The Case for Investing in Master Limited Partnerships (MLPs)

By Richard Fortin, CFA
Senior V.P. – Portfolio Manager, Stonebridge Advisors LLC
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Introduction to MLPs

Master Limited Partnerships (MLPs) are publicly listed limited partnerships that trade much like the shares of a public corporation. MLPs are flow through entities whose income stream is taxed in the hands of its unitholders and as such, are not subject to state or federal income tax at the partnership level. They operate in asset intensive businesses that typically produce cash flow in excess of GAAP earnings due to substantial noncash expense items (such as depreciation) that are generated at the operating entity level. MLP ownership is divided between the limited partners and the general partner (GP). Collectively, limited partners generally have a 98% ownership stake in the partnership, provide the capital necessary to operate the partnership, but are effectively passive investors since they have no role in the day-to-day operations of the underlying business. Conversely, the general partner manages the business of the partnership and typically has a 2% ownership stake in the partnership. General and limited partners are entitled to their pro-rata share of partnership distributions; however, the general partner is also entitled to receive incentive distributions in return for delivering growth in cash flow to LP unitholders.

Some issuers in the MLP sector are structured as limited liability corporations (LLCs). These structures are hybrids between the corporate and partnership form and generally provide investors with the same advantages as MLPs, but do not have a GP or incentive distribution plans.

To retain its MLP status, a partnership must derive 90% of its income from qualified sources which include interest income, dividends, real property rents and income (and gains) from the exploration, development, mining, production, processing refining, transportation or marketing of any minerals or natural resources.

As of April 30, 2008, the MLP sector exhibited the following industry breakdown:

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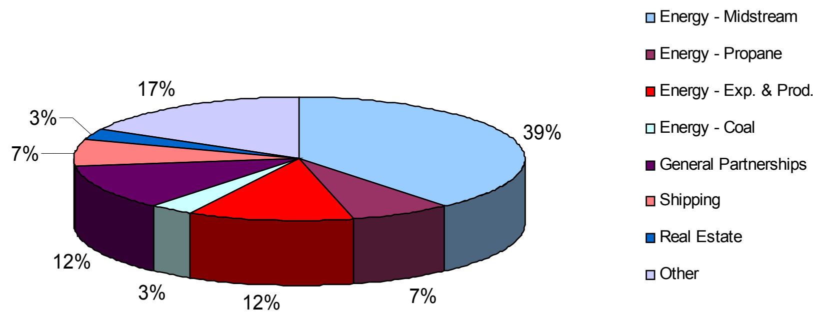
MLP Industry Breakdown
as of April 30, 2008



Source: Citi Investment Research

The following table outlines the high level difference between businesses operating under a corporate legal form and under an MLP structure:

	Corporation	MLP
Security Type	Shares	Units
Income Stream	Dividends	Distributions
Taxation Level	Corp. & Shareholder	Unitholder
Tax Reporting	1099	K1
Tax Treatment	15% QDI rate	80-90% Tax Deferred
Investor Base	Institutional	Retail
General Partner	No	Yes
Voting Rights	Yes	No

