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Oil & Gas Breakout

# The Rise of the Midstream Shale Reinvigorates Midstream Growth

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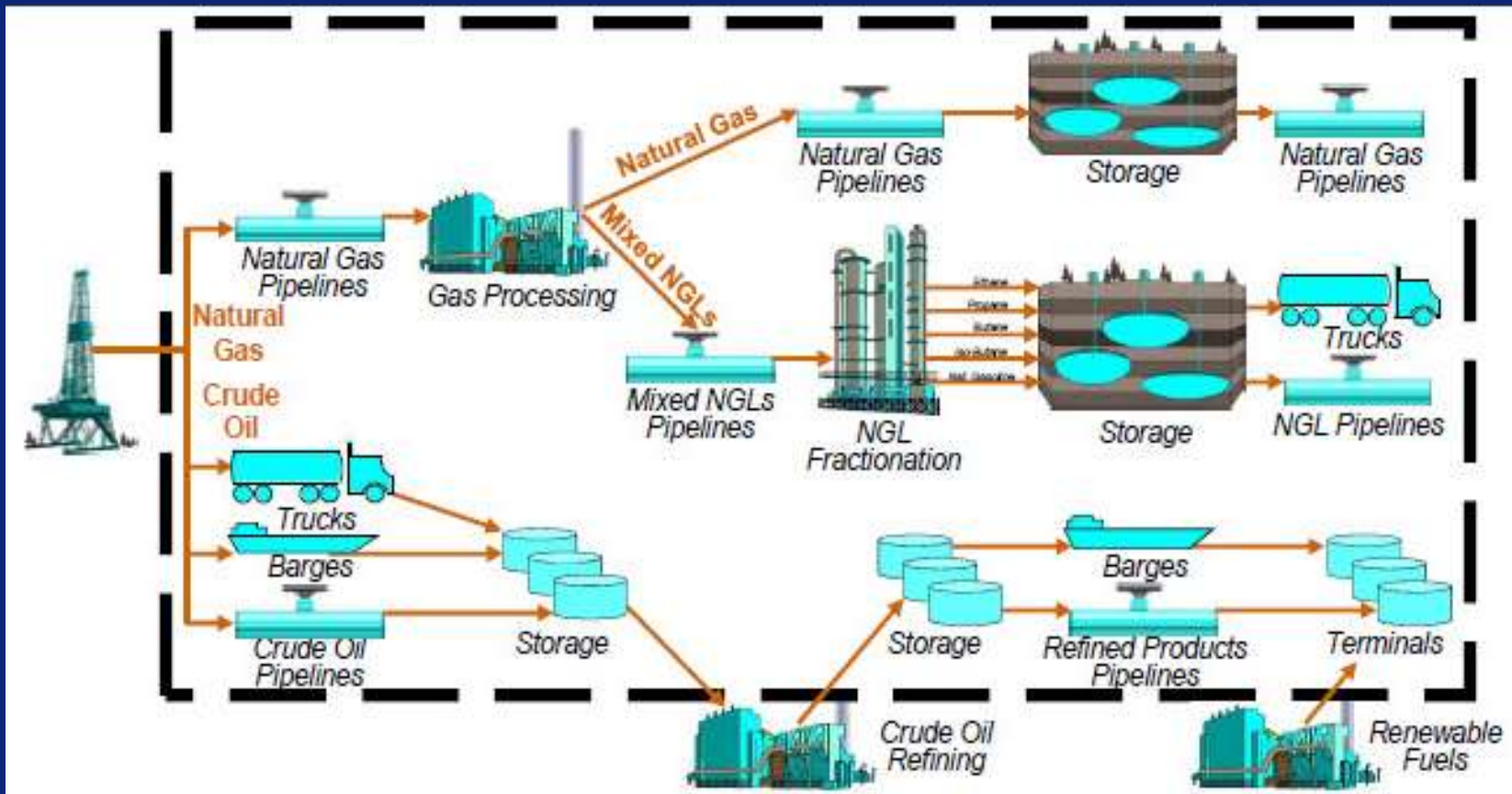
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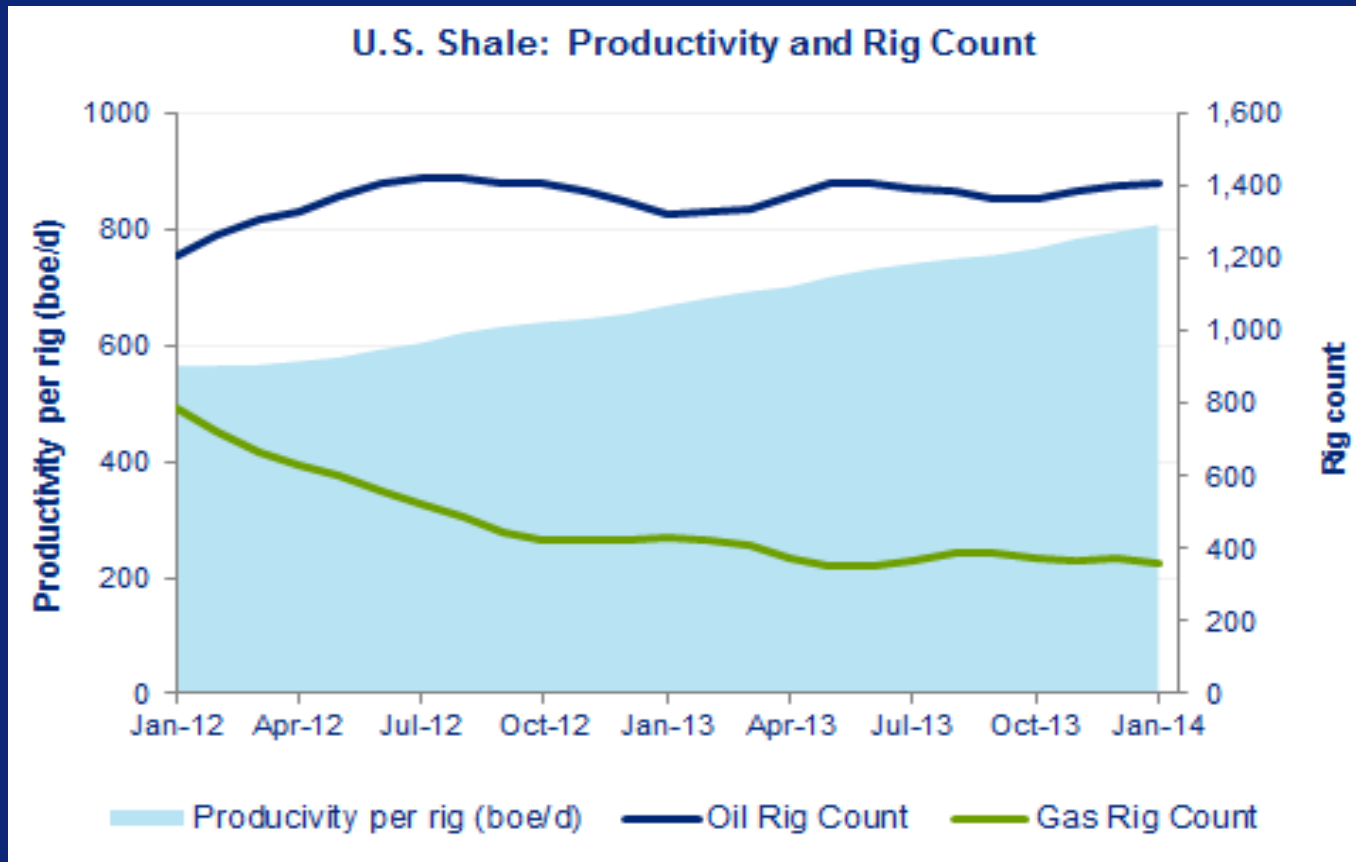


