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.

Pam Kearney: Hello, I'm Pam Kearney, Director of Investor and Public Relations at Tortoise, I'm joined today by Brad Adams, CEO of the Tortoise closed end funds. Thank you for joining us for this special QuickTake podcast recapping energy value chain performance at mid-year and highlights regarding our closed end funds. This is the first in a series of closed end fund podcasts we plan to record this year. Brad, let's start by giving an overview of how the broad energy sector performed in the second quarter.

Brad Adams: Thanks Pam. It's great to be here and join you on the podcast. Investor sentiment, mirroring the change in oil prices, weighed down performance for the energy sector, although company fundamentals, particularly those in the midstream segment, were solid. Broadly speaking, energy was down, and midstream followed, all tracking crude oil prices lower. Investors turned to weekly crude oil inventory reports to gauge supply and demand, and then grew impatient with a lack of significant draws. And while the May OPEC meeting resulted in expected production cuts, the market reaction was to the downside. This negative sentiment trumped fundamentals during the quarter in our view. Equity capital markets in energy remain challenged, but debt markets remain attractive and alternative means of financing are available. We believe midstream valuations are compelling and provide a solid yield as fundamentals improve and volumes are expected to continue to move higher in the back half of the year. Our long-term outlook for the midstream sector remains positive with a projection for capital investments of approximately $125 billion from 2017 to 2019. U.S. and global oil inventories are expected to decline throughout the second half of 2017 as we enter a period when oil demand is the strongest and the supply glut should see a meaningful impact from the OPEC production cuts. If oil prices remain below $45 per barrel then the pace of 2018 U.S. production growth should moderate. Natural gas continues to be a meaningful part of the energy story. Storage levels ended the second quarter approximately 6% above the five year average as higher than expected demand and lower than expected production helped reduce elevated inventories which had built during the warmer than normal winter. Natural gas supply is expected to resume growth in late 2017, driven by Appalachia as pipeline capacity comes online. We continue to believe the U.S. will play a pivotal role in the LNG trade. Last year, the U.S. exported liquefied natural gas for the first time. Two LNG facilities came on-line last year, and three more are expected this year. We expect natural gas and NGL, primarily from the Permian, to play an increasing role in supply growth moving forward.

Moving specifically to performance, the price of crude impacted the entire value chain. The energy sector, represented by the S&P Energy Select Sector® Index, fell by -6.6% for the second quarter.

The Tortoise North American Oil and Gas Producers Index SM, (TNEP) returned -14.1% with oil prices slipping from a high of $50.60 to end the quarter at $46.04 per barrel.

Pipeline companies pulled back too, with the Tortoise North American Pipeline Index SM returning -2.4%. MLPs faced additional pressure, causing them to retreat further with a return of -6.5% for the quarter, as represented by the Tortoise MLP Index®. While the midstream segment was negative for the quarter, not all pipeline companies retreated to the same extent. Refined products pipelines were the least affected by lower crude oil prices as lower prices tend to drive demand for refined products, such as gasoline. Gathering and processing pipeline companies were impacted the most, particularly those with non-fee-based contracts, due to the negative impact of lower commodity prices on those contracts.

I guess, Pam, net/net… the energy sector was down, yet disconnected from fundamentals in our view.

Pam Kearney: Thank you Brad. How has all that impacted the performance of our closed-end funds?

Brad Adams: Our funds span the energy value chain, and in our view, fundamentals have continued to improve quarter over quarter. All performance information is as of July 31, 2017.

Beginning with upstream: As a reminder, NDP invests in oil and gas producers that, in our view, are located in the best locations in the best oil and gas fields within North America. The fund also utilizes a covered call strategy.

NDP's year-to-date market-based total return was -5.95% and its NAV-based total return was -16.25%. Liquids producers underperformed natural gas producers, particularly those in Permian and Eagle Ford basins. The fund's negative performance was somewhat mitigated by its exposure to midstream companies that it holds to execute its covered call strategy.

Within the midstream space, TYG, NTG and TTP focus on high quality companies with strategic assets providing visible, growing cash flows, and strong balance sheets and distribution coverage. Lower commodity prices weighed on market sentiment causing negative performance for the energy sector, including MLPs and pipeline companies, and these funds.

