



MLP 101: An Investor's Guide

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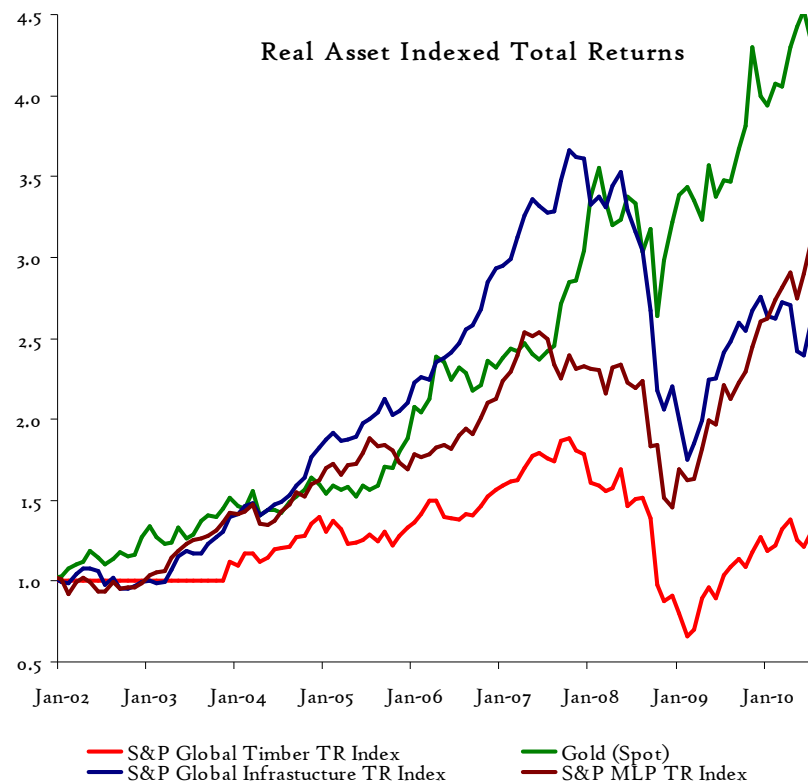
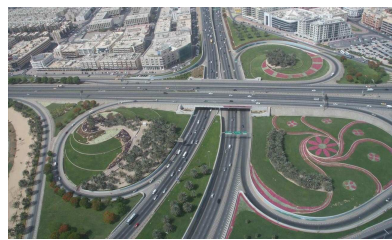
What are MLPs and PTPs?

- Master Limited Partnership (MLPs) are passive investment vehicles where profits and losses are passed through the ownership structure to the limited partners. MLPs are limited partnerships which retain their partnership tax treatment. As such, the partnership itself does not pay entity level taxes. Rather, all tax items flow through to the partners, as long as 90% of its income is from qualifying sources.
- Publicly Traded Partnerships (PTPs) – PTPs are limited partnerships (i.e., MLPs), the interests in which (known as units) are traded on public securities exchanges such as the NYSE. Buying MLP units makes you a limited partner in that PTP.