# What is midstream?

Simply put, midstream assets connect supply to demand



# Growing productivity, falling costs supporting production from shales despite decade-low gas prices



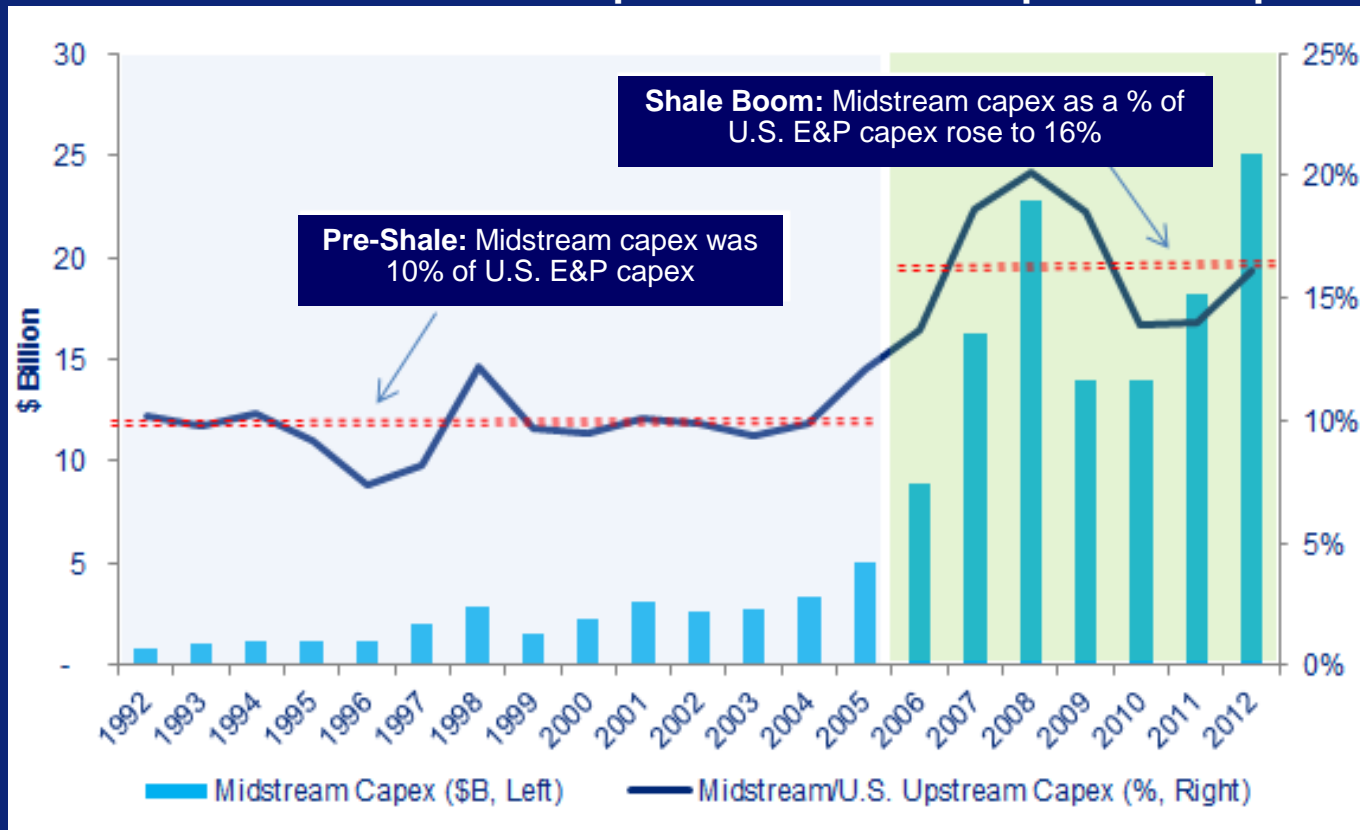
Note: Productivity per well per rig is based on data from Bakken, Niobrara, Permian, Haynesville, Marcellus, and Eagle Ford basins. Average productivity per rig is the weighted average number for the shale plays based on total production values.

