Tortoise

Energy Value Chain Update Call
Prepared Remarks
Jan. 23, 2018

Pam Kearney: Thank you. Good afternoon and welcome to the Tortoise Energy Value Chain update call. I'm Pam Kearney, Vice President of Investor and Public Relations at Tortoise. I'm joined by energy Portfolio Managers Brian Kessens, Matt Sallee and Rob Thummel to provide a review of the energy sector.

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With that, I'll turn it over to Matt Sallee for an energy sector update.

Matt Sallee: Thank you and good afternoon. I'll warn you, if you heard my podcast yesterday you know by now my voice sustained some damage during the Chiefs game Sunday so please pardon me. The broader energy sector as represented by the S&P Energy Select Sector® Index, retreated substantially during the last quarter of the year, returning just shy of -24%, bringing the 2018 performance for the year to -18%. After energy stocks hit a low on Christmas Eve, the S&P Energy Select Sector® Index has seen a significant rebound, so far up over 11% so far in 2019 as of last Friday, January 18th. So, while we have a significant road to recovery, we're off to a good start.

Obviously, the main reason that the sector did so poorly in the fourth quarter was broad market volatility, but also commodity prices were very volatile. Crude oil specifically, prices hitting both 2018 peak and trough during the 4th quarter, and obviously that pulled exploration and production as well as oilfield services sectors down along with it.

Also along with that it was frustrating how the midstream sector ended the year, giving up year-to-date gains in the fourth quarter after three straight quarters of phenomenal profits as the aforementioned commodity volatility plus broad market volatility triggered weakness really to a point where it turned into technical selling pressure in particular in our view from tax loss selling. The Tortoise North American Pipeline Index℠ returned -13.6% in the fourth quarter and -10.5% for the year and the Tortoise MLP Index® returned just shy of -17% for the fourth quarter bringing 2018 performance to -13.4%. The technical selling pressure that I mentioned abated as the year rolled over and the index is up about 13% through last Friday on a year-to-date basis.

4th quarter earnings calls kicked off last week and the narrative is cautiously optimistic heading into 2019. Companies across the energy value chain are affirming a commitment to become more capital disciplined, generate free cash flow and in many cases, buyback shares. So I'd highlight those as emerging themes.

Pam Kearney: Thanks, Matt. Rob, turning to OPEC, where are we at following the Dec. 7th production cut announcement and what are our supply and demand and oil price forecasts?

Rob Thummel: So, related to the oil markets, the two most important numbers for investors to commit to memory in 2019 in my opinion are 1.5 and 50. So, one and a half million barrels per day is roughly the amount the global oil markets were oversupplied in the fourth quarter of 2018. So, how did this happen? Starting last summer**,** Saudi Arabia dramatically increased oil production in anticipation of Iranian sanctions going into effect. As we know, the U.S. Administration granted sanctions and kept Iranian production flowing, creating an oversupplied oil market and a significant drop in oil prices as Matt mentioned. It is important that global oil inventories remain around at the 5-year average. So the 1.5 million barrel per day of excess supply needs to be eliminated to balance the market. Now this can happen in one of two ways. First, waivers associated with the Iranian sanctions expire in May and may not be extended. This would reduce the global supply. Second, OPEC+ countries like Russia has committed to reducing global supply announcing a 1.2 million barrel per day supply cut in December of last year. The cuts took effect on January 1st so the oil markets are starting to rebalance right now.

1.5 million barrels per day is also an important number as 1.5 million barrels per day is what the EIA expects global liquids fuels consumption to grow by in 2019, largely driven by increases in China, U.S. and India.

50 is other critical number to commit to memory. And what I mean is $50 per barrel. U.S. West Texas Intermediate or WTI oil prices remain around $50 per barrel. U.S. crude oil production averaged 10.9 million barrels per day (MMbbl/d) in 2018 and is expected to increase to 12.1 MMbbl/d in 2019. If U.S. oil prices remain at current levels, we expect production growth to be less than forecasted as U.S. oil producers become more disciplined with capital spending. We are watching first quarter E&P company budget announcements, which may soften our production outlook as producers respond to lower commodity prices. But let me be clear, we still expect the U.S. to grow oil production in 2019; however, the oil price will dictate the magnitude of growth.

