Center Coast Brookfield Midstream Focus Fund Q1 2025 Podcast Transcript Recorded on May 6, 2025

Joe Herman (Joe): Hey everyone, thank you for listening to the Center Coast Brookfield Team's first podcast-style end of quarter review. We really appreciate everybody letting us try something new as we really try and create some relevant, timely, and digestible content for you guys. As always, if you have questions or feedback for anyone on our team, feel free to reach out to your Brookfield Oaktree Wealth Solutions or BOWS sales representative. We love speaking with our investors and taking questions, so would love to take some calls.

Please also be on the lookout for short videocast summary and outlook from us. I think the intention is to have different rotating guests from quarter-to-quarter, month-to-month.

In the way of formal introduction, I'm Joe Herman, one of the portfolio managers on Brookfield's dedicated energy infrastructure strategies, and today I'm joined by one of my co-PMs, Boran Buturovic.

Boran Buturovic (Boran): Hey everyone, thanks for tuning in.

Joe: I think our plan for these going forward is to provide an overview of prior quarter themes and helpful commentary about what we're seeing in midstream or energy infrastructure markets at any given point in time. As it relates to today and the first quarter, I think the three primary topics we're going to focus on are recent volatility, anticipated natural gas demand growth, and performance dispersion across midstream.

Boran: And Joe, let me jump in here. Obviously volatility is at the forefront of everyone's mind, especially with what has happened with both proposed tariffs and the crude markets in April. But we saw a little bit of an uptick in volatility in Q1 as well. So to set the stage for the rest of the discussion, why don't you give us an overview of what we saw in Q1 and what led to that uptick in volatility.

Joe: Sure, Boran. If the first quarter felt like a bumpier ride than it has been for midstream recently, that's really because it was. During the first quarter midstream experienced the most days of plus or minus 1% movement, basically the absolute value of moves than in any quarter over the last two years, driven by increased broader market volatility, some periodic technical unwinds of momentum-levered stocks, and geopolitical headlines. As I just mentioned, the broader market also experienced higher levels of volatility during Q1 and we felt it even more so since. I think we remain impressed, but not entirely surprised by the midstream sector's ability to outperform the broader market during some of the recent periods of volatility and weak oil prices. But I would say, since the end of Q1, the post-quarter tariff-related volatility has been an exception and I know we'll get into that here in a second.

But back to the first quarter, I think specifically DeepSeek and its efficient artificial intelligence or AI model was one of the more notable news items, in our view, that sent shock waves through the global markets. The midstream sector was initially negatively impacted, particularly those companies expected to benefit from rising domestic natural gas and power demand. That led to the biggest daily drawdown for the Alerian Midstream Energy Index or AMNA, in more than two years, until April, and was a gentle reminder that there has been a degree of growth priced into midstream equities that really hasn't been there in recent years. I think, thankfully, at least as the first quarter goes, performance had largely recovered by March 31st and those stocks that were initially disproportionately impacted actually outperformed in April, as tariff-related volatility impacted a different set of midstream equities in early April.

Boran: Yeah, and let me get into that a little bit. As you already mentioned, the volatility has endured here in the second quarter and accelerated, and midstream in particular, this time, has been relatively more impacted when compared to broader markets. So in early April, in addition to the escalation of tensions between the US and various trade partners, the OPEC+ coalition announced that they would accelerate certain plant production increases in May, effectively adding 400,000 barrels per day into the market, and recently announced an additional 400,000 barrels per day in June. Things appear to be moving pretty quickly in the crude markets and that's something we constantly have our eyes on. How does it all add up? On one hand, the tariff escalations created concerns about the pace of economic growth, which we think created additional uncertainty for crude oil demand. And then on the other hand, the OPEC+ coalition has signaled that it will increase supply into this uncertainty.

As a result, the price of a barrel of crude in the US, which traded as high as $80 per barrel in January, has been regularly testing lows below $60 per barrel. I do think this $60 per barrel is an important threshold to keep in mind. In a Dallas Fed survey released in March, large US producers responded to survey questions indicating that even the most prolific crude oil basins in the US are not profitable below $60 per barrel. This sentiment has been echoed by various CEOs and market commentators, and the implication is that if crude prices were sustainably below 60, we should be revising down our assumptions of volumetric supply growth from the US in oil focused shales, including the Permian Basin.