Sources:

- U.S. DOE/EIA, "Drilling Productivity Report", January, 2014
- Reuters. "Analysis: Bakken drillers undaunted by local oil prices under \$80", November 2013

# U.S. midstream sector is responding to the rise in shale volumes by making record investments

## U.S. Midstream Sector's Capex as a % of U.S. Upstream Capex

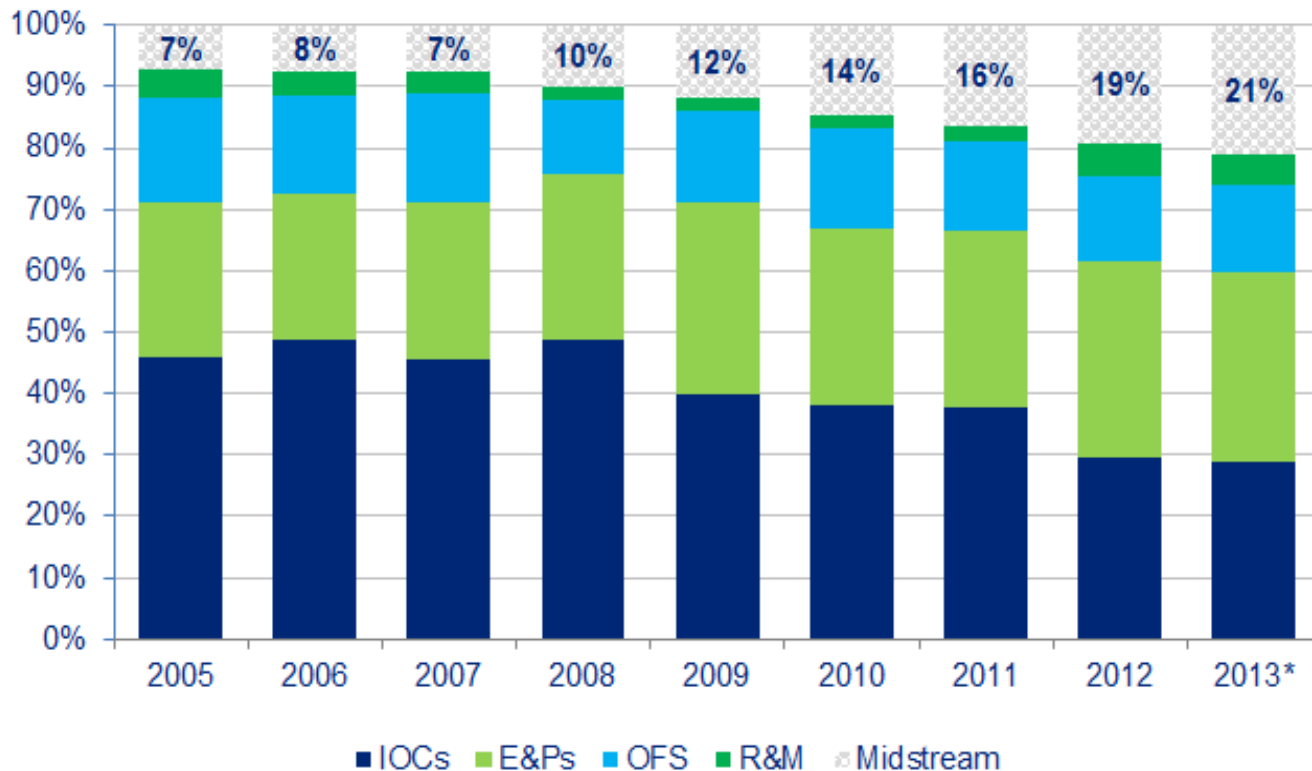


**Notes:**

- Based on listed companies only (existing and acquired).
- Companies are classified as midstream or upstream based on their primary business.
- Midstream capex is of listed partnerships/MLPs rather than that of General Partner (GPs) or Sponsors to avoid double counting, except KMI
- Midstream capex of E&P independents and IOCs is not adjusted.
- International capex of the following independents has been deducted from their total capex – APA, APC, MRO, COP, OXY, DVN
- U.S. upstream capex of the following IOCs is considered – XOM, BP, RDSA, CVX, TOT, MUR, HES

The result: Since 2006, midstream sector has been the fastest growing oil and gas sector in the U.S.

