Tortoise QuickTake Energy Podcast

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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.

Whew! Last week could not end soon enough. The broad market got spooked by the investigation into the death of the Saudi Arabian journalist, higher interest rate narratives and trade fears. The S&P 500 ended down 4%. The fact that U.S. 3rd quarter GDP growth came in at 3.5%, above expectations, and the PCE price inflation index increased 1.6%, below the expected 2.2% increase, got little attention. We're in a good news is bad sentiment, with the view that higher growth will lead to higher interest rates even if inflation appears benign.

Energy was no place to hide out last week. Assessing the carnage: broad energy declined 7%, with producers off 9%. MLPs bettered both, yet were still down 6%. That despite crude oil hanging in relatively well, down 2.2%, natural gas ending up 1.5%, and fundamentals continuing to point toward strength, though with some exceptions.

Let's jump into the week that was.

The two largest U.S. independent natural gas producers both reported last week and offered a stark contrast. EQT Corporation increased 2018 capex by 14% and took production guidance down 2%. Rationale for the guide, EQT experimented with drilling laterals greater than 15,000 feet, and observed a loss in efficiency gains. In this environment where investors are focused on returning cash to shareholders, no surprise the stock did not take the announcement well. Beware to other producers that try to increase capex and reduce production expectations. Over the longer-term, EQT continues to own a strategic position in low cost, vast natural gas reserves in the Northeast.

On the flip side, Cabot Oil and Gas announced 2019 guidance of lower capex and lower production. Management noted a focus on being free cash flow positive and on returning cash to shareholders through higher dividends and buybacks. The stock closed up 7%. We believe other producers should heed the call to do the same.

With EQT, EQT Midstream also reported. Earnings were in-line yet 2019 guidance was soft and 2019 capex increased due to pipe and labor inflation. Noteworthy, Equitrans Midstream Corporation, ticker ETRN, will start trading on November 13th. This is the midstream ownership currently residing at the parent EQT level that will be spun off, and is a part of the broader company's efforts to simplification.

Speaking of simplification - last week Enlink Midsteam C-Corp general partner or ENLC agreed to acquire Enlink Midstream Partners or ENLK at a 3.5% premium to the prior 30-day average or a 1.1% premium to the prior day's close. The transaction was expected and the low premium was not unexpected as ENLK outperformed ENLC 20% since 6/30. Pro forma, Enlink expects low double digit annualized growth in DCF per unit through 2021 with 1.3x – 1.5x distribution coverage. Simplification, IDR elimination and self-funding – check, check, check.

In further midstream earnings, Phillips 66 Partners, or PSXP, reported earnings ahead of consensus, due to strong crude oil and product pipeline volumes. Further, Bakken regional pipelines were full – a good read through to other pipeline operators with Bakken assets and giving good reason for a Dakota Access Pipeline expansion.

The refiners reported good results. Valero came in above consensus on strong throughput, bought back over $400 million of stock during the quarter and reiterated a commitment to return cash to shareholders. PSX blew through street expectations by 25%, demonstrating the strength of its integrated business model. Cash returns to shareholders were also meaningful, also posting over $400 million in share buybacks.

One item weighing on refiner equities recently is a potential delay in IMO 2020 implementation. Recall, starting in 2020, the global marine fuels sulfur limit is set to drop from 3.5% to 0.5%, forcing ships to use a cleaner fuel, with the potential to significantly boost refiner profitably. Following a meeting last week of the IMO's Marine Environment Protection Committee, and any concerns about a delay in IMO 2020 implementation can be put to rest as a proposal for an 'experience building phase' was rejected.

So what did we learn last week? Energy companies are generally reporting in-line to slightly better than expectations. Investors continue to favor returning greater cash flow to shareholders over capex increases, and in midstream, simplification transactions continue with an outcome focused on higher distribution coverage with an ability to self-fund new projects. Relative to previous sell-offs, the oil market and company fundamentals are on much sounder footing. Balance sheets are stronger and new project potential over the next several years are compelling. We view last week's market performance as only a better buying opportunity.

This week offers a full week of earnings reporting in the energy sector. We expect many more treats here than tricks when weighing energy sector cash flows.

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.

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