Energy Value Chain Update Call
Prepared Remarks
April 25, 2018

Ed Russell: Good afternoon and welcome to the Tortoise Energy Value Chain update call. I'm Ed Russell, Senior Managing Director at Tortoise. Today we're going to review the state of the energy sector. Following that, we'll open up the call for questions from our listeners. As a reminder, some of the statements made during the course of this presentation are not purely historical and may be forward-looking statements regarding our intentions, projections and strategies for the future. These statements are subject to various risks and uncertainties and actual outcomes and results may differ materially from our forward-looking statements. We do not update our forward-looking statements. This presentation is for information only and shall not constitute an offer to sell or a solicitation of an offer to buy any securities.

So with that, today I'm joined by energy Portfolio Managers Brian Kessens, Rob Thummel and Matt Sallee. Matt, can you walk us through the highlights from the first quarter?

Matt Sallee: You bet. Well, despite a positive start, the broader energy sector, represented by the S&P Energy Select Sector® Index, closed out the quarter down 6%, falling victim to negative sentiment and a spike in volatility across the broader market. The midstream sector followed along, with the Tortoise North American Pipeline Index℠ down almost 10% and the Tortoise MLP Index® down about 11% for the quarter. A key factor impacting MLPs was FERC's decision to disallow the income tax component for MLPs when setting pipeline cost of service tariffs which we'll discuss more in detail later in the call.

In the face of those headwinds in energy equities, crude oil prices continued to rise, setting the stage for a positive 2018 in our view. We think investors will be motivated to return to the sector by stable commodity prices and record demand that will drive increased production domestically. Midstream companies, armed with stronger balance sheets and self-funding strategies, are also expected to generate positive returns in 2018 as stock prices catch-up to fundamentals and we've already seen this start to play out in April.

Ed Russell: Thanks Matt. So Rob, what are your thoughts on the soaring oil prices that Matt mentioned and where do we stand on the global crude oil supply and demand?

Rob Thummel: You're right. Oil prices have increased by over 60% since June 2017. Just this year oil prices have risen by 12%. The current price, around $67 per barrel, is the highest level we've seen since November 2014. So when we look at supply and demand, with the global economy hitting on all cylinders, 2018 is expected to be another year of above average growth in global oil demand. In fact, global oil demand is expected to grow by 1.7 million barrels per day. To put this in perspective, global oil demand growth is about 1 million barrels per day, so 2018 growth is forecasted to be 70% higher than normal. Given this robust demand, the current global oil market is undersupplied. In other words, global oil demand exceeds supply. As a result, oil prices have been supported by declines in U.S. and global oil inventories. In addition, there have been several other factors that support the recent oil price rise including: better than expected OPEC compliance, the potential for OPEC's production cuts to be extended into 2019 and beyond, escalating geopolitical risk and the possibility of Iran sanctions. We believe that stable oil prices are a key driver that will boost the performance of energy stocks and MLPs allowing these stocks to catch-up to the rise in oil prices.

Ed Russell: Okay, so moving to natural gas, it seems like the winter of 2018 was never ending. Brian, can you talk to us about demand and your outlook for natural gas?

Brian Kessens: Sure. Weather was certainly on the minds of most of us in the U.S. this winter. Natural gas prices were volatile at the beginning of the year, particularly in the Northeast where the "bomb cyclone" brought exceptionally cold weather in January. The high demand for natural gas in that region drove prices sharply higher and liquefied natural gas (LNG) was brought in from Russia to help fill demand. From a price perspective, natural gas prices opened the year at $3.69 per million British thermal units (MMBtu), quickly peaked at $6.24 on January 2nd and then ended the quarter at just under $3 and has remained steady.

Natural gas production is expected to average 79.6 billion cubic feet per day in 2018 and 84.9 bcf/d in 2019, both of those are significantly above 2017 levels. This production will be facilitated by increased pipeline takeaway capacity in the Northeast and associated natural gas production from the Permian basin. Demand is being driven by greater natural gas fired power generation, higher industrial activity and exports, both exports to Mexico via pipeline and exports via LNG.

Ed Russell: Okay, so turning to midstream, Matt in your opening remarks, you mentioned the FERC ruling which scripted a major plot twist for the sector toward the end of the quarter. Can you give us the cliff notes version of what transpired and your take on it?