**U.S. Origin O&G Companies' Share of Industry Enterprise Value by Sectors**



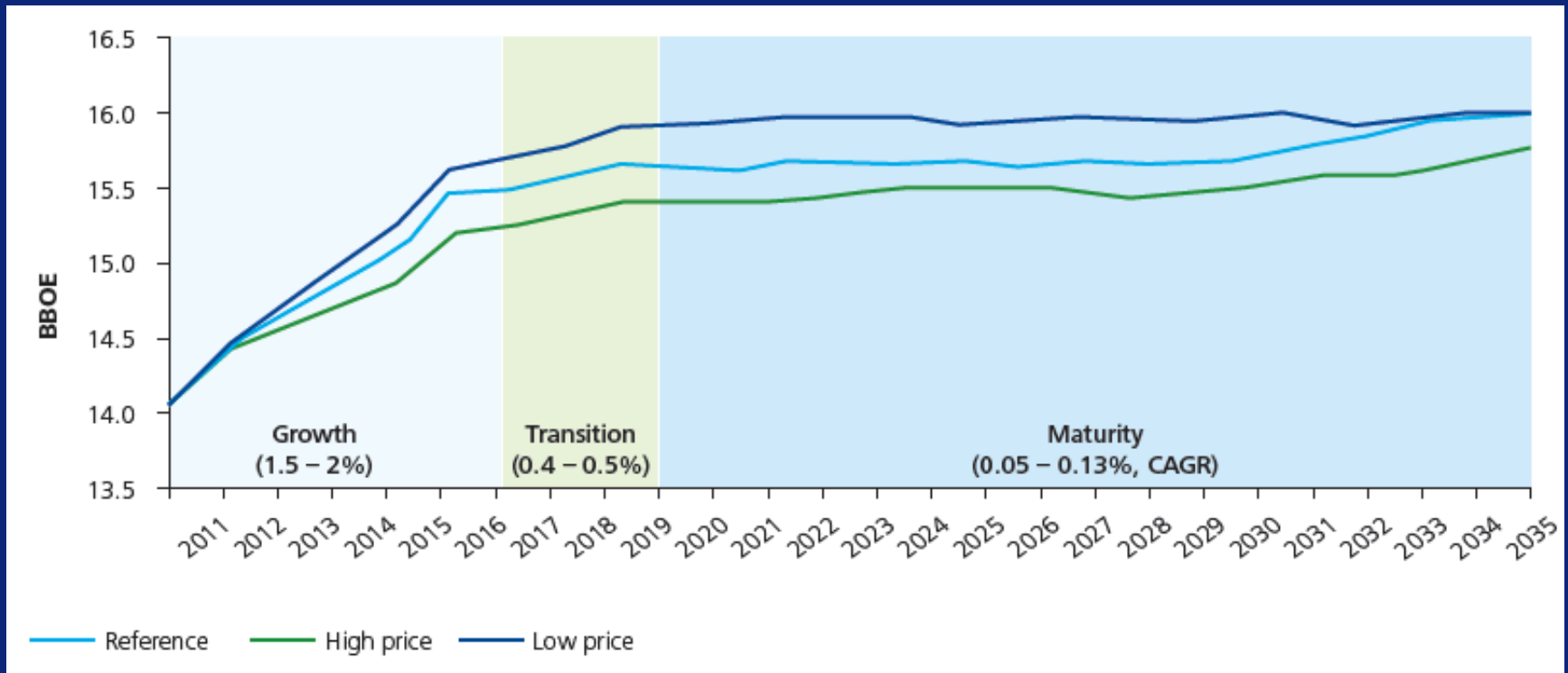
Kinder Morgan is now bigger than the U.S. independents: Occidental, Anadarko, and Apache.

Today there are nearly 25 midstream companies with an EV >\$5B, compared to seven companies in 2006.

*Notes:*

- EV of midstream LPs is considered rather than that of their sponsors or GPs, except KMI which has substantial midstream operations of its own.
- Midstream segment excludes companies in the distribution segment.
- \*2013 data is as of June 28, 2013.

# Crude oil and NGLs will likely drive midstream sector's high growth until 2016 and increase the sector's market size to 15.5 BBOE



#### Notes:

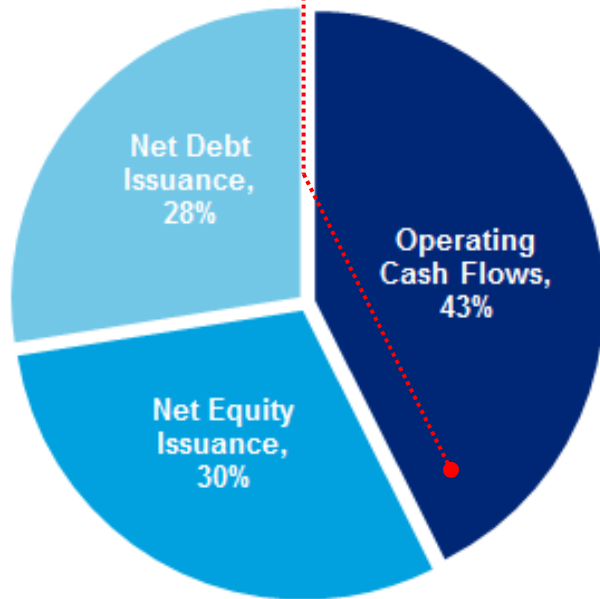
- Crude oil imports from Canada are based on EIA's 2012 Annual Energy Outlook (AEO).
- Petroleum product imports include unfinished oils, blending components, and finished petroleum products.
- NGL exports from the United States are estimated from the Canadian Energy Research Institute (GERI) study on "Natural Gas Liquids in North America: Overview and Outlook to 2035"; due to limited availability of data, NGL exports are assumed to be the same across all the three cases.

#### Sources:

- EIA's 2013 AEO, 2012 AEO, and data tables (downloaded on May 30 and May 31, 2013).
- Canadian Energy Research Institute. "Natural gas liquids in North America: Overview and Outlook to 2035". Study No. 130. July 2012.

