Midstream: In past months, we've made the case that midstream is well-positioned to benefit from an inflationary environment. Perhaps less appreciated is the fact that as financing costs rise, midstream is uniquely positioned to see increased financing flexibility. Midstream companies will be returning capital into the market, while other sectors focused on growth – like utilities and renewables – are at the whim of the capital markets.

Natural Resources: Negative oil prices seen during the COVID-19 downturn, following multi-year commodity price weakness, caused E&P (Exploration and Production) companies to re-evaluate their business models. In recent quarters, mergers and restructurings have improved the sector's competitive positioning. Two years ago, we discussed how high debt and high capex were ill-suited to shale's high-cost position. Today, we return to look at how debt and reinvestment requirements have been reduced via bankruptcy or consolidation.

Check out Recurrent's new video series, "Research in 99 Seconds" here.

MLP & Infrastructure

Performance review

During the month of May 2021, the Recurrent MLP & Infrastructure Strategy generated net returns of +7.03%, underperforming the +7.57% return of the Alerian MLP Index (AMZ) by (0.54%). Since the strategy's July 2017 inception, Recurrent's MLP & Infrastructure Strategy has outperformed the AMZ by +3.60% (annualized, net of fees). Please see the performance section at bottom for more detail.

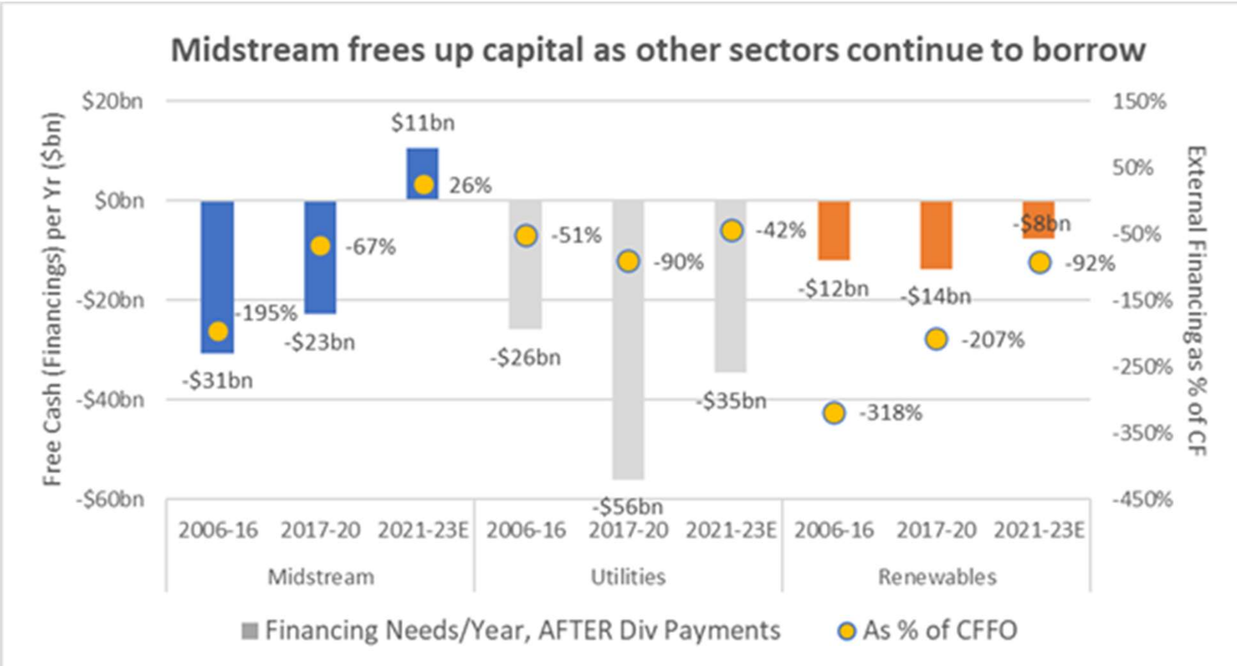
While other infrastructure sectors "rely on the kindness of strangers," midstream is freeing up capital

As we've discussed in the past, the midstream sector is moving to a period of significant free cash flow (FCF) after years of over-reliance on external capital markets to finance capex.