Matt Sallee: Ed, how come you ask Brian about bomb cyclones and I get to talk about FERC! But seriously, the Federal Energy Regulatory Commission announced what industry participants believe was a decision that really lacked a well-reasoned basis which significantly disrupted the market on March 15th. FERC ruled against a long-standing policy allowing MLPs to include an income tax allowance in cost-of-service rates. Removal of this allowance in these calculations may result in a lower tariff rate and ultimately lower cash flow for pipelines that are affected. However, this change only affects MLPs with interstate natural gas or petroleum pipelines operating in a cost-of-service framework with the latter, the petroleum pipelines, not seeing any potential impact until 2021. Pipelines using negotiated or market-based rates are unaffected. The ruling also does not impact pipelines held by C-corporations, it also does not impact gathering and processing assets. So I'd say the bottom line here, is not all companies are impacted the same, if at all. In fact, we estimate less than 10% of the cash flow for midstream MLPs operate under this cost of service arrangement making the net impact of income tax allowance or ITA loss less than 2% of cash flows. Nearly all MLPs concur and have issued public press releases confirming this with an announcement that it is immaterial to their business.

Ed Russell: So, sticking with the midstream sector, Rob, what's the temperature in the capital markets, what impact is fund flows having on financing growth projects and also talk about the progress of the self-funding model we've been hearing about.

Rob Thummel: Sure. So, historically, the capital markets have been critical as the primary source of financing growth projects and acquisitions. Over our long history of investing in MLPs here at Tortoise, there have been periods when capital markets have been less accessible. Given the current poor sentiment associated with the energy sector, capital markets access has been challenging. MLP management teams are adapting and looking for alternative ways to finance growth projects in the future. We believe the need for alternative forms of capital, like private investment in public equity or PIPE deals and preferred equity will continue into the foreseeable future. Also, MLPs generate a lot of free cash flow and we expect MLPs to retain more of this internally generated cash flow to fund growth projects. In fact, our models indicate by 2020 internally generated cash flow could fund 40% of capital requirements.

If you shift to M&A activity, among MLPs and other pipeline companies, it slowed during the first quarter with approximately $11 billion in activity announced. Enbridge Inc. had the largest transaction of the quarter as it purchased newly issued common units from Spectra Energy Partners, LP in exchange for all if its incentive distribution rights (IDRs) as well as its general partner economic interests for approximately $7.2 billion.

Now, we believe removing or eliminating IDRs is a key component in the evolution of the MLP self-funding model, as they enhance coverage, reduce leverage and improve the cost of capital. While this is not an easy transition for all companies and we have seen some pain across the space, the transition is certainly making progress and we believe investors are beginning to take notice.

Ed Russell: So, on that note, Brian where are we at with MLPs simplifications? Should we expect this trend to continue and to what degree?

Brian Kessens: Sure. As we look at the changing MLP landscape we continue to see companies simplifying their structure and eliminating IDRs. We think this evolution is good for the sector and will result in a more sustainable MLP model as the cost of capital is lowered and corporate governance is improved.

More than half of the companies in our Tortoise MLP Index® **now** no longer have IDRs and by the end of 2019, we expect three/fourths of the companies on a weighted basis in the index will no longer have IDRs. In fact, the 10 largest MLPs based off of today's sizes, will not have IDRs by the end of 2019.

A frequent question that we are fielding is "Are all MLPs converting to C-corporations?" From a tax perspective both the C-Corp and the MLP structures benefitted from tax reform. C-Corps received a corporate tax rate reduction from 35% to 21% and MLPs were granted a 20% deduction for domestic income earned from pass through entities along with a reduction in the highest marginal tax rate by 2%.

Despite the negative rhetoric in the market about conversions, many companies are assessing their options to determine if there is an advantage. We think this is a company-specific decision and conversion may make sense for some MLPs, but not necessarily all. For some midstream companies, the C-Corp structure may be more attractive, particularly if as part of a transaction the company is able to avoid paying taxes for a period of time. But it's hard to argue that there isn't value to having no entity level tax as an MLP than to have a tax liability. So over the long term, an MLP has a lower cost of capital. Largely though, we are structure agnostic. We are interested in the underlying midstream assets so it makes no difference to us whether or not the assets are held by an MLP or a C-corporation.

We also get asked a lot if conversions to C-Corps means a distribution cut always takes place when a company converts or eliminates its IDRs. This is case specific, yet the most recent deal from Tallgrass does not result in a reduced distribution. We also looked at three other transactions that we anticipate. In each case, there is little to no impact to the LP distribution.