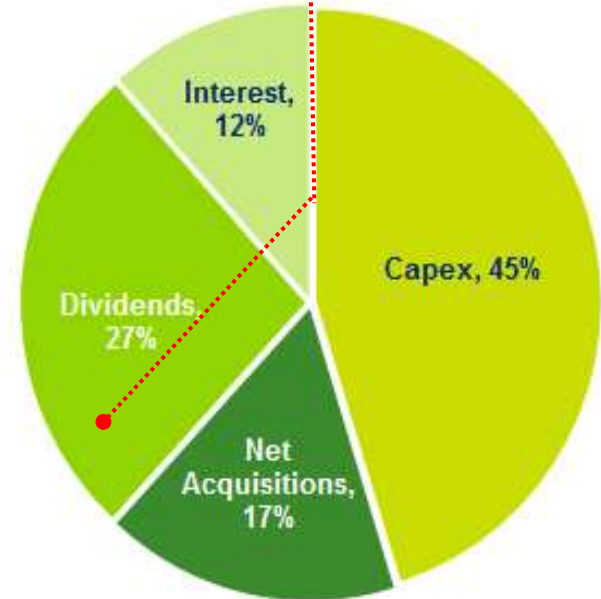
# Funding the growth: Midstream sector relies heavily on capital markets for funding its growth

## Sources of Cash (2008-2012)



*Nearly all of midstream sector's cash flows is used for paying dividends and interests*

## Uses of Cash (2008-2012)

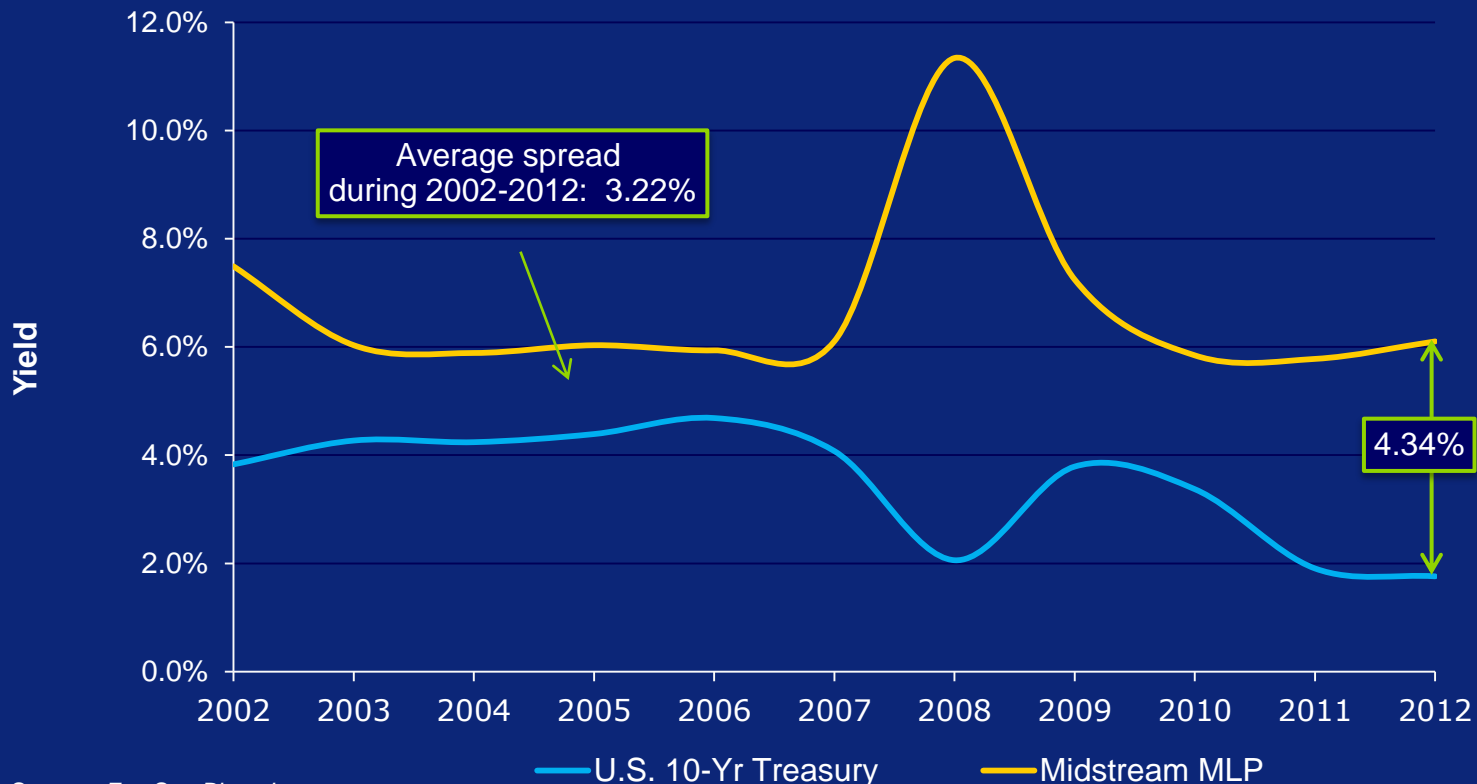


Source: FactSet; Deloitte, "The rise of the midstream: Shale reinvigorates midstream growth", November 2013

# How has the MLP-Treasury yield spread been?

Midstream MLPs delivered a yield of 6.1% in 2012, 4.3% higher than the benchmark 10-year treasury yield during that period. The industry's current yield spread of 4.3% is on the higher side, considering the average MLP-Treasury yield spread of 3.2% during the past 10 years.

