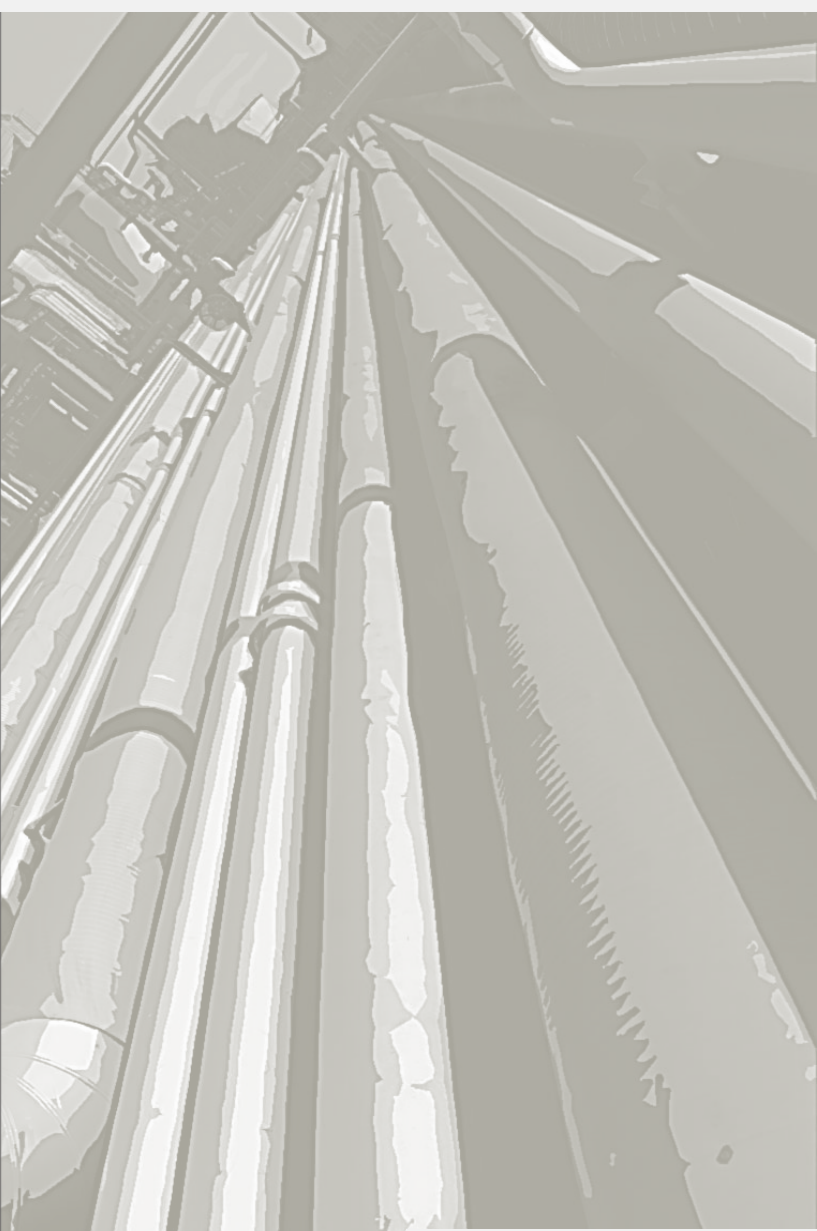


Kayne Anderson

Capital Advisors, L.P

Investing in Midstream Energy

2019 Theme: Returning Cash to Shareholders



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SECTOR OVERVIEW

The four-year bear market for the North American midstream energy sector appears to be finally over, primarily as a result of critical decisions many management teams made between 2015 and 2018 to correct a number of structural issues. The impact of these changes, combined with the sector enjoying record profitability, is enabling management teams to once again return cash to shareholders via dividend/distribution increases and share buy-backs. These factors and the potential to capture mid-teens total returns, without a valuation re-rating, has helped drive positive change in investor sentiment and an increase in fund flows into the sector.

