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Master Limited Partnerships

Strong Performers in a Difficult Market

SALOMON SMITH BARNEY

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Why Now?

- Strong industry fundamentals
- Attractive yield—substantially tax-deferred
- Defensive security
- Growth potential from acquisitions and expansions
- Ideal for income and income/growth investors
- Not recommended for IRAs or other retirement accounts

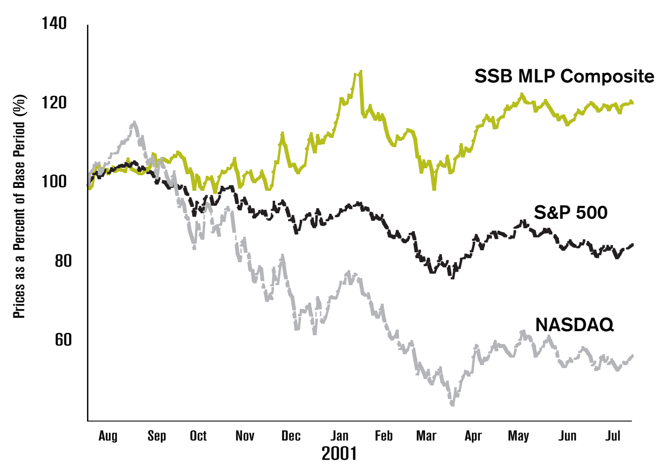
Over the past 18 months, investors have sought out investments in companies with solid cash-generating ability and good industry fundamentals. One area that has been gaining more attention recently is publicly traded master limited partnerships or "MLPs." In fact, the MLPs in Salomon Smith Barney's Equity Research Coverage universe have bested the tech-heavy Nasdaq stocks by over 69%, and the more broadly held S&P 500 index by over 38% over the past 12 months.

Aside from some basic structural elements, the MLPs in our composite have little in common with the limited partnership roll-up transactions of the early 1970's. Today there are about 50 MLPs in the market. These companies operate primarily in natural resource, financial services and real estate-related industries, but also include several other sectors as well. Salomon Smith Barney Equity Research maintains coverage on 20 of these partnerships. Each of our top-rated MLPs has expansive operations, substantial market caps, strong balance sheets and, perhaps most importantly, a consistent track record of increasing cash distributions to investors.

What is an MLP?

An MLP is simply a partnership. Interests or "units" in the partnership are traded on public stock exchanges. As such, an MLP combines the tax advantages of a partnership with the liquidity of a publicly traded stock. Like all partnerships, MLPs do not pay corporate-level taxes. Instead, taxes are paid only at the individual investor level. The elimination of this "double taxation" is an important benefit of MLPs and one of the reasons they can maintain their cash distribution levels.

Daily Data: August 2, 2000 through August 2, 2001



A Good Choice in a Difficult Market

All of the MLPs in our universe provide tax advantages to their holders. The cash distributions made by an MLP are not taxed but rather are treated as a return of capital, thereby reducing the unitholder's tax basis in the investment. When he or she sells the MLP investment, any gain will be taxed at the ordinary income tax rate. This tax-deferral feature may make an MLP an appropriate investment alternative for estate planning. These securities are also an excellent diversification alternative to bonds, utilities, real estate investment trusts and other high-yielding investments.

MLP investors are also allocated for tax purposes their portion of the MLP's income or loss. However, due to their large asset bases, most MLPs do not generate much taxable income. Although they typically generate excellent cash flow, noncash charges like depreciation and depletion result in little taxable income and, in some cases, result in tax losses. For MLPs that do generate taxable income, investors will have a tax liability for their portion, which will be taxed at the ordinary income rates. Each unitholder receives his or her information in a Schedule K-1, which is distributed by the partnership each year.

More than Just Yield

For investors looking for more than just yield, several MLPs continue to grow their earnings and distributable cash through acquisitions and operational expansions. Greater distributable cash flow has subsequently led to larger cash distributions payable to unitholders. The result of increasing cash distributions is usually an improved yield valuation, since cash distributions drive unit prices. As cash distributions continue to increase, the unit price of an MLP should also increase, offering investors the opportunity for attractive total returns.

What Makes a Good MLP Investment?

Since every partnership is different, and generally has been created for a myriad of different reasons, investors should focus on more than just a partnership's yield. Common reasons for the formation of an MLP typically involve a corporation attempting to increase shareholder value or using the partnership structure as a corporate financing tool. A corporation that believes the value of its assets is not being correctly recognized by the market may decide to monetize a portion of its asset base under the MLP structure. This strategy is based on the expectation that a more favorable valuation would be rewarded by the market once the assets are separated from the corporation. As a corporate financing tool, a corporation could obtain cash on its assets in an amount equal to its fair value, without surrendering control of the assets.

Investors should attempt to determine the partnership's ability to cover its current distribution obligations and the potential for any future cash distribution increases. Trends among many MLPs have shown a greater emphasis on improving cash flow and increasing distributions payable to unitholders. Growth initiatives such as developing new markets, capacity expansions, and strategic acquisitions have played key roles for MLPs seeking ways to grow distributable cash flow. Higher cash flows and distribution increases are ultimately the driving force behind higher unit valuations. Partnerships that successfully grow should provide attractive total returns.

Are Cash Distributions Guaranteed?

Cash distributions payable to unitholders are not guaranteed. Any changes in the supply or demand for crude oil, propane, natural gas, timber or other relevant business driver that has a material adverse effect on the partnership's profitability could jeopardize the cash distribution. An MLP's distributable cash flow coverage ratio can provide valuable information about an MLP's ability to sustain its current cash distribution level. A ratio of 1:1 or better generally indicates adequate reserves to cover cash distributions. The risk of whether an MLP will be able to cover the minimum quarterly distribution increases when the ratio falls too far below one.

Salomon Smith Barney's Top MLP Picks

Name (Ticker Symbol)	Rating	Business Type	Unit Price (8/08)	Per Unit Annual Distribution	Current Yield	Estimated Tax Deferral	Expected Distribution Growth	2001 E Total Distribution Coverage
Alliance Capital Mgmt. (AC)	IM	AssetMgmt.	$53.28	$3.05	5.7%	50%	12%	1.00 x(a)
El Paso Energy (EPN)	IM	Pipeline	35.85	2.30	6.4	95	10	1.10
Enterprise Products (EPD)	IM	Pipeline	42.65	2.35	5.5	80	10	1.40
Heritage Propane (HPG)	IH	Propane	27.04	2.45	9.1	95	5	1.60
Kinder Morgan Energy (KMP)	IM	Pipeline	72.01	4.20	5.8	95	10	1.00
Northern Border (NBP)	IM	Pipeline	37.95	3.05	8.0	95	10	1.20
Plains All American (PAA)	IH	Pipeline	25.71	2.00	7.8	70	10	1.00

(a) Distribution policy differs from natural resource MLP's policy of steady distributions. Alliance distributes all available cash flow as it varies each quarter.

Interested in Learning More?

Please contact your Salomon Smith Barney Financial Consultant for details on offerings that may be appropriate for you.

All rates are subject to change and availability.

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