchase the MLP, and passes through (or swaps) the income and capital gains/losses to the investor in exchange for a pre-determined borrowing rate. Since the investment bank is viewed as the owner of the MLP portfolio, the UBTI risk to the tax-exempt institution is typically eliminated. In addition, Treasury Regulation 1.512(b)-1 specifically excludes income from notional principal contracts from UBTI. Note that the investor does take on counterparty exposure to the investment bank under these arrangements.

Figure 17 summarizes the alternative structures.

---

**FIGURE 17**

**MLP Alternative Structures**

<table>
<thead>
<tr>
<th></th>
<th>Open-End Funds</th>
<th>Closed-End Funds</th>
<th>ETNs</th>
<th>ETFs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active Management</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Blocks UBTI</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Counterparty Risk</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate Level Tax Drag*</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NAV Pricing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Publicly-Traded</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Use of Leverage</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax Form</td>
<td>1099</td>
<td>1099</td>
<td>1099</td>
<td>1099</td>
</tr>
<tr>
<td>Legal Structure</td>
<td>Taxable C-Corp or RIC</td>
<td>Taxable C-Corp or RIC</td>
<td>Note</td>
<td>Taxable C-Corp or RIC</td>
</tr>
<tr>
<td>Dividend Treatment</td>
<td>Mix of Return of Capital &amp; Ordinary Income</td>
<td>Mix of Return of Capital &amp; Ordinary Income</td>
<td>Ordinary Income</td>
<td>Mix of Return of Capital &amp; Ordinary Income</td>
</tr>
</tbody>
</table>

For illustrative purposes only. Salient does not provide tax advice. Please contact your tax professional to determine how the information contained in this document may apply to your situation. *Applies to C-Corp Funds only.

Source: Salient Capital Advisors, LLC, as of 12/31/16.
6. Risks

Each individual partnership has its own set of risks, which generally include (but are not limited to) commodity price movements, declines in throughput volumes, integration and execution risks associated with acquisitions, damages from natural disasters or terrorism, and interest rate risks. Some of the risks to the MLP space as a whole are discussed below.

**Economic Weakness.** While equity markets have performed relatively well following the 2008 financial crisis, the U.S. and global economies have not recovered as quickly as they have following previous recessions. Many economists expect the economy to continue to limp along at a 2-3% growth rate, but there are some that argue for higher growth and yet others that see a looming recession. If the economy experiences another round of weakness, MLP returns may be impacted.

**Treasury Rates.** While MLPs have historically had a low correlation to Treasury rates, a rapid, dramatic move upward in Treasury yields may create some near-term pressure on MLPs.

**Credit Spreads.** MLPs have historically exhibited a relatively high correlation to major credit spread widening (and tightening) events. If debt issues in either the U.S. or globally begin to escalate once again, both investment grade and high yield credit spreads could be negatively impacted. Such a situation would most likely negatively impact MLP valuations.

**Commodities.** Prices for both natural gas and NGLs have been weak for some time (natural gas since 2009, NGLs since May 2012), while crude oil prices have just begun to recover from a dramatic decline between mid-2014 and early 2016. Although we believe we are now in an oil market recovery, if oil prices stay “lower for longer”, it may lead to lower future production and thus fewer growth opportunities for MLPs which, in turn, may negatively impact valuations.

**Fund Flows.** Investors remain concerned about the low rates on bonds and CDs not meeting their income needs, as well as the potential drop in bond prices if yields increase rapidly. MLPs have sometimes been seen as an alternative to bonds due to higher yields and the ability to grow the distribution to offset any potential increase in interest rates. While we believe near term fund flows will continue to improve following the recent bear market, we could see investors ultimately return to traditional fixed income instruments if rates rise quickly.

**Tax Law Changes.** We believe this is unlikely in the absence of overall tax reform, but any negative change in the tax code would likely have a detrimental impact on MLPs.
7. Glossary

10-Year Treasury is a debt obligation issued by the United States government that matures in 10 years. A 10-year Treasury note pays interest at a fixed rate once every six months and pays the face value to the holder at maturity. **RISKS:** Interest rate risk (as interest rates rise bond prices usually fall), and inflation risk exist.

% Split is the percentage split of the incremental cash flow between the limited partner and general partner.

Alerian MLP Index (AMZ) is a composite with some of the most prominent energy MLPs that provides investors with a comprehensive benchmark for this emerging asset class. **RISKS:** Discussed throughout this material include tax related risks due to their partnership status, unlike the other asset classes discussed, as well as possible higher volatility than the majority of the other asset classes discussed.

Alpha is the excess return of the fund relative to the return of the benchmark index’s return.