Joe: Yeah, there are some obvious and recent analogs here that you and I can point to Boran, because we've lived through a bunch of mini cycles in our decade plus covering midstream. I think the easiest one to point to initially is 2020, where we had a simultaneous economic shock along with a large sudden supply increase from OPEC+. I don't think either of us would predict that both of those outcomes are a certainty today. And I'm not even suggesting that if they were to happen we would see crude trade in negative territory as it did famously in 2020. But I do think we can draw a valuable comparison nonetheless, as we analyze what could happen in the oil markets. I think it's important to note that OPEC+'s willingness to endure pain to gain market share isn't unlimited, there is a bit of a shelf life in our view. That was the case in 2020, is media reports suggested that Saudi Arabia was frustrated with other members of the coalition continuing to exceed production quotas.

That's kind of happening today, too. I think one of the levers that we've seen pulled before, as it did in 2020, was Saudis effectively flooding the market with their own spare supply, which is substantial. This can happen in a period of economic instability to force crude prices down and other members into complying with their quotas. If you have listened to our webcasts in the past, I think you've probably heard us say the best cure for low prices is low prices, and that idiom can apply to cartels as well. The pain threshold of participants is not unlimited, and I think that any self-induced shock to crude oil prices could ultimately yield a resolution that we'll see OPEC+ withdraw supply from the market as it has in prior cycles. I think, though, as we're all aware though, that that interim period can create substantial volatility in energy markets and midstream equities is kind of a tag-along.

Boran: Yeah, and since we're talking about the 2020 analog, we also need to point out that midstream companies are in a vastly different position today than they were in 2020. Leverage on the aggregate is much lower and virtually all companies are funding both their dividends and capital obligations with operating cash flow. So during that COVID period where for a period of time crude oil demand was substantially impacted, we actually saw nominal cash flow impacts in midstream, which is what we would expect. We would expect significantly better insulation in midstream than other pockets of energy. However, leverage had to be right sized and CapEx programs still had to be completed, which necessitated the painful distribution cuts we saw in 2020. So it wasn't the changes in top line cash flow expectations, we think it was more of a product of the corporate finance model at the time, which is different today.

But back to my point on U.S. crude production, I mentioned 60 as being an important threshold to keep in mind because below it, we believe we may have to revisit our US crude supply growth assumptions. We think one of the reasons volatility has picked up is because we are testing those levels. So over the past several years now as crude oil prices have generally traded in a $70 to $90 per barrel band, the US was in a steady state growth environment. Producers generally didn't adjust their drilling plans higher or lower within that range. Volumes were fairly predictable and midstream companies, which make money moving volume and not on price, exhibited low crude correlation. However, and this is historically true as well, when we start approaching levels that could induce changes in upstream activity, which we believe is around that $60 per barrel today, midstream correlation with crude has historically increased. So long story short, we believe that the recent incremental volatility in midstream and the recent uptick in correlation of crude prices that we haven't seen in the last few years is due to that.

Joe: Yeah. I'll also point out that not all midstream is equal. We've also discussed this quite a bit and I think as we've alluded to already, I think today we're dealing with more uncertainty in the crude story than the natural gas story, which is a reversal of the brief uncertainty that was introduced in January by the DeepSeek announcement. The market has responded and drawn that distinction pretty well, or said another way, I think names with more exposure to supply out of crude oil basins have materially underperformed in the recent environment, while names with little exposure to impacts in oil supply or demand have generally held up well. So the dispersion has been appropriate and we haven't really seen a throw the baby out with a bath water situation just yet. I think we've also seen in history that natural gas consumption has been more insulated during economic downturns than crude oil consumption.

The specific demand drivers underpinning natural gas growth, which primarily are power generation growth and liquefied natural gas, or LNG growth, still remain intact and are pretty visible today. I think where we sit today, LNG capacity is already higher than it was throughout 2024. Barring some unforeseen circumstance, I think we would expect it to be higher over the course of the year. We continue to see more commercial announcements and positive final investment decisions, or FIDs, on the LNG front, and I think that's providing upside to even our expectations coming into the year. On LNG, I think those numbers are even in excess of what you and I would normally expect in terms of growth from the power sector.

