



2022 Midstream/MLP Outlook: Tailwinds Intact

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Summary

- Free cash flow generation and the related potential for buybacks are likely to remain in focus for midstream in 2022.
- With excess cash flow, improved balance sheets, and more normalized yields, dividend increases are likely to see more traction into 2022, albeit at measured rates.
- Companies are expected to make continued progress on opportunities related to the energy transition through partnerships or with specific projects.

The midstream space provided solid performance in 2021 supported by a macro recovery in energy and positive company-level developments. [The Alerian Midstream Index](#) (AMNA) and [Alerian MLP Infrastructure Index](#) (AMZI) gained 38.4% and 40.9%, respectively, on a total-return basis for the year. Looking ahead to 2022, key themes for midstream in 2021 are likely to remain in focus, namely free cash flow generation and the related potential for buybacks. With excess cash flow, improved balance sheets, and more normalized yields, dividend increases are likely to see more traction into 2022, albeit at measured rates. Companies are expected to make continued progress on opportunities related to the energy transition through partnerships or with specific projects. Given ongoing company-level tailwinds and an improving macro environment, midstream's positive momentum from 2021 can continue into 2022.

Dividend stability expected with modest growth from several names.

For the first time in two years, there were no cuts across Alerian's midstream indexes for 3Q21 dividends ([read more](#)). Looking ahead to 2022, more cut-free quarters are expected along with additional examples of dividend growth. Companies that needed to reset their payouts have largely done so, which should stave off cuts. With much of the space generating free cash flow even after generous dividends and stronger balance sheets in place, the potential for dividend increases is improving. For example, EnLink (ENLC) [announced](#) plans last month to increase its distribution by 20% for its 4Q21 payout noting free cash flow generation and significant progress with its balance sheet. Companies that previously cut payouts may provide greater percentage growth, but generally, dividend growth is expected to be more moderate (i.e., growth of less than 5%). More normalized yield levels from better performance also make dividend increases more palatable. Alerian will cover dividends in more detail in an upcoming note – stay tuned.

Buybacks add another layer to shareholder returns.

With widespread buyback authorizations for midstream, returning capital to shareholders is not just a dividend story anymore. Enbridge (ENB) is the latest midstream company to announce a buyback plan, with the potential to repurchase up to [\\$1.5 billion](#). In 2022 outlooks from December, KMI [noted](#) up to \$750 million in opportunistic buybacks, while Pembina Pipeline (PPL CN) [plans](#) to use up to \$200 million of excess cash flow after dividends and capital investment on share repurchases. Buybacks could help support midstream equities in 2022, adding to the total return potential for the space. As of December 31, 74.3% of the AMNA Index and 69.3% of the AMZI Index by weighting have buyback authorizations in place.

Stable-to-growing EBITDA expected, setting aside 1Q21 windfalls.

While some companies have already provided 2022 financial outlooks, others are likely to provide guidance with 4Q21 results. Ongoing improvements in the macro environment should generally support stable-to-growing EBITDA for most. The Energy Information Administration is [forecasting](#) 2022 US marketed natural gas production growth of 3.1% to 103.3 billion cubic feet per day and US oil production growth of 6.0% to 11.9 million barrels per day. The handful of companies that have provided 2022 EBITDA guidance thus far are generally expecting moderate growth. Stable EBITDA and capital discipline should continue to support significant free cash flow generation for midstream, adding to financial flexibility.

For companies that made windfall profits in 1Q21 related to the severe winter storm in Texas and the Mid-Continent in February 2021, EBITDA will likely be down in 2022 relative to 2021. For context, Kinder Morgan (KMI) beat 1Q21 EBITDA estimates by \$1 billion, and Energy Transfer (ET) [reported](#) a full-year storm benefit of \$2.4 billion. Enterprise Products Partners (EPD), ONEOK (OKE), Targa Resources (TRGP), and Williams Companies (WMB) were some of the others that experienced storm benefits in 1Q21. Excluding the impact from the storm, EBITDA is likely to be more stable or growing. For example, Kinder Morgan [guided](#) to 5% EBITDA growth in 2022 excluding the storm impact in 2021 and including the benefit of a full-year of the Stagecoach assets purchased in 2021.

Progress on energy transition opportunities expected.

Many midstream companies are pursuing opportunities related to the energy transition around carbon capture, hydrogen, renewable natural gas, and renewable transportation fuels. Some companies have strategic teams dedicated to pursuing projects in these areas. Given that some of these teams were newly formed in 2021, further announcements on alternative energy projects or partnerships are expected as time passes. Potential projects that have been discussed with little detail may be more fleshed out through 2022 or officially added to capital budgets.

For opportunities around emerging solutions like hydrogen and carbon capture, there may be more partnership announcements ahead as companies leverage their respective expertise and work

together to capitalize on these opportunities. Several strategic partnerships between midstream names and traditional and alternative energy companies were announced in 2H21 ([read more](#)). For more early-stage opportunities, partnerships may be a more attractive way for midstream companies to dip their toes into some of these areas, whereas opportunities around transporting renewable natural gas or blending renewable fuels are firmly within midstream's existing capabilities.

What are other potential tailwinds and challenges for midstream in 2022?

While the outlook for midstream is constructive from a macro and company-level perspective, broader market considerations also bear mentioning. Inflation remains a concern for many, and the midstream space is well positioned for an inflationary environment given its real asset exposure and the nature of midstream contracts, which often have rate adjustments for inflation ([read more](#)). Inflation is driving expectations for interest rate hikes. Typically, midstream is less sensitive to rising interest rates than other income sectors like utilities. Rising interest rates are not expected to be a headwind for midstream this year; rather, rising interest rates could support a rotation into value, which could be beneficial for energy broadly, including midstream.

While there are a number of potential tailwinds for midstream equities in 2022, some ongoing challenges could continue. Though oil prices have improved significantly and have likely been better than most would have expected given the pandemic and new variants, oil price volatility could continue to weigh on sentiment for energy-related stocks. Flows into midstream equities could remain a challenge as investors focus on sectors other than energy, despite the positive fundamentals for midstream companies.

Bottom line

For midstream broadly, free cash flow generation should continue to support buybacks and modest dividend increases. Ideally, these positives will start to attract new flows into the space and help insulate midstream equity performance from potential oil price volatility.

AMNA is the underlying index for the ETRACS Alerian Midstream Energy Index ETN (AMNA). AMZI is the underlying index for the Alerian MLP ETF (AMLP) and the ETRACS Alerian MLP Infrastructure Index ETN Series B (AMUB).

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