Amortization is the paying off of debt with a fixed repayment schedule in regular installments over a period of time for example with a mortgage or a car loan.

Barclays Capital U.S. Aggregate Bond Index is a composite comprised of the Barclays Capital U.S. Intermediate Government/Credit Index and the Barclay Capital Mortgage-Backed Securities Index. All issues in the index are rated investment grade or higher, have a least one year to maturity, and have an outstanding par value of at least $100 million. **RISKS:** Interest rate risk (as interest rates rise bond prices usually fall), the risk of issuer default, and inflation risk exist. As a lower-quality debt security, this involves greater risk of default or price changes and is more volatile than Bonds and T-Bills.

Barclays U.S. High Yield Bond Index is a U.S. Aggregate index that is comprised of fixed-rate, publicly issued, non-investment grade debt. **RISKS:** Interest rate risk (as interest rates rise bond prices usually fall), the risk of issuer default, and inflation risk exist. As a lower-quality debt security, this involves greater risk of default or price changes and is more volatile than Bonds and T-Bills.

Bear Market is a bear market is a condition in which securities prices fall and widespread pessimism causes the stock market’s downward spiral to be self-sustaining. Investors anticipate losses as pessimism and selling increases. Although figures vary, a downturn of 20% or more from a peak in multiple broad market indexes, such as the Dow Jones Industrial Average (DJIA) or Standard & Poor’s 500 Index (S&P 500), over a two-month period is considered an entry into a bear market.

Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. A beta of 1 indicates that the security’s price will move with the market. A beta of less than 1 means that the security will be less volatile than the market. A beta of greater than 1 indicates that the security’s price will be more volatile than the market.

Brent Crude is a major trading classification of light sweet crude oil that serves as a major benchmark price for purchases of oil worldwide.

Capital Expenditure, or CapEx, are funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment. It is often used to undertake new projects or investments by the firm.

Cumulative Return is the aggregate amount that an investment has gained or lost over time, independent of the period of time involved.

Depreciation is a reduction in the value of an asset with the passage of time, due in particular to wear and tear.

C-Corp is a legal structure that businesses can choose to organize themselves under to limit their owners’ legal and financial liabilities. C corporations are an alternative to S corporations, where profits pass through to owners and are only taxed at the individual level, and limited liability companies, which provide the legal protections of corporations but are taxed like sole proprietorships.

Compound Return is the rate of return that represents the cumulative effect that a series of gains or losses has on an original amount of capital over a period of time.

Consumer Price Index (CPI) is the measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

Contango is a situation where the futures price of a commodity is above the expected future spot price. Contango refers to a situation where the future spot price is below the current price, and people are willing to pay more for a commodity at some point in the future than the actual expected price of the commodity. This may be due to people’s desire to pay a premium to have the commodity in the future rather than paying the costs of storage and carry costs of buying the commodity today.

Correlation in the finance and investment industries, is a statistic that measures the degree to which two securities move in relation to each other. Correlations are used in advanced portfolio management. Correlation is computed into what is known as the correlation coefficient, which has value that must fall between -1 and 1.

Credit Spread is the difference in yield between two bonds of similar maturity but different credit quality. For example, if the 10-year Treasury note is trading at a yield of 6% and a 10-year corporate bond is trading at a yield of 8%, the corporate bond is said to offer a 200-basis-point spread over the Treasury.

Cumulative Return is the aggregate amount that an investment has gained or lost over time, independent of the period of time involved.

% Split is the percentage split of the incremental cash flow between the limited partner and general partner.
**Distribution Schedule** is the schedule of distributions at an annual rate.

**Dow Jones U.S. Utilities Index** measures the performance of utility companies within the United States. **RISKS:** Non-diversified and therefore may be more volatile than the S&P 500 Index.

**Down-Market Capture Ratio** evaluates how well or poorly an investment manager performed relative to an index during periods when that index has dropped.

**EBITDA** is a measure of a company’s ability to produce income on its operations in a given year. It is calculated as the company’s revenue less most of its expenses (such as overhead) but not subtracting its tax liability, interest paid on debt, amortization or depreciation. It is important to note that EBITDA does not account for one off or otherwise unusual revenues and expenses, only recurring ones.

**Exchange Traded Funds (ETF)** is a marketable security that tracks an index, a commodity, bonds, or a basket of assets like an index fund. Unlike mutual funds, an ETF trades like a common stock on a stock exchange. ETFs experience price changes throughout the day as they are bought and sold.

**Exchange Traded Notes Exchange-traded notes (ETNs)** are a type of unsecured, unsubordinated debt security first issued by Barclays Bank PLC based on the performance of a market index minus applicable fees, with no period coupon payments distributed and no principal protections. Similar to exchange-traded funds (ETFs), ETNs are traded on a major exchange, such as the New York Stock Exchange (NYSE) during normal trading hours.

