Tortoise QuickTake Energy Podcast

Tortoise

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Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, senior members of Tortoise provide 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.

Last week Apple's market value surpassed $1 trillion. Pretty astounding no matter how you look at it and as investors, we continuously compare values. This brings up the question, would you rather own Apple, or all of the energy pipeline infrastructure in North America? Estimated values are probably about equal.

As you ponder that, and while it was a good week for Apple, it was also a good week for MLPs, higher by just over 4%.

Paving the way for the sector was Energy Transfer, and they didn't even announce earnings yet. Happening sooner than we expected and in what might end up being the largest transaction of the year, Energy Transfer Equity agreed to acquire Energy Transfer Partners, or the GP acquiring the LP, for an 11% premium. Importantly, the transaction eliminates the incentive distribution rights and control of one over the other. Better corporate alignment with unitholders and a lower cost of capital is the result. Note the company will remain an MLP as well. Not only do we think the announcement is good from Energy Transfer, given the company's size, it is healthy for the sector. For MLPs that have yet to eliminate IDRs, they're on notice as there is no more pointing to Energy Transfer as someone larger and deeper into the splits.

Earnings were also a tailwind for MLPs last week. Volumes were consistently higher across all segments. For those with extra pipeline capacity, excess profits were available as companies took advantage of basis spreads. Liquids storage assets were selectively weaker partly due to the backwardation of the crude oil forward market. 2018 financial guidance was generally raised or tightened with the lower end of the range moving higher. Strategically, MLPs continued to emphasize self-funding and simplification.

Buckeye Partners is one name we've been concerned about regarding a distribution cut. The company announced a flat distribution for this quarter, while also beginning a comprehensive review of its asset portfolio and financial strategy. A distribution reduction still a possibility, along with asset sales, JVs or an outright sale of the company. We think the company offers a good value here though we'll continue to evaluate as Buckeye emerges from its review.

And if you need more midstream news, there were two large pipeline projects announced. First, developed by a consortium of Targa Resources, NextEra, Whitewater Midstream and MPLX, the Whistler Project will carry 2 Bcf/d of natural gas from the Permian to the Gulf Coast, with an expected in service in late 2020. And second, Tallgrass Energy plans to develop the Seahorse pipeline to move crude oil from Cushing, Okla. to St. James, La. The pipeline would supply the refining network at St. James and crude oil export terminals in Plaquemines, La. expected to open in 2020.

On the trade front, China may impose a tariff of 25% on U.S. LNG cargoes if the U.S. continues to place tariffs on more Chinese goods. If the tariff is implemented, we think it disappointing as there are friction costs to shipping to other destinations, yet importantly we don't think it changes the outlook of total LNG demand, including China's demand. While U.S. LNG may be competitively disadvantaged to China, China would likely source more non-U.S. LNG, opening other markets to U.S. flows. We think the deadweight loss to U.S. sellers and Chinese buyers would be a lot less than 25%.

Broader energy didn't experience the same level of success as midstream last week, with the S&P 500 Energy Select Sector® Index down 1.8%, though WTI was flat.

The broad energy action was mostly a response to upstream earnings that raised concerns around capital efficiency. Most notably, down-spacing, or drilling wells closer together, did not lead to the same level of increased efficiency as previously reached in select areas. NPV per section continued to move higher, though with less initial production per well. Needless to say, producers that increased capex while lowering production guidance didn't fare well. Also notable and mostly expected, many producers shifted drilling to the Eagle Ford or Rockies, partly due to Permian bottlenecks yet also due to the attractive returns in both the DJ and Powder River Basin. We'll look for increased drilling there and the positive impact it may have on midstream volumes in the future. Despite the capital efficiency concerns, producers largely continued to tout returning cash to shareholders, both through stock buybacks and higher dividends.

Going back to the opening question of Apple versus all North American energy infrastructure, Apple has a lot of merit with its first class product, prospects for growth and balance sheet strength. Which is more strategic? If Apple went away, there would be a disruption as users shifted to a competitor phone or PC. I did see a new Blackberry ad last week. If we lost energy infrastructure, we'd take cold showers, walk or ride a bike to work, and without A/C, sweat in the summer. Energy infrastructure might win the strategic argument. I'll also take energy infrastructure for higher barriers to entry, visibility to long-term cash flows from stable energy demand and even for growth. Have you counted all the new pipeline project announcements recently? I'm obviously biased, but to me energy infrastructure is the clear winner.

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.

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.