Broadly, transactions that are taking place are from a position of strength are handled and received much differently than some of the previous transactions or historical transactions that occurred from a position of weakness, usually related to balance sheet pressures.

Ed Russell: Turning to Matt, how are midstream valuations?

Matt Sallee: Midstream valuations are quite attractive and at levels that we have not seen since the financial crisis in 2008-2009. As of March 31st, we estimate MLP equities are trading 35% and 47% cheap based on EV/EBITDA and P/DCF metrics, respectively. So in our view, these are clearly disconnected from the fundamentals. For instance, going back to the 2015, and looking at distributable cash flow per unit, pipeline companies have earned on a weighted-average basis a 10% compound annual growth rate and we think they continue to grow more quickly from here. With oil and natural gas production and demand at an all-time high, we need to get these structural issues behind us, and assuming that occurs we see a lot of light at the end of the tunnel.

Ed Russell: Thanks Matt. So Rob going to you, these current valuations are providing what has historically been very attractive yields. But the question I get from shareholders every day is…is the yield real?

Rob Thummel: We understand that many investors like MLPs for the current income that they provide. We also recognize that the distribution cuts by several MLPs and some MLP products have diminished investor confidence in the MLPs sector. At Tortoise, our focus is on sustainable income. This is where our high quality, company-focused, actively managed approach has served our investors well during turbulent time, specifically in regards to income. We think owning quality companies with asset footprints in strategic production areas is the key to growing income streams for MLPs. For the overall sector, we think MLP investors should see sustained quarterly growth in income growth for first time since 2015. A growing income stream should be a big catalyst for the MLP market, restoring investor confidence by signaling renewed health of the sector.

Ed Russell: Brian: So let's move to downstream area. Can you walk us through some of the highlights from that sector?

Brian Kessens: It's always good to talk about some highlights. The U.S. exports story does continue to build, especially with LNG exports. Dominion Energy's Cove Point export terminal in Maryland became the second facility now to ship LNG cargo from the U.S. following Cheniere Energy's Sabine Pass facility. The Cove Point facility is particularly important to the northeast given the region's robust natural gas production. Other export facilities are currently under construction and several more are proposed. With low cost natural gas prices in the U.S. and high international prices, along with increasing global demand, U.S. LNG potential is great. According to the International Energy Agency, the U.S. could lead the world in LNG exports by 2022.

In addition, the U.S. petrochemical industry has seen a resurgence as a result of the cheap feed stocks available to it in the form of ethane, propane and butane. Specifically, we anticipate over $180 billion dollars to be invested in the petrochemical industry domestically over the next few years, driving continued growing demand for NGLs.

At Tortoise, we actively research the entire energy value chain, including renewable energy, where wind and solar have played an increasing role in electricity generation. According to the EIA, wind is projected to generate 778,000 megawatt hours per day (MWh/d) in 2019, an increase of 12% from 2017. Barring any changes in forecasted factors such as precipitation and snowpack, 2019 is expected to be the first year that wind generation exceeds hydropower electricity generation. Solar electricity generation is expected to increase to 294,000 MWh/d in 2019 from 211,000 in 2017, an increase of nearly 40%. We expect this growth to present further investment opportunities.

Ed Russell: Thank you gentlemen. As we wrap-up, here's a recap of what we think are key catalysts for the energy sector:

- From a macro perspective, the U.S. is expected to be a critical supplier of energy to the rest of the world over the next two decades. As highlighted in BP's Annual Energy Outlook, the U.S. is expected to increase its market share of global oil supply to 18% over the next two decades while supplying nearly one-quarter of the global natural gas demand over the next two decades.
- Right now, stable oil and natural gas pricees will allow U.S. oil and gas producers as well as energy infrastructure companies to showcase operational excellence that results in cash flow growth.
- For midstream, catalysts will most likely be continued execution by companies and proof that they can consistently fund capex with limited access to public equity markets.
- Continuation of the simplification and evolution story will enhance the attractiveness of the space and importantly we feel it can be accomplished without material distribution cuts.
- Midstream companies will need to prove out that the FERC decision is truly immaterial.
- And as catalysts play out, we expect the entire energy value chain, including the MLP sector, to experience higher valuations if the factors I've just listed play out.

Thank you all for joining us today. We look forward to talking with you again. In the meantime, we invite you to visit our website at www.tortoiseadvisors.com to read our recent Tortoise Talk commentary piece and check out our Tortoise QuickTake energy podcast series where we share our views on timely events each week.

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