**Exploration & Production (E&P)** is a group of companies that explore for, and produce oil and gas.

**Federal Energy Regulatory Commission (FERC)** is a United States government agency, established in 1977 to oversee the country’s interstate transmission and pricing of a variety of energy resources, including electricity, natural gas and oil.

**Fractionation** is a term that measures some aspect of a company’s financial well-being, determined by dividing one metric by another metric.

**Gathering & Processing** involves moving natural gas from the wellhead to a natural gas processing plant, where NGLs and other impurities are removed from the natural gas stream.

**General Partnership** is an arrangement by which partners conducting a business jointly have unlimited liability, which means their personal assets are liable to the partnership’s obligations.

**Growth** is the process of improving an enterprise’s success, which can be achieved either by greater revenue or by increasing the bottom line or profitability of the operation by minimizing costs. In the context of the piece, growth refers to distribution growth.

**Hedging** against investment risk means strategically using instruments in the market to offset the risk of any adverse price movements. In other words, investors hedge one investment by making another.

**Incentive Distribution Rights (IDRs)** are give a limited partnership’s general partner an increasing share in the incremental distributable cash flow the partnership generates. This occurs alongside of per-unit distribution increases to the limited partners. The general partner’s share of incremental distributable cash flow usually starts at 2% and climbs to higher levels such as 20% or 50%.

**Incremental Distributions** is the limited partner’s and general partner’s share of the incremental increase in the distribution rate.

**Keep-whole contracts** are contracts under which the processor retains the NGLs extracted and returns the processed natural gas or value of the natural gas to the producer. Under this contract, the processor benefits when the price of NGLs increases and the price of natural gas decreases.

**Leverage** is the use of various financial instruments or borrowed capital, such as margin, to increase the potential return of an investment.

**Limited Partnership** is a partnership consisting of a general partner, who manages the business and has unlimited personal liability for the debts and obligations of the Limited Partnership, and a limited partner, who has limited liability but cannot participate in management.

**Liquefied Natural Gas (LNG)** consists mostly of methane and is cooled to approximately -256 degrees Fahrenheit so that it can be transported from countries that have more natural gas than they need to countries that use more natural gas than they produce. In its liquefied state, natural gas takes up 1/600th of the space, making it much easier to ship and store when pipeline transport is not feasible. As world energy consumption increases, experts anticipate that the LNG trade will grow in importance.

**Marcellus Shale** is a sedimentary rock buried thousands of feet beneath the earth’s surface. It stretches from upstate New York south through Pennsylvania to West Virginia and west to parts of Ohio.

**Midstream Asset** is a term used to describe one of the three major stages of oil and gas industry operations. Midstream activities include the processing, storing, transporting and marketing of oil, natural gas and natural gas liquids. Midstream assets are the physical structures that enable the midstream activity.

**Max Drawdown** is the maximum peak-to-trough decline during a specific record period of an investment, fund or commodity.

**Moody’s Baa** is an investment index comprised of medium grade, moderate risk bonds as rated by Moody’s (an independent, unaffiliated research company that rates fixed income securities). **RISKS:** Interest rate risk (as interest rates rise bond prices usually fall), the risk of issuer default, and inflation risk exist.

**MSCI U.S. REIT Index** a free float-adjusted market capitalization index consists of equity REITs that are included in the MSCI US Investable Market 2500 Index, except for specialty equity REITs that do not generate a majority of their revenue and income from real estate rental and leasing operations. **RISKS:** Real estate industry concentration risk (non-diversification), interest rate risk (as interest rates rise bond prices usually fall), the risk of issuer default, and inflation risk exist.

**Mutual Fund** an investment program funded by shareholders that trades in diversified holdings and is professionally managed.

**Natural Gas Liquids (NGLs)** are hydrocarbons that are contained in natural gas and include ethane, propane, butane, isobutene, and natural gasoline.

**Net Asset Value (NAV)** is value per share of a mutual fund or an exchange-traded fund (ETF) on a specific date or time.
Notional Principal Contracts (NPC) is a term used by U.S. federal income tax professionals for contracts based on an underlying notional amount (other financial services professionals refer to such NPCs under the more general heading “swaps,” although not all swaps are NPCs). The reason the underlying amount is “notional” is because neither party to the NPC is required to actually hold the property comprising the underlying amount. NPCs involve two parties who agree contractually to pay each other amounts at specified times, based on the underlying notional amount.

