Tortoise QuickTake Energy Podcast

July 2, 2018

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.

Thanks for joining us today on the Tortoise Quick Take Podcast. I'm James Mick, Managing Director and Energy Portfolio Manager with Tortoise.

The NBA season is over, MLB is coming up on the all-star break and of course the NFL is yet to begin. But for sports fans across the globe, the FIFA World Cup is here to save the day. And it has certainly been exciting. Spoiler alert, if you haven't watched this weekend's games, stop listening now. Still with me? Okay, good, because soccer's two biggest stars, Messi and Ronaldo are both out. And two favorites are out as well, as Germany didn't even advance to the knockout rounds and host country Russia eliminated Spain. It's been exciting with two PK shootouts already in the knockout round. And that's just after four games! Hopefully energy stocks can give us something to cheer about for the second half of 2018. In a few minutes, we'll touch on a multitude of news events as well as a recap of the first half of 2018.

But first, let's start with market performance for the week that was:

- On the commodity front, crude oil was exceptionally strong, up over 7%, while
- Natural gas finished in the red, declining 71 bps
- Shifting to equities, the broader S&P Energy Select Sector Index® moved higher by 1%
- Exploration and production companies, as measured by the Tortoise North American Oil & Gas Producers Index℠ followed crude, up 2.4%
- And finally MLPs struggled, as the Tortoise MLP Index® went down 1.3%

It was a busy week of news, with several noteworthy items, so we'll go rapid fire through these events to hit on all of them.

- On the commodity front, crude oil experienced a huge draw from inventory in the U.S. as supplies dwindled by almost 10 million barrels
- U.S. refinery inputs hit an all-time record high of 17.8 million bpd
- While exports out of the U.S. surged to a new record of 3 million bpd
- Canadian joint venture Syncrude experienced a power outage that has knocked offline over 350,000 bpd of production
  - The facility is likely to be out until end of July per Suncor, the majority owner
  - The result is lower flow of crude oil into Cushing, OK, serving to tighten the spread between WTI and Brent
- Finally, President Trump tweeted that the Saudi's agreed to potentially increase production up to 2 million bpd to offset declines elsewhere in the world
  - It sounds like the true response was that the Saudi's agreed they indeed <u>have</u> 2 million bpd of spare capacity and they would strive to keep the market balanced
  - Needless to say, we believe crude oil will likely see some volatility this coming week as investors digest the latest round of news

Let's jump to company specific news for the week.

- Kinder Morgan announced plans to build another natural gas takeaway pipeline out of the Permian basin, with capacity up to 2 bcf per day. This is much needed in our view and will be the first of likely a few new pipeline announcements to come to market on the natural gas side
- GE announced its intent to sell its 62.5% stake in Baker Hughes in an orderly fashion over the next 2-3 years. Despite the term "orderly," sales such as this very often create equity overhangs and preclude shares from trading well
- Tallgrass Energy Partners unitholders approved the previously announced merger with Tallgrass Energy GP on Tuesday

- As Matt noted last week, equity markets remain challenged within energy, this time evidenced by CNX Midstream Partners. Second largest holder Noble Energy announced a secondary offering of 5 million units, but it was costly as it priced down a whopping 12%!
- Enbridge Inc. received approval for replacement of its line 3 project from the Minnesota PUC with minimal changes, providing a nice boost to the stock, which traded up almost 8% on Friday
- Parent company Loews announced it was exercising its right to acquire the remaining portion of Boardwalk Pipeline Partners units, ticker BWP, it doesn't currently own at the average price of the stock over the last 180 days, or approximately $12.06. This was expected given management's discussion of the event on its last quarterly call. Note, the clause utilized is not present in other MLPs at the same level, which in BWP's case was ownership over 50%. So needless to say we don't anticipate this occurring with others
- Finally, Dominion Midstream Partners, ticker symbol DM, announced that it was resetting its incentive distribution rights by issuing equity to parent company Dominion Inc. Based on our models, this appears to be cash flow neutral, but does provide a longer runway for DM to grow its distribution at the forecasted 5% per quarter. Management is awaiting the outcome of its request for FERC to review its case in response to the income tax allowance ruling as well as how the MLP capital markets progress. This buys more time for those outcomes to present themselves.

Wow, that was a busy week to end the quarter!

Speaking of ending the quarter, we are now halfway through 2018 and it has blazed by. This is a perfect opportunity to quickly reflect back on what we have seen from a performance perspective.

First, crude oil has been red hot, up 23% so far for 2018. Natural gas, not so much, just a shade under flat.

On the stock front, the broad S&P energy index is up almost 7%. MLPs are now down 1% and producers are positive 11%. Utilities haven't fared that well either, essentially flat for 2018.

All energy stocks seemed to be hit by the continual trade war rhetoric in the market and the perceived impact on energy commodities.

That being said, the crude market is leading, and in our view, energy stocks will eventually follow. However, while the front month of the crude contract has moved up nicely this year, the latter end of the curve hasn't moved nearly as much, with the end of 2021's price only moving higher by a little over $3. This continues to weigh on E&P stocks in particular in our view.

On the midstream front, we believe it's a bit more puzzling. Despite strong earnings and outstanding fundamentals, midstream has not been able to keep pace with other energy players. We believe this will change and the fundamental concern remains company specific restructurings and the lingering uncertainty as a result. As those progress and get cleaned up, we believe it will lead the way for midstream to trade in-line with its fundamental underpinnings, which is to say, a lot higher in our opinion!

On the downstream front, utilities as noted have been weaker, but refiners have been very strong as spreads have blown out across not only Brent and WTI, but also across various locations domestically, leading to cost advantaged crude for refiners to profit from.

In summary, it's been a solid start for most energy stocks, besting the S&P 500 for a change. The fundamental backdrop remains very solid and we believe good things are in store for the 2nd half of 2018 as well.

So remain confident energy investors, as we believe momentum is building.

That will do it for today…have a great week and we look forward to speaking with you again soon.

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.

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