Tortoise Energy Podcast

Tortoise

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

Good to be with you today, I am Quinn Kiley, Managing Director and Energy Portfolio Manager at Tortoise. Last week was a roller coaster week for global markets reacting to coronavirus news and for domestic politics with the vote on impeachment, the State of the Union address and the Iowa caucuses. We saw the expected impeachment outcome, but the delayed caucus results and the President handing out prizes to guests during his speech felt unprecedented. On coronavirus, markets may have finally capitulated as returns were positive for the week with the S&P 500 up 3.8%.

We are still in the thick of earnings season, but we'll start things off with some highlights about broader market performance for the last week:

• On the commodity front, crude oil hit 52-week lows, briefly dipping below $50 per barrel on its way to losing 2.4% for the week. Inventories built by 3.4mm bbls, compared to an expectation of a 3.0mmbbls build. This theme of 52-week lows will be repeated during our discussion of energy market performance.

• Natural gas prices remain below $2 per thousand cubic feet and hit multi-year lows before ending the week up 1.1% after withdrawals from storage were slightly higher than expected.

• Looking at equities, two measures of energy sector performance in the S&P 500, the ETF XLE hit 52-week lows and another ETF, the XOP, focused more on oil and gas producers, hit all-time lows. However both rallied to post gains of 1.2% and 0.3% for the week.

• Utilities, per the Philadelphia Utility Index, lost 0.3%

• And finally MLPs moved lower, faring worse than other energy sectors as the Tortoise MLP Index® declined -0.5% during the week.

The single biggest mover of the markets recently has been the coronavirus scare, now officially an epidemic according to the World Health Organization. An epidemic in the world's second largest economy and largest population base sounds scary, and the recent risk off reaction in the market reflects that. Many have tried to compare the outbreak with the SARS outbreak in 2003. Last week the global number of deaths from coronavirus exceeded the death total for SARS. Chinese markets reopened last week after being closed for the lunar new year holidays, and abruptly shed 9% but climbed a wall of worry to end the week down only 3.4%. In response Chinese and other central banks flooded the market with liquidity, which buoyed global markets. The outbreak has raised crude oil demand concerns, and rightfully so as travel has been impacted globally. We think the impacts are short-lived and the market is ignoring some positive balancing items in the global supply and demand picture. Specifically, almost one million barrels a day of production are offline in Libya. This is part of major escalation in their civil war and the production could be out of the market for some time. Talks are ongoing, but the outcome and timing remain uncertain. Additionally, OPEC+, a group of nine countries, had impromptu emergency meetings last week to discuss their efforts to put a floor on global crude oil prices. The outcome of the meetings was a recommendation for short-term production cut of 600,000 barrels per day of production through June. The epidemic has caused price impacts on natural gas as well. Liquefied natural gas prices in Asia have fallen 30% since January 15th. The Trump administration has acknowledged that the coronavirus outbreak will likely delay China's ability to fulfill its commitment to purchase exports from the U.S., including crude oil and LNG. In response to this, China has lowered tariffs on goods. The impact should be minimal as the tariffs on crude oil were 5%, now 2.5%, and the 25% tariffs on LNG were not mentioned. The good news is that the spread of the virus has slowed in China, perhaps due the government's containment efforts.

The impact on energy equities from the virus outbreak was highlighted in this podcast last week by fellow portfolio manager James Mick. At about the same time the podcast was being recorded, Jim Cramer from CNBC said he was "done with fossil

fuels." He discussed the ESG movement, expected a long-term trend of divestment, and compared energy stocks to big tobacco. We agree whole-heartedly that companies must adopt ESG principals in their business strategies, and our team advocates for that in our meetings with management teams on an almost daily basis. While there is no tangible benefit to the world from tobacco, we think there is great value in abundant and cheap, clean energy. While some might argue that like tobacco, the world is addicted to fossil fuels; we see fossil fuels, especially natural gas, as essential to modern daily life. Low cost energy is the single biggest driver of bringing people out of poverty. In a far-off future, renewables will be the majority source of electricity, but even then, crude oil for transportation and manufacturing of goods and natural gas for electricity and heating will be major components of our energy consumption according the Department of Energy's Annual Energy Outlook for 2020. In that renewable future, the EIA projects crude oil and natural gas consumption to be at or higher than today's levels at the expense of coal and nuclear. The contrast is stark between tobacco and energy, which is used by a shrinking minority of the population, and energy which is used by the vast majority of the population and demand is growing. However, we note that our colleagues at Wells Fargo also noted the comparison of energy to tobacco in a December 8th note last year. In that piece they advocated for "Midstream [to] adopt the strategy of the tobacco industry, which includes a high payout model of yield plus dividend growth plus buybacks. The tobacco industry has been one of the best performing segments of the market for close to 20 years. Since 1999, tobacco has generated total return of 946% compared to 278% for the S&P 500." On the returns front we hope Jim Cramer is correct, but we know he is wrong about discarding the essential nature of energy in our modern future.