At mid-year, TYG's year-to-date market-based total return was 2.94% and its NAV-based total return was -1.62%. NTG's year-to-date market-based total return was 5.65% and its NAV-based total return was -2.17%.

TTP invests in diversified pipeline equities, along with some independent energy companies and utilizes a covered call strategy. TTP's year-to-date market-based total return was -3.55% and its NAV-based total return was -7.17%.

Finally, TPZ is a downstream strategy which invests primarily in power and energy infrastructure fixed income, with the remainder in equities. TPZ's year-to-date market-based total return was -0.18% and its NAV-based total return was -1.61%. Performance was helped by the fund's focus on power and utilities which had positive performance for the fiscal quarter due to lower interest rates.

Pam Kearney: Thank you Brad. Can you talk a bit about our use of leverage in the closed-end funds?

Brad Adams: Consistent with our historical approach, we remain prudent in our use of leverage to maintain adequate cushion in excess of asset coverage requirements. We monitor leverage closely and as a reminder, report updated leverage amounts and ratios on our website each week.

Pam Kearney: Can you also touch on our thoughts about the health of portfolio companies' distributions?

Brad Adams: Sure. Overall, midstream companies have healthier balance sheets from where they were in 2016, improved distribution coverage and a tailwind of volume growth of crude oil, natural gas and natural gas liquids. We continue to expect midstream dividend and distribution growth of 5%-7% over the next 12 months.

Pam Kearney: On that note, then how are fund distributions holding up?

Brad Adams: We maintained distributions quarter-over-quarter for all the funds. Our goal with our MLP-focused funds, TYG and NTG, is to have adequate distribution coverage over the long-term, supporting our emphasis on distribution sustainability. As a reminder, distribution coverage is DCF divided by distributions paid to stockholders. There are a number of factors impacting DCF, including growth in the distributions from portfolio investments, leverage costs, changes in asset value based expenses, including management fees and administration expenses. We've been doing this long enough to know that coverage can move around a bit from quarter to quarter, but over the longer-term, adequate coverage is very important. We'll continue to focus on high-quality companies that generate solid cash flows to reach our long-term distribution goals.

As I mentioned, we maintained the quarter-over-quarter distributions for the RIC funds also. As a reminder, RICs must pay out their investment income and capital gains in order to avoid fund level taxes. A portion of distributions may be designated as capital gains and the funds may also distribute additional capital gains in the last calendar quarter of the year if necessary to meet minimum annual distribution requirements. Not too dissimilar to the MLP funds, our goal is to have adequate distribution coverage over the long-term supported by DCF and realized gains.

Pam Kearney: Anything else you'd like to add, Brad?

Brad Adams: In times like these it's helpful to keep the big picture in mind. There are always bumps in the road in any transition and the shale revolution is certainly a significant transition. Energy infrastructure is an essential part of our economy and midstream cash flows have steadily grown during the downturn in oil prices on the back of fee-based revenue and volume growth.

Pam: Thanks Brad. And thanks for kicking off our closed-end fund podcast series. That concludes our discussion. We hope this has been helpful. Thank you for joining us, we look forward to speaking with you again soon.

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.

The S&P Energy Select Sector® Index
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.

Tortoise North American Pipeline Index℠
The Tortoise North American Pipeline Index℠ is a float-adjusted, capitalization weighted index of pipeline companies headquartered in the United States and Canada. A pipeline company is defined as a company that either 1) has been assigned a standard industrial classification ("SIC") system code that indicates the company operates in the energy pipeline industry or 2) has at least 50% of its assets, cash flow or revenue associated with the operation or ownership of energy pipelines. Pipeline companies engage in the business of transporting natural gas, crude oil and refined products, storing, gathering and processing such as gas, crude oil and products and local gas distribution. The index includes pipeline companies structured as corporations, limited liability companies and master limited partnerships (MLPs).

Tortoise MLP Index®
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.

Tortoise North American Oil & Gas Producers Index ℠
The Tortoise North American Oil & Gas Producers Index ℠ is a float-adjusted, capitalization weighted index of North American energy companies primarily engaged in the production of crude oil, condensate, natural gas or natural gas liquids (NGLs). The index includes exploration and production companies structured as corporations, limited liability companies and master limited partnerships but excludes United States royalty trusts.

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