MLP vs. U.S. 10-YR Treasury Yield



Source: FactSet, Bloomberg

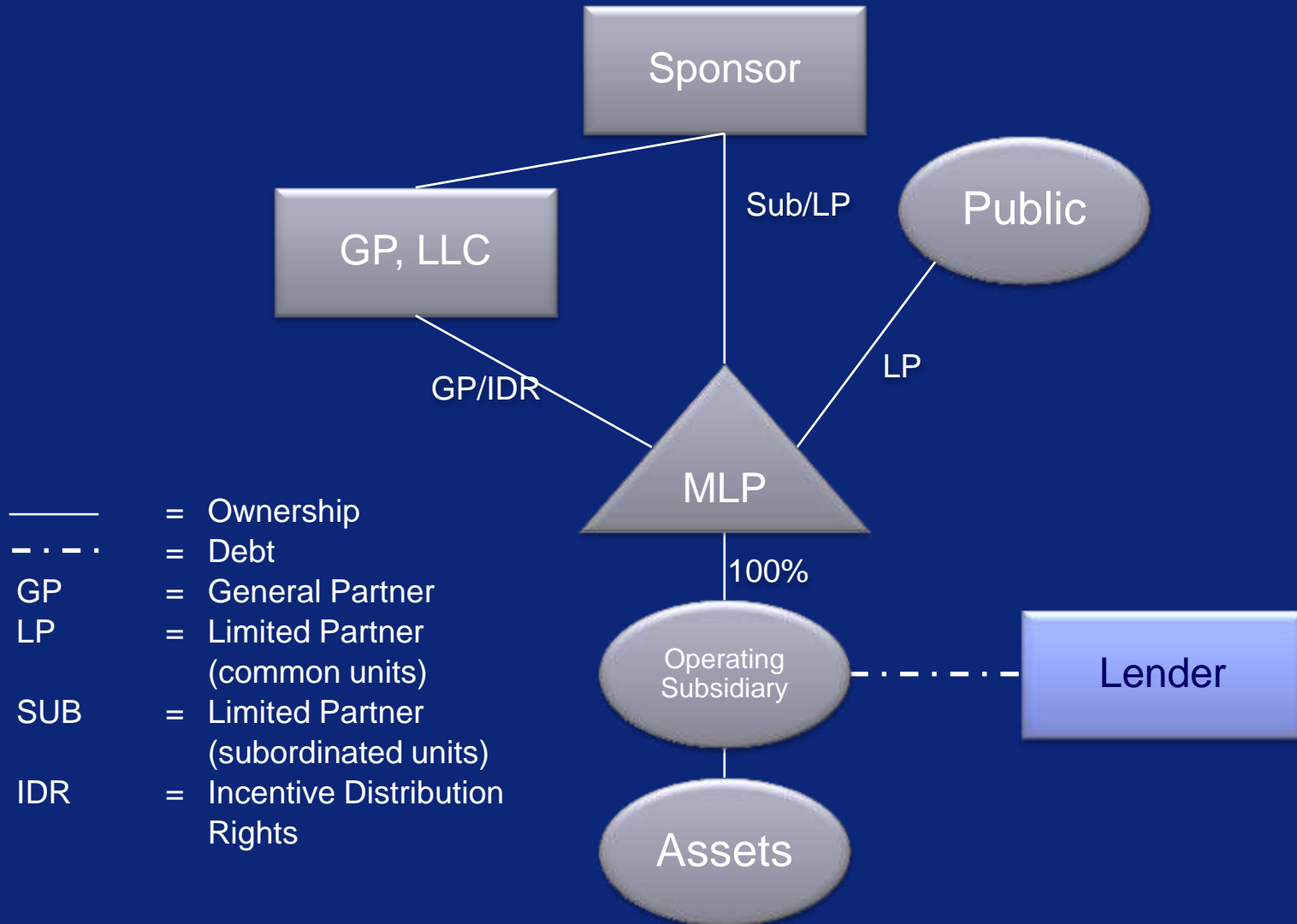
Deloitte, "The rise of the midstream: Shale reinvigorates midstream growth," November 2013



# U.S. Federal Tax Implications



# Typical MLP Structure



# Key Attributes of MLP

## Advantages:

- Higher multiple on assets
- IDRs incentivize the GP to grow cash distributions
- Potential tax deferral on IPO proceeds
- Pass-through structure provides no double taxation which means lower cost of capital