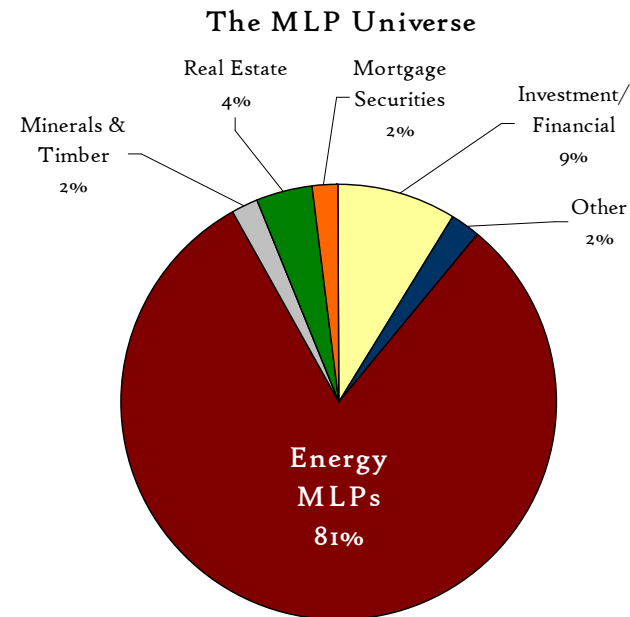


MLPs: Real Assets

- Real assets – land, infrastructure, and raw materials, among other things – are generally understood to be tangible assets with intrinsic value. These assets are also “real” in that they provide a real return rather than a nominal return and offer protection against inflation.
- In recent years, real assets have grown in popularity with institutional investors seeking diversified, inflation-protected returns.
- MLPs provide real asset exposure by means of ownership of energy infrastructure assets, including pipelines, terminals, and storage assets. Unlike many other real assets opportunities, MLPs feature the liquidity and daily pricing of a publicly-traded security. This removes a barrier of entry and is a unique advantage.

