Tortoise QuickTake
Energy Podcast

April 15, 2019

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

Hello I am Matt Sallee, Energy Portfolio Manager at Tortoise. Happy tax day everybody! Just kidding, actually there is nothing happy about it. However, to cheer us up I'm going to start with some tax jokes.

1) Tax Day is the day that ordinary Americans send their money to Washington, D.C., and wealthy Americans send their money to the Cayman Islands. (Jimmy Kimmel)

2) People who struggle with their income tax can be divided into two categories: Men and women. (Unknown)

3) Worried about an IRS audit? Avoid what's called a red flag. That's something the IRS always looks for. For example, say you have some money left in your bank account after paying taxes. That's a red flag. (Jay Leno)

Anyway….Moving to energy. Chevron stole the show last week with their $50 billion acquisition of Anadarko announced Friday morning. The deal valued APC at 6.6x EBITDA and represents a 39% premium to their prior close. In our view, the deal highlights the value of the Permian basin, LNG capacity and midstream connectivity. The news got the entire space moving with most Permian E&Ps gaining several percent as the market asked "who's next?" I'm not going to name names, but our expectation is their will be additional deals as the majors, including Exxon, Oxy and Shell are looking to expand shale asset footprints. We expect they will be looking at independents with a large Permian footprint that ideally offsets existing acreage.

Another big industry event last week was the Enterprise Products investor day. I'll hit some key takeaways and interesting tidbits but first who is Enterprise?

Well, first off, they're one of our largest portfolio holdings with $7 billion in cash flow last year and enterprise value of $90 billion. They are the self-proclaimed "Amazon of energy" and why is that? They don't produce anything but they handle all the production and they have a world-class distribution system that takes it to consumers. By the way, using the numbers I just referenced, Enterprise has an enterprise value to EBITDA of 12.9x. Compare this to Amazon who trades at 32.9x EBITDA. For fun, if EPD were a tech company and closes that 20 turn discount, the implied stock price would be $93 or triple the current value….I'm just saying.

Believe it or not, I did get more out of the investor day than just my new EPD price target. The key fundamental takeaways are their big cash flow tailwind from numerous projects put in service in 2018 and ramping throughout 2019 plus several more large scale projects entering service in 2019. Some of the noteworthy projects in this list include one new crude and one new NGL line out of the Permian, a pipe being converted from NGL to crude service, several processing plants, one PDH unit and one IBDH unit. If you're wondering what the heck a PDH and IDBH are, look around your office and chances are there are dozens of objects within reach that are, at least partially, made from the materials produced by these plants. If you want to see the full names of these facilities you can reference the transcript but I'm not trying to pronounce them publically [PDH: propane dehydrogenation; IBDH: isobutane dehydrogenation].

These and many other current projects drive visible growth for the next few years and beyond that the company has another >$5 billion of investment under evaluation. Importantly the company can fund these projects without issuing new shares so it accretive to cash flow per unit. For 2019 the plan is to take this cash flow growth and build coverage while maintaining 2% distribution growth. But in early 2020 the company will revisit its growth rate and we think will increase it to around 4-6%. They also updated the market and how they are viewing their $2 billion stock buyback program. I was little disappointed with their color that it will only be used opportunistically in the case of price dislocation similar to what we saw in Q418. As expected on the structure question, the company largely dismissed the idea on converting to a c-corp. I can't blame them, why convert and have a future tax liability even if you aren't paying the in near term. Also who knows if corporate rates will remain at the new, lower level for the long term. And finally if you want to covert to attract “the generalist investor” look no further. EPD already counts Blackrock, T-Rowe and Fidelity among some of its investors.

On the macro side, EPD’s fundamentals group gave a thorough energy value chain update. Highlights include a projected 35–50 years of drilling inventory in the Permian making it one of the key supply growth source for the world in the future. And according to the company we’re going to need it. India and China currently consume about 10 and 30%, respectively of the energy compared to the U.S. on a per capital basis. As those countries urbanize and develop they will almost certainly require vast increases in energy. For perspective since 2000, non OECD Asia’s energy demand has increased about 80%.

They are particularly bullish on ethylene and propylene which are the key building blocks used in a large portion manufactured goods you see around your house, car, office, etc. In fact the IEA projects demand for plastics to double over the next 20 years. Not a bad outlook for EPD and U.S. energy in general.

I’ll leave it there for now, thanks for listening.

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@tortoiseadvisors.com.

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