Tortoise Energy Podcast

March 16, 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 Brian Kessens with this week's QuickTake podcast. The energy markets were brutal last week, sparing no one. What started off as a surprise move last weekend by Saudi Arabia to pump more oil supply into a market already facing demand challenges due to the coronavirus, was amplified by fears of the impact the coronavirus will have, short and long-term, across global economies. Sports, school, and work from the office carried on during World Wars, yet now we find ourselves without them.

To the numbers, on the week, broad energy, crude oil and midstream energy were down between 23% and 29%.

We called all of our company management teams last week to understand impacts. We've been calling for more capital discipline, were starting to see it through lower capex, and now we expect to see lower capex accelerate further. And there were already some announcements last week. ONEOK is a good example. Last week, the company announced a $500 million or 20% reduction in 2020 capex, while maintaining 2020 financial guidance. Management teams indicated any volume declines are likely to emerge in the second half of the year as it takes six to nine months for lower producer activity to show up in supply. On dividends and distributions, the general feeling is no need to reduce and a willingness to see how the market plays out, after all, distribution coverage is healthy. Buying back shares or reducing debt may be better options. As a reminder, buying shares and reducing debt is part of our midstream management team playbook we released a couple of weeks ago.

We also confirmed that liquidity issues are fine, something different than we faced during the 2008/9 financial crisis. Other differences from that period are that leverage is lower, distribution coverage is higher, and midstream companies are self-funding. Looking at our midstream strategies, our portfolio is 90% investment grade, average tenor of debt is 11 years, and the average revolver is less than 10% utilized with an average maturity date of 2023.

We also ran an extreme stress test where crude oil volumes fall by 20% next year. In that scenario, distribution coverage moves to 1.3x from 1.4x and leverage moves from 4.1x to 4.2x. And what about counterparty risk? We estimate midstream counterparty risk is 85% investment grade and 15% high yield. That's based on knowing 60% of counterparties are investment grade, 10% is high yield, and splitting the remaining 30% not published number between the two credits. Needless to say, we feel good about the quality of our portfolios.

As we sift through the downturn for opportunities, specific to crude oil price, there are some midstream assets that become more valuable in a lower price environment. For example, the crude oil price curve was formerly in backwardation (with future prices lower than spot). That quickly reversed and now are in steep contango, with the spot price over $4 lower than the 12 month forward price. Crude oil storage is now more valuable. Following, President Trump even announced that the U.S. government will take advantage of the low oil prices and fill the strategic petroleum reserve (SPR) "right to the top". We estimate the SPR currently has 92 million barrels of additional capacity.

Also, natural gas was in oversupply in 2020 which was weighing on the price. In an environment with lower crude oil drilling, less associated natural gas will be produced which will bring natural gas supply back into balance with demand faster. In fact, natural gas prices moved higher by 9% last week. That's helpful to northeast gas producers and pipeline companies that transport gas. And as a reminder, the majority of our portfolio is natural gas pipelines, which is also consistent with midstream sector indices.

Regarding management team actions, what one thing would you like to see them do in this environment? Buy shares? Well they've been doing so in droves. We calculate 36 midstream insiders bought back $20 million in stock from 14 different companies just last week. YTD, the total is 92 insiders buying over $190 million.

We are confident the coronavirus fears and its impact on overall demand will pass. China is now going back to work. It will be messy in the U.S. for a period, yet that will pass and demand will bounce back. When that occurs, refined product pipelines in particular will benefit from the tailwind of lower oil prices and the positive impact on end user demand.

As an aside, I'd encourage anyone with more questions to go to our website, tortoiseadvisors.com. We consistently posted market commentary there last week, focused on the top questions we're getting and how energy will be affected by the coronavirus. We'll continue to post helpful items there as the pandemic unfolds and markets react.

Finally, midstream valuations stand at about 7 times next year's EBITDA. The index is well, well below, arguably even tougher periods, being during the financial crisis of 2008/9 and the 2016 oil price collapse when oil was $27 per barrel. Midstream companies generate primarily fee-based cash flows from moving energy products. Cash flows really remain resilient through crude oil price swings. When companies proved this and investors realized it following those periods, midstream prices surged higher. 76% higher from March 2009 lows to year-end 2009 and by coincidence, 76% higher from February 2016 lows to year-end 2016. It is now that I'm reminded of my high school English class where I was inspired by Kipling's poem, "If". "If you can keep your head when all about you are losing theirs",…there is a lot of money to be made. That last part is mine. Warren Buffett's idea of a fat pitch has never been clearer to me.

Thanks for listening and for your trust in us.

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.

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.

Crude Oil = West Texas Intermediate (WTI): Light, sweet crude oil commonly referred to as "oil" in the Western world. West Texas Intermediate is the underlying commodity of the New York Mercantile Exchange's oil futures contracts.

Midstream Energy = 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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