Percentage of proceeds contracts (POP) are contracts under which processors receive an agreed upon percentage of the actual proceeds of the sale of the dry natural gas and NGLs, or an agreed upon percentage based on index prices for the commodities (also called “percentage of index” or POI). Under this contract, the higher the price of natural gas and NGLs, the stronger the processors margins will be.

PHLX Oil Service Sector Index (OSX) is a price weighted index composed of companies involved in the oil services sector.

Private Letter Ruling (PLR) is an interpretation of statute or administrative rules and their application to a particular set of facts or circumstances. The private letter ruling addresses unusual or complex questions pertaining to a particular taxpayer and his or her tax situation.

Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services.

Real Estate Investment Trusts (REIT) is a type of security that invests in real estate through property or mortgages and often trades on major exchanges like a stock. REITs provide investors with an extremely liquid stake in real estate. They receive special tax considerations and typically offer high dividend yields.

RIC is a regulated investment company (RIC) can be any one of several investment entities – for example, a mutual fund or exchange-traded fund (ETF), a real estate investment trust (REIT) or unit investment trust (UIT) – that is deemed eligible by the Internal Revenue Service (IRS) to pass through the taxes on capital gains, dividends or interest earned through investments to individual investors. A regulated investment company is qualified to pass through income under Regulation M of the IRS, with the specific regulations for qualifying as a RIC delineated in U.S. code, title 26, sections 851 through 855, 860 and 4982.

Russell 2000 Index is an index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks.

Schedule K-1 is a partnership must file an annual tax return on Form 1120S. The Partnership provides Schedule K-1s that report each shareholder’s share of income, losses, deductions and credits. The shareholders use the information on the K-1 to report the same thing on their separate tax returns.

S&P 500 Oil & E&P Index S&P Select Industry Indices are designed to measure the performance of narrow GICS® sub-industries. The index comprises stocks in the S&P Total Market Index that are classified in the GICS oil & gas exploration & production sub-industry.

S&P 500 Refining and Marketing Index S&P Select Industry Indices are designed to measure the performance of narrow GICS® sub-industries. The index comprises stocks in the S&P Total Market Index that are classified in the GICS oil & gas Refining and Marketing sub-industry.

S&P 500 Total Return (TR) Index a stock market index based on the common stock prices of 500 top publicly traded American companies. RISKS: Can be affected by general market or economic conditions.

S&P 500 Utilities Index is an unmanaged index considered representative of the utilities market. RISKS: Can be affected by general market or economic conditions.

Sharpe Ratio measures the risk-adjusted performance of an investment.

Sortino Ratio differentiates between upward and downward volatility, allowing the calculation to provide a risk-adjusted measure of a security or fund’s performance without penalizing it for upward price changes.

Standard Deviation is the annual rate of return of an investment to measure the investment’s volatility.

Take-or-pay contract is a rule structuring negotiations between companies and their suppliers. With this kind of contract, the company either takes the product from the supplier or pays the supplier a penalty. For any product the company takes, they agree to pay the supplier a certain price.

Tariffs specify the rates, terms, and conditions that apply for the transportation services offered by a pipeline.

Total Quarterly Distribution is the total quarterly distribution rate allocated between the limited partner and general partner, including the general partner’s incentive distribution rights.

Total Return Swaps is a swap agreement in which one party makes payments based on a set rate, either fixed or variable, while the other party makes payments based on the return of an underlying asset, which includes both the income it generates and any capital gains. In total return swaps, the underlying asset, referred to as the reference asset, is usually an equity index, loans or bonds. The asset is owned by the party receiving the set rate payment.

Treasuries a marketable U.S. government debt security with a fixed interest rate and a maturity between one and 10 years. Treasury notes are available from the government with either a competitive or noncompetitive bid. With a competitive bid, investors specify the yield they want, at the risk that their bid may not be approved; with a noncompetitive bid, investors accept whatever yield is determined at auction.

Up-Capture Ratio evaluates performance relative to an index during periods when the index has risen.

Utilities a category of stocks for utilities such as gas and power. The sector contains companies such as electric, gas and water firms, and integrated providers. Because utilities require significant infrastructure, these firms often carry large amounts of debt; with a high debt load, utilities companies become sensitive to changes in the interest rate.

Valuation is the change in yield during the period ((Beginning yield – ending yield)/Beginning yield).

West Texas Intermediate (WTI) is also known as Texas light sweet, a grade of crude oil used as a benchmark in oil pricing.

Yield reflects the income return on an investment expressed as a ratio of income divided by current value of investment expressed as an annualized rate (annualized income/value of investment = yield).

Yield Companies (Yield Cos) are publicly traded companies that are formed to own operating assets that produce a predictable cash flow.