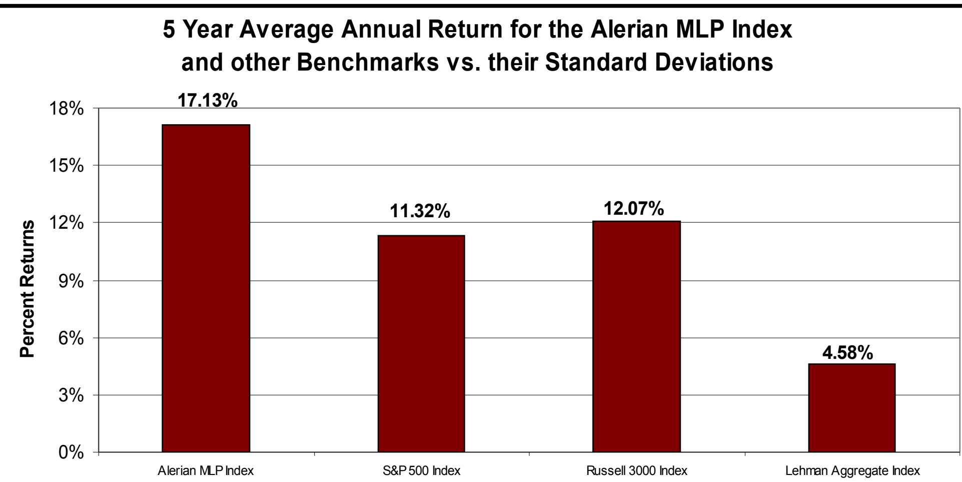
The Case for MLP Ownership

An investment in the MLP asset class represents an investment in the future growth of the U.S. energy infrastructure sector. Changing energy supply dynamics (such as the development, processing and transportation of unconventional energy supplies) and population movements will necessitate billions of dollars in infrastructure investment. The MLP sector is well positioned to provide much of the investment dollars needed for the anticipated build out. Some prominent U.S. investment banks predict the MLP sector's market capitalization could reach $200 billion by the end of this decade (from its current $125 billion level). Much of the capitalization growth observed in the sector over the past five years has been driven by acquisitions. MLPs have been able to grow by acquiring and rolling into their partnerships qualifying assets held outside the structure. MLPs enjoy a cost of capital advantage relative to their corporate peers and have been able to acquire these assets in an accretive fashion resulting in strong distribution growth for many MLP investors.

MLP ownership advantages include:

1. ***Superior Risk-Adjusted Returns***

   As the table below outlines, the average annual return for the Alerian MLP index over the five-year period ending March 31, 2008 was 17.13%. This compares favorably against the S&P 500 and other asset classes.



	Alerian MLP Index	S&P 500 Index	Russell 3000 Index	Lehman Aggregate Index
Standard Deviation:	**11.78%**	**9.18%**	**9.61%**	**3.60%**
Return/Unit of Risk:	**1.45**	**1.23**	**1.26**	**1.27**

Source: Bloomberg, Stonebridge Advisors LLC

Furthermore, risk (as measured by the standard deviation of annual returns) is only slightly higher than traditional equities. Hence, risk-adjusted returns (returns per unit of risk) produced by this asset class have been excellent. The MLP business model derives its risk-return advantage, versus traditional equities, from a number of factors:

a) Many MLPs operate in a more defensive segment of the energy value chain. These businesses often have limited direct commodity exposure and manage long-lived assets generating relatively stable, fee based revenues.

b) Revenue and cash flow visibility is strong given the nature of the business model.

c) Several businesses in the MLP space have dominant market positions with high barriers to entry given the regulated nature of the business model. This has resulted in attractive historical returns for investors.

d) The regulated nature of the business model has also contributed toward producing an inflation adjusted income stream, since fee-based revenues are often established on a cost basis and indexed to an inflation benchmark.

2. Uncorrelated Returns

As the table below indicates, MLP returns (from March 1998 to March 2008) have been largely uncorrelated to those of conventional equities and other income producing asset classes:

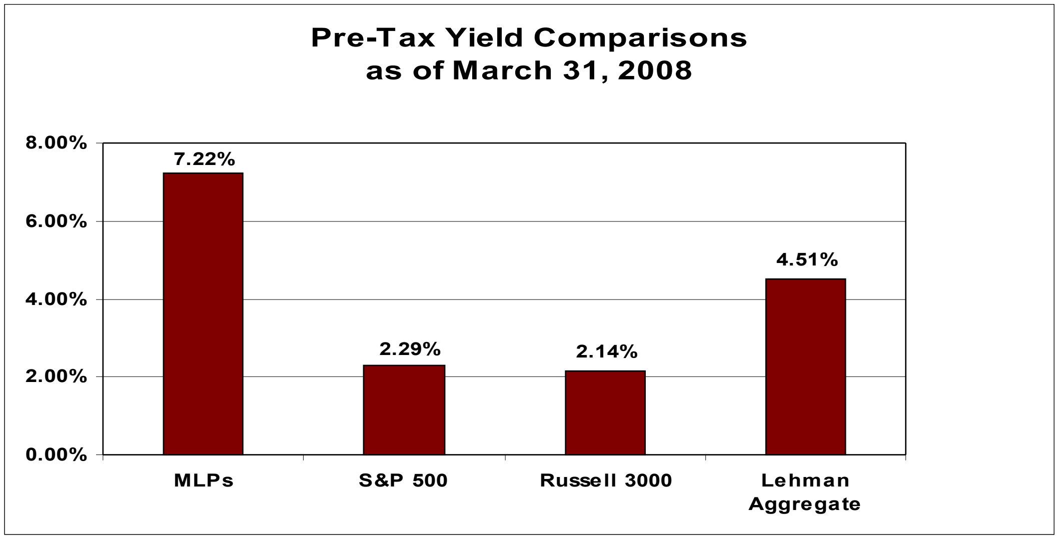
	Alerian Index	S&P 500 Index	Russell 3000 Index	Lehman Agg. Index
Alerian Index	1.00			
S&P 500 Index	0.24	1.00		
Russell 3000 Index	0.27	0.99	1.00	
Lehman Agg. Index	0.11	(0.22)	(0.22)	1.00

Source: Bloomberg, Stonebridge Advisors LLC

The correlation data clearly illustrates the diversification benefits of allocating a portion of one's investment portfolio into MLPs.

3. High Current Yields & Attractive Growth in Distributions

MLP yields (as measured by the March 31, 2008 yield of the Alerian MLP index) are attractive relative to other dividend paying equities and fixed income instruments:



Source: Bloomberg, Stonebridge Advisors LLC

The historical rate of growth in MLP cash distributions is another distinguishing feature of this asset class. The average annual MLP distribution growth rate over the 5-year period ending December 31, 2007 was 8.03%. The future investment opportunities present in this sector enable many issuers to continue delivering strong growth in operating cash flow and unitholder distributions. Growing unitholder distributions equate to an inflation adjusted income stream (and hedge) for investors.

4. *Tax Advantaged Income*

MLP investors benefit not only from high absolute levels of current income and growing distributions, but they also benefit from receiving a tax advantaged income stream. First, income produced within an MLP structure is not subject to the double taxation inherent within a corporate structure, since taxation occurs only once at the unitholder level. Furthermore, 70-80% of MLP distributions are comprised of a return of capital for income tax purposes. This tax deferral reduces a unitholders' adjusted cost base and is recaptured upon disposition of the units. The taxable portion of the distribution is taxed at ordinary income rates (not the 15% QDI rate) while the income recapture is taxed at capital gains rates upon disposition of the units.

The tax treatment of MLP distributions minimizes current year cash taxes and allows for tax planning strategies since investors can control the timing of the recognition of their tax liability. However, one modest negative relating to the tax consequence of MLPs is the issuance Schedule K-1s instead of the standard Form 1099s issued by corporations. Many investors have concerns with the K1 state filing requirements and the generally late timing of their issuance (usually in March). Lastly, MLPs held in tax-exempt accounts such as IRAs and 401K plans can generate unrelated business taxable income (UBTI). Prospective investors considering an investment in MLPs should consult with their tax advisor for a detailed understanding of the tax consequences.

MLP Investment Risks

MLP investment risks can include (but are not limited to) interest rates, commodity prices, financing/access to capital markets, regulatory risks and weather. Investors must remember that an investment in the MLP sector represents ownership in an underlying business or asset. Accordingly, performing fundamental analysis on business factors such as management track record, growth prospects, returns on invested capital, competitive position, cost structure, financial position and unit price valuation will usually convey a good “risk profile” for each individual issuer.

Richard Fortin, CFA, *is Senior Vice President, Portfolio Manager and Equity Research Analyst at Stonebridge Advisors LLC and manages the North American Equity Income portfolio. Stonebridge Advisors is a Wilton, CT- based RIA, is a manager of specialty products, including MLP’s.*