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.

Hello. I am Tortoise Managing Director and Senior Portfolio Manager Brian Kessens with this week's QuickTake podcast.

Last week energy claimed the title of best performing sector for the third consecutive week. The economy is slowly creeping back, oil supply and demand balance is improving and during earnings, companies estimated business impacts from COVID-19 better than expectations.

Specifically, broader energy leapt 8.3% last week with midstream improving 4.7%, following broader market strength and better energy sentiment following crude oil's 24% surge to nearly $25 per barrel (though still an ultra-low level). Crude oil sentiment improved for multiple reasons: (1) there are further indications that refined product demand is starting to recover globally given the easing of lockdown restrictions, 23 states have now lifted stay at home orders; Evidence? Gasoline prices rallied 24% last week. (2) The increase in U.S. storage levels slowed to 4.6 million barrels, suggesting storage could fill by the end of June or early July, much later than previous forecasts indicating a mid-May fill. (3) Curtailments, where announcements from U.S. producers now amount to a peak of about 1.5 million bpd in the second quarter. (4) U.S. crude oil exports remain strong at 3.5 million bpd. (5) Saudi Arabia increased its June pricing, and (6) consumers are favoring driving their car to using mass transportation, particularly in China where morning traffic is now higher than 2019 averages and subway use is well below normal. The bottom line is that the market no longer fears crude oil will imminently hit storage tank tops.

Where does that now leave us on oil supply and demand? IHS forecasts second quarter oil demand down 22 million bpd with 14 million bpd of crude oil to be cut or shut-in. That's still a meaningfully gap, yet the trend in both supply and demand is for a continued improvement. We'll look to see how producer shut-ins continue, refinery utilization improves, and if exports remain strong.

Last week was a big week of earnings. What did we learn?

In upstream, the aforementioned shut-ins were a big theme, with companies viewing shut-ins as a way to utilize low cost storage. Many companies announced a frac holiday – fully halting completion activity. That is leading to a build-up of uncompleted well inventory. Generally, management teams indicated they needed to see pricing of $30 to $40 per barrel to recommence completion activity. Companies also continue to cut 2020 capex. EOG Resources is a good barometer for producer actions. EOG's planned capex is down 50% from initial 2020 expectations. EOG sees May as the peak month for production shut-ins as some production is brought back on-line in June. The company also noted that most wells can be brought on-line in a number of days with no damage to reservoirs. Producers are also noting improvements in efficiencies and some ability to lower service costs.

In midstream, capital expenditures continue to fall, and we estimate capex is now 25% lower than original 2020 plans. 2020 earnings guidance offered a wide range, largely depending on the length of the production shut-ins. Full year guidance is now 8% lower on average, with some companies with significant natural gas businesses and / or take or pay contracts, like Enbridge and Williams, reaffirming guidance though Williams at the low end, whereas others with cash flows more tied to wellhead volumes providing a wider range of outcomes. Targa Resources and Plains All American are good examples of the later.

Targa offered a range of EBITDA, $1.4 billion at the low end and $1.625 billion at the high, or 10% lower on average. On shut-ins, the company estimates 10% in the Permian and 20%-40% in the Bakken during May. The low end of their guidance assumes 30% production shut-ins through year-end in the Permian. That feels really conservative. Management expects the actual duration to be a couple of months. Targa also announced it opportunistically repurchased $300 million of debt at a 21% discount during the quarter.

Plains lowered guidance by 6%, assuming shut-ins persist beyond the second quarter with a muted recovery following. That conservatism gave investors confidence in the durability of cash flows. Notably, Plains also raised its supply and logistics expectations by $150 million, reflecting contango market opportunities.

Ratings agencies are not applying pressure following weaker financial outlooks. Recently ratings were reaffirmed for Oneok, Kinder Morgan, Magellan and Cheniere. We think the agencies understand the general stability of cash flows to weather a weak second quarter, believe the capex cuts and some dividend reductions are real tools and have been helpful, and that leverage metrics heading into the crisis were relatively healthy. Finally, companies are also reducing costs, another lever to offset some revenue pressures.

The big midstream takeaway – guidance is not near as poor as feared.

In the broader market, investment grade issuance has been on fire. In the last eight weeks, markets digested an average of $74 billion per week. Last week, brought $92 billion in deals making it the third largest week of U.S. dollar volume on record. Midstream has opportunistically taken advantage of the strength with Oneok, Cheniere, Magellan and Williams (@ their Transco Pipeline level) issuing a combined $5.2 billion last week.

This week, we hit the last stretch of the earnings season, with Saudi Aramco notably reporting on Tuesday. During this week in history, in 1796, Dr. Edward Jenner, a physician in rural England, developed the smallpox vaccine. At the time, vaccination was a new procedure, injecting a milder form of a disease into healthy people leading to immunity. Soon after, 12,000 English were vaccinated and the number of smallpox deaths dropped by two-thirds. I've no doubt that this week will bring further progress for a coronavirus vaccine and that economic green shoots will continue. We'll tell you how strong those shoots emerge next week. Until then, 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.

The **Alerian MLP Index** is the leading gauge of energy infrastructure master limited partnerships (MLPs). 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 (AMZ) and on a total-return basis (AMZX).

The **Energy Sector Index** seeks to provide an effective representation of the energy sector of the S&P 500 Index. The Index includes companies from the following industries: oil, gas and consumable fuels; and energy equipment and services.

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

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