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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Investing in the Best Opportunities in Midstream Energy

TED GARDNER, CFA, is a Managing Director and serves as a Portfolio Manager for Salient Partners' MLP complex. Mr. Gardner formerly served as Portfolio Manager and Director of Research at RDG Capital, LLC, a Houston-based asset management firm specializing in MLP investments. RDG was acquired by Salient in 2011. Previously, Mr. Gardner served as a research analyst with Raymond James and Associates following MLPs in the pipeline, midstream, propane, maritime and coal industries. Mr. Gardner is a CFA charterholder and holds a Bachelor of Business Administration from The University of Texas at Austin and an MBA from the University of St. Thomas, Cameron School of Business in Houston, Texas.

SECTOR — GENERAL INVESTING

TWST: Can you tell us about Salient, the types of investments you focus on and your Salient MLP & Energy Infrastructure strategy?

Mr. Gardner: Salient was founded in 2002 and is a real asset and alternative investment firm that offers a suite of strategies focused on real assets — comprised of energy and infrastructure, real estate and tactical alternative investments. We have approximately $7.2 billion in assets under management with the energy infrastructure strategies comprising approximately $4.7 billion in assets. We have two real estate strategies as well, and one is focused on real estate investment trust — REIT — preferred securities, as well as tactical strategies.

Our team manages a suite of energy and infrastructure strategies that includes institutional separately managed accounts, a private fund that looks similar to our separately managed accounts, a closed-end fund and our open-end mutual fund strategy. We refer to it as our midstream — or energy infrastructure — complex because the strategies are all investing in the same asset class, though the strategies might have slightly different structures. From an investment standpoint, we look at them all the same way.

Our open-end mutual fund strategy has only a certain amount of true MLPs in there, meaning those that issue K-1s, due to regulatory requirements, while the rest of the holdings consist of C-Corporations. We used to refer to it as the master limited partnership — MLP — complex but have started calling it the midstream and energy infrastructure complex given the changes that have taken place in the industry over the past few years. You now have a lot of midstream assets inside traditional corporate structures other than the legacy MLP structure.

TWST: As MLPs are moving away from a traditional structure, are they becoming a misnomer?

Mr. Gardner: Yes and no. You have types of assets that live in both the partnership structure and, increasingly over the last few years, in the corporate structure. Whenever the term MLP has been used or whenever somebody hears it, they tend to think about pipelines. But a master limited partnership is really just a corporate structure where the entity is a partnership rather than a corporation. We now refer to these strategies as MLPs and energy infrastructure, or simply midstream, and some use the term energy infrastructure rather than calling the strategies MLPs.

In terms of what we at Salient invest in in the midstream or MLP space, think of it as just midstream energy, which includes the pipelines and storage to gathering and processing energy assets. Everything that we own in our strategies are publicly traded stocks. We do not invest in the private markets.

TWST: Can you describe the Salient energy and infrastructure complex of investments?

Mr. Gardner: We consider ourselves bottom-up managers. We are not necessarily taking a top-down view and saying, "Hey, we want to own more natural gas pipelines or less natural gas pipelines or oil pipelines." We go where we think the best opportunities are. Right now, our portfolio includes predominantly natural gas, oil and refined products investments, with a smaller focus on natural gas liquids assets.

TWST: When you look at that composition, what does it reflect back to you about your bottom-up process and thoughts on the market and where the best investments are now?

Mr. Gardner: Over the last few years, we have seen some consolidation in the space. There are more and more diversified entities now. When you look at some of the largest players in the space, they are going to have multiple business lines. It is rare these days that you would find somebody that only operates, say, oil pipelines in the Permian Basin or oil pipelines in the Eagle Ford shale.

If you look at one of the largest names in the space, **Enterprise Products** (NYSE:EPD), it includes oil pipelines, natural gas pipelines as well as natural gas liquids pipelines. They also have petrochemical assets that deliver feedstocks into petrochemical plants and other assets. It is not unusual these days to have this diversification, particularly among the larger-cap names. We don't seek an oil pipeline in XYZ basin; rather, we are really looking at whole businesses.

There are opportunities in multiple areas. There is a pretty large infrastructure buildout occurring in the Permian Basin for both oil and natural gas. We have also had some opportunities in the natural gas liquid space. Our approach is holistic.

TWST: Some of the trends that are going on in this industry are this move from IDRs — incentive distribution rights — to corporate structures, as well as an influx of private equity. What do these trends mean in terms of the entire investment opportunity as well as the dynamics within the market? How is the market, for example, absorbing and responding to those changes?

Mr. Gardner: We have seen several companies move from a partnership to a more traditional corporate structure after being acquired by their corporate parent. Along with that structural change comes arguably better governance, which has been viewed favorably by investors. In the partnerships, if you control the general partner, you basically control the board. As we used to emphasize, the "L" in the "LP" is the "limited" in "limited partner."

