Tortoise QuickTake Energy Podcast

Tortoise

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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 Tortoise Managing Director and Portfolio Manager Brian Kessens with this week's QuickTake podcast. During a heavy week of earnings reports last week, energy performance was mixed. MLPs improved a tenth of one percent and broad energy fell just less than half of one percent. Crude oil prices were range-bound, helped by inventories falling nearly 11 million barrels in the U.S. and continued tensions in the Strait of Hormuz, offsetting Saudi Arabia and Kuwait discussing plans to restart some shared production in a neutral zone between the two countries. Producers did feel some pressure last week, off 3.2%, though services were higher by 1.2%. Part of the move to the downside for producers was natural gas prices hitting a year-to-date low due to a mild weather forecast, Kinder Morgan's 2.0 Bcf/d Gulf Coast Express pipeline set to come on-line as early as September, and elevated levels of gas storage in Europe. Yes, with the growth in U.S. LNG, gas is becoming a global market like crude oil.

Looking at earnings and beginning with upstream, on Monday, service provider Halliburton, provided earnings results ahead of consensus led by its completion and production segment. On the forward look, Halliburton indicated U.S. activity and pricing is likely to go lower, with international ticking higher. Strategically, the company delivered a tight message on capital discipline, suggesting lower capital expenditure in 2020 and emphasizing a singular focus on returns to capital over increasingly taking market share.

The largest natural gas producers in the northeast reported second quarter results that were solid, yet the forward look led to stock price weakness. At EQT, the new management team led by Toby Rice indicated production growth is unlikely in a $2.50/mmbtu gas environment versus prior plans for 5% growth. Further, management noted a commitment to staying highly disciplined on capital allocation and driving more drilling efficiencies. Cabot Oil and Gas provided 2020 production growth of 5%, lower than expectations, and noted they may curtail production if natural gas prices continue to fall. Cabot also remains focused on returning cash to shareholders, being one of the few producers in a position to buy back shares.

In midstream, another IDR elimination last week. Phillips 66 Partners or PSXP announced it is buying its IDRs from parent company Phillips 66 in exchange for LP units. The implied multiple on the exchange is in-line with precedent transactions at 16 times cash flow. This is an IDR elimination we expected this year, though the timing with the second quarter earnings release was sooner than we expected. In addition, the company modestly beat expectations due to higher liquids throughput volumes. Expect this organic growth to continue with the opportunity for future dropdowns of more midstream assets as the parent remains committed to selling all of its midstream assets to PSXP over time.

Staying with midstream, the EPIC crude oil pipeline, transporting volumes from the Permian to the Gulf Coast, began operation last week by taking crude oil for line-fill. Expect to see some immediate improvement in the Midland crude oil price versus other hubs.

Moving to downstream, refining bellwether, Valero Energy reported earnings better than expectations driven by both strong refining throughput and operating margins. Generally, U.S. refineries have been maximizing domestic light sweet crude oils to capture favorable Brent-WTI differentials. Valero also refined over 190 mbpd of Canadian heavy crude oils, a record. As more debottlenecking continues, that number is likely to increase as heavy crudes from Venezuela and Mexico decline. In the second quarter, Valero also repurchased over $200 million in stock. Including dividends, the company returned nearly $600 million to shareholders in the quarter. With IMO 2020 ahead and ample crude oil supply, visibility into continued cash returns to shareholders remains.

The largest utility and leading renewable developer, NextEra Energy, reported in-line results and reiterated EPS guidance of 6%-8% through 2022. Notably, the company added 1.9 GWs of new solar and wind power since last quarter. The current backlog stands at 11.7 GWs, providing significant visibility into new build activity over the next 18 months.

What to take away from last week? Second quarter results were mostly in-line to the better. The forward guidance largely drove stock price performance, either to the positive as we saw for the oilfield service sector or the negative as we witnessed for Northeast producers. Regarding that guidance, for both it was consistent. We heard companies accelerate their focus toward capital returns, and less toward growth. This reset in some growth expectations we think is healthy for stocks over the longer run as supply and demand will be in better balance, leading to an improved commodity backdrop. We think it's also important energy companies generate a compelling free cash flow yield to ease comparisons to other industries. This returns- focus emphasizes the free cash flow – a good thing.

This week is another big reporting week for second quarter earnings, only with less focus on the large caps, and more focus on the small- to mid-caps and crude oil producers. We'll be looking for a continued shift to more returns focus from a growth emphasis. 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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