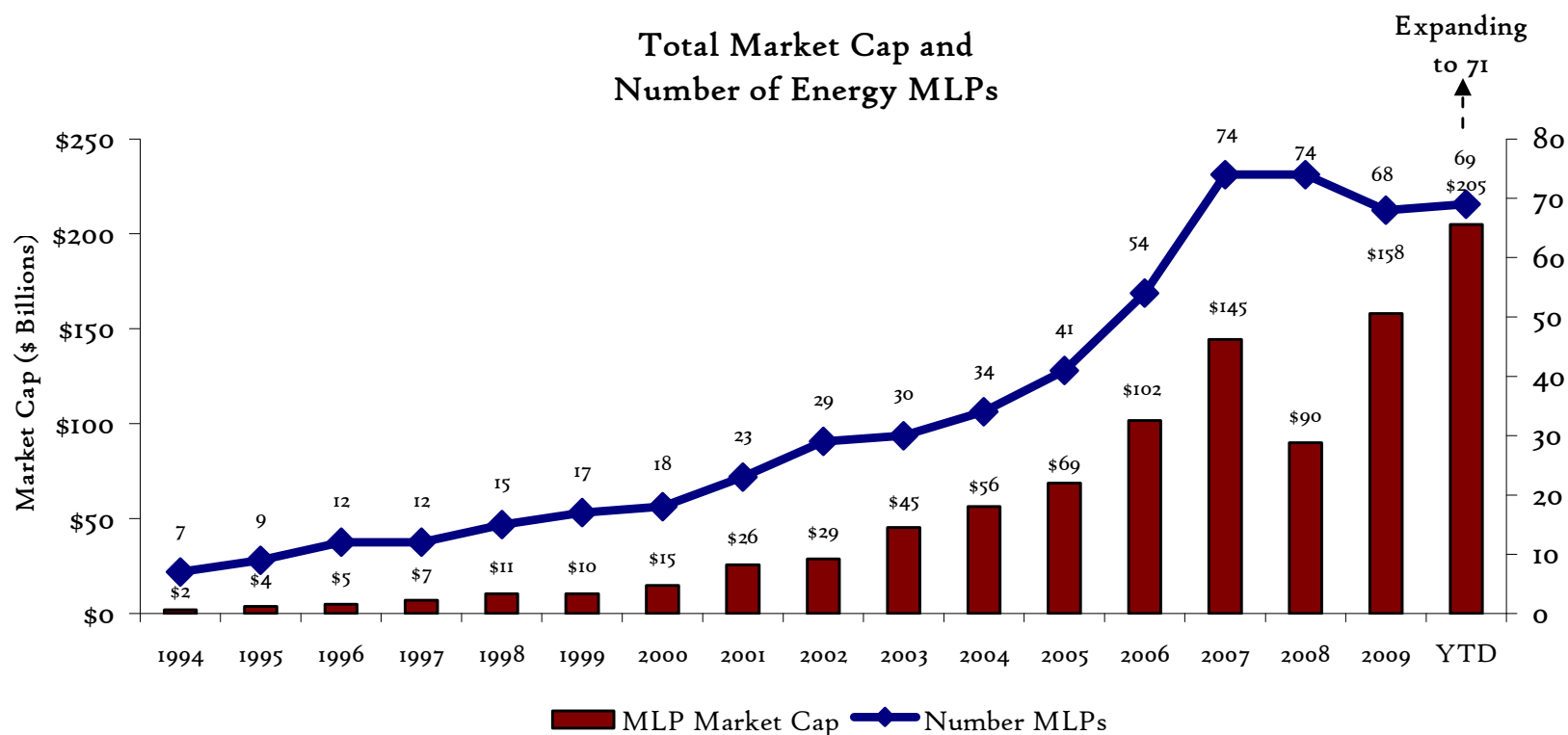


- The modern MLP got its start with the Tax Reform Act of 1986. This legislation gave companies an incentive to restructure as publicly traded partnerships in order to take advantage of certain tax shelter benefits. In 1987, the Revenue Act was enacted, which required publicly traded partnerships to earn income only from specific sources (i.e., qualifying income).
- In the 1980s, MLPs were formed that were involved in various businesses including exploration and production (E&P) of oil and natural gas, restaurants, sports teams, and other consumer activities. The cyclical in nature of these businesses was not well-suited to an entity that distributed large amounts of its cash flow.
- In the 1990s, MLPs were reincarnated as entities that generally own midstream assets used to transport, process, and store natural gas, crude oil, and refined petroleum products with limited exposure to commodity price risk. The early energy MLPs consisted primarily of refined-product pipelines that were characterized as mature assets that required modest maintenance capital and generated significant cash flows that were distributed to unit holders. By the mid-2000s, the majority of MLPs were energy related.



MLP History (continued)

- By 2000, energy MLPs began reorienting their focus towards growth, making acquisitions, accelerating internal projects, and aggressively raising distributions. As major diversified energy players sought to monetize mature assets and redeploy the proceeds into faster-growing entities, the MLPs prospered. MLPs were able to take advantage of their unique tax structure which affords a lower cost of capital to acquire midstream assets and achieve superior returns compared to corporations.





The Energy MLP Universe

Energy-related MLPs generally focus on pipeline assets, gas-producing assets, and bulk and liquids storage facilities that transport energy products (i.e., crude oil, natural gas, and refined products) to consumer markets of the commodities.

Natural Gas Pipeline & Storage MLPs	(12)	Oil & Products Pipeline MLPs	(10)	Processor MLPs	(10)
Boardwalk Pipeline Partners, L.P.	BWP	Blueknight Energy Partners LP	BKEP	Atlas Pipeline Partners, L.P.	APL