A Closer Look: 2015-2018

Following the commodity price downturn that began in late 2014 when OPEC effectively engaged in a “price war” with U.S. shale oil producers, the North American midstream energy sector has focused on de-leveraging, simplifying its operating structure, and retaining more cash to self-fund growth initiatives. Although a number of companies announced dividend/distribution cuts between 2015 and 2018, the decision to do so largely reflected efforts to address each of the issues listed above rather than being the result of lower profitability.

Historically, midstream energy companies (and energy-related master limited partnerships, or “MLPs”) adopted a “full-payout” strategy, whereby almost all free cash flow was returned to shareholders or unitholders via dividends or distributions. When companies wished to fund a new capital project or acquisition, they were required to finance their project with newly issued debt and equity. MLPs were typically structured with incentive distributions rights (“IDRs”) that rewarded general partners (“GPs”) and management teams with a higher split of cash flows if they delivered distribution growth. This recipe worked well for the sector for over a decade, enabling consistent outperformance as compared to the broader market.

Going into 2015, as a number of companies needed capital to fund their project backlogs, access to equity capital was no longer available, or if it was, it was at an extraordinarily high cost. Many of these companies continued to lever up their balance sheets until credit rating agencies began to threaten downgrades and subsequent loss of investment grade status. With equity capital markets effectively remaining closed, many management teams began reassessing the full-payout model with a focus on reducing outstanding debt.

Since lowering distribution payouts disproportionately affects GPs that hold IDRs, distribution cuts were often part of an LP/GP merger, or simplification that eliminated IDRs. In some cases, these transactions also included the conversion of an MLP to a corporate structure, but these instances were generally company-specific decisions and not the product of a broader trend. Today, most large-cap bellwether names in the sector have eliminated IDRs and simplified their operating structures, better aligning investor and management interests.

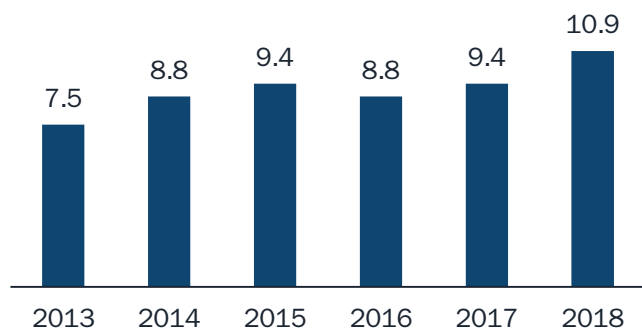
Lack of access to equity capital over the past few years has changed the way most management teams think about funding growth projects. Many companies are now self-funding their equity capital requirements (~50% of projected annual spending) with internally generated cash flow. By reducing dividends/distributions, companies have more cash on hand to de-lever and fund growth projects. Ultimately, this strategy should also help support share price appreciation because incremental fund flows into the sector won't be allocated to purchasing new shares issued to fund growth projects.

Record Profits Accelerating Sector's Recovery

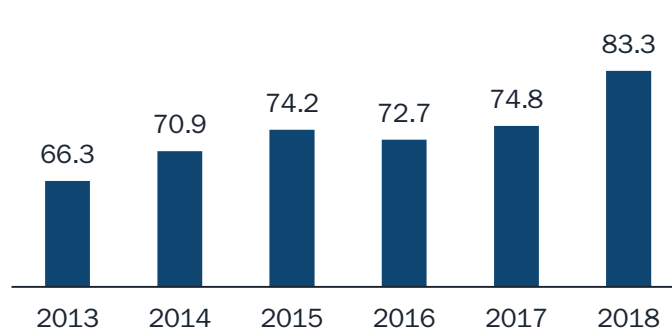
U.S. crude oil production reached a record 9.1mm b/d by the end of 2014, and grew by another 500,000 b/d by May 2015 before lower prices caused output to fall. The rout in oil prices from >\$100/bbl in mid-2014 to <\$30/bbl in February 2016 triggered a production decline of ~11.5% to 8.5mm b/d by August 2016. However, as crude oil prices began to firm in 2016, climbing above \$50/barrel in early 2017, U.S. shale oil producers had incentive to begin drilling once again. In 2017, the oil rig count increased by >40%, setting the stage for production to reach a new all-time high of 9.8mm b/d by year-end. Production growth accelerated even more in 2018 with output reaching 11.7mm b/d, a 38% increase from the 2016 bottom.

