Tortoise QuickTake Podcast

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Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, a senior member of Tortoise provides a timely update on trending topics in the market.

Hello. I am Tortoise Managing Director and Portfolio Manager Brian Kessens with this week's QuickTake podcast.

Last week we experienced the third week in a row of petroleum draws. Crude oil inventories were 4.7 million barrels lower and product draws were 6.5 million barrels, all helping drive crude oil prices higher midweek. Specifically, imports from Saudi Arabia were 524 thousand barrels per day, their lowest weekly average in seven years. At the May 25th OPEC meeting, the Kingdom indicated exports to the U.S. would decline this summer – nice to see the data back it up. Fundamentally then, inventory numbers are moving in the right direction. The rig count has more or less stabilized, falling two last week, one oil rig and one natural gas. Late in the week though, crude oil faded after reports that OPEC production increased in July. Higher output from Libya and Nigeria, two countries exempt from OPEC's production agreement, being the root cause. For the week, crude oil was down 2%.

Natural gas prices were higher by 3.3% as a build of 28 Bcf was below expectations for a 34 Bcf build.

Energy stocks followed crude oil lower. Broader energy fell one half of one percent and MLPs were off 2 percent.

Now to company news - two energy heavyweights reported last week, Kinder Morgan and Schlumberger.

Kinder Morgan announced earnings in-line. Bigger takeaways were proposed expansions to its El Paso Natural Gas system and a new build pipeline to south Texas. Both indicate the need for more natural gas takeaway from the Permian Basin. Until the new capacity comes on-line, expect basis differentials between west and east Texas to expand. Regarding shareholder returns, KMI surprised by providing future dividend guidance. The company indicated 60% dividend growth in 2018, with 25% growth in each of 2019 and 2020. Icing on the cake is a $2 billion share buyback program over that same three-year period.

Schlumberger had a slight EPS beat, noting strength in pressure pumping and directional drilling – longer laterals and higher intensity completions helping. International markets also experienced sequential growth. Recall, the company said last quarter that it expected the first quarter to be a trough internationally.

Schlumberger also indicated a significant reduction in shale activity was unlikely at current prices. Their hydraulic fracturing calendar is already fully booked well into the fourth quarter.

Bigger picture, management reiterated a takeaway from last week's podcast related to the need for more crude oil production from others beyond shale due to the cumulative loss in production from the decline curve, saying "the longer the current underinvestment carries on, the more severe the cliff-like decline trend will likely be when producers run out of short-term options to maintain production."

In regulatory news, the Atlantic Coast Pipeline, owned by four energy companies led by Dominion Energy, received its Final Environmental Impact Statement from the FERC. Expected in-service is in late 2019 as it moves 1.5 Bcf/d of natural gas from West Virginia to southeast delivery points, helping Marcellus producers in southwest Pennsylvania and West Virginia.

In midstream M&A, one announcement last week as Tesoro Logistics offered to acquire Tesoro affiliate Western Refining Logistics in an all-stock offering. We think this is an important step in a simplification, including IDRs, of Tesoro Logistics.

In capital markets, one midstream deal priced last week, as $700 million of secondary units of Western Gas Partners were sold at a 6.4% discount. The healthy discount indicates appetite for new equity raised through traditional means remains weak.

Finally, the only notable announcement of its kind last week in the MLP sector was BP's announcement that it is evaluating an IPO of its vast midstream business that moves products through 3,500 miles of pipelines in the U.S. If BP goes this route, it would join Shell among the large integrated oil companies to form MLPs around their midstream business. Rationale for forming an MLP includes another source to raise capital while keeping control of the underlying assets.

To sum the events of last week, fundamentals in energy are improving. Petroleum inventories are declining, shale activity is driving production growth across natural gas and crude oil, and despite fickle capital markets for MLPs, sophisticated companies are finding merit in the structure.

This week, earnings continue in a much bigger way. And there is an OPEC plus Russia meeting in St. Petersburg on Monday and Tuesday. Expect to hear rhetoric jawboning crude oil higher, though we expect no official change in policy as its likely too early to amend the current agreement.

Until next week, stay cool out there.

Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at info@tortoiseinvest.com.

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