Read the transcript from the AICA Bootcamp and Round Table Presentation Titled: “Energy Investing in 2020 and Beyond”

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Rob Chisholm, Managing Director and Portfolio Manager at Brookfield, talked about energy investing in 2020 and beyond at the AICA Boot Camp and Round Table held on November 6th in New York City. The moderator of the discussion was John Cole Scott, CIO at CEF Advisors and Executive Chairman at AICA. Read the transcript below.

Rob Chisholm

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Rob Chisholm: My name is Rob Chisholm, I'm the senior portfolio manager for the Center Coast Brookfield MLP & Energy Infrastructure Fund. The ticker is CEN; Charlie, Edward, Nancy. Today I'm here to talk about CEN, the fund. But I'm also here to introduce the asset class, which is energy infrastructure formally known as MLP. I'm here to talk about us, the Center Coast Brookfield team. We believe we are a differentiated manager, not just in a closed-end space but in the energy infrastructure space. CEN, which we'll get into, is roughly a 440 million dollar closed-end fund. But our team at Brookfield manages approximately three and half billion across separate account, open-ended mutual funds and the closed-end fund.

So I'm going to touch a little bit about who we are, and we're not going to spend a whole lot of time about Brookfield Asset Management, but Brookfield Asset Management, or BAM, is the world's largest infrastructure manager. We represent the public securities side of the Brookfield world. So obviously Brookfield does a tremendous amount on the private side, all on infrastructure. They do real estate infrastructure and energy infrastructure. If you look at the public securities group within Brookfield, the Brookfield Public Securities Group does the same thing, just on the public side. We have a real estate strategy. We have an infrastructure strategy. We have energy infrastructure, and a real asset solution. And so at Brookfield Public Securities Group, we're trying to be the real asset solution provider on the public side, to complement the private.

So specifically about what we refer to ourselves, we are Brookfield Energy Infrastructure inside the Brookfield Public Securities Group. We are formally known as Center Coast. Brookfield acquired us in February of 2018, so we're coming up on two years. Why did we decide to team up with Brookfield? Well, Brookfield brings an owner operator perspective to the investment table. We bring that same owner operator perspective to our investment strategy. We bring operational experience. I'm not here with our founder, Dan Tutcher, but Dan's a former CEO within the space. And I worked alongside Dan from 2002 to 2006, where I ran the valuation models for all M&A and new build activity with Dan at Enbridge for a number of years. So Dan was the president and CEO of Enbridge Energy Partners, which has been acquired by Enbridge. And he ran Transportation South from 2001 to 2006. And I worked with Dan from 2002 to 2006. We saw a number of these companies build themselves. We saw what they're acquiring, what they were paying. We were watching projects they were taking on, what risks they were taking on. So we do bring that operation experience to the table. We also bring financial expertise to the table. A co-portfolio manager of mine, Jeff Jorgensen, he joined us four years ago. He came from UBS's Energy Investment Banking Group, where he had advised a number of these companies going public. And so Jeff, like Dan and I, had been under the hood a number of these investments that we invest in today.

That operational financial expertise helps us manage our investment process. It's the same investment process as when we started back in 2007. We're looking for high-quality assets that are fee-based, that have the highest quality management teams and quality balance sheets. That's what we've been investing in since we launched back in 2007, and after that, that's never changed. We are located in Houston, Texas. Roughly 60% of the publicly traded space is based in Houston. Another 30% is in Dallas, which is not far away from us in Texas. And so it's not just the companies are based there, but the investment banks, the private equity. And so we're right in the middle of all that action, and we think that network helps us and our investment process.

So just a little introduction to the team I touched upon, myself, co-portfolio manager Jeff Jorgensen, UBS investment Banking Group, Dan has been in the business for over 40 years. But all of our research group comes from where we come from. Boren, Joe, Juan Carlos, and Robert all come from investment banking backgrounds, where they have done energy infrastructure and banking for a number of years, and have worked with these companies. And a number of the companies that they cover, they advised going public. So they have a tremendous amount of experience with these companies.

