Tortoise QuickTake Podcast with Matt Sallee

October 5, 2015

Welcome to the Tortoise QuickTake podcast highlighting our views on the top energy events of last week. I am Matt Sallee, Managing Director and Portfolio Manager at Tortoise Capital Advisors.

- As the quote generally attributed to Winston Churchill goes, if you are going through hell, keep going. And while maybe "hell" is a strong word, this market sure has been frustrating.
- Last week's extreme volatility wrapped up one of the worst months and quarters on record for energy sector performance. Given the magnitude of the move I will take a minute and summarize both periods
  - For the month
    - Oil was down 8%
    - S&P Energy index dropped 7%
    - While MLPs lost 16%
  - That resulted in quarterly performance of –24%, -18% and –24%, respectively for those groups…ouch!
- As we previously discussed, midstream fundamentals are holding up well in current environment and cash flows continue to grow so the logical question is why MLP's were the worst energy performer during the month and quarter?
- We see technical selling pressure from three key sources in order of magnitude, open end fund and exchange traded product redemptions, short selling and closed end fund deleveraging
  - While we don't have perfect or up to the latest minute data on all of these sources we pulled available public data and estimate the following
    - OEF and ETP products had net outflows of $800M over the last couple months compared to average monthly inflows of $1.5B during 2014 and the first half of '15
    - Shorting interest in the space has increased about $700M during over the last quarter
    - And we estimate CEFs have reduced leverage several hundred million dollars; our data here is someone delayed
- So while we firmly believe in midstream fundamentals, these technical factors may continue to drive near term volatility. However, for a long term investor we continue to confidently say this is an attractive entry point. With a current index yield over 8% the market is pricing in no growth and we still believe MLPs will grow their distributions mid-single digits in the near term based off our detailed financial models. We caution that in the current market some management teams may conservatively decide to hold back some growth in order to build more coverage and increase internal funding of growth projects. But even if we are wrong and only get low single-digit growth with our 8% yield we are still looking for at least 10% cash on cash returns from yield and growth in a low case scenario. On the other hand, if we are right about growth and yields return to more normal historical levels the result would be returns well into the 20% range which is our high case return scenario.

Switching gears to last week's news, the EIA released its latest 914 report with domestic oil production for the month of July. As expected onshore volumes were down 53 Mbopd m/m. Also bullish was that June oil output was revised lower by ~32 Mbopd, taking June m/m decline to -115 Mbopd vs. originally reported -103 Mbopd (May also revised down by ~21 Mbopd). Relative to early 2015 peak, numbers imply total oil output is down 244 Mbopd as of July, while onshore oil output is down approximately 400 Mbopd.

I'll finish up today with the company specific news items from last week

- On Monday, ETE announced they had reached an agreement to acquire WMB in a $58B deal widely expected by the markets
- In capital markets, Concho Resources priced a $700M equity offering which traded up nicely demonstrating capital markets, though challenged, are open for high quality energy companies.
- Additionally, Shell announced it will abandon its artic exploration program after investing several years and several billions of dollars of the project
- Lastly Stone Energy is the latest NE producer to announce plans to curtail production while they await much needed new infrastructure out of the area.

That wraps up this week's podcast. Thanks for listening.