However, the IDR issue is not about just moving from an MLP to a corporation. In many partnerships, the IDRs have been eliminated, but they have remained MLPs. We are structure-agnostic, so we don't want to just own MLPs or C-Corps. We are looking at the assets themselves.

Highlights

Ted Gardner discusses Salient Partners' MLP & Energy Infrastructure strategy. The strategy invests in publicly traded stocks in midstream energy, which includes pipelines, storage, and gathering and processing assets. Mr. Gardner says he is a bottom-up manager. He goes where he thinks the best opportunities are. Currently, the portfolio is predominantly natural gas, oil and refined products. Mr. Gardner believes Salient's differentiators include its research approach, local resources and access to local company information.

Companies discussed: Enterprise Products Partners L.P. (NYSE:EPD); MPLX LP (NYSE:MPLX); Exxon Mobil Corporation (NYSE:XOM) and Plains All American Pipeline, L.P. (NYSE:PAA).

side of capex. Traditionally, this space paid out virtually all of its cash flows in the form of dividends or distributions. They would then go to the capital markets to finance growth projects with public debt and equity.

That is a big shift as well, driven by the capital market difficulties that arose in the 2015 time frame. The stocks really have not recovered as quickly as many had expected and would want them to. So there has been a push for more internal funding of capex, given the lower stock prices. That has become somewhat of an investor hot button.

There is also a large deleveraging trend that we have seen, because when we did have the meltdown in the energy space in that 2015 time frame, companies didn't want to issue equity to fund capex. They leaned a little bit more heavily on debt facilities. We have been in a multiyear build cycle, whereby companies have already spent the capital and have debt on the balance sheet but do not have the cash flow to show for it. So the industry had higher leverage than what we have seen historically. We are seeing that deleveraging trend now, particularly as many of these projects have come online or are about to come online.

All of these trends have come together in a way that we think is positive for the space. Transitions are never easy as they say, but our view is that the transitions are ultimately positive for the long term. The bottom line is, the transitions we have seen in the space over the last few years following the energy bear market are very positive for the long term. We believe these changes should bring more stability and less volatility to the space.

TWST: In a recent presentation from your group, you write that midstream multiples can expand if ROIC improves. What variables need to shift for ROIC to improve, and how connected is any improvement going to be to the specific variables of geography as well as capacity?

Mr. Gardner: We try to take an academic view of this, as in looking at the textbook formula of what an EBITDA multiple should be and the components that are involved to determine the multiple that a company should trade at. It is a function of your return on invested capital, your growth rate and your weighted average cost of capital — those are three big inputs. We think the weighted average cost of capital, just from the IDR eliminations we have seen, reduces the cost of equity. But the returns on capital beyond that are about capital discipline.

In the broad energy space right now, investors don't want capital to be spent just for spending's sake. They want to see that you are going to earn your target returns on those dollars that you are allocating. A good

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For those that have converted to a C-Corp or were already a C-Corp, there is a wider investor audience. Right now, we are seeing C-Corps trade at a premium to MLPs, even though they either already are or eventually will be taxpayers. Traditional MLPs don't pay taxes.

Along with the simplification of structures and the elimination of the IDRs has come a push for internal funding of capex, at least on the equity example in our space is the Permian Basin where a number of new pipelines have been proposed. Not all of those pipelines have gotten enough commitments from producers to support the economics. Perhaps in years past, you might have seen midstream players go ahead and build them, even if they are not quite at the level they need to secure the minimum return. Now, we are seeing some of these companies back away from those projects and say, "Well, it is not meeting our return threshold, and we don't have enough shipper commitments, so let's not do it."

1-Year Daily Chart of Enterprise Products Partners L.P.

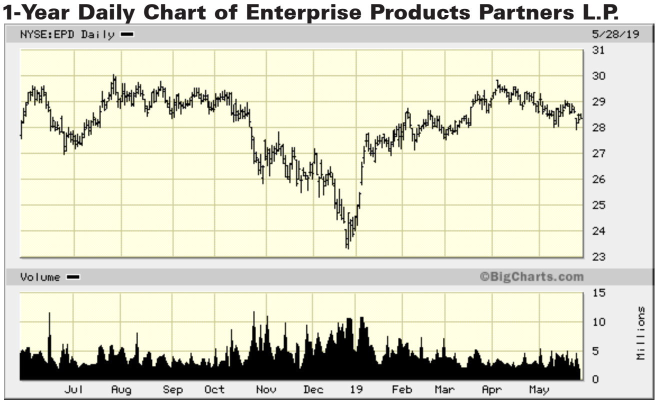

Chart provided by www.BigCharts.com

In other instances, you hear of conversations among companies about consolidating projects. What we mean by that is, if you had two or three pipelines being contemplated, none of which have the necessary level of commitment to secure their economics individually, if you put them together in one joint venture pipeline, then you get to your economics. A good example of this is **MPLX's** (NYSE:MPLX) recent public announcement that it would join the Wink to Webster Pipeline project along with **Exxon Mobil** (NYSE:XOM) and **Plains All American** (NYSE:PAA), rather than pursue a separate project. These are some of the trends that we are seeing from a return-on-invested-capital perspective.

