Tortoise QuickTake Energy Podcast

Oct. 15, 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 Matt Sallee, Energy Portfolio Manager at Tortoise.

WOW folks that was a rough one last week. It reminds of a quote from one the all-time greatest 80's movies. "One minute you're up half a million in soybeans and next minute, boom, your kids don't go to college and they've repossessed your Bentley." Who can name it? That's right, these famous words came from Louis Winthorpe III played by Dan Aykroyd in Trading Places. Well at least I don't have a Bentley but I do have four kids to put through college. But about last week, I'll spare you the specifics of how bad things were and instead I'll highlight the worst performer I could think off (email me at if you can find one worse). If you are feeling bad because you're S&P 500 ETF was down 4%, be thankful you're not long heavy crude oil in Western Canada. At least I'm assuming our typical listener isn't. Due to pipeline constraints from Canada to the U.S., heavy Canadian crude also known as bitumen was down 60% over the last five days and actually closed at $2.99 per barrel on Thursday. Now that's a rough week. Why do I bring this up? Well, because I've always wanted to say bitumen on my podcast but also it demonstrates how tight pipeline infrastructure is across North America.

Speaking of infrastructure…

The big midstream event last week was the conclusion of Antero's strategic review which has been ongoing since early Q1 this year. During this process the company was addressing a few investor concerns including economic misalignment of interest between management and public investors, a complex structure and a desire to unlock value for and return capital to shareholders. After what we believe to be a thorough analysis, with all potential outcomes on the table, the company decided to:

1) Retain the midstream business as they see significant value in the integration of midstream and upstream operations;
2) Combine their midstream entities, AMGP and AM, to simplify the structure and eliminate the IDRs; and finally
3) To return capital to AR shareholders through a $600 million share buyback

In all, we think they did a pretty nice job of creating a solution that had a little something for everyone.

In our view, the LPs were the biggest winner since AM will be acquired by AMGP for a 6% premium and AMGP traded up an additional 9% on the news resulting in a 15% one-day gain for AM unitholders. It's always nice to see the LP come out well in a simplification and it's just a smart long term move for management since the LPs are the long term supplier of capital. The distribution guidance was great too. Rather than the 'ole stealth cut we've gotten all too familiar with, the proforma distribution guidance for 2019 actually moves higher than the status quo. This is a function of AM getting a premium and AMGP sharing deal accretion through 130% year-over-year distribution growth in 2019.

AMGP also fared well through a basis step up from the AM acquisition resulting in a tax shield through at least 2024. This, combined with accretion from the deal, allows for the rapid acceleration of distribution growth I referenced before.

Additionally, the combined company will have 1.25x coverage, leverage between 2 and 3 times and a 27% three-year distribution CAGR. Not to mention they have no external equity needs, access to a deeper investor pool and will have a majority independent board elected by the shareholders.

Last but not least AR will be able to retain control of the midstream assets, unlock the inherent value of their midstream ownership and their shareholders we see some capital returned through the buyback.

Bottom line, I think the company did a nice job in this deal and if you think I'm full of it, just check what the market said. AR, AMGP and AM traded up 3%, 9% and 15% respectively. Not a bad day when all parties involved trade well.

Related to this, one question we continue to get is what does a transaction like this mean for MLP investors. This is just another example of the MLP "going away." I just did air quotes. Aren't you running out of name to invest in? The short answer is no but let me explain why. At a very high level, the way we assess potential investments is by the quality of management, assets and cash flows. These factors determine whether or not we will invest and if so how much. Furthermore, we view a GP and an LP as one security for position sizing purposes. So recent examples like Antero or Williams where the MLP is acquired by its C-Corp sponsor don't result in a smaller investable universe. It simply changes the makeup of that universe. Obviously my explanation of how we look at companies is greatly simplified and much more goes into the actual selection and sizing including our financial model, valuation, energy themes and so on but the point is the same. We analyze companies based off these metrics, not whether or not they have the letters LP after their name.

I'll quickly hit a couple other notable events in the energy market. First, offshore driller, Ensco, announced a deal to buy Rowan for $2.4 billion in the latest offshore consolidation as they navigate challenging offshore fundamentals. And in energy storage news, lithium provider Livent, which is the former lithium unit of FMC, completed its IPO and began trading Thursday. Now it had to price well below the range but it's remarkable they we able to get a deal done in such a tough tape.

I'd like to wrap up today by adding that for those impacted by Hurricane Michael, please know that our thoughts and prayers go out to you. 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.