So a little bit more about the fund specifically, CEN. We're roughly just over 440 million. We launched in September of 2013. The objective of the fund is to provide a high level of total return, with an emphasis on distribution to shareholders. I apologize, this is more of a compliance slide. The following, that's from our compliance folks here. But it is telling us what we're investing in. And so what is gathering and processing, or pipeline transportation? What exactly is it? And so if you look at how we define our universe, if you look down here, you're looking at all the value chain of energy. You start at the wellhead, exploration and production, obviously a lot of volatility in those cash-flows depending upon commodity prices. Refining, a lot of volatility in those cash-flows depending upon the margin between where they're buying crude and where they're selling the refined product. And as you move further to the right, to the box that we're investing in, is Midstream. Which are gathering pipelines. Which gather crude oil or natural gas from the wellhead, the natural gas is then transported to process and fractionating facilities.

And then that product is moved to long haul pipelines, and there's obviously terminalling and storage in there as well. There is indirect commodity price exposure. If there's no activity, that's going to have an impact on us. But by and large, there's no direct commodity price exposure in the space that we're investing in. We're collecting fees for transporting product from the supply centers to the demand centers. And so what's going on in the energy infrastructure space today? We believe the energy infrastructure sector fundamentals are very constructive. You would not know it by looking at the valuations of the space. The midstream companies allow the shale to realize it's growth potential, and we'll go through some of the supplies in the following slide. But I think a lot of people in this room know that the level of production of crude oil, natural gas, and natural gas liquids, has grown exponentially over the past decade. And Midstream, the pipelines allowing to collect supply and demand, is necessary for that to occur. There has been and evolution of the investor makeup. Traditionally it was a retail held space, not a lot of institutional presence. Over the past five years we've seen some of the retail space leave the market, and so there's been an evolution of the investor makeup. And as a result, valuations are attractive. Again, we'll go into the details but even today, the market's selling off and valuations are almost back to all-time lows. If you look at the Alerian MLP Index, in February of 2009, we touched 200, which was the bottom of the index valuation. February 2016, when crude oil is $26 and there was a giant risk off trade, we touched 200. And the giant tax-loss sell-off of last year, the fourth quarter, we didn't touch 200, we touched 210. Right now the Alerian MLP Index is 214. And as a frame of reference, the all-time high was 540, and so we're 60% below where the valuation strayed back in 2014. And so let's start with the fundamentals. What's really going on, and then we'll go into the valuations. There has been and continues to be growing demands of liquid consumption and global natural gas consumption in the world. Some might argue about the demand side, especially with a possible global recession. A lot of people have been coming down on the demand forecast with the global recessions on the liquid side. But the global natural gas consumption, as we talk about our carbon footprint and this shift to sustainable energy, natural gas is going to play a huge part of that. And we have a lot of that. And if you look at the supplies, the U.S. has now become a major factor in satisfying the growing demand of the world. And as such, we've been able to obviously grow our output on the liquid side, and we've been able to grow the natural gas production as well. And so where does that leave us in the world in terms of supplying the world's energy? We are now the largest producer of crude oil, above Russia, Saudi Arabia. If you look at the Permian on a standalone basis, which is the crown jewel on the crude side, it's output is higher than many of the countries around the world. And then you have Bakken down here. And if you look at production growth spans outside of the Persian Gulf in '95, the U.S. has been growing production, whereas the rest of the world has been relatively stagnant. This slide's a little bit out of place, but I think this slide right here is what is the backdrop of energy. We've grown production. We've grown crude oil production. We've grown natural gas production. We've grown liquid production. Liquids are ethane, propane, primarily consumed by the petrochemical side. And we've lowered price. So crude oil prices have come down from $100 to $50. Natural gas prices have gone from $10 to two the three bucks. But natural gas liquid prices have come down as well. And as a result, we're actually growing demand. There is a tremendous amount of investment going on in terms of the petrochemicals. Billions of dollars of investments of ethane crackers. And whether it's ethane or propane, taking advantage of low-cost ethane and low-cost propane, these low-cost feedstocks are actually stimulating demand. And what's gone from a supply push, is turning into a demand pull. The demand on the LNG side, we're now supplying the world. The demand on the liquid side, that demand is being built in the U.S. The crude oil side of the world, the demand is there. But the crude oil is only 20% of what we're moving. The whole world wants to focus on that and drive our valuations based upon what crude oil is doing, but it's really gas and liquids that are 80% of what our pipelines are moving.

