Tortoise QuickTake Energy Podcast

Aug. 13, 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.

Last week we declared an official end to the second quarter earnings season. Since beginning of the earnings season on July 18th, our team listened to approximately 250 hours of conference calls highlighting quarter earnings and the outlook for the remainder of the year for companies across the energy sector. At Tortoise, our coverage spans the entire energy sector – all the way from the big behemoth Exxon Mobil down the value chain to wood pellet manufacturer Enviva Partners.

In the final week of the earnings season, many of the companies emphasized some of the common themes experienced during this earnings season.

The first common theme relates to rising Permian basis differentials due to lack of pipeline takeaway capacity. Last week, oil and gas producer Carrizo Oil and Gas announced plans to shift drilling rigs away from the Permian Basin and into the Eagle Ford Shale. In general, the discounted oil price realizations received by many Permian producers are resulting in several Permian producers reducing drilling activity. Of course, they are companies that benefit from cheap Permian crude oil prices. One of the direct beneficiaries of the cheap crude also reported results last week. Delek Corporation operates refining assets primarily in Texas and Louisiana. Delek buys two-thirds of its oil at discounted Permian prices refining it into gasoline, diesel and jet fuel. Delek highlighted its earnings potential if the Permian Basin oil prices remain $15 below the benchmark – West Texas Intermediate or WTI. Analysts forecast Delek's third quarter EBITDA to almost double over second quarter EBITDA if differential remain wide. So the next question is, "How long will this differential last?" Plains All American is one of the energy infrastructure providers that is building a pipeline to solve the basis differential challenge. On its conference call last week, Plains noted that partial service on its Cactus II pipeline could begin during the late third quarter of 2019 which is a little earlier than most expected. However, Plain's management made another interesting observation noting that Permian pipeline construction is moving at a little faster pace than the docks. "Why does this matter?" Well, a majority of the oil running through the new pipelines being constructed will likely be exported. Additional infrastructure in the form of new export docks need to be built or existing docks need to be expanded to complete the infrastructure puzzle allowing for efficient transportation of Permian oil to the ships to carry the oil to its ultimate international destination.

A second common theme this earnings season is the impact of steel tariffs on oil and gas producers. Last week, Permian producers Pioneer Natural Resources and Parsley Energy raised capital expenditures for 2018 partially due to steel tariffs. Pioneer indicated that steel costs will be 20% to 25% over prior years cost for the same products.

Speaking of tariffs, liquefied natural gas provider Cheniere Energy addressed the possibility of tariffs on U.S. LNG imports to China last week. Cheniere management confirmed that its existing contract with China would not be altered by any tariff change. Cheniere still expects long-term LNG demand to remain strong. In the future, U.S. LNG could fill a supply gap created if China chooses to import LNG from another source.

Shifting to performance last week. The energy sector as represented by the S&P Energy Select Sector® Index was unchanged last week while MLPs as represented by the Tortoise MLP Index® kept up their blistering pace rising by over 2%. Once again, positive or near positive returns show improving sentiment for the energy sector given the 1% decline in crude oil prices for the week.

Now that the earnings season has come to a close, let me give you a recap of the best and worst from a performance perspective during the second quarter earnings season. The second quarter earnings season began on July 18th ended August 10th. During this time period, commodity prices were mixed with oil prices declining by almost 2% while natural gas prices rose by 9%. Returns for the broad energy sector were flat. For the second quarter earnings season, MLPs delivered the best performance rising by 9%. MLPs started the earnings season with significant momentum from the announcement of FERC's revised income tax allowance policy. This momentum accelerated throughout the earnings season as many MLPs reported better than expected results as well as new projects propelling the MLP sector even higher. In my opinion, the highlight of the earnings season related to the number of export projects announced. At Tortoise, we have been talking about increasing U.S. energy exports and the critical role that the U.S. will play as a supplier of energy to the rest of the world for a while. We are starting to see the infrastructure be put in place to make this happen. For example, Enterprise Products, Tallgrass Energy and Trafigura, all announced new potential offshore oil export terminals. In fact, Trafigura projects U.S. oil exports to more than double current levels reaching 4.8 million barrels per day by 2022. The award that no one wants as the worst performer during the second quarter earnings season goes to DJ/Rockies oil and gas producers that experienced an average decline of 9%. The weakness is attributed to a Colorado ballot initiative that may have garnered enough votes to appear on the November ballot. Initiative 97 would establish the minimum setback of oil and gas wells to 2,500 feet — from the current 500 feet for homes and 1,000 feet for schools. If passed, experts estimate that 4 out of 5 acres would be off limits to new oil and gas drilling.

Before we go, one additional noteworthy item. A new MLP IPO was filed last week. Rattler Midstream Partners LP filed a Form S-1 for a $100 million initial public offering. Rattler operates crude oil gathering pipelines, natural gas gathering pipelines and a fully integrated water system in the Permian Basin. What is so significant about this IPO? Rattler filed as an MLP with no incentive distribution rights or IDRs.

Sadly, two legendary MLP entrepreneurs Dan Duncan and John Eckel both who led the charge for elimination of IDRs are no longer alive to celebrate this day.

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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The Tortoise MLP Index® is a float-adjusted, capitalization weighted index of energy master limited partnerships (MLPs). The index is comprised of publicly traded companies organized in the form of limited partnerships or limited liability companies engaged in transportation, production, processing and/or storage of energy commodities.
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