On the other hand, other infrastructure sectors are increasing their vulnerability to potential rising rate or inflationary environments as they continue to finance large "fixed fee" assets with rising costs of capital. The risk inherent in financing fixed cash flows with more expensive capital is well-understood by the midstream industry, who suffered through tightening energy financing markets in 2016-20.

As shown below, after all dividends are paid, the midstream sector will have capacity to **return $11bn per year** to the capital markets after fully funding dividends, in the form of debt reductions and stock buybacks (all projections are based on Bloomberg Consensus estimates). As we've mentioned before, roughly $5bn of aggregate buyback capacity has already been established by the midstream sector.

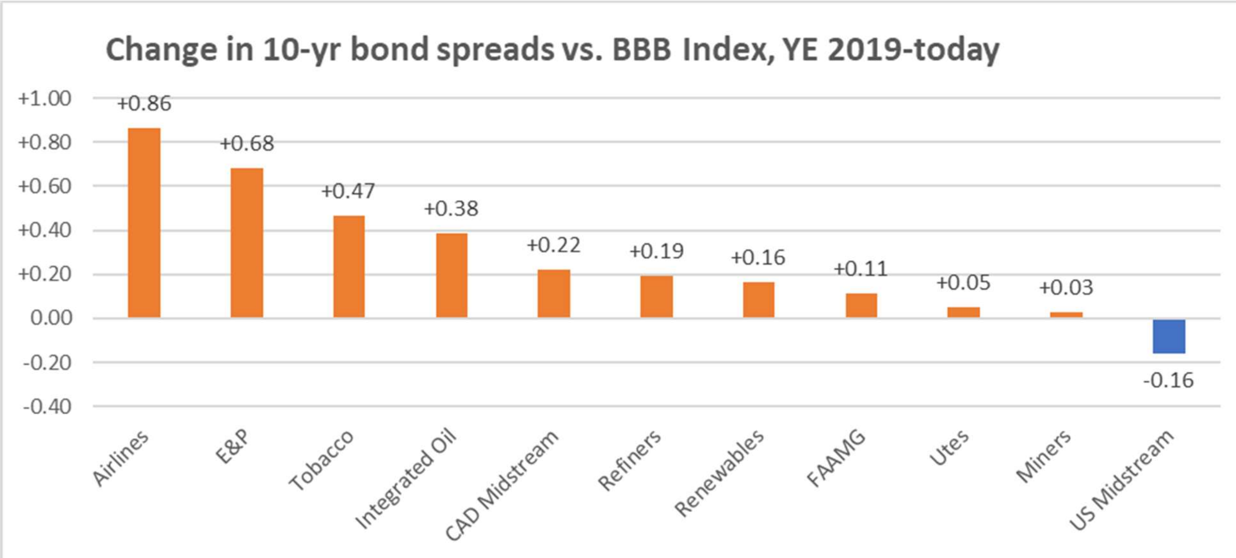
This compares very favorably to the utility sector, which will remain beholden to capital markets for $35bn of annual financing requirements. The renewable sector's $8bn/year of forecasted financing requirements is likely understated, as renewable growth capital is often deployed through acquisitions, falling outside the scope of Bloomberg "capex" estimates.



Source: Bloomberg, public filings, Recurrent research. Future financings
"Midstream" includes KMI, EPD, ENLC, ET, WMB, PAA, MMP, TRGP, OKE, MPLX, PSXP, WES and MLP predecessors.
"Utilities" includes DUK, AEP, SRE, FE, EIX, PCG, EXC, D, CNP, SO, XEL, ETR, PEG, DTE, NEE.
"Renewables" includes CLNE, PLUG, ENPH, SEDG, RUN, NOVA, BLDP, FCEL, FSLR, ORSTED/DC, VWS/DC, BEP, AY, CWEN, NEP.