We expect U.S. crude oil prices to range between $50-$60 per barrel in 2019 and about $10 more per barrel for Brent price. When OPEC ministers met, it was very clear that Saudi Arabia will no longer be willing to accept these lower oil prices so we do expect prices to improve and stabilize.

Pam Kearney: Okay thanks Rob. 1.5 and 50. Got it! Brian, moving to midstream, 2018 was a watermark year for MLPs. Can you highlight the changes and catalysts for the sector?

Brian Kessens: Sure, thanks Pam. We've deemed 2018 as the year of the transaction, with more than half of MLP companies participating in simplification transactions. Or simply transactions where companies collapse LP/GP structures or remove incentive distribution rights (IDRs). These transactions have benefited the sector, leading to improved corporate governance and lower costs of capital. We think we're in the 8^{th} to 9^{th} inning of simplifications and by the end of 2019 we anticipate more than 85% of MLPs will have eliminated IDRs.

As the midstream energy landscape continues to evolve, so does the MLP structure. We expect even higher coverage and lower leverage going forward. Many companies have shifted to self-funding the equity portion of their capex programs, reducing reliance on capital markets access. And as a result, we expect dramatically less equity supply issuance in 2019 and beyond as companies focus on return of capital to shareholders in the form of a strong yield, debt pay-down, distribution growth and stock buybacks.

Some companies are also selling non-core assets to arbitrage the valuation gap between private and public midstream assets. We are seeing renewed investor interest in this sector with private equity investing via asset acquisitions.

With significant midstream investment needed to transport the record U.S. energy supply to areas of demand, including export facilities, several pipeline companies are planning to consolidate efforts to efficiently put capital to work. One example is a potential consolidation of two competing Permian crude oil export lines. If combined, the project would be owned by six different midstream companies and would ease concerns of too much investment in takeaway capacity in the basin. Our outlook for capital investments remains at approximately $139 billion for 2018 to 2020 in MLPs, pipelines and related organic projects.

Pam Kearney: Thanks Brian. Matt, do we still hold our view on an undervalued MLP sector?

Matt Sallee: Well, Pam we could probably just replay the last, about 15 quarterly calls and my answer is about the same. No matter how you look at the metrics, valuations are cheap and continue to trade at significant discounts. So, Enterprise value to EBITDA and Price to Distributable Cash Flow currently at 30% and 51% below historical averages, respectively. MLPs relative to utilities and REITs, 16% and 44% discount, that's also EV to EBITDA. So from a total return outlook, what we are forecasting for the next 12 months, we expect cash distribution growth of 4-6% over the next 12 months, that includes the impact of simplifications, so it's not a gross number that's getting netted down by stealth cuts, we built all that into the forecast. So take that 4-6% growth combined with the current yield we are forecasting out cash-on-cash returns of 13-15% over the next 12 months. And just to clarify, that's on top of the nice start that we've had so far in January. Obviously, based off the valuation metrics that I mentioned we expect to have a good year, as there's a lot of room for improvement. Midstream fundamentals look incredible really even at lower crude prices at $40s but that's not our price expectation. But if prices were to move there, fundamentals still look good. Evidence of strength includes record production, record consumption and record exports of oil, gas and NGLs along with that you see price discounts across various basins, and in the U.S. relative to other countries and that signals the need for additional infrastructure.

Pam Kearney: **Thanks. Rob, turning to you what impact is this cold weather having on the natural gas sector and is the stage set for a strong 2019?**

Rob Thummel: Well, as of today we have endured about 37% of winter and the National Weather Service has assigned nine of the 26 winter storms names designated for this winter season. And sorry Jayden but your name is up next. But we are on pace for a normal winter season. Natural gas prices are expected to remain volatile for the remainder of winter as inventories are at the low end of historical norms. But we do expect natural gas prices to average between $3.00 and $3.50 per mcf in 2019.