So I think this is probably the most important slide in the deck. You're looking at fund flows into the of the space on the yellow line. You're looking at growth and distributions on the bar chart. And so from 2010 to 2014, you saw growth of your distributions and dividends, averaging about six percent per year. But with the drop in commodity prices, the companies, when fund flows were coming in, were funding all of their growth with the capital markets. And so if there was a new growth opportunity, you went to the equity markets and you funded your growth, or you raised your capital and you funded your growth. Meanwhile, all the cash-flow that you generated, you were paying out to your unit holders. Well, when commodity prices dropped off and activities slowed down, the demand for that equity fell off a cliff. And so the companies were no longer able to access the capital markets to fund growth. Meanwhile, the demand for new infrastructure was at an all-time high.

Now we've invested billions, and billions, and billions of dollars new infrastructure to move all these hydrocarbons, and the companies had to fund it from somewhere. And so they had to start self-funding. So that payout to investors, that cash had to come from somewhere. And so a lot of times they reduced the payout to investors to start funding the growth, and that's what we call the shift to self-funding. As a result, it did impact a payout to investors. And so from 2015 to 2018, investors couldn't really count or look at us as a yield, because it was going down in certain places. Not everywhere. A lot of places, they payouts kept increasing. But there were pockets where investors got clipped. And so they couldn't really look at us from a yield perspective. So whether it's an EV/EBITDA multiple, a price/distributor cash-flow multiple. Valuations fell off the cliff and investors left the space, and that's where you see the outflows. Importantly, now that we've gone through this evolution to self-funding space, we've also eliminated a lot of the GP/LP relationships along the way. And so we don't have this complicated GP/LP, we've simplified the space. We are now starting to see the payout to investors start to grow again. And in 2019, the payout of the Alerian MLP Index that I referenced, will be higher to investors than it was in 2018. And that's the first time that has occurred since 2014 over 2013. And that from our perspective, is a really important attribute for investors in our space. Investors want to look at this as an income investment that will grow, and that's really what's going to drive your returns. If we get multiple expansion, again I'll touch on valuations, great. But we're now going to return to an income plus growth, and that's going to be your value driver. And that's what it was from roughly late 90's through 2014. It wasn't multiples continuing to go up, it was income plus growth that drive returns. And we're finally going to get to return to that again.

And so in our opinion, that yellow line of the investor outflow, if they can actually see the growth and the dependability of that income, we think that we'll see that reverse and we'll see inflows into the space. So how are we different from where we were in 2014? How are the investments different today than they were? Well, obviously the distribution rate is higher because valuations have gone down. Price to DCF, been cut in half. But the distribution coverage. When we were growing, growth at all cost, companies were running 1 times, 1.2, 1.2 times coverage, 1.3 would be high back in the day. And investors ask me, "Why don't you grow that all the way down to one?" Today it's a different market, it's 1.4. It's really about 1.6, 1.7, is the weighted average distribution for the companies that we're investing in. And that excess cash-flow is what's funding the new growth. It's not additional equity, it's that coverage that they're producing now.

Now as CapEx slows down, which it will at some point. It's still going hot and heavy. We're still building pipelines. The infrastructure is desperately needed. You can see that between the prices in the supply center, versus the prices in the demand center. Prices are way lower than supply producing regions, because there's not enough infrastructure, there's not enough pipeline to get the product to market. And so coverage is healthy, balance sheets have been paid down, the GP take, that's that GP/LP. The simplification, that GP/LP by and large has been eliminated, and so there's not potential for a corporate governance issues. Which did occur unfortunately, but again by and large that's behind us. It has come as the expense of the growth of that payout. You saw Q2 2014, about an eight percent growth on that three year CAGR. That's now down to four percent. You've seen companies like Enterprise Product Partners reduce the growth of their payout, the move to self-funding. But they're also not getting rewarded for the growth at this time, so they'd rather not grow as fast. So that's the only thing that's really come down, but the companies are in really good shape at this point compared to where we were back in 2014. But valuations are near all-time lows. For compliance reasons, for some point, we usually have a number but they've been taken out. That's roughly about a 40% discount on prices to DCF. That's roughly about a 40% discount EV/EBITDA to historical. And then if you look at spreads, when we launch CEN in 2013, all we got was, "What's going to happen when rates rise?" It was roughly a three percent, 10-year touched. Three percent when we were on the road, the CEN Roadshow back in September of 2013. Well, now we're not talking about rising rates anymore, we're talking about a low interest rate environment. And so spreads to the 10 years, spreads to utilities, spreads to high-yield muni's, anything you look at it, it's 30 to 40% discount to where we were.