Capital markets - especially bond markets - are responding to midstream's shift from "borrower" to "repayer"

As might be expected, the reduction in midstream fixed income paper is being felt in the bond markets. Since December 31, 2019, despite the impacts of COVID, midstream yields have fallen compared to the Bloomberg/Barclays BBB Index (across 5-10 year maturities). By comparison, airlines and other "COVID-impacted" sectors have seen bond yields widen, while utilities and renewables have slightly widened vs. the index.



Source: Bloomberg data, Recurrent research. Data as of 6/8/21.Changes reflect average 5-10 year maturities across each sector, compared to the yield of the Bloomberg/Barclays US Credit Corporate 5-10 year Index, measured on 12/31/19 and again on 6/8/21.

So while we continue to see improving operational and financial performance among midstream companies as the impacts of higher energy demand are reflected in financial results, we would also note that midstream's ability to generate its own capital, not relying on the vagaries of the financial markets, will become increasingly advantageous as higher levels of government borrowing and inflationary pressures increase costs of capital for other corporate borrowers.

Natural Resources

Performance Review

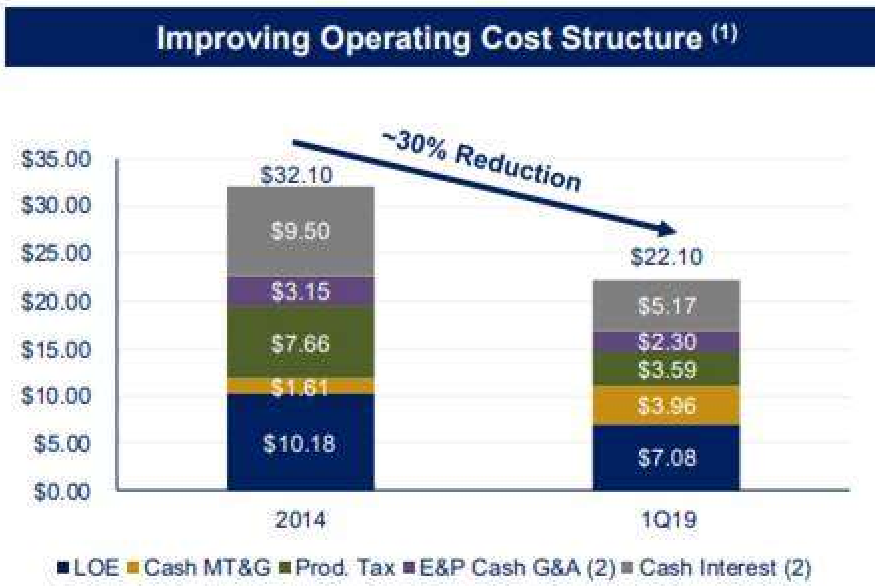
During the month of May, the Recurrent North American Natural Resources Strategy returned +7.73% net of fees, outpacing the S&P North American Natural Resources' +7.06% return by +0.67%. During the month, copper, steel and aluminum sectors continued to add significant value, while midstream positions, primarily in Energy Transfer (ET) and Plains All American (PAGP) added to performance.

Investment Discussion – wave of E&P mergers, restructurings create a sector better matched to shale's high-cost position

With the post-2014 challenges of the energy industry only furthered by COVID, many companies have undergone strategic reviews, and in many cases, zero-premium mergers and financial restructurings. Importantly, corporate priorities have changed significantly, with several companies making changes offering a glimpse of the future of E&P (Exploration and Production) companies.