Chesapeake Midstream Partners, L.P.	CHKM	Buckeye Partners, L.P.	BPL	Copano Energy, L.L.C.	CPNO
Duncan Energy Partners, L.P.	DEP	Enbridge Energy Partners, L.P.	EEP	CrossTex Energy, L.P.	XTEX
El Paso Pipeline Partners, L.P.	EPB	Holly Energy Partners, L.P.	HEP	DCP Midstream Partners, L.P.	DPM
Energy Transfer Partners, L.P.	ETP	Kinder Morgan Energy Partners, L.P.	KMP	MarkWest Energy Partners, L.P.	MWE
Enterprise Products Partners L.P.	EPD	Magellan Midstream Partners, L.P.	MMP	Quicksilver Gas Services, L.P.	KGS
Niska Gas Storage Partners, L.L.C.	NKA	NuStar Energy, L.P.	NS	Regency Energy Partners, L.P.	RGNC
ONEOK Partners, L.P.	OKS	Plains All American Pipeline, L.P.	PAA	Targa Resources Partners, L.P.	NGLS
PAA Natural Gas Storage, L.P.	PNG	Sunoco Logistics Partners, L.P.	SXL	Western Gas Resources, L.P.	WES
Spectra Energy Partners, L.P.	SEP	TransMontaigne Partners, L.P.	TLP	Williams Partners, L.P.	WPZ
TC Pipelines, L.P.	TCLP				
Williams Pipeline Partners, L.P.	WMZ				
General Partner Interests	(8)	E&P MLPs	(8)	Specialty MLPs	(7)
Alliance Holdings GP, L.P.	AHGP	BreitBurn Energy Partners, L.P.	BBEP	Calumet Specialty Prod. Partners, L.P.	CLMT
Atlas Pipeline Holdings, L.P.	AHD	Constellation Energy Partners, L.P.	CEP	Cheniere Energy Partners, L.P.	CQP
Buckeye GP Holdings, L.P.	BGH	Encore Energy Partners, L.P.	ENP	Eagle Rock Energy Partners, L.P.	EROC
Energy Transfer Equity, L.P.	ETE	EV Energy Partners, L.P.	EVEP	Exterran Partners L.P.	EXLP
Enterprise GP Holdings L.P.	EPE	Legacy Reserves, L.P.	LGCY	Genesis Energy, L.P.	GEL
Inergy Holdings, L.P.	NRGP	Linn Energy, L.L.C.	LINE	Global Partners, L.P.	GLP
NuStar GP Holdings, L.L.C.	NSH	Pioneer Southwest Energy Partners, L.	PSE	Martin Midstream Partners, L.P.	MMLP
Penn Virginia GP Holdings, L.P.	PVG	Vanguard Natural Resources, L.P	VNR		
Propane MLPs	(5)	Coal MLPs	(4)	Shipping MLPs	(5)
AmeriGas Partners, L.P.	APU	Alliance Resource Partners, L.P.	ARLP	Capital Product Partners, L.P.	CPLP
Ferrellgas Partners, L.P.	FGP	Natural Resource Partners, L.P.	NRP	K-Sea Transportation Partners, L.P.	KSP
Inergy, L.P.	NRGY	Oxford Resource Partners, L.P.	OXF	Navios Maritime Partners, L.P.	NMM
Star Gas Partners, L.P.	SGU	Penn Virginia Resource Partners, L.P.	PVR	Teekay LNG Partners, L.P.	TGP
Suburban Propane Partners, L.P.	SPH			Teekay Offshore Partners, L.P.	TOO

