NEUBERGER BERMAN

Rachlin Energy Transition & Infrastructure (ETI) Portfolio

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Performance Highlights

The Rachlin Energy Transition & Infrastructure (ETI) Portfolio (Portfolio) posted a positive return in the first quarter of 2025, but underperformed its benchmark, the Alerian MLP Index (AMZ).

Market Context

The energy midstream sector continued to outperform the S&P 500 Index ("S&P 500") as well as broader energy indices in the first three months of 2025. The first quarter witnessed an unprecedented flurry of announcements and executive actions from the new administration. The Trump administration's implementation and threat of further tariffs have created some instability in the stock market as investors weigh the probability of a recession. Energy midstream, for the most part, has sidestepped this, and share performance continued its upward trajectory from the past few years.

President Trump has put domestic energy production at the forefront of his policy initiatives. One of his first executive actions was to remove the "Biden Pause" on licensing and approving new liquified natural gas (LNG) export projects. In conjunction, the Trump administration has been pressuring countries in Europe and Asia to buy more of America's LNG as part of tariff negotiations. While the emphasis on encouraging countries to buy America's natural gas is welcomed by the energy industry, the U.S. was already ramping up LNG exports before January 2025. Even with the temporary pause on permitting new LNG export facilities, the U.S. had previously approved construction in progress to increase our daily export capacity from 14 billion cubic feet per day (bcf/d) today to an expected 25 bcf/d by the end of 2028. With Trump's executive order, LNG exports could potentially reach 35 bcf/d by the year 2034. To put that into context, the U.S. is currently producing about 104 bcf/d of natural gas in total.

Another wild card is the amount of natural gas that will be needed to meet the burgeoning build out of AI data centers in the U.S. Estimates indicate that in the next 5 to 7 years, an additional 6 to 9 bcf/d of natural gas will be required explicitly for data centers. With the combination of rising demand from LNG exports as well as how much more natural gas will be needed from the domestic utility and power sector, we believe this framework provides a strong tailwind for natural gas demand. We anticipate this will be a long-term benefit for midstream energy companies.

April Supplement

Since April 3, the stock market and the portfolio have experienced sharp declines in the wake of President Trump's tariff announcement. Subsequently, the portfolio's year-to-date performance has turned negative during the first week of April.

While we cannot predict how long today's market turbulence will persist; we remain confident in the resilience and financial strength of our portfolio companies. A key difference this time is the substantially improved balance sheets of our holdings—leverage ratios are the healthiest they have ever been with strong dividend coverage ratios. In prior market downturns, many companies faced pressure to reduce dividend payments; however, with average dividend payout ratios now between 50 to 60%, we believe current dividends are well protected.

Our portfolio companies generate excess cash flow to fund both maintenance and growth capital expenditures, eliminating the need to jeopardize dividends for other obligations. Furthermore, their cash flows are primarily supported by multi-year fee-based contracts, which provide insulation during periods of falling commodity prices. Interestingly, in recent days, natural gas prices have remained high while oil prices have dropped sharply. Given our portfolio's significant focus on natural gas and natural gas liquids businesses, we believe this provides a strong foundation for resilience.

It remains ironic that during major market and oil price downturns, natural gas-related equities often decline as sharply as oil-related ones. In our view, the current market malaise presents a compelling buying opportunity to acquire leading natural gas pipeline and midstream franchises.

Portfolio Review

Fourth quarter 2024 earnings results were quite strong across our midstream holdings. Many continued to grow dividends at a healthy pace. Additionally, in the first quarter several midstream companies announced partnerships with AI and data center developers. In March one of our largest holdings announced a $1.6 billion project to deliver onsite natural gas and power generation infrastructure for a major investment-grade customer. The initiative includes a 10-year fixed-price power purchase agreement (PPA) with an option to extend. It will utilize two behind-the-meter simple cycle gas turbines in Ohio, providing a total capacity of 400 MW. The project addresses growing energy demands in grid-constrained markets, especially data centers, while offering speed-to-market advantages. This high-return venture establishes a blueprint for future similar deals with favorable build multiples and permitting timelines.