## Disadvantages:

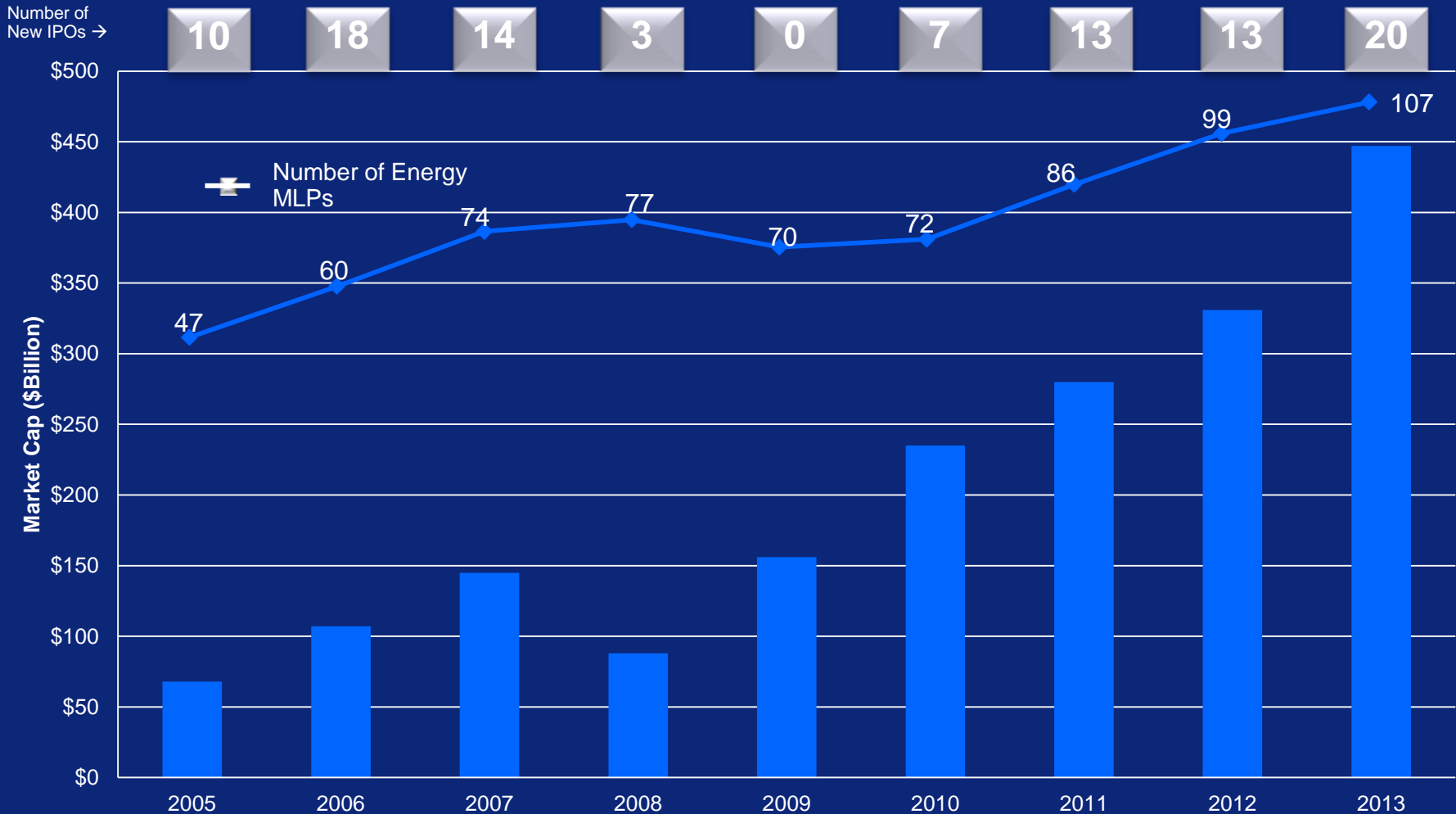
- Must continually expand to grow IDRs and increase unit price
- Pressure to raise cash distributions to LP units
- Lower retained earnings means must raise either debt or equity for expansions or acquisitions
- Section 704(c) remedial income allocations for gain deferral

# Business Valuation



# What is the size of the MLP market?

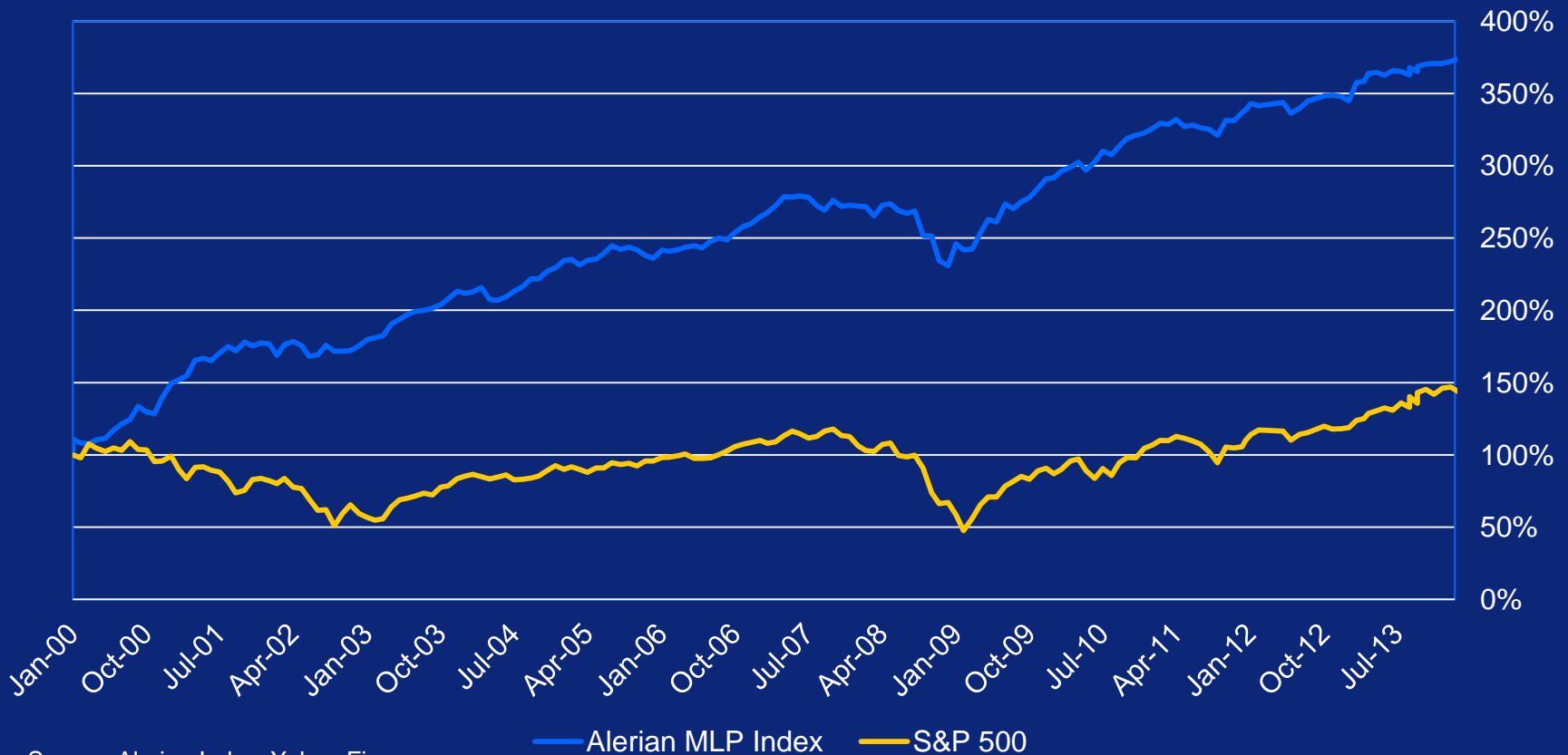
There are ~100 trading MLPs with total market capitalization of ~\$447 billion.