Now we get asked a lot of times now,, "Is this a value trap?" We've been trading at these valuations now almost two to three years, and every time we pop our head back up, we get beat back down. And what we look at is, what is M&A telling us? These are just two examples. Energy transfer paid a 65% premium for SIM Group. SIM Group had traded down before this acquisition, so it was really about a 40% takeout premium, is what we saw. You saw Pembina acquire Kinder Morgan Canada or KML at a 38% premium. And those are just two examples of what we've seen. I know I need to wrap up here, but Buckeye was taken private at 38% premium earlier this year. We continue to see private assets trade at a 14 to 18 multiple, where we're trading at just under a 10 multiple. And so there's a disconnect between the public and the private, and you're also seeing acquisitions public as well.

John Cole Scott: Questions now would be really great.

Audience: I'm not an expert in this field. If the natural gas price stays low, do companies have any incentive to dig up more natural gas? And will that affect using the pipelines?

Rob Chisholm: Great question. I think it's a very popular question in this low natural gas price environment. And what's interesting is, you have associated natural gas and non-associated natural gas. The associated natural gas comes out of the ground when people are drilling for crude oil. You have a ton of associated natural gas coming out of the Permian, with the growing crude oil production there. If you look at the Marcellus up in the Northeast, that's primarily non-associated gas. And so those drillers are dependent upon natural gas prices to drill. And so what you're seeing is activity in the Northeast is starting to slow down because of natural gas prices. Chesapeake's been in the news, and Terra Resources, and the Northeast producers have been under pressure because natural gas is coming out of the ground out of the Permian as a by-product. You have to pay people to take the natural gas in the Permian. Literally it's trading a negative price. In order to clear it, you have to pay someone to take it because there's not enough pipelines to get it out of there. And so as we monitor the pipelines and the throughput, we look at the Northeast and we say, "Okay, what's going to happen to that production level? What's the throughput of that pipeline going to be? Is it long-term contracts?" And so we look at that when we're analyzing out investments. But yes, low gas prices are weighing on non-associated gas producers, primarily in the Northeast.

John Cole Scott: Any other questions? Right there.

Audience: Yeah, what about this liquified natural gas? I've heard and read obviously that some of these companies have contracts; 10, 20 years with India and China.

Rob Chisholm: Correct. So whether it's LNG or a long-haul pipeline, these are billions of dollars of investments. And wise management teams are not going to put billions of dollars in a ground or a pipeline, or build a liquification facility without long-term offtake agreements or long-term contracts. And so yes, these are 10, 20, 30-year contracts; sale on purchase agreements. And so I think one of the interesting things right now, because we actually currently are over supplied in terms of LNG, we will be short LNG capacity in 2022, 2023, based upon growing demand. But right now we're long. However the U.S. LNG facilities and our LNG export remains elevated because of that contract structure. That gas is going to be liquified and taken off, because the contract structure almost mandates that. And so that's that demand pull that I was talking about. Natural gas is now demand pull. We need more LNG, or more electricity natural gas power generation to grow demand. We have the supply. And we do believe there's going to be another wave of LNG facilities that will be built, that will come online probably in 2023, 2024, that will grow demand for natural gas. But you're also seeing that on the NGL side. Chevron just announced an eight billion dollar investment in petchem cracker down on the Gulf Coast. That's right on the heels of Exxon. And Saudi is announcing an eight billion dollar investment down on the Gulf Coast.

These are billions of dollars being invested on the demand pull to take advantage of the low-cost feedstock that we have. Sorry that was a long answer, but these are long-term contracts. And the dependability of the cash-flows is what we're investing in.

John Cole Scott: One last question, then we've got to move on.

Audience: Yeah, can you comment on your use of leverage? You talked about the underlying asset class and it's rejection of debts. The fact that it's become much more self-funding. Tell me about your use of leverage and the structure of the leverage in your closed-end fund?

Rob Chisholm: Sure. We run leverage usually anywhere from 25-30%. We pride ourselves in not being forced sellers. And so we want to give ourselves some wiggle room if the prices were to go down, that we weren't in violation of the 40 Act leverage of 33.3%. So on average, 25-30%. Line of credit is a LIBOR plus, pretty typical. I think we haven't really mentioned it, but inside CEN, we do private equity investments. Roughly 10% of the fund is invested in a private asset. It's a co-investment alongside Pembina Pipeline Corporation and KKR, and that represents about 10% of the fund. And so it's a differentiator of CEN versus some of the other closed-end funds.

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