Tortoise's 2023 Essential Playbook for Midstream Management

In 2019, we published the first iteration of this report to address investor concerns of deficiencies in the midstream asset class. At that point in time, the midstream energy space had already accomplished many governance improvements through a painful, yet productive series of organization simplifications. Still, improvements were needed. We chose to focus on what we believed were areas with significant room for improvement: financial health, capital allocation and environmental practices. Since 2019, the midstream energy sector has completed a transformation of governance and social practices and is now on par with sectors in the broader domestic equity market. Further, in our view, the companies' capital allocation, financial health and ability to impact global decarbonization are superior to other asset classes in the broader equity markets.

Midstream improvements since 2019
(as represented by the Alerian Midstream Energy Index)

Financial health

- >10% free cash flow yield in 2022 and are projected to grow in future years

Capital allocation

- Leverage reduction greater than 1.0x debt to EBITDA
- Transition from significant number of issuers of equity to $5 billion in buybacks in 2022

Environmental practices

- Publishing of Corporate Sustainability/Impact reports along with emission reduction programs are nearly universal
- Numerous investments in renewable fuels and carbon capture
- U.S. natural gas pipelines have facilitated 4.4B metric tons of CO_2 reduction from power plants since 2005
- U.S. liquefied natural gas (LNG) facilities allowed for an additional 500+ million tons of reductions outside the U.S., cumulatively

Sources: TCA estimates, Cheniere Energy and Bloomberg.

We still believe that as a large shareholder of various midstream energy companies, we can help influence change. We saw improvement from several companies after our engagement activities throughout the past few years and hope to continue this trajectory. This list is not intended to be comprehensive, but rather a focus on specific areas we believe need further improvement.

Company Guidance:

Exercise Capital Discipline

- Focus on generating free cash flow
- Capital expenditures should generally be modest and limited to brownfield projects
- Project return hurdle guidelines: all numbers vary based off actual weighted average cost of capital (WACC)
  - o >20% return on equity (ROE) for logistics with contract
  - o >30% ROE for gathering
    - – Baseline numbers assume those with lowest WACC
- Rationalize existing capacity of assets and consider sale of non-core assets
  - o Consolidate potential projects with partners

Return Capital to Equity

- Repurchase stock - Unless leverage is well above target, prioritize cash returns to equity holders
  - o For assets with less certain, long-term demand outlook, such as refined products, buyback program is essential
- Strongly consider whether distribution growth is appropriate if equity yield is over 7%

Report Widely Accepted Metrics

- Report free cash flow consistently with S&P 500; CFO-CFI
- Return on equity and earnings need to be a part of the discussion

Improve Financial Health

- Leverage Targets
  - o 4.0x is maximum and less than 3.5x is ideal for logistics companies
  - o 3.0x or less for gathering
- Distribution/dividend coverage
  - o 1.5-2.0x for pipeline/logistics companies
  - o At least 2.0-3.0x for gathering and processing companies
  - o Well connects and other capital to maintain cash flow are sustaining capital expenditures (capex)

Implement governance best practices

- Elected board is essential
- Majority independent board is a necessity
- Separate chairman and CEO roles are preferred
- Improve management and unit/shareholder alignment
  - o Compensate management on total shareholder return (TSR) relative to S&P 500 and/or absolute level of return
  - o Compensate management on environmental progress metrics

Implement Environmental Best Practices

- Methane and CO_2 emission reduction programs are required
  - o Set quantifiable goals and report progress
  - o Plans need near, medium and long-term targets
- Be transparent - Impact or sustainability report is required
- Form dedicated "new energy" teams
  - o Embrace renewable power in operations
  - o Integrate renewable natural gas, renewable diesel and sustainable aviation fuel into supply where possible
  - o Invest in carbon capture around operations
    - – Post Inflation Reduction Act (IRA) many investments provide attractive returns
- Participate in best practices coalitions such as One Future
- Engage with environmental, social and governance (ESG) ratings firms and other stakeholders to explain each company's critical role in global decarbonization

We believe that active engagement with our portfolio companies can drive improvements in all areas.

The Alerian Midstream Energy Index is a broad-based composite of North American energy infrastructure companies. The capped, float-adjusted, capitalization-weighted index, whose constituents earn the majority of their cash flow from midstream activities involving energy commodities, is disseminated real-time on a price-return basis (AMNA) and on a total-return basis (AMNAX). The S&P 500® Index is an unmanaged, market-value weighted index of stocks that is widely regarded as the standard for measuring large-cap U.S. stock market performance.

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) is a non-GAAP measure used to provide an approximation of a company's profitability. This measure excludes the potential distortion that accounting and financing rules April have on a company's earnings; therefore, EBITDA is a useful tool when comparing companies that incur large amounts of depreciation expense because it excludes these non-cash items which could understate the company's true performance. Capital expenditures (CapEx): funds used by a company to acquire, upgrade, and maintain physical assets such as property, plants, buildings, technology, or equipment.