The sharp uptick in crude oil output over the past few years has also driven material increases in natural gas and natural gas liquids (“NGLs”) production. Natural gas production reached a record of 88.6 Bcf/d at year-end 2018, up >11%, or 9 Bcf/d from year-end 2017 and is up 21%, or 15 Bcf/d from year-end 2014. Total natural gas exports reached a record 10 Bcf/d in 2018, with the U.S. exporting more gas than it imports for the second consecutive year. NGL production is trending near 4.5mm b/d, up 13% from year-end 2017 and up a staggering 42% as compared to the 2014 exit rate. Net NGL exports surged 16% to a record 1.4mm b/d in 2018 as compared to 2017 and is up a whopping 140% from 2014.

U.S. Crude Oil Production (MMBD)



U.S. Natural Gas Production (Bcf/d)



Crude oil production at YE2018 was 11.8mm b/d

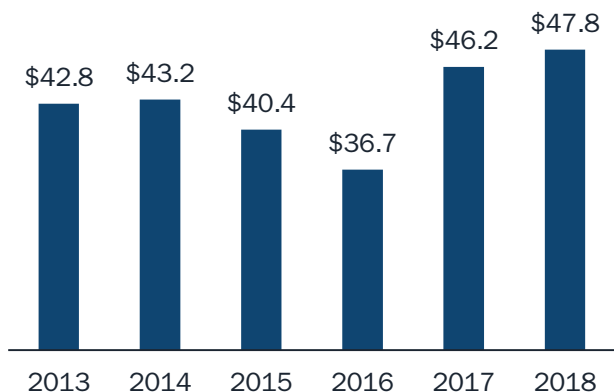
Natural Gas Production at YE2018 was 88.6 Bcf/d

Source: EIA.

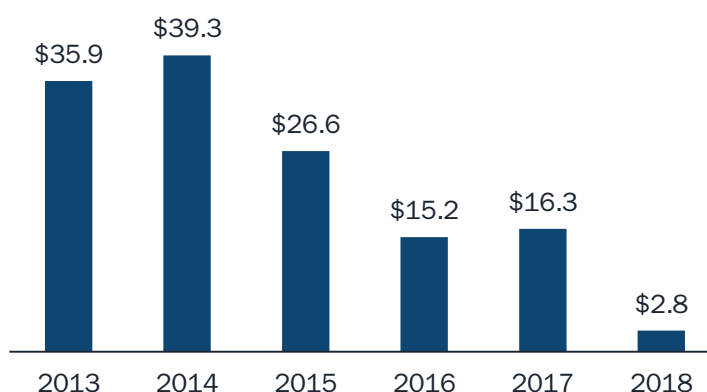
The rapid increase in hydrocarbon production has benefitted the midstream energy sector by filling up available capacity on existing assets sooner than anticipated and enabling many companies to report record financial performance. As examples, Enterprise Products (“EPD”), Magellan Midstream (“MMP”), and Oneok (“OKE”) all earned cash flows that were 25% to 30% higher on a per share basis in 2018 versus 2014. These results also helped some companies accelerate the de-levering process by four quarters or more.

Two consecutive years of record hydrocarbon production has also caused capital spending in the midstream energy sector to reach record highs. Capital spending surpassed \$45 billion in both 2017 and 2018 and is poised to remain in this range this year. Major investments in large diameter, long-haul pipelines for all commodities represent the largest area of investment activity. Hydrocarbons produced in the Permian Basin, DJ Basin, Bakken, and Canada are all trying to reach the U.S. Gulf Coast where they can either be consumed locally or exported to foreign markets. These investments should provide earnings growth visibility for the next several years.

