Tortoise Energy Podcast

August 3, 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 Senior Portfolio Manager Brian Kessens with this week's QuickTake podcast.

In the biggest week of 2Q earnings so far, MLPs slipped one half of one percent last week in a week with several ex-dividend dates, outperforming broader energy's 4.1% skid and crude oil softening by 2.1%.

Sticking with oil, imports into the U.S. are falling sharply leading to inventory draws. In fact, last week saw the biggest one week drop in U.S. inventories, which fell 10.6 million barrels. The better supply and demand balance, however, was overshadowed by concerns about a potential coronavirus resurgence, a stalling U.S. economic recovery and U.S. / China tensions.

In M&A activity last week, CNX Resources (CNX) and CNX Midstream Partners (CNXM) announced an agreement where CNX Resources, the parent company, will acquire the midstream business at a 15% premium. Management expects the combined company to be a low cost Appalachia producer with a lower cost of capital and increased free cash flow. We don't think this transaction is the beginning of a trend, but rather an exception given CNXM's small size and liquidity along with the fact that CNX already owns over 50% of the company.

As noted, it was big week for earnings. Most midstream companies reported in-line with Enterprise notably beating estimates due to strong crude oil storage opportunities and ONEOK missing following lower volumes in the Bakken. Looking forward, companies generally maintained second half financial guidance, if not narrowing the range of outcomes. Specific takeaways include:

(1) Production volumes are rebounding quickly. Enterprise indicated natural gas inlet volumes and NGL production recovered to 88% and 98% of March levels, respectively, with fractionation plants and NGL pipelines above March levels. Enterprise noted that crude oil shut-ins were not insignificant at 1.5 to 1.8 million bpd, but they were short-lived. ONEOK noted that if current market conditions remain, all curtailed volumes could be back in Q3, already noting a strong volume bounce back this month in the Bakken. Further, Enbridge said its Mainline crude oil pipe is fully utilized in July and TC Energy noted natural gas volumes on its U.S. and Canadian systems are at or even above 2019 levels.

(2) What about those crude oil storage opportunities we suspected in 2Q? Enterprise capitalized on the outsized contango with storage driving a 2Q beat. Management characterized the opportunity as $500 to $600 million, half of which could be realized in the second half of this year. We'll see if Plains All-American and Energy Transfer indicate the same this week.

(3) And on refined product demand? Kinder Morgan already pointed to a potential slow recovery and Magellan confirmed it this week, expecting a 6% gasoline volume decline and a 12% distillate decline in the second half after previously assuming a return to normal volumes.

(4) The trend in capex remains lower. Enterprise reduced capex by $700 million, ONEOK kept it flat, and Magellan announced 2021 capex of $40 million, down 90% year over year. This confirms our view of growing free cash flow for the sector.

(5) And while we expect the trend for lower capex to continue, there was one new project announcement. TC Energy announced a $400 million replacement and modernization project for its ANR natural gas pipeline to supply an existing power plant. We think these smaller, brownfield pipeline upgrades for demand pull purposes are the more likely types of capex we'll see in the future. They offer a surer return and a lot less regulatory risk.

(6) Debt capital markets remain healthy. Kinder Morgan and Enterprise both issued 30 year paper last week with very attractive coupons for the issuers at just above 3%.

(7) There were several questions about the potential of Hydrogen transport in pipelines and it is clear management teams are contemplating its future role in energy. Enbridge noted its network is well positioned if there is a transition to hydrogen, though noted the potential is likely decades from now. TC Energy indicated hydrogen can be blended with natural gas flowing through existing pipelines and left comingled or separated. Right now, management characterized hydrogen as an interesting concept and they're ready to capitalize when it becomes economic. We also understand Enterprise is studying hydrogen transport concepts.

Lastly, we have been pushing companies to provide sustainability reports and update them routinely. We were really happy to see Enterprise release its report last week. The report had significant detail on environmental performance, emergency preparedness, safety and integrity of the company's systems, along with alignment of management and shareholder interests. Specifically, Enterprise noted a 19% improvement in direct CO_2 emissions in the last decade and a 99.999% safe handling of volumes rate. We always expected midstream companies are managing emissions well. Great to see confirmation.

This week remains another heavy week of earnings releases. We're expecting continued forward guidance within previous ranges and look for further updates on the energy recovery in the second half of the year.

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.

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