Tortoise QuickTake EnergyPodcast

Tortoise

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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.

I am Matt Sallee, Managing Director and Energy Portfolio Manager at Tortoise

It was another good one last week in the energy patch with MLPs up over 2% and oil trading over $66 in the U.S. and over $70 overseas.

This leads me to a question I've heard and seen written about a couple of times recently which is "Have MLPs run too far?" Now let me tell you that it warms my heart to get that question after 3 ½ years of being the "C59 boarding pass" of the investing world. No disrespect Southwest in all honesty I love you, your service, my A list and my wife's companion pass. But anyway, so after a 10% run in less than a month, I agree it's fair to ask have MLPs overshot. As we like to say at Tortoise I'm as biased as can be, but, in our view, heck no the midstream space isn't overheated! But my kids going to college depends on energy investments so hopefully some actual facts will lend some credibility.

Based off last Friday's close:

- EV/EBITDA was right at 10.0x for the midstream space relative to an 11.5x long term median resulting in a 15% discount and P/DCF is just under 8x more than 20% below normal
- Another common comparison is MLP yield spreads to utilities. At a current spread of 415 basis points versus 5 year average of 275 basis points, MLPs are one standard deviation below normal
- And while we don't typically track P/E, based off JP Morgan research, MLPs are trading at 15x which is one standard deviation below normal and about 25% below the S&P 500.

So in conclusion, am I biased? Yes. Did I just bore you with a bunch of stats? Probably. Do we think MLPs overdone? Heck no!

Let's move on,

The big news of the week was Spectra Energy Partners becoming the latest MLP to agree with its general partner to eliminate their IDRs, in this case for 172.5 million LP units or a 15.7x multiple. While the multiple was not overly egregious, we had advised the company we were hoping they would take a longer term view with a slightly lower multiple. Nonetheless, dilution from the exchange was manageable and SEP will hold its previous distribution growth steady from pre-restructuring guidance, a win in our view. For all those LP investors out there, don't worry, we continue to fight the good fight for fair unitholder treatment and will be vocal on other potential IDR eliminations with our portfolio companies. If you listened to our recent quarterly call, sorry for the repeat, but this deal results in over half of the MLP space, by market cap, without IDRs and we forecast by the end of 2019 over 75% of the index (and the 10 largest MLPs) will not have IDRs, getting rid of one of the biggest pushbacks from potential MLP investors.

Quickly, in other news, Plains announced they have received sufficient shipper commitments to proceed with Cactus 2, bringing new capacity out of the Permian and Targa and Hess Midstream announced a joint venture to construct a 200 mmcf/d processing plant in the Bakken.

Finally, Sunoco announce closing of its retail divestiture to 7-11 and will redeem $850 million of preferred units held by ETP / ETE. We believe the proceeds combined with the previous asset sales and preferred issuance take ETP out of the common equity market for 2018.

In capital markets, FTS International launched its widely expected IPO of 15.2 million shares in the range of $15-18. The firm's assets include 1.6 million horsepower of completions equipment. The completions market is red-hot right now so we think this relatively small IPO should do okay if the priced right but we do have concerns that too many companies try to come to market or otherwise issue equity.

I'll wrap it up on a related comment on capital discipline. I think management teams focusing on returns over absolute growth will be a key determinate to market performance this year. On that note, Range Resources put out updated five year guidance with significantly lower production growth, but very attractive free cash flow production. So how did the market take it? Not well. The stock took a 10% beating which on the surface looks odd, given they are delivering what the market has been asking for. But when looking beyond the release, the weakness was likely more a factor of them taking down their Louisiana type curve, further evidence that the Memorial Resource acquisition was simply a bad deal.

I'll sign off there, 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.