Tortoise QuickTake Special Edition Podcast with James Mick

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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.

Thanks for joining us today on the Tortoise Quick Take Podcast. I'm James Mick, managing director and Portfolio Manager with Tortoise Capital.

Well, simply put, the roller coaster continues as energy remained at the forefront of volatility. As an example, MLPs actually had more than a 10% swing within a 2 day stretch during the week.

Quickly on performance, crude oil led the move down, off over 11% for the week, while natural gas almost kept pace, but "only" finished down 9.5%. Stocks followed as:

- The broader S&P energy index was down 6.4%
- Exploration and production companies were down 8.9%
- And MLPs finished down 5.8% for last week

The key topic on investors' minds was the stability of distributions within the MLP space following the cut in the dividend of midstream bell weather and former MLP, Kinder Morgan Inc, on Tuesday after market close.

First a little history:

Kinder of course previously operated 2 separate MLPs, Kinder Morgan Energy Partners, ticker KMP and El Paso Pipeline Partners, ticker EPB. Additionally, the general partner of both, KMI was publicly traded. In August of 2014, KMI announced the roll-up of both MLPs into the c-corp general partner. At the time, the leverage, as measured by Debt to EBITDA, at the two MLPs was approximately 3.7x and 4.0x respectively. After the roll-up transaction, the KMI leverage ballooned to 5.6x. This was clearly outside the norm for a midstream pipeline company, but the rating agencies allowed KMI to retain its investment grade credit rating. Fast forward to the 1st quarter of 2015 and KMI completed an acquisition for approximately $3B of Bakken gathering assets. This elevated leverage once again to roughly 5.9x. After leverage came down marginally during the year, KMI announced another acquisition, this time of incremental interests in NGPL pipeline. After the incremental purchase, Moody's determined NGPL, a highly levered entity at over 10x debt to EBITDA, should be consolidated by KMI. This again pushed leverage close to 6.0x.

With a large capex backlog for 2016, KMI was now faced with a dilemma from a funding perspective. Moody's placed them on negative watch and having already utilized preferred equity, KMI was left with a decision, how to fund a large 2016 capex program given an equity yield north of 12% and limited capacity for new debt.

KMI made the decision that cutting the dividend, relying less on the capital markets and instead utilizing internally generated cash flow to fund capex projects was the best choice for shareholders.

Note, we believe of critical importance is that the underlying base business of Kinder Morgan remains stable and is actually growing in 2016. This has clearly been lost on the popular press and many investors as well. Quite simply, this was a capital allocation decision.

Of course the question asked by investors was, who's next?

Our view is that Kinder is unique in some respects, but not unique in many others. It's unique in that it has a leverage profile that is not consistent with most midstream MLPs. As an example, the leverage on the Tortoise MLP Index on a weighted average basis is approximately 4.0x. A far cry from the Kinder leverage near 6.0x.

Kinder, however, is not unique in that MLPs in history have also made acquisitions that elevated leverage and ultimately ended in a distribution cut.

So as we evaluate the MLP space, we have already experienced over 15 cuts to distributions this year. Of those 15, twelve were within the upstream or exploration and production MLP space. To be expected given the sharp drop in commodity prices. Within the midstream MLP space, we have only seen 1 cut, and that was for a company that was completely unrelated to the current environment.

We believe that midstream MLPs will continue to have stable to growing cash flow. And we believe that the cash flow paid out by midstream MLPs is also stable to growing for most companies.

In fact, we attended an industry conference this past week in New York where we met with a majority of our portfolio companies. The message from management teams was clear, "we are not Kinder, and we plan to sustain our current distribution".

One prime example was Plains All American, one of the largest MLPs, who stated in their actual presentation that they do NOT intend to cut their distribution in 2016.

To be clear, our base case is that distribution cuts within the midstream space will be the exception, as companies have multiple levers to pull to weather this technical storm, including reducing capex instead.

It's not an easy time in energy, as the technicals have overwhelmed the fundamentals, but we continue to be vigilant in attempting to select the best securities from a risk/reward perspective to meet investor objectives.

With that, thank you for joining us and we look forward to speaking with you again soon when we will have a special podcast highlighting our 2016 outlook.

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