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.

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Don't look now but MLPs actually posted a positive week. Unfortunately I can't say the same for the first quarter where MLPs got off to early lead only to turn the ball over to broad market volatility and then get dunked on by FERC. Well thankfully we still have plenty of game left and it is Easter Monday so I'm feeling good about a comeback story if you know what I mean. The positive side of the market action is the inbound call volume has spiked with investors looking to allocate capital, especially from insurance and family office money. Hey, who doesn't like a 9% yield?

Shifting gears to last week, the big theme in energy was consolidation where there were two deals including one midstream simplification which was widely expected and a Permian E&P consolidation. Both deals represent a sign of the times that management teams are taking steps to improve equity cost of capital, enhance capital returns and improve governance to highlight the value of their assets. So let's hit the details…

On Monday night I was going through emails as I often do when the rest of the Sallee family is busy watching the "Voice" and a press release came through from just down the road in good ole' Leawood, Kansas, that Tallgrass Energy had announced an agreement between its GP and LP for a consolidation transaction which will eliminate its incentive distribution rights, preserve the current LP level distribution (aka no "stealth cut") and leave the combined entity with 1.2x distribution coverage. It should be noted that the management team announced on February 7th that they were considering a consolidation transaction which caused the LP to outperform the GP by about 20% leading up to the deal's actual announcement which resulted in no premium to the prior night's close. This was the main pushback on the deal, however, if you were already long the stock it worked out pretty well, plus you got an additional pop in both securities following the announcement. Overall, a pretty good outcome in my view.

Moving on, Wednesday morning Concho Resources announced it will acquire RSP Permian in a deal with an equity value of $8 billion, a 29% premium to RSP's prior close. I told you these energy companies are cheap! This creates the largest pure- play Permian E&P and the industrial logic makes sense to us. It's worth noting management expects $2 billion in present value of capital efficiencies and $60 million of annual overhead savings but we always want to do our own work and take these estimates with a grain of salt, as management teams have been known to take some liberties. That said, one thing is for sure, we think Concho and RSP are both top notch operators and we do not doubt the quality of the acreage that RSP brings to the table.

Moving on…while clearly the energy market has pretty much stunk since 2014, let's take a step back and see what last week's deals demonstrate. Tallgrass went public in May of 2013 at $21.50 paying an annual distribution of $1.05 per year. At this point in time oil was $100, natural gas was $4 and the MLP Index was trading inside a 6% yield. Ah those were the days, when life was simple and anybody with calling themselves an MLP manager could get gather some assets make some pretty decent returns. Fast forward to today, oil is around $65, natural gas is $2.70 and the MLP Index is sporting a 9% yield. Well as of Thursday's close, Tall Grass has produced a 130% total return since its IPO and is paying a $4 dividend. Oh, and that other deal I mentioned, RSP, its produced a 140% total return since its IPO in January 2014 (oil was $100 then too). These names were two of our biggest bets in our midstream and energy value chain strategies, respectively. The point of all my rambling here is to demonstrate that our portfolio companies have great value and can produce very nice returns even in a tough commodity tape. You just need to make sure you own the right names and sooner or later something will lead to the market recognizing that value.

I'll finish up with some organizational thoughts. Since the FERC income tax allowance news, there has been a ton of discussion on whether we will see more MLPs convert to corporations. We've already touched on this in prior podcasts but we think the answer is yes. Why am I bringing it up again? Because last week we saw two partnerships announce they are electing to be taxed as a corporation to touch a broader investor base. Now to be fair both companies were small upstream MLPs but they are data points…add to this the Tallgrass roll-up which results in the LP going away and a corporation remaining. So how did the three names trade? The average return post announcement for those three names was a positive 8%. So do I think all MLPs are all converting to C-corps? Hopefully! Seriously though we like midstream assets and don't really care whether they are MLPs or corporations, but I would note that we believe it's still makes the most sense to be an MLP and not pay entity level tax. I know I personally don't like paying taxes. Take Oneok for an example. It was one of our biggest positions when they had an MLP and it still is now as a C-corp. And just to be clear, I'm not predicting widespread conversions, but in a few instances we do expect some more roll-up transactions.

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.