Midstream Capital Spending



Midstream Equity Issuance



Amounts in billions of dollars. Source: Wells Fargo and Barclays research. Includes public midstream energy companies (MLPs and C-Corps).

The midstream energy companies in our portfolios tend to be more heavily weighted toward natural gas than crude oil. We also tend to favor vertically integrated models whereby a company can collect fees for providing a variety of different services such as gathering, storage, processing/treating, transportation and export. This integrated business model enables the midstream provider to operate as a one-stop shop, which can be very appealing to both producers and end-use customers (i.e., utilities, refineries and petrochemical plants). These companies also tend to have more demand-driven growth opportunities, which are not tied to the drilling economics of specific hydrocarbon producing regions.

Bullish Outlook for 2019 (and Beyond)

Now that the sector’s structural simplifications are virtually complete and leverage targets have either been achieved, or at the very least a glide-path to those targets has been established (typically <4.0x Debt/EBITDA), many companies are once again focused on returning cash to shareholders via dividend increases and share buy-backs. EPD announced a \$2 billion unit buyback in January 2019 and Plains All American Pipeline (“PAA”) announced a 20% distribution increase in 1Q 2019, its first distribution hike since cutting its payouts in 2016 and 2017. These trends provide a positive impact on investor sentiment with fund flows streaming into the sector since the end of last year.

Midstream Energy Financial Statistics	2014	2015	2016	2017	2018
EV/NTM EBITDA¹	15.4x	12.9x	13.3x	11.9x	10.8x
Debt/LTM EBITDA	4.6x	4.9x	4.7x	4.5x	4.2x
Distribution Coverage	1.24x	1.17x	1.69x	1.58x	1.73x

Note: Market-cap weighted average of EPD, ET (ETP), KMI, MMP, MPLX, OKE (OKS), PAA, TRGP, WES and WMB (WPZ).

¹*Unit/share prices based on 4Q average of each year. NTM EBITDA based on FactSet consensus at year-end.*

Multiples are excluded if company/MLP is restructuring or involved in M&A. 2014 excludes WPZ due to its merger with ACMP, MPLX due to its merger with MWE and TRGP due to its merger with NGLS. 2014 and 2015 exclude ETP due to its merger with SXL.

The midstream energy sector offers investors a chance to earn mid-teens total returns, based on an average dividend yield of ~7% and cash flows per share growing by an average of 7% to 8% annually. The table above illustrates the contraction in EV/EBITDA multiples over the past five years despite the sector having been materially de-risked by de-levering, improving corporate governance, and reducing capital market dependence (higher distribution coverage). Assuming the sector continues to deliver strong financial results, there could be an opportunity for multiples to expand closer to historical averages, which would provide annualized rate of returns exceeding 20%.

Although the energy sector has had its ups and downs over the past few years, investing in midstream energy has proven to be a successful strategy over the long term. Collectively, our midstream-focused funds are up >1,200% since inception (February 2000) as compared to the Alerian MLP Total Return Index (“AMZX”) being up >700% and S&P 500 Index only being up >170% over the same time period. And while past performance is no guarantee of future results, we believe the midstream energy sector looks to be particularly well suited to outperform the market again.

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The above-stated return for "since inception of the strategy" is calculated on the following basis: (a) for the period February 2000 through December 2002, the monthly returns represent the performance of the energy master limited partnership strategy within Kayne Anderson Capital Income Partners (QP), L.P. (KACIP) (Note that the computation of returns for the carve-out portfolio entails the use of certain assumptions and estimates we believe to be reasonable); (b) for the period January 2003 (inception) through January 2009, the monthly net of management fee (pre-performance fee) returns for Kayne Anderson MLP Fund, L.P. (KAMLP); (c) for the period February 2009 to January 31, 2019, the monthly net of management fee returns for Kayne Anderson Midstream Institutional Fund, L.P. (KAMIF). Returns for investors in each of the funds will differ for a number of reasons including differences in fee structures, investment timing and the ability to participate in new issues. The "since inception of the strategy" is a composite and not indicative of the actual returns realized by any one investor in the funds over time. Past performance is not a guarantee of future results.

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