In our June 2019 monthly commentary, we wrote about Oasis Petroleum. In our note, we highlighted that while the company proudly highlighted its reduced cost operating structure ($32/boe to $22/boe), higher reinvestment - CAPEX - largely offset operating cost reductions, limiting free cash flow. With significant debt service requirements, companies like OAS were forced to maintain high CAPEX in order to try to outgrow burdensome debt loads. While the chart below shows the improvement in operating costs, $20/BOE of CAPEX in 2019 – an approximately $5/BOE increase over 2018 levels - helped production to grow 7% over 2018 levels.

2019 Oasis Petroleum Presentation



With an operating model which provided limited free cash flow through business cycles, over time Oasis' debt levels rose, ending 2019 at $2.7 Bn, or 2.7x 2019 EBITDA. Low oil prices pushed leverage even higher throughout 2020 and cash flow was insufficient to maintain production growth. In 4Q 2020, Oasis underwent a pre-packaged bankruptcy, reducing the debt burden by $1.8 bn.

Post-bankruptcy, Oasis emerged as a notably different company for 3 main reasons:

1. **Streamlined operations:** In 1Q 2021, Oasis acquired more Bakken assets and divested Permian Basin operations. Although elements of the Bakken cost structure are higher than the Permian Basin, the benefits of operational focus provide higher return-on-investment opportunities.
2. **Lower debt service = less pressure to reinvest:** After years of high CAPEX to grow production, Oasis changed its strategy to limit reinvestment rates to 55% of cash flow, with resulting production growth identified as "an output, rather than an input". As seen in Exhibit 1, the company announced 2021 E&P capital expenditures between $215-230 MM, or $10/BOE, compared to the $20/BOE spent on CAPEX in 2019.
3. **Sustainably lower debt, limited capital markets dependence:** After emerging from bankruptcy, Oasis reduced debt levels from 2.7x Net Debt/EBITDA to <1x EBITDA. Additionally, the company committed to return cash to shareholders in the form of both a dividend and share buyback – which hadn't been done in the shale era.

From June 2021 presentation

Exhibit 1

CAPEX budget reduced greatly

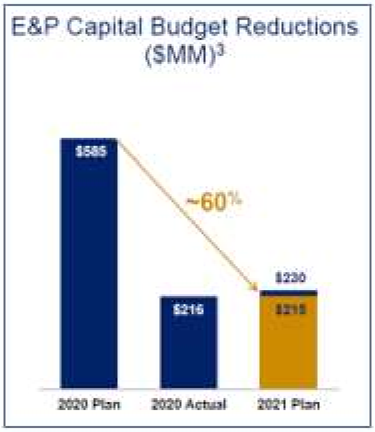
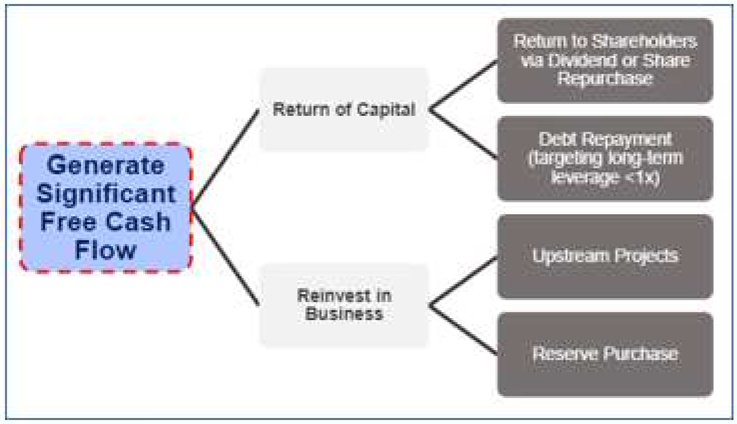


Exhibit 2

Focus on "Generate Free Cash Flow" and "Return of Capital"



As the E&P industry faced many challenges since 2014, many companies have made changes in an attempt to thrive in a variety of commodity environments. However, with the latest iteration of strategic initiatives, Oasis has evolved to a business model which appears significantly more likely to endure the inevitable cyclicality shale producers face.

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