Now the U.S. set records in 2018 for natural gas production. 2019 is expected to be a record breaking year in terms of natural gas production with production expected to rise to 87.3 bcf/d in 2019 according to PIRA. It's also expected to be a big year for U.S. liquefied natural gas or LNG exports in 2019 and the U.S. continues to export significant amounts of natural gas by pipeline to Mexico. And 2019 is expected to be a record setting year with gross U.S. exports of natural gas growing by more than 30% and another 15% in 2020 according to the EIA.

Pam Kearney: Okay thank you and now turning to you Brian, can you walk us through the downstream segment?

Brian Kessens: Sure, renewable energy solutions continue to change the energy landscape. And the breakdown of electricity generation in the U.S. continues to evolve. The most notable transition is the continued displacement of coal by natural gas. The share of U.S total utility-scale electricity generation from natural gas is expected to rise from 35% to 37% from 2018-2020 and conversely, the share of electricity generation from coal is expected to decrease from 28% to 24% from 2018-2020. Renewables are also expected to continue to gain market share, primarily through the use of solar energy as the EIA expects average U.S. solar generation to rise by more than 40% from 2017 to 2019. We expect utilities will continue to find opportunities to include renewable infrastructure into their rate base, the value of the property on which the utility is permitted to earn a rate of return.

In other parts of downstream, petrochemical companies will likely take advantage of increased natural gas liquids supplies, likely boosting their margins.

And refiners are expected to benefit from the upcoming International Maritime Organization (IMO) 2020 initiative. Starting in January of 2020, the maximum sulphur content of marine fuel oil used in ocean vessels will decrease from 3.5% to 0.5%. It is expected that in the fourth quarter of 2019, U.S. refinery runs will increase and refiners will maximize upgrading of high-sulphur fuel oil into low-sulphur distillate fuel. This likely results in refinery above average utilization rates in 2020 according to the EIA.

Pam Kearney: Okay. The last question to you Matt. What key regulatory matters are we tracking?

Matt Sallee: First, Colorado's Proposition 112, the recent proposal for a 2,500 foot drilling setback from occupied structures was defeated. We believe that the Colorado energy industry and state legislature will likely work together towards a permanent set-back resolution in the near future maybe as early as the first half of this year.

Second, in Nevada, voters approved Question 6, a ballot measure to increase the state's renewable portfolio standard (RPS) to 50% by 2030. This measure will require re-approval in 2020 in order to go into effect. The state hopes to spur investment and advance its leadership in renewable energy. A similar measure failed next door in Arizona.

Also, the State Department announced a plan to perform an additional environmental review for Keystone XL's Supplemental Environmental Impact Statement (SEIS) in accordance with the mandate from the Montana federal district court. It likely pushes the timeline for starting significant construction closer to the end of the first quarter or beginning of the second quarter.

Lastly, FERC Commissioner Kevin McIntyre passed away on January 2nd. The committee is once again split 2:2 along party lines following confirmation of Bernard McNamee in December. We expect Mr. McIntyre's replacement to be announced soon.

Pam Kearney: Thank you. We'll wrap-up, with a recap of what we covered in today's call:

- U.S. production growth for crude oil, natural gas and NGLs are expected to meaningfully increase again and likely surpass the record 2018 production.
- WTI oil prices should improve, ranging between $50-$60 per barrel in 2019.
- Renewable energy solutions continue to change the energy landscape. The most notable transition is the continued displacement of coal by natural gas.
- Colorado's Proposition 112 recent proposal for a 2,500 foot drilling setback from occupied. structures was defeated, with a more permanent set-back resolution expected in the near future.
- Lastly, beyond strong fundamentals and compelling valuations, key catalysts unfolding in the midstream sector include structure clarity as simplification transactions wind down, increased return of capital to shareholders and improved fund flows into the sector.

Thank you all for joining us today. We invite you to visit our website at www.tortoiseadvisors.com and download our Tortoise QuickTake energy podcast series where we will share our views on timely energy events weekly. Thank you.

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