Mr. Gardner: Trump signed an executive order to streamline the permitting process, and that is always a positive. But the fact is that many of the issues that we have seen from a permitting perspective have lived at the state level, particularly in the Northeast. So while it is a positive to have the White House at the federal level behind you, that doesn't necessarily mean that you won't still run into issues at the state level, which is ultimately where these pipelines are constructed. It is nice to have, but does it dramatically shift what occurs at the state level? So far, we haven't really seen it. We're still seeing some challenges from a permitting perspective.

TWST: Can you speak to your geographical selections and why they were selected? Would you characterize a broad group of selections as, in any way, contrarian?

Mr. Gardner: In past years, we certainly would have been seen as contrarian on some names. For a lot of our core holdings, we tend to be among the largest owners. It is probably when you start getting down to the midcap names that we might have a little bit different positioning. We are not a tiny shop by any means, but we are smaller in size than a number of our competitors, which allows us to be more nimble in selecting some of the small-cap and midcap names and having them as meaningful positions in our portfolios.

TWST: Did you want to comment more about some of the selections that you have made? Again, for selections, whether it's by geography or anything else, are they reflective of something going on? For example, have certain selections been made because you feel strongly that a certain geography is going to produce as expected or, through permitting, will be favorable? Certainly expand if you will on other variables as well.

Mr. Gardner: As you may be aware, the Permian Basin is where a lot of capital is going these days. On the oil side of it, we are frankly going to be at least in a near- to medium-term overbuild situation on the oil pipeline side, although this will depend on the slope of the production curve. If there is one area in the country where producers can push the accelerator, it is the Permian. How long that excess capacity will last is ultimately going to be a function of producer behavior.

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TWST: In this case, you are talking about expected returns that will be occurring despite current inexpensive valuations, correct? Even there, you see an expected influx of return on invested capital? You are saying that the space is still relatively undervalued?

Mr. Gardner: Yes, we do believe that. When you look at five- and 10-year average EBITDA multiples, the space is trading at roughly 20% discounts. We do think that there is some revaluation to be had in the space. So when we start talking about the returns on invested capital and how to get multiple expansion, it further supports those returns.

TWST: There has been talk in the energy sector in general that perhaps the loosening of the regulations under the Trump Administration has been helpful. Is that true for this space? And if so, has that tailwind run its course?

What you do see in the Permian is that the associated gas has become a problem. There is a lot of flaring going on. There are a couple of pipelines that are being built, but we do think that there will need to be more gas pipelines built there, particularly if you bring in the regulatory component. Texas has always been a pretty friendly state in terms of oil and gas production. But you are getting to a level now in Texas where there has been more flaring of natural gas on a daily basis than is actually consumed by residents of the state.

At some point, you might see the Texas Railroad Commission, which regulates oil and gas production in the state, come in with some regulations to capture this flared gas like what we saw in the Dakotas a few years ago. If that happens, you will see more natural gas pipelines be announced and committed to. Now, we can't say for sure what is going to happen with the Texas Railroad

Commission, but what we do know is that there is a lot of flaring going on, and there may be a lot of opportunity for new gas pipelines. That is one area to take a look at.

We also think that there is some room for expansion in the midcontinent region for oil pipelines. You have a lot of oil that is coming into Cushing, Oklahoma, which is your central delivery point for oil, but there is not as much capacity on outgoing pipelines, so you are creating some bottlenecks in that region. There may be a need for more pipes in the SCOOP/STACK area of Oklahoma, depending on the production ramp as well. Those are areas where we see potential opportunities.

TWST: In closing, why should somebody choose to invest in your MLP-focused funds as opposed to others? You mentioned earlier you feel you are perhaps a bit smaller than some of your competitors, so you can be more nimble. What other factors might you want to mention?

Mr. Gardner: We are located in Houston, which is the center of the universe in terms of energy. It is referred to as the energy capital of the world. A large percentage of the midstream space is headquartered here, and we have a lot of producers, service companies, investment bankers, private equity firms, accountants, attorneys and other folks that are in or around the industry. We try to utilize all of these resources and not just have conversations with the management teams themselves. That approach has worked well for us over the years.

I already mentioned our more nimble size and our ability to take advantage of small-cap and midcap stocks that others cannot. We are also a research-focused team with a long history in the space, and we really dig into the details of every company in our investable universe. We believe our research approach, local resources and access to local company information are true differentiators for Salient.

TWST: Thank you. (KJL)

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