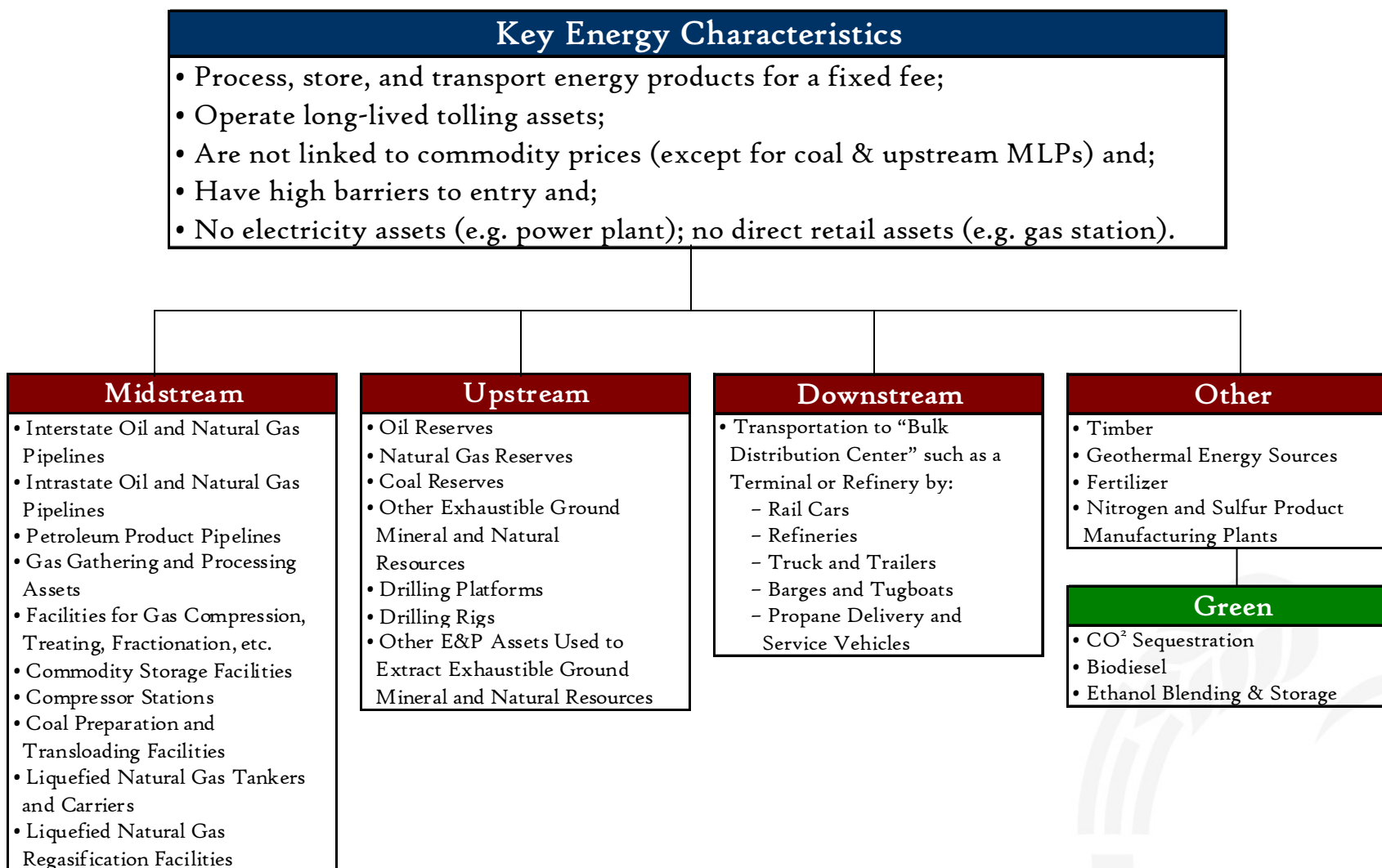
Partnership Mechanics – GPs and LPs

- MLPs are comprised of one or more general partner (the GP) and multiple limited partners (LP holders).
- General Partner (GP) – A limited partnership can have one or more general partner that manage the partnership. The GP usually owns 2% of the partnership, is responsible for the operations and maintenance of the MLP, and has the authority to make decisions. Generally, the GP is eligible to receive incentive distributions as an incentive to grow the partnership's distributions.
- Limited Partner (LP) – An LP provides capital to the partnership and receives a majority of the cash flows generated by the partnership through distributions. An LP has no decision making authority for the partnership's ownership and assets. Liability is limited to the amount of capital invested.



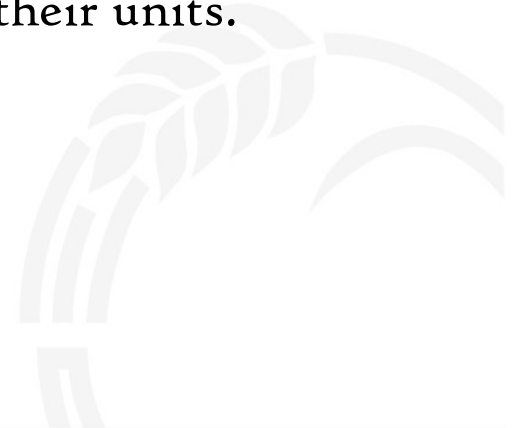
What is Qualifying Income?

- In order to be an MLP, the partnership must have at least 90% of its income derived from the following qualified sources/activities:
 - Natural resources (exploration, mining, production, processing, refining, transportation, storage, and marketing of natural resources);
 - Interest;
 - Dividends;
 - Real property rents; and
 - Gain from sale or other disposition of real estate.
- Transportation definition encompasses the following:
 - Includes any transport by pipeline of gas, oil or products thereof. Also includes transportation to a “Bulk Distribution Center” such as a terminal whether by pipeline, truck, barge, or rail; and
 - Excludes transport of oil and gas to a place where it is dispensed or sold to retail customers (e.g., gas stations). Refiners and processors who acquire the oil or gas for further refining or processing are not considered retail customers.



What are MLP Distributions?

- MLPs generally distribute available cash flow.
- Distributable cash flow is calculated as net income plus depreciation and other non-cash items, less maintenance capital expenditures.
- Unit holders receive distributions on a quarterly basis. These distributions are similar to dividends made by C-Corporations.
- Distributions reduce the unit holder's original basis in their units.



What are Incentive Distribution Rights (IDRs)?

- IDRs are typically agreed to between the partnership and the GP.
- IDRs allocate the percentage of total cash distributions that are allocated between the GP and LPs.
- The GP is allocated an increasing share of cash distributions as certain targeted levels of cash distribution to the LPs are achieved.
- The IDR structure is intended to encourage the GP to operate the MLP in a manner that maximizes cash distributions to the unit holders. The GP is thereby financially motivated to improve performance and ratchet-up the distributions to the partnership.

How are Distributions Allocated Between the LP and the GP?

