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Guilt by association

"Small, illiquid, complex" was the headline over the July 10 *Grant's* analysis of Westlake Chemical Partners LP (WLKP on the NYSE). To which we may now add another attribute: unprofitable. After a price drop to $16 from $23, the shares deliver a 7.5% distribution yield. "The essence of the bullish narrative," we wrote six months ago, "is that the cash flow is sturdy, well-protected and on a course to grow." So it remains.

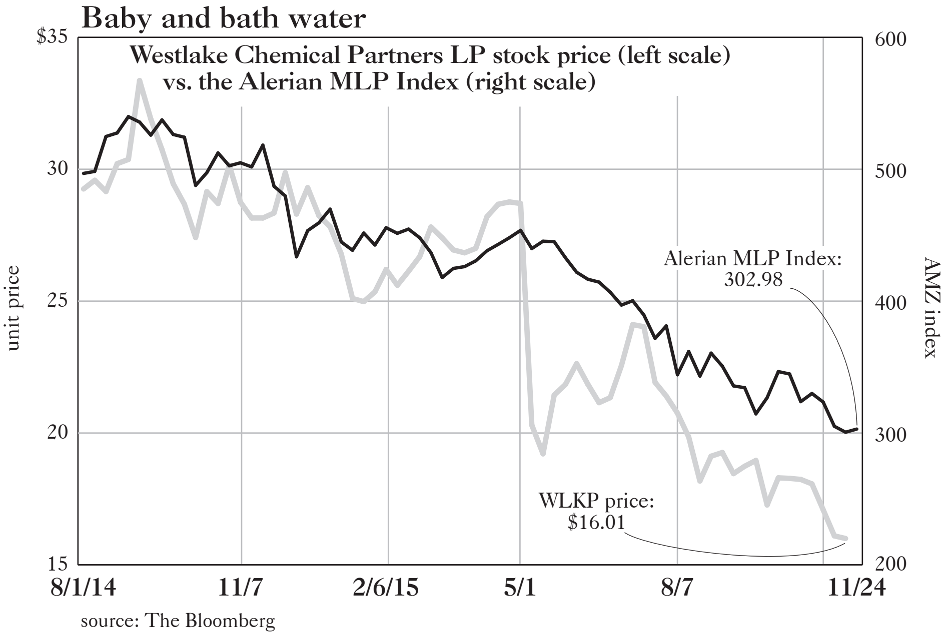
The essence of the bearish narrative is that WLKP is a master limited partnership, an interest-rate-sensitive investment vehicle that is almost as unpopular as it used to be popular. Worse, for WLKP, it's a financially engineered MLP, a derivative—you'll recall it owns a 13.3% interest in Westlake Chemical OpCo LP. The parent company, Westlake Chemical Corp. (WLK on the NYSE), owns the remaining 86.7% of OpCo. Bear in mind that Westlake Chemical Corp. is a Baa3/BBB-rated credit with a balance sheet that, as of Sept. 30, showed cash, cash equivalents and marketable securities substantially in excess of long-term debt ($1.2 billion vs. $764.1 million). Then, too, the parent company does need the ethylene that OpCo delivers; it uses that basic building block in everything it makes.

It's true enough that the integrated ethylene margin is closer to 15 cents a pound than to the 40 cents of 2014. "But," colleague David Peligal observes, "the reality is that this is more of an issue for the parent company (WLK)—not WLKP. WLKP is selling only 5% of its ethylene into the marketplace, a vanishingly small percentage of its cash flow."

"As a result of the long-term fixed-margin ethylene sales agreement," notes WLKP president and CEO Albert Chao in the third-quarter earnings release, "the margin associated with the majority of our ethylene sales is not subject to the recent volatility in the oil and ethylene markets. This arrangement positions us to provide stable cash flows to our unitholders and highlights the benefit of the structure of our operations and sales contract."

You'll recall that WLKP is embroiled in a federal-tax dispute; no hard news to report on that front (though a trade blog did quote Curtis Wilson, the IRS associate chief counsel with responsibility for pass-through matters, at a Chicago meeting in September as saying, "We thought we had an understanding. We might have been wrong"). Final tax rules are expected by next summer.

"Perhaps the key question is what will happen with WLKP, and its ability to make distributions, if the proposed regulations *do not* change," Peligal reflects. "It seems as if the company has alternatives. It can continue to think about the 10-year grandfather period that is in the current proposal. It can accelerate the rate of drop-downs in that 10-year period to continue to provide good growth and distribution. It can lobby Congress. It might even consider the MLP a failed experiment and decide



to buy it in (the $24 IPO price would be nice). To be clear, the company will be reluctant to consider WLKP a failed experiment as long as the valuation arbitrage between the partnership and the C-corporation exists. While both multiples have come down since July—WLKP trades around 10 to 11 times EBITDA, WLK at around six times EBITDA—that relative arbitrage does still exist."

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