Tortoise QuickTake Energy Podcast

Oct. 8, 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.

Hello. I am Tortoise Managing Director and Portfolio Manager Rob Thummel with this week's Tortoise QuickTake podcast.

In September 1987, Ronald Reagan was President and the daily oil production from traditional vertical oil wells was around 8 million barrels per day. Fast forward to today, U.S. shale producers by themselves are producing nearly 8 million barrels per day representing over 70% of total U.S. production. That is pretty remarkable. But what I am about to say is even more remarkable. September 1987 was the last time that a quarterback drafted by our hometown Kansas City Chiefs won an NFL football game. The streak ended this year with emergence of Patrick Mahomes. Mahomes Mania is spreading and coming to an NFL city near you very soon. So, to all of the non-Kansas City Chief fans please accept my apologies for my jubilation around our new hometown quarterback but it's been a long wait.

Now Mahomes has nothing to do with the energy sector but he did attend Texas Tech – the closest major college university to the Permian basin. The U.S. energy sector continues to look for the spark similar to Mahomes left handed pass that led to the Chiefs victory last Monday night. Based on performance last week, maybe the spark has been lit for the sector. The energy sector was the best performing sector in the S&P 500 last week. The energy sector as represented by the S&P Energy Select Sector® Index rose by 1.9%. MLPs performed even better rising by 2.0%. Both sectors were boosted by higher oil prices that increased by 1.5% on continued supply concerns given the low level of global oil spare capacity. In addition, announcement of the USMCA formerly known as NAFTA reduced trade war concerns.

Now, my last Mahomes references I promise, but if you look back at performance since Mahomes debut on September 9th, the energy sector has been the best performing sector in the S&P 500 rising by almost 7% while the S&P is only up 0.6% during the same period. Coincidence? Probably as oil prices have also risen by almost 10% over the same period.

Even with its recent outperformance, valuations in the energy sector remain compelling relative to other sectors in the S&P 500 in our opinion. Take a look at the Price Earnings to Growth Ratio commonly referred to as a PEG ratio. A low PEG ratio indicates that one sector or stock may be undervalued relative to another. When we compare the PEG ratio of the energy sector to other sectors in the S&P 500, the energy sector exhibits the lowest PEG ratio across the S&P 500. While the energy sector's price-earnings ratio is in-line with other sectors in the S&P 500, the sector's growth rate positions the energy sector as the most undervalued sector in the S&P 500 based on its PEG ratio. In fact, according to Bloomberg, the energy sector's 2019 EPS growth rate is the highest amongst all sectors in the S&P 500.

Moving onto news from last week, there were two big announcements.

First, EPIC Midstream Holdings announced a creative solution that will assist with the lack of oil pipeline infrastructure in the Permian. EPIC plans to temporarily convert a natural gas liquids pipeline that it is building to provide crude oil transportation service instead. For background, in 2017, EPIC announced a new 650-mile pipeline that would transport natural gas liquids from the Permian to the U.S. Gulf Coast anchored by a contract with BP. At the time, concerns about lack of crude oil pipeline transportation from the Permian were limited. For instance, Permian oil prices were trading at a $4 discount to Gulf Coast prices when EPIC announced its original NGL pipeline. As mentioned many times this year on podcasts, the Permian basin discount has risen to over $20 per barrel this year and is currently around $15 per barrel. The reason for the elevated discount is lack of pipeline infrastructure to transport growing Permian oil production volumes. EPIC's conversion provides temporary relief alleviating some of the infrastructure bottlenecks until new oil pipelines become operational. In January 2020, EPIC's NGL pipeline will switch back to its original purpose providing natural gas liquids transportation from the Permian to the Gulf Coast.

The second notable announcement in the energy sector last week related to a new liquefied natural gas or LNG export facility in Canada. Royal Dutch Shell and its partners Petronas, PetroChina, Mitsubishi and Kogas plan to construct Canada's first LNG export terminal. Starting in 2023, this project will be capable of exporting almost 2 bcf/d of LNG. This is the first mega LNG project approved in five years and the largest since 2013. The LNG facility will cost $14 billion to build. For comparison, facilities in the U.S cost 25% less to construct while similar facilities in Australia cost almost three times more to build. The allure of this project is that it takes only 10 days to transport LNG from Canada to Asia while it takes 24 days to transport LNG from the Gulf Coast to Asia. The Canadian LNG facility also requires construction of the Coastal GasLink Pipeline Project by TransCanada. This 420-mile pipeline will cost $4.8 billion and will transport up to 2.1 bcf/d of natural gas from the Montney Shale in northern Canada to the LNG facility in Kitimat, British Columbia. At Tortoise, we are capturing various investment opportunities as the global LNG theme grows. Here are a few facts and figures supporting our excitement about this long-term theme. According to the 2018 World LNG report by the International Gas Union, there are currently 478 ships that transport almost 37 bcf per day of LNG to 38 different countries. Japan, China, South Korea and India collectively import 63% of global LNG. Currently, 18 countries export LNG with Qatar and Australia providing 47% of global LNG exports. Global LNG demand has grown at a rate of 6% per year since 2000 and demand is expected to double to 75 bcf per day by 2035. Current utilization rate of existing LNG facilities is approximately 82% so new facilities will need to be built to accommodate growing LNG demand. This is where the U.S. comes into play. By 2023, the U.S. is expected to gain additional market share in the global LNG market growing its current 5% market share to almost 15% by 2023. By 2023, we project the U.S. to be the second or third largest supplier of LNG exports in the world behind only Qatar and possibly Australia.

Those are the highlights from last week. Thanks for listening. We will talk to you next week.

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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