- MLPs have a standard distribution schedule for the percentage of cash that is distributed each quarter between the LP and the GP. The schedule allocates the distributions based on tiers or levels. The highest distribution tier is known as the “High Splits.”
- A hypothetical split arrangement is shown immediately below:

Distribution Schedule	LP%	GP%	LP Distribution Up to
Tier 1	98%	2%	\$1.00
Tier 2	85%	15%	\$2.00
Tier 3	75%	25%	\$3.00
Tier 4 (High Splits)	50%	50%	Above \$3.00



How are Distributions Allocated Between the LP and the GP? (Continued)

- To illustrate a hypothetical split, assume an MLP were to declare a distribution of \$4.00 per LP unit.
- Based upon the distribution schedule in the previous slide, the distribution breakdown would be as follows:

Payment Tiers	Incremental Cash Distributions Per LP Unit	
	LP	GP
Tier 1 (\$0.00-\$1.00)	\$1.00	\$0.02
Tier 2 (\$1.00-\$2.00)	\$1.00	\$0.18
Tier 3 (\$2.00-\$3.00)	\$1.00	\$0.33
Tier 4 (High Splits >\$3.00)	\$1.00	\$1.00
Total	\$4.00	\$1.53
% of Total Cash Distribution	72%	28%

If the distribution is increased to \$5.00 per limited unit, the formulas for tiers 1-4 would apply, and both the LP and GP would receive \$1.00 for the incremental \$1.00 increase (i.e., from \$4.00 to \$5.00).

- Due to their partnership structure, MLPs are not subject to corporate-level income tax on income they earn, unlike a corporation. This eliminates double taxation at the unit holder level.
- The MLP structure typically allows LP unit holders to receive a tax shield equivalent to 80-90% of their cash distributions in a given year.
- Deferred tax will not be paid until units are sold by the LP unit holder.
- The basis on LP units is stepped up upon death of the unitholder if passed to an heir as an estate planning strategy.
- Any losses incurred by the partnership passed through to unit holders are passive losses. These losses cannot be used by the unit holder to offset income from other sources.
- These losses can be carried forward and used to offset future income from the same MLP.
- Thus, an MLP investor typically pays income taxes roughly equal to 10-20% of their distribution. The remaining 80-90% is deferred until the investor sells the LP units.



How is the MLP LP Investor Taxed?

- Investors pay tax on their allocated share of partnership income and not on the cash distribution.
- An investor's basis is calculated by taking the initial basis Plus allocated income less depreciation, Less the cash distribution.
- In the example below, 100 MLP units are purchased at \$20 per unit; the 100 units are held for three years and then sold for approximately \$22 per unit; yield is assumed at 7% annually, distribution growth is assumed at 5% annually, and capital appreciation is assumed at 7% annually; 90% of the allocated share of income is tax deferred (due to the depreciation tax shield); and taxes are paid on the non-shielded portion of income at an ordinary 35% tax rate.

Assumptions			Year 1		Year 2		Year 3	
			Per Unit	Total	Per Unit	Total	Per Unit	Total
Units	100	Initial Investment	\$ 20	(\$ 2,000)				
Purchase Price	\$ 20	Distribution	\$ 1.40	\$ 140.00	\$ 1.47	\$ 147.00	\$ 1.54	\$ 154.40
Annual Distribution	\$ 1.40	Tax Deferred Income (Tax Shield)	\$ 1.26	\$ 126.00	\$ 1.32	\$ 132.30	\$ 1.39	\$ 138.90
Yield Assumption	7%	Taxable Income	\$ 0.14	\$ 14.00	\$ 0.15	\$ 15.00	\$ 0.15	\$ 15.00
Distribution Growth Rate	5%	Current Taxes Paid	\$ 0.049	\$ 4.90	\$ 0.051	\$ 5.10	\$ 0.054	\$ 5.40
Personal Tax Rate	35%	Implied Unit Price	\$ 20.00	\$ 2,000	\$ 21.00	\$ 2,100	\$ 22.05	\$ 2,205
Tax Deferral Rate	90%	Cost Basis	\$ 18.74	\$ 1,874	\$ 17.42	\$ 1,742	\$ 16.03	\$ 1,603



MLP Purchase and Sale Mechanics

In the example provided, after three years, the investor's tax basis in the units would be reduced to \$16.03.