Moving on to a busy earnings period, at a high level we have seen most companies beat or meet expectations, although outside of midstream there have been some big misses for the integrated oil and refinery names. In midstream we have also received most of the company distribution announcements with fourth quarter payouts modestly higher than third quarter and generally growing at a 4% annual pace. Now we'll cover some company specific news that caught our eye.

Plains All American Pipeline, ticker PAA, announced earnings last week. Plains was a subject of interest across midstream as it was viewed as the name most exposed to risk of an over build of pipeline takeaway capacity from the Permian basin. Fourth quarter earnings were notable as they beat consensus estimates in all three of their business segments. Predictably the company was questioned about share buybacks but reiterated their priorities of safely and efficiently executing for their clients and keeping leverage below target. Share buybacks have not been a priority and with leverage expected to be higher in 2020, any perceived impact from buybacks may be delayed.

In related news, Plains, along with partners Western Midstream Partners, ticker WES, and Magellan Midstream Partners, ticker MMP, announced the sale of 20% of their Saddlehorn Pipeline. Saddlehorn carries crude oil from the DJ basin in northern Colorado to the West Texas Intermediate crude oil pricing hub in Cushing, OK. Noble Midstream, ticker NBLX, and private equity-backed Greenfield Midstream were the buyers. This is yet another example of markets seeing value in midstream assets and the ability of midstream companies to raise capital despite the weak equity markets for energy. The sale helps the partners fund the expansion of Saddlehorn, which should be operational later this year. This is also part of Plains efforts to optimize their asset portfolio. On their earnings call, they announced a $300mm acquisition of a gathering system in the Permian basin and the intent to sell $600mm more of assets during 2020.

Another liquids-oriented MLP, NuStar Energy, ticker NS, reported earnings last week as well. Similar to Plains, NuStar beat across its business segments. A common thread here is that despite concerns about an over build of midstream capacity in the Permian, volume growth remains robust and unlike other basins around the country drilling activity remains strong. As with other commodities, we must wait and see if an extended coronavirus pandemic reduces global demand and pushes prices to levels that delay consumption, which would be negative for volumes.

On the utility side of energy infrastructure, we saw more asset sale activity. Last week CenterPoint Energy, ticker CNP, announced the sale of the utility services business it acquired as part of its acquisition in 2018 of the gas utility Vectren. The deal is another example of a company simplifying its story to investors. The sale also reduces the need to raise equity, which

partially addresses credit agency concerns following an unfavorable rate case in Texas last year. We view the outcome as favorable, but it is likely that rating agencies must weigh in before the market is comfortable with CNP's outlook.

Staying with natural gas, prices remain weak and natural gas producers remain under pressure. The latest company reaction to this was the recent announcement by Cabot Oil & Gas, ticker COG, that they were transitioning into maintenance mode with their capital expenditure plans. This means they will spend only the capital needed to maintain natural gas production levels, in other words a no growth scenario. This announcement is the realization of investors' concerns about natural gas producers in a low-price enviornment. Last year this concern rolled into midstream companies with exposure to lower production outlooks, specifically in the northeast. The largest gatherers of gas in the northeast, the Williams Companies, ticker WMB, and MPLX are potentially impacted by Cabot's decision. There is a risk that additional reduced spending announcements by natural gas producers could negatively impact the earnings of these midstream companies. This outcome would require natural gas prices to remain on a lower trajectory and the situation is worth monitoring. In related news, Standard & Poor's credit rating agency downgraded six northeast gas producers, further highlighting the need for capital discipline among the group.

One issue that has impeded midstream execution over the past few years has been local regulatory delays on essential infrastructure projects across the country. One such delay has been Minnesota's review of Enbridge's Line 3 replacement. Enbridge's ticker is ENB. The Line 3 pipeline carries crude oil from Hardisty, Alberta to Superior, WI. The project aims to replace over 1,000 miles of existing pipeline with a new state of the art system, which will improve the safety of the existing system and expand its capabilities. Minnesota regulators had delayed the project on several grounds. Three necessary approvals were finally granted last week and while the outcome was expected, the length of any costly delays remains unknown as we expect further challenges to the project. For perspective, this replacement plan was first announced in 2014, initially approved in 2018, and currently Citigroup thinks the project comes on line in 2022. We think the logic of replacing an aging, riskier pipeline with a new, safer system makes sense from an environmental and safety perspective, and overtime that will have economic benefits to Enbridge and the communities they serve.

On the regulatory front, it is also worth monitoring the progress of the Democratic Party nominating process. As the candidates move from Iowa to New Hampshire, we will be watching with interest as the energy industry and tax policy will be topics of discussion and both could impact our portfolios. Rhetoric around banning drilling on federal lands or an outright ban of hydraulic fracturing could drive volatility. Our view remains rooted in our Teal Energy Deal which expects that the continued electrification of the global economy will drive energy demand higher, the need to reduce greenhouse gas emissions worldwide will be achieved by shifting towards natural gas and renewables and the important role the U.S. can play exporting low-cost energy to the rest of the world.

With that, we thank you for your interest and look forward to speaking with you again soon.

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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