Source: Wells Fargo Securities, LLC & Simmons & Co. International

# Return on Midstream/MLPs have outperformed the broader market

MLPs have significantly outperformed the broader S&P market index due to favorable tax structure, consistent yields, and tremendous growth in the energy sector.

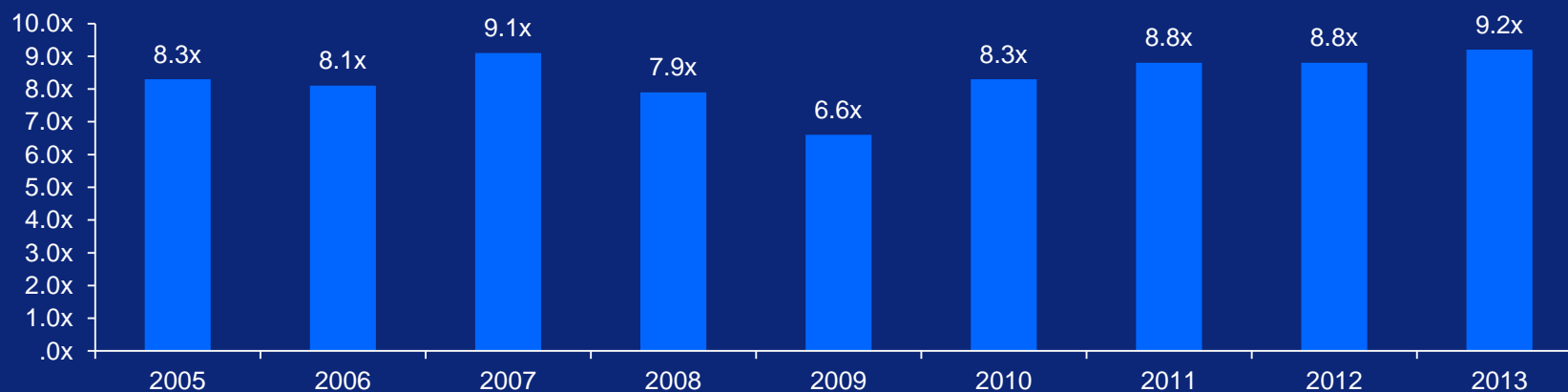


Source: Alerian Index, Yahoo Finance

# Valuation methodologies – Transaction multiples

Transaction multiples have been trending higher and reflect consolidation in the sector. Acquisition activity should continue throughout 2014 given MLP's low cost of capital.

## Forward EBITDA Multiple for Acquisitions



	2005	2006	2007	2008	2009	2010	2011	2012	2013
<b>Pipelines</b>	8.3x	8.4x	13.9x	9.3x	8.2x	9.5x	10.9x	11.0x	11.2x
<b>Storage</b>	11.6x	9.2x	10.0x	8.3x	8.8x	9.9x	11.3x	8.9x	10.9x
<b>Gathering/Processing/Fractionation</b>	9.7x	9.2x	9.9x	10.0x	6.7x	9.1x	10.6x	11.7x	10.4x
<b>Marine Transportation</b>	-	9.1x	9.0x	9.1x	6.0x	7.1x	7.8x	6.7x	8.5x
<b>Propane</b>	7.4x	7.5x	6.3x	5.5x	6.4x	-	7.8x	7.5x	-
<b>Total</b>	<b>9.3x</b>	<b>8.7x</b>	<b>9.8x</b>	<b>8.4x</b>	<b>7.2x</b>	<b>8.9x</b>	<b>9.7x</b>	<b>9.6x</b>	<b>12.5x</b>

Source: Wells Fargo Monthly MLP Report 2005 - 2013

# Midstream of the future

- Who will emerge as the industry leaders (i.e. the midstream majors)?
- What is the source of the investment capital?
- Will there be significant industry consolidation?
- How will the growth of energy exports impact the markets and the need for midstream infrastructure?
- Given shale opportunities in other countries, will we see U.S. midstream companies grow globally?





Questions?

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