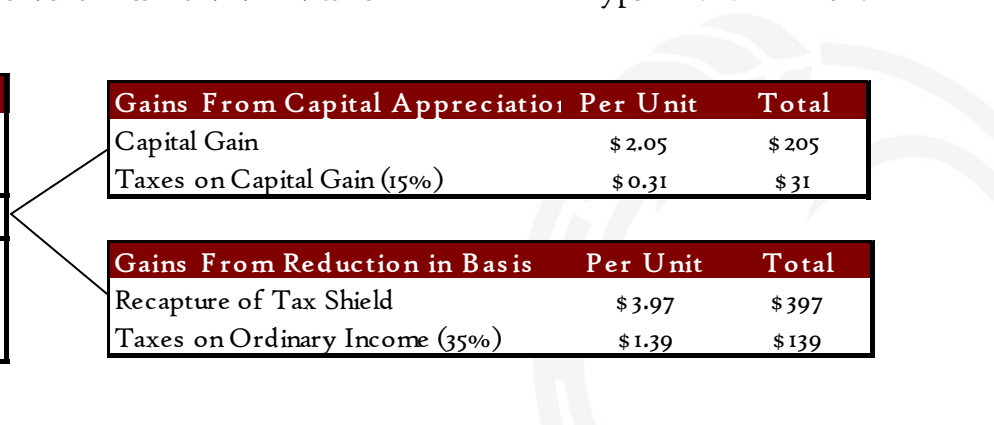
Tax Implications -- Per LP Unit	Year 1	Year 2	Year 3
Original Basis	\$ 20.00	\$ 18.74	\$ 17.42
MINUS: Cash Distributions	\$ 1.40	\$ 1.47	\$ 1.54
PLUS: Taxable Income	\$ 0.14	\$ 0.15	\$ 0.15
Net Reduction in Cost Basis	\$ 1.26	\$ 1.32	\$ 1.39
Adjusted Basis	\$ 18.74	\$ 17.42	\$ 16.03

When the investor sells the units for \$22.05 per unit at the end of year 3, they would realize a total gain of approximately \$6.00 per unit, in addition to having received \$4.41 per unit in cash distributions over the three year period. This includes a capital gain of \$2.05 and ordinary income of about \$4.00 per unit, which represents the recapture of depreciation and amortization deductions. Taxes would total \$1.70 per unit, consisting of \$0.31 in capital gains tax and \$1.39 of ordinary income. On 100 units, this would be roughly \$170. On a \$2,000 investment over three years, an investor would earn a gross profit of \$205 from the sale of the security, pay taxes on allocable net income over three years of \$15.40, and pay long-term capital gains and ordinary income taxes totaling \$170 at the time of sale. This represents an internal rate of return (IRR) of approximately 8.2%. This is an illustrative example only, and is not intended to demonstrate actual or typical MLP returns.

Year 3 Tax Consequences	Per Unit	Total
Proceeds From Sale	\$ 22.05	\$ 2,205
Cost Basis	\$ 16.03	\$ 1,603
Pretax Gain On Sale	\$ 6.02	\$ 602
Pretax IRR		11.20%
After-Tax Gain On Sale	\$ 4.32	\$ 432
After-Tax IRR		8.20%

Gains From Capital Appreciation	Per Unit	Total
Capital Gain	\$ 2.05	\$ 205
Taxes on Capital Gain (15%)	\$ 0.31	\$ 31

Gains From Reduction in Basis	Per Unit	Total
Recapture of Tax Shield	\$ 3.97	\$ 397
Taxes on Ordinary Income (35%)	\$ 1.39	\$ 139



What is the K-1 Statement?

- The Form K-1 that an MLP investor receives each year shows the investor's share of the partnership's income, gain, loss, deductions, and credits.
- The Form K-1 is typically distributed in February and is similar to a Form 1099 issued by a corporation.
- The investor pays tax on the portion of net income allocated to them (which is shielded by losses, deductions, and credits) at their individual ordinary income tax rate.
- Typically, the Form K-1 statement is generated allocating partnership income and loss items to each State in which the partnership has operations. Investors are required to file income tax returns in each of these States, even if they do not have other sources of income from these States.

- MLPs are typically owned by retail investors supported through major brokerage channels.
 - 75% retail investors
 - 25% institutions

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