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 Matt Sallee, energy portfolio manager at Tortoise. Hello folks, happy belated Martin Luther King Jr day. If you're thinking I sound a little hoarse today it's because, well, I am. I attended the first ever AFC championship played at Arrowhead Stadium and nearly blew out a lung screaming only to have my heart broken yet again. Let's move on before I start back in with the profanities. I do have some good news though, energy markets were up again last week with midstream MLPs up 2% and C-corps 3%. Likewise, oil was up 4% and the S&P Energy Select Sector® Index up 3%.

Switching to news, last week OPEC released their December market report which contained a few noteworthy points:

- December production from OPEC was down 750 mbpd from November led by Saudi Arabia which was down half a million barrels per day. Additionally despite waivers on sanctions from the U.S., Iran dropped yet again. Also, as expected Venezuela's decline continued.
- 2019 U.S. liquids supply growth is estimated at 1.7 mbpd which seems pretty aggressive to me with tight infrastructure across various basins but 2018 surprised me too.
- Demand growth forecast continues to be robust with an expected 1.3 mbpd higher consumption

Earnings kicked off last week with Kinder Morgan and Schlumberger.

Starting with Kinder, results were in line with our expectations for a strong quarter. Refined product volumes were up 1%, crude volumes were up 10% and natural gas volumes were up a whopping 15%. One big discussion topic on the call was their exposure to PG&E who recently announced plans to file for bankruptcy due to liability from the California wildfires. We believe Kinder's only exposure is $100 million per year of revenue on the Ruby Pipeline or about 1% of EBITDA, so manageable. Regardless, when PG&E had to file in the early 2000s from poor regulation which didn't allow pass through of increasing supply costs, they didn't reject any transportation contracts so that is a promising precedent. That said, with the bankruptcy there is obviously uncertainty.

I will comment more on PG&E shortly but sticking with earnings, Schlumberger also reported last week. Despite poor North American results where margins contacted and revenue fell sharply the stock traded up 8% on the report. So what gives? Well, we see a few reasons. They held the dividend, called for improvement in their international business and let's face it, the OFS sector got destroyed last year so anything short of a train wreck may be rewarded. This will be interesting to watch this quarter.

I've said this before but I love earnings season because it gives us a chance to get the latest health checkup on our portfolio and grade ourselves on our forecasts and our picks. And the other really cool thing is distribution announcements. So how has it been so far? In the MLP space we've had 21 declarations with an average 1.6% sequential increase. In fact as we look forward in 2019 we estimate the combination of healthy profits, the near completion of the simplification trend and heathy coverage and balance sheets result in sequential distribution increases for MLP indices which we think is a key ingredient to attracting retail investors back to midstream.

So I want to get back to PG&E. I covered gas transmission contracts but what about all those legacy power purchase agreements they've signed over the last several years from solar and wind projects? The unique factor here compared to gas transmission is due to significant decline in the cost of renewable projects over the last 10 years many of their PPAs are way out of the money compared to current market price per MWh. For context, PG&E has many PPAs in the mid $100 per MWH and as high as $180 per MWh versus $30-$50/MWh market price today. This is a huge uncertainty for those companies but there is a strong argument these contacts won't be reset as this would significantly impair California's ability to meet its lofty renewable goals. Specifically for PG&E it is hard to imagine them having the ability to procure additional PPAs anytime soon. Further, while it's uncommon for a utility to be forced into bankruptcy, project developers may already be requiring a higher hurdle rate across the country following PG&E's recent troubles.

I'll leave it there for now. 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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Producers = Tortoise North American Oil & Gas Producers Index℠
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