Tortoise QuickTake
Energy Podcast

May 7, 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.

Thanks for joining us today on the Tortoise QuickTake Podcast. I'm James Mick, Managing Director and Energy Portfolio Manager with Tortoise.

It finally feels warm here in Kansas City with a couple of weekend days in the 80's. That brings about summer movies, baseball and of course barbecues. Never mind the fact that we appear to have skipped right over spring. Early May also brings with it lots and lots of earnings. We'll get to those momentarily.

But first, let's start with a recap of market performance:

- On the commodity front, crude oil was pretty strong, up approximately 2.4%, while
- Natural gas was weak, falling 2.2%
- Shifting to equities, the broader S&P Energy Select Sector Index® increased 2 basis points
- Exploration and production companies, as measured by the Tortoise North American Oil & Gas Producers Index℠ were just marginally better, higher by 33 basis points
- And finally MLPs were essentially flat, as the Tortoise MLP Index® fell 5 basis points

The big news of the week was the announced merger between Marathon Petroleum Corp. and Andeavor, already two of the larger refiners in the United States. In the deal, Marathon, (ticker MPC), will acquire Andeavor, (ticker ANDV), for approximately $152 per share, a 24% premium to the previous close. Despite becoming the largest domestic refiner post transaction, the deal is likely to receive FTC approval as the assets of the two companies barely overlap. MPC operates primarily in the Midwest and Gulf Coast, while ANDV operates almost exclusively in the West, with some Midwest exposure.

Post combination, the pro forma entity will have 16 refineries, representing over 3 million barrels per day of capacity. The expected closing date is sometime in the 2nd half of 2018.

Additionally, both companies have midstream MLPs: MPLX, owned by Marathon and ANDX, owned by Andeavor. While over $1 billion of expected synergies helps bring accretion to the parent companies, it's less clear the outcome for ANDX. The company was well positioned with over $700 million of EBITDA remaining at the parent to be dropped into the MLP over time as well as an attractive growth profile of organic opportunities, specifically in the Permian. The transaction brings into question how the new general partner will handle its new LP. Ultimately, if history is any guide, this likely results in a roll-up of ANDX into MPLX at some point, but should allow for ANDX to continue growing prior to that given solid coverage metrics and organic growth projects.

And based on that, we fully anticipate a very positive benefit for MPLX. Already one of the largest MLPs with an attractive asset footprint, MPLX stands to gain a more robust footprint in the Permian, as well as a solid foothold in the Bakken when the likely combination occurs, extending an already impressive growth profile.

On the negative front, midstream MLP TC Pipelines announced a 35% distribution cut as a result of the FERC announcement about 3 weeks ago regarding MLPs no longer being able to utilize the income tax allowance when setting tariffs. This was very puzzling to us. While we do not own the security at Tortoise, we had identified it as a name with a pretty decent cash flow impact as a result of the FERC decision. However, the timing of the events is odd and what we considered puzzling. Management noted in their press release they are reviewing strategic alternatives, with what would presumably include a buyout by parent company TransCanada or even a conversion to a C-corp. What doesn't make sense to us is why one would pre-emptively cut the distribution prior to knowing the ultimate outcome of their own strategic review?

Needless to say we were more concerned about the impact to the entire space, but fortunately it did not cascade across the entire sector as the Tortoise MLP Index® was down less than 1% on the day of the announcement and rebounded to end the week.

We'll end on a positive note. While earnings were far too numerous to touch on every company, I wanted to share some general themes.

From an upstream perspective, cost inflation appears relatively in line with previous estimates of 5-15%, depending on the company. A few companies noted increases in spending, but for the most part, the party line was held, and i.e. spending will remain what was originally lined out, despite the higher crude oil prices. Additionally, a handful of companies noted higher production for 2018. Finally, some massive well results were generated in the Bakken, Permian and Stack plays by various companies.

Midstream has had a great quarter with several solid beats so far this earnings season. Strong volumes and improving rates are the main themes, as well as the need for continued infrastructure as several new project announcements were made in conjunction with earnings.

Finally, on the downstream side we continue to see strong results out of several companies, but the biggest beat of the quarter belonged to Cheniere Energy, who posted a massive earnings result versus consensus on the back of higher volumes and strong marketing margins.

While obviously not all companies have been positive, it has been a very strong earnings season for energy stocks and supports one of the major tenants of our bullish thesis, that of improving fundamentals driving stock prices higher.
That will do it for today. Have a great week and we look forward to speaking with you again soon.

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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