Tortoise's Essential Playbook for Midstream Management

Tortoise is a signatory to the Principles for Responsible Investment (PRI), the leading global network for financial industry participants and investors who are committed to integrating environmental, social and governance (ESG) considerations into their investment practices and ownership policies. The reporting requirements that come with becoming a signatory improve the transparency of our sustainability efforts, promote engagement, and foster and improve alignment of our company goals.

We believe that we can use our position as a large shareholder to engage with our portfolio companies and advocate for change and improvement regarding governance. As a result, we have created a playbook of considerations for management of midstream companies that we believe are essential to deliver value to shareholders. If we do not see improvement after engagement activities, it will impact investment positioning and could result in selective divestment from certain companies.

Exercise Capital Discipline

- Focus on generating free cash flow (FCF)
- Project return hurdle guidelines; all numbers vary based off actual weighted average cost of capital (WACC)
    - 15% return on equity (ROE) for logistics with contract
    - 20% ROE for gathering & processing companies
        - Baseline numbers assume those with lowest WACC
- Consider sale of non-core assets
- Consolidate potential projects with partners

Return Capital to Equity

- Ideally fund capital expenditures with internally generated cash flow only until leverage target hit
    - At a minimum, use a funding mix that results in lower leverage after project completion
        - This assumes also funding dividend
- If at leverage target and funding investments with cash flow and debt after dividend, buy back stock

Report Widely Accepted Metrics

- Illustrate FCF similarly to S&P 500: (cash flow from operations – cash flow from investing)
    - Our models show compelling FCF yield for midstream vs S&P 500 going forward
- Return on equity and earnings need to be a part of the discussion

Improve Financial Health

- Leverage
  - o 4.5x is maximum and less than 4.0x is ideal for logistics companies
  - o 3.5x or less for gathering & processing companies
- Distribution / dividend coverage
  - o 1.2x for pipeline/logistics companies
  - o At least 1.5x for gathering, processing and water companies
  - o Well connects and other capital to maintain cash flow are maintenance capex
- Distribution policy guidelines, all situations are unique
  - o In our view, the cost of equity for pipeline companies is generally between 10% - 15%
    - If the yield on equity chronically exceeds this level, we think (1) leverage is too high resulting in equity distress or (2) the market is mispricing the equity
      - If leverage is too high, we recommend reducing the distribution and using the proceeds for debt reduction
      - If the market is mispricing the equity, we recommend reducing the distribution and using the proceeds for stock buybacks
      - In some cases, an all of the above approach is most appropriate

Make ESG initiatives a top priority

- Implement governance best practices
  - o Elected board is strongly encouraged
  - o Majority independent board is strongly encouraged
  - o Separate chairman and CEO roles preferred
  - o Improve management and unit/shareholder alignment
    - Compensate CEO on total shareholder return (TSR) relative to S&P 500 and / or absolute level of return
- Implement environmental best practices
  - o Methane and CO2 emission reduction programs are strongly encouraged
  - o Transparency: Impact or sustainability report is strongly encouraged
  - o Impact measurement should be a part of every discussion and presentation
  - o Embrace renewable power in operations
  - o Participate in best practices coalitions such as One Future
- Implement social best practices
  - o Embrace diversity across management, workforce and board
  - o Implement a cybersecurity policy
- Engage with ESG ratings firms to tell the company story and commit to ESG improvement

As ESG and socially responsible investing continues to gain popularity, we think it's important to educate investors on each of the pillars. Some activist groups are calling on divestment of all fossil fuel-related companies as part of impact investing. At Tortoise, we believe that divestment is not the answer. Pulling capital only makes it harder for these companies to implement change. We believe that by engaging with companies and holding them accountable for improvement, we can help them innovate to provide cleaner energy for the world.