Tortoise QuickTake Podcast

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Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, a senior member of 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 last week of April was a mix of sun and rain for the energy sector as related to earnings and stock performance as broad energy was flat, producers suffered 1.5% and MLPs improved half of one percent.

The primary reason for the producer selloff was lower crude oil prices which ended the week just short of the psychologically important level of $50 per barrel. As we look through the labyrinthine OPEC decision matrix, we expect and believe the consensus remains that an OPEC production cut extension later this month is likely, yet markets are focusing on current fundamentals where at least year-to-date, the cuts have not meaningfully resulted in visibly lower crude oil inventories, especially in the U.S. Further, U.S. shale growth remains a concern where some, including the EIA, believe U.S. shale could add 100 thousand bpd per month for the rest of the year if oil remains above $50 per barrel. Indeed, the oil rig count added another nine last week.

OPEC seems to get it. The secretary general acknowledges extended cuts are necessary to improve stockpiles and meetings between Saudi Arabia and Russia will occur over the next couple of weeks to coordinate the effort. The Saudi Energy Minister noted the importance to extend the agreement into the second half of the year when stockpile declines should accelerate. And for Russia, lower crude oil prices are as much of a concern for them as OPEC countries regarding national financial stability. We may just have to wait a bit longer for the inventory data to show an improved supply and demand balance.

Last week was the first full week of energy earnings.

For producer earnings, some second quarter production guidance was softened, yet 2017 outlooks are relatively unchanged. Producer focus remains on costs and efficiencies where costs are expected 10% to 15% higher. The ability to offset this cost inflation with greater efficiencies is key. Improved efficiencies continue to manifest in longer lateral lengths, increasing the number of intervals between fractures and downspacing (or placing wells closer together). These efforts are all improving volume extraction per well. Generally, capital investment programs are set for 2017 being protected with hedges. Thus any oil price volatility like we saw last week is unlikely to materially change producer drilling plans for the remainder of the year.

Another notable upstream item last week was that Anadarko Petroleum shut in 3,000 vertical wells in Northeast Colorado as a precaution after a home explosion 200 feet from one well unfortunately killed two people. The cause of the explosion remains unknown and is under investigation by the authorities.

In services earnings, land drillers' costs were higher than expected due to rig reactivation costs, and margins are yet to improve as longer term contracts expire and are replaced with improving, though lower contract rates. For those service providers with global operations, North America showed strength that was offset by international weakness. Our sense is that international has yet to begin a recovery that, for North America, started in 2016. It's good to have the lowest breakeven costs.

In midstream, earnings were largely in-line with the bulk of companies yet to report. There were three notable items all related to companies reducing their cost of capital:

- One IPO filing where Kinder Morgan filed a preliminary prospectus in Canada to potentially take their Canadian operations public. We'll stay tuned on whether this transpires or if management rather decides to enter into a joint venture for their largest Canadian project, an expansion of the Trans Mountain crude oil pipeline.
- Energy Transfer Partners unitholders approved the merger with Sunoco Logistics Partners.
- Enbridge Energy Partners concluded their strategic review, resulting in a reduction in the distribution by 40% and a sale of its gathering and processing assets to its parent. The resulting company has an improved credit profile and per management, expects to grow cash flow 3% annually through 2020 with 1.2x distribution coverage.

For refiners, U.S. exports are increasing as refiners continue to take advantage of operational struggles at Mexican and other Latin American refiners. Also, it's worth noting that refinery runs for the week ending April 21st hit 17.3 million bpd, the highest for April since 2001. All in all, a good opportunity for U.S. refiners to enhance margins.

We had one team member in Washington D.C. last week. He reported back that top energy policy for the Trump administration centers on rolling back regulations and streamlining the federal permitting process. There was a lot of news on tax reform last week though a 'wait-and-see' is probably the best approach as differences remain between the House, Senate and Executive branch. And finally, meaningful energy policy action is being delayed by a lack of appointment of high priority officials, including at the FERC.

Wrapping it all together, the U.S. energy complex continues to strengthen versus global competitors. Efficiency remains a key producer focus keeping a lid on breakeven prices. Midstream companies are taking more opportunities to lower costs of capital to improve returns on further pipeline buildout. And no one can match the cost and flexibility advantage of the U.S. refining industry. Future commodity prices are uncertain, yet we believe U.S. energy is in a certain, enviable position to endure and grow compared to international peers.

This week, earnings are especially heavy Tuesday through Thursday. There are also two energy IPOs that are scheduled to price mid-week, Antero Midstream GP and Liberty Oilfield Services. Finally, expect discussion among OPEC and non-OPEC countries to pick up as the May 25th Vienna meeting approaches.

Thanks for listening. Back at 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@tortoiseinvest.com.