While the portfolio's midstream holdings have performed well, its utility holdings have underperformed. Rising interest rates, along with company-specific factors weighed on share prices. Although the need for additional power and the ongoing upgrades to the nation's electricity grid present growth opportunities for a select number of utility companies, higher financing costs and uncertainty surrounding local regulatory environments have led us to significantly reduce the portfolio's allocation to this sector.

In our opinion, the investment opportunity in energy midstream has become increasingly attractive compared to utilities. The portfolio's strategy has always emphasized concentrating in our highest-conviction ideas—not only by individual companies but also by industry segments. Within the energy midstream segment, we are highly focused on owning businesses that dominate in the transportation, processing, storage, and increasingly, the export of both natural gas and natural gas liquids.

Our strategy to concentrate on natural gas names has led to substantial portfolio gains since the COVID-19 driven lows of 2020. Since emerging from the COVID-19 era, the MLP/Midstream sector has become increasingly polarized into what we refer to as "the haves and the have-nots." Despite a highly favorable environment for energy infrastructure, we believe that significant operational scale and a robust balance sheet are critical for businesses to fully capitalize on the best opportunities. Many smaller companies, unable to compete with larger and more financially resilient players, are opting to be acquired. This has spurred notable consolidation within the sector, allowing leading companies to strengthen their asset footprints and position themselves to capitalize on the favorable industry trends.

As much as we are excited about the additional demand coming from data centers, LNG exports are expected to be the main driver of the gas demand growth through the end of the decade. With President Trump's repeal of the Biden administration's pause on LNG export developments, several projects previously awaiting approval have now received the green light to move forward. Our portfolio stands to benefit from every stage shale gas travels in the US—from gathering to processing, to transportation to the coast to liquefaction. The majority of the new capacity has already been contracted, and in our opinion, the remaining open capacity is likely to be secured quickly, given the favorable LNG contracting environment under the new administration.

Outlook

Even with the strong returns in recent years, we believe midstream equity valuations remain reasonable relative to historical averages and inexpensive vs. the broader market represented by the S&P 500. Currently, midstream stocks, as represented by the Alerian MLP Index, trade at an average Enterprise Value to EBITDA (EV/EBITDA) multiple of 10.5x, compared to the 10-year average of 10.1x.

Looking ahead, we maintain a positive outlook for the energy midstream sector. The combination of strong demand drivers—including the ramp-up in LNG exports, the growing need for natural gas to support AI data center development, and the continued expansion of domestic energy production—provides a foundation for sustained growth. These trends underscore the critical role midstream companies play in enabling the transportation, processing, and export of natural gas and natural gas liquids. While broader market volatility persists due to tariff concerns and potential recession risks, the midstream sector has demonstrated resilience, benefiting from structural tailwinds and disciplined capital allocation.

Sources: FactSet, Neuberger Berman, Alerian, Federal Reserve, Wells Fargo Research Estimates.

Information as of March 31, 2025.

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Due to investment in a limited number of sector, industry, or sub-sector of the market, the Portfolio's performance will be especially sensitive to developments that significantly affect those sectors, industries, or subsectors. An individual sector, industry, or sub-sector of the market may be more volatile, and may perform differently, than the broader market. The industries that constitute a sector may all react in the same way to economic, political or regulatory events.

Master Limited Partnerships (MLPs) are limited partnerships that are publicly traded and which have the tax benefits of a limited partnership and the liquidity of a publicly traded company. As an income producing investment, MLPs could be affected by increases in interest rates and inflation. The total market capitalization of the MLP universe is approximately $500 billion (Sources: Bloomberg and Alerian). Investors should consider relative exposure and liquidity in this asset class before making an investment.

The Alerian MLP Index is a composite of the 50 most prominent energy master limited partnerships calculated by Standard & Poor's using a float-adjusted market capitalization methodology. The index is disseminated by the New York Stock Exchange real-time on a price return basis (NYSE: AMZ). The corresponding total return index is calculated and disseminated daily through ticker AMZX.

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