Boran: Yeah, you're right. I think the main point we'd like to convey to our investors here is that we believe certain assets with exposure to gas oriented shale basins, such as the Hainesville in Louisiana, and the Marcellus in the Northeast US, could actually be poised to benefit from volume growth if associated natural gas output from crude oil basins declines.

There are natural offsets embedded within midstream the way we see it, that can serve as tailwinds and steady the ship, if you will. Again, that 2020 COVID analog provides a compelling data point. In that year, refined products consumption in the US was nearly 11% lower than in 2019, yet natural gas consumption was only 2% lower and was offset by higher year over year exports of LNG. So the flattish demand for natural gas, coupled with a decline in production out of the Permian, which responds to crude oil prices, paved the path for the Hainesville shale in Louisiana to grow by nearly 10% in 2020. So again, said another way, in our view, there can be certain companies that benefit from economic activity slowdowns, assuming gas consumption stays relatively consistent.

So back to now, energy analysts at East Daly estimate that 6 billion cubic feet a day of new LNG export capacity is due to come online by the end of 2026. That's against the 8 BCF a day of incremental natural gas production expected between 2024 and 2026, a total natural gas market growth rate of around 7%. If we decide that that isn't going to come from the Permian, because we are in this below $60 crude environment and producers do ratchet bag their plans, then that natural gas still has to come from somewhere. I'll add to that, that our expectations for growth from the domestic power sector continue to accelerate and could be additive to those demand forecasts I just mentioned, given that some of the names involved in this rapid increase in expected power consumption, which include the Amazons, the Metas, the Googles of the world, come with high profiles. We believe, and we have heard anecdotes that investors that may be looking for alternative or second derivative lower beta ways to capitalize on this AI thematic have been attracted to the midstream sector, and we think that could continue.

Joe: Yeah. I should also mention that there was that one high profile announcement from one of our constituents during the first quarter. That company is planning on moving forward with a $1.6 billion, 400 megawatt integrated power solution, that's supported by a 10 year fixed price agreement, and expected to generate a five times EBITDA investment multiple for the company building the project. Which I would say is generally on the lower to mid end, in terms of investment multiple or higher return projects that we see in midstream. We're excited and believe there's potential for more of these types of solutions to be announced by midstream companies. Generally, we're excited for how that growth could reverberate positively throughout the whole energy infrastructure sector.

Boran: Yeah, and at a high level, I think we talk a lot about supply growth and demand growth, and just quickly framing what that gas macro means for midstream. We believe gas is not as fungible as a commodity as crude oil is. You can't just be flooded with overseas supply to satisfy domestic demand growth. So if we see domestic demand growth here in the US, the demand growth, we expect to come from contracted LNG capacity and from power demand, as we've been discussing, that will have to be met by supply growth from the US. That should come from a variety of supply basins and it should require incremental infrastructure to be built at attractive returns, greater than current cost of capital, which we are seeing today, and which we believe will ultimately create meaningful value for those midstream companies and their investors. With the vast majority of our constituents enjoying healthy free cash flow profiles and low leverage levels, we continue to believe that the companies are well positioned to build new infrastructure without meaningful reliance on equity capital markets.

So Joe, if I might summarize the setup we see for midstream today, I think we'd say that we will continue to monitor the uncertainty and look for opportunities to make adjustments if we believe the situation warrants. We'll continue to keep our investors posted on our perspective as we navigate this period of uncertainty, but we'd also reiterate that the sector is quite different than prior low price periods. Natural gas demand growth is accelerating, we believe, and we think material pullbacks where growth and the companies appear mispriced could provide compelling entry points for investors.

As always, we appreciate your investment with us and we always available to take your calls and questions. We look forward to providing another update to you all sometime soon.

All investing involves risk. The value of an investment will fluctuate over time, and an investor may gain or lose money or the entire investment. Past performance is no guarantee of future results.

A fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company, and it may be obtained by visiting www.brookfieldoaktree.com Read the prospectus carefully before investing.