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 Rob Thummel with this week's Tortoise QuickTake podcast.

Last week the U.S. unemployment rate fell to a 50-year low; however, this positive was offset by the lowest monthly U.S. manufacturing activity in more than a decade. The net result was a decline in the S&P 500 of one third of one percent. Energy stocks as represented by the S&P 500 Energy Select Sector Index fell by almost 4% as oil prices declined due to the weak manufacturing data and the return of Saudi oil production. U.S. oil prices ended the week approximately 4% lower than the closing price on Friday September 13th, which was the day before the attack on the Saudi oil facilities. MLPs, as represented by the Tortoise MLP Index declined by 0.8%.

There were a two pieces of news last week that I want to go into more depth about. First, the EIA updated its International Energy Outlook for 2019. One of the core themes in our Teal Energy Deal white paper released earlier this month is electrification drives global energy demand growth The EIA reports supports our views on electrification. What is electrification? At Tortoise, electrification means the increased use of electric power. In fact, the International Energy Outlook forecasts electricity demand to double between 2016 and 2050. Do you know that over one billion people in the world don't have access to electricity today? That is changing and will boost electricity demand. In addition, accelerated adoption of electric vehicles and a larger middle class will increase global electricity demand. The other critical data point from International Energy Outlook is the transition that is expected in the global supply sources to generate electricity. Today, coal remains the largest source representing 35% of the global electricity supply source. Natural gas supplies 23% of global electricity generated while combined wind and solar represent 10%. You fast forward five years - wind and solar are forecasted to increase market share supplying 16% of global electricity generated while natural gas maintains its market share. Keep in mind that the global electricity market is growing, so solar and wind are increasing market share in an increasing market. It's kind of like my kids adding syrup to their chocolate chip pancakes it gets even sweeter. Longer term, coal remains in the global supply mix representing 22% of global energy supply by 2050 according to the EIA. In our opinion, lower carbon supply sources like natural gas and renewables must displace coal now to reduce carbon dioxide emissions.

As the world transitions to greener forms of electricity generation, several utilities are transforming beyond the traditional utility model. Let me give you an example. Ten years ago, Florida Power and Light generated a majority of its EBITDA as a rate-regulated utility providing electricity to customers in Florida. In 2010, Florida Power and Light changed its name to NextEra Energy. Today, NextEra is the world's largest generator of wind and solar power with regulated and unregulated assets in 22 states. NextEra successfully transitioned from a traditional utility into a dynamic, forward-looking energy provider. Shareholders serenade NextEra's CEO with the lyrics from a popular 1980's Styx song saying domo arigato Mr. Robo as NextEra CEO Jim Robo has rewarded shareholders with returns of approximately 20% per year over the last ten years supported by annualized EPS growth of 7.5% and dividend growth of 9.5% per year. In 2014, NextEra created NextEra Energy Partners or NEP as a growth-oriented limited partnership. NEP owns and operates wind and solar projects as well as natural gas infrastructure assets. Last week, NEP announced an agreement to acquire a critical pipeline that transports natural gas from the Marcellus to the mid-Atlantic and Southeastern regions of the U.S. The purchase prices was $1.37 billion. On the conference call discussing this transaction NextEra CEO Robo stated that he views gas pipelines as clean energy and natural gas as an important bridge fuel to a low or zero carbon future. Mr. Robo's comments have us singing domo arigato around Tortoise as well as Mr. Robo's view aligns perfectly with our vision of a low cost, low carbon future.

The second piece of news from last week that I wanted to provide some in depth analysis on relates to Permian Basin producer Diamondback Energy announcing the departure of its Chief Operating Officer. On the surface, it doesn't sound like a big deal. However, some analysts speculated that a pending sale of Diamondback to an integrated oil producer like Exxon might have been the reason for the departure. To be clear, nothing has happened on this front but I wanted to

highlight the challenge that Exxon and other integrated oil company faces right now in acquiring a potential target. Exxon currently trades at a 6.7 times enterprise value to EBITDA while several high quality Permian oil producers trade at 4.5 times enterprise value to EBITDA. A spreadsheet would tell you that a higher multiple company could purchase the lower multiple company and pay a premium. This is true but the challenge comes from a potential increase in debt ratios associated with a transaction. Investors prefer integrated oil and gas producers like Exxon and other oil and gas producers to keep debt levels low. Exxon's current debt balance is approximately the same as its EBITDA so a 1.0 debt-to -EBITDA ratio. Most publicly-traded oil and gas producers have debt to EBITDA ratios above 1.0x. To acquire another publicly-traded oil and gas producer today, cash rather than stock needs to be the most significant source of consideration paid to the target. Higher cash consideration requires an acquirer like Exxon to increase its debt to make an acquisition. This is not just a theory. Let me give you a recent example Earlier this year, Occidental Petroleum paid a 62% premium to acquire Anadarko Petroleum. Occidental's consideration to Anadarko shareholders was 78% cash and 22% stock. In addition, Anadarko's ratio of total debt-to-EBITDA was higher than Occidental's metrics. In fact, Occidental's debt-to-EBITDA rose from around 1.2 times at the beginning of the year to 2.7 times today even after considering asset sales. As a result, Occidental has been one of the worst performers in the S&P energy sector this year and 484 out of 500 stocks in the S&P 500 have outperformed Occidental. Of course, there are always a lot of factors to consider when evaluating an acquisition and timing but given the current environment it does not appear that a large integrated oil and gas producer like Exxon or Chevron will be going on a buying spree anytime soon.

Those are the highlights from last week. Thanks for listening. We will talk to you next

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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The **PCE inflation rate** is the Personal Consumption Expenditures Price Index. It measures price changes for household goods and services. Increases in the PCEPI warn of inflation while decreases indicate deflation.

Broad Energy = The S&P Energy Select Sector® Index is a capitalization-weighted index of S&P 500® Index companies in the energy sector involved in the development or production of energy products.

Producers = Tortoise North American Oil & Gas Producers Index℠
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MLPs = The Tortoise MLP Index® is a float-adjusted, capitalization weighted index of energy master limited partnerships (MLPs). The index is comprised of publicly traded companies organized in the form of limited partnerships or limited liability companies engaged in transportation, production, processing and/or storage of energy commodities.

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