Tortoise Energy Podcast

March 2, 2020

Welcome to the Tortoise 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.

Bernie, PMI, coronavirus were all being hurled around as investors looked for answers as the global markets plunged. One four letter word best describes investor's emotions last week and that was fear. No market was immune to the sell-off. In the U.S., the NASDAQ, Dow and S&P 500 indices all declined 11-12%. In Europe, indices representing the largest companies in the Eurozone as well as the largest companies trading on the London Stock Exchange fell by 11-12% as well. Across the world, the best performing indices were in Asia as the Hang Seng and CSI 300 falling 4% and 5%, respectively. The Hang Seng is a market cap weight index based on the 50 largest companies traded on the Hong Kong stock exchange while the CSI 300 is a market cap weighted index that replicates the performance of the top 300 stocks traded on the Shanghai and Shenzhen stock exchanges. Across the energy sector, global utilities as represented by the MSCI World Utilities Sector Index declined by 10% and the energy infrastructure sector as represented by the Alerian Midstream Energy Index fell by 11% last week.

Investor fears center on the global financial impact of the coronavirus. We recognize that there is still a lot of uncertainty surrounding the impact of the virus. My fellow portfolio managers James Mick and Brian Kessens shared our latest thoughts on this topic in a special podcast titled *Update on Recent Market Volatility*. The entire podcast is on our website but the three main takeaways are the following: First, global energy demand has growth in 37 of the last 38 years in spite of previous health concerns surrounding SARS, MERS, Zika and Ebola. Second, in answering the question as to how long the coronavirus will last, research by Evercore-ISI suggests that the number of cases in China might have peaked in mid-February. Of course, new cases across the world are adding to investor fear. Third, midstream cash flows are resilient. We acknowledge that the virus could spread in the U.S. We do not know if U.S. energy demand will be impacted. What we do know is that during the 2008/2009 financial crisis when economic activity slowed for months, the energy infrastructure companies that we invest in experienced less than a 5% decline in volumes.

With fear comes opportunity and several companies that reported fourth quarter earnings last week laid out paths that we think are clear opportunities for investors.

First, Cheniere Energy, the largest pure-play U.S. LNG provider, reported better than expected fourth quarter results. Cheniere acknowledged that two of 40 cargoes scheduled for April had been cancelled due to low global natural gas prices. However, the company reiterated 2020 expected guidance in which consensus EBITDA is forecasted to grow by 30%. While you will continue to read headlines about collapsing LNG prices in Asia and Europe and U.S. LNG project delays and cancellations, we think Cheniere's existing LNG assets provides Cheniere with a first mover advantage. In addition, Cheniere's highly contracted cash flows (around 85%) reduces its exposure to short-term price swings setting Cheniere apart from other companies that operate in the global LNG industry.

Second, ONEOK Inc. reported solid fourth quarter results. More importantly, the company provided preliminary 2021 EBITDA guidance that forecasts 20% growth. If achieved, this would be over 20% growth in EBITDA in both 2020 and 2021 for one of the largest energy infrastructure companies in the U.S. Not only is the cash flow growth a positive but the impact of the growth projects is important as well. In my opinion, flaring that burns natural gas in open air is the most important environmental challenge for the oil and gas industry. ONEOK is making an impact by adding energy infrastructure that permanently reduces flaring in North Dakota. This is one of the reasons that ONEOK has received an A MSCI ESG rating.

The last significant news from last week came from Equitrans Midstream Corporation. Equitrans is one of the largest natural gas gatherers in the U.S. with a premier asset footprint in the Marcellus Shale. Equitrans announced what management described as transformative actions. These actions included the following: Equitrans acquiring EQM

Midstream Partners, a 67% reduction in the Equitrans dividend, and a new gas gathering agreement with its largest customer EQT.

Lots to digest so let's look at these individually. Why is Equitrans acquiring EQM Midstream Partners? Equitrans is formed as a corporation that plans to acquire the units of the MLP EQM Midstream. This transaction is aligned with a simplification trend that is happening in the midstream sector. As a corporation, Equitrans will have an enhanced corporate governance and potentially attract a larger investor base.

So why is the dividend being reduced? Equitrans is reducing its dividend to $0.15 per share – a 67% reduction. The dividend reduction is necessary to reduce leverage. Equitrans assets remain essential and its cash flows remain steady. However, in 2014 Equitrans began the process of constructing the 330-mile Mountain Valley Pipeline. The pipeline has experienced significant regulatory delays and cost overruns. As a result, Equitran's debt ratios have increased as the project has been financed with debt with no corresponding EBITDA contribution. By reducing its dividend, Equitrans can reallocate cash flow towards reducing debt with a goal of achieving a debt-to-EBITDA ratio of 4.0x by the end of 2021.

Why is a new 15-year gas gathering agreement relevant? The new agreement is between Equitrans and its largest customer EQT – the largest natural gas producer in the U.S. The agreement is important because Equitrans and EQT have been discussing it with investors for more than a year so the announcement removes uncertainty. The agreement improves EQT's operating margins as a lower gathering fee reduces operating costs. The new gathering agreement commences as soon as the Mountain Valley Pipeline is in-service which is expected to be the beginning of 2021. Equitrans recoups some of its lost revenue from the lower gathering fee from a new 5-year water services agreement with EQT as well as additional cash payments if natural gas prices exceed certain thresholds.

What is Tortoise's view on this announcement? Last week, we released the Tortoise Midstream Playbook on our website. This action aligns with our Playbook that suggests management teams re-allocate capital in order to reduce leverage if yield on equity chronically exceeds 10-15%.

If you are interested, the Tortoise Playbook can be found on our website here.

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

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.

The S&P 500® Index is a market-value weighted index of equity securities.

The Hang Seng Index is a freefloat-adjusted market-capitalization-weighted stock-market index in Hong Kong. It is used to record and monitor daily changes of the largest companies of the Hong Kong stock market and is the main indicator of the overall market performance in Hong Kong.

The CSI 300 is a capitalization-weighted stock market index designed to replicate the performance of top 300 stocks traded in the Shanghai and Shenzhen stock exchanges.

The MSCI World Utilities Index is designed to capture the large and mid cap segments across 23 Developed Markets (DM) countries. All securities in the index are classified in the Utilities sector as per the Global Industry Classification Standard (GICS®)

Alerian Midstream Energy Index is the capped, float-adjusted, capitalization-weighted index, whose constituents earn the majority of their cash flow from midstream activities involving energy commodities, is disseminated real-time on a price-return basis (AMNA) and on a total-return basis (AMNAX).

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