Tortoise QuickTake Energy Podcast

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Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, Tortoise provides a timely update on trending topics in the market.

Hello. I am Tortoise Managing Director and Portfolio Manager Brian Kessens with this week's QuickTake podcast.

Halloween came early this year in Kansas City. The sight of Chiefs quarterback Patrick Mahomes laying still as a mummy on the ground with a deformed leg joint, filled fans with fear, horror, and panic. Stomachs churned, eyes closed and beer spilled at the thought of a promising football season ending in an instant. Fortunately, Mahomes was seen walking later in the game and there was nothing horrific to the start of energy earnings season.

Kinder Morgan kicked off third quarter midstream earnings, reporting in-line with expectations. Specifically, natural gas transport volumes showed continued strength, higher by 13% year over year with the largest gains from Permian and LNG feed activity and coal to gas fuel switching for power generation. Related to the sale of Kinder Morgan Canada, the company expects to use the proceeds for a combination of debt reduction, capex financing and share repurchases. Kinder also noted that interest in its assets from private equity and others is strong and at multiples above KMI's current multiple.

The largest oilfield service company, Schlumberger, reported results slightly ahead of estimates. The quarter was helped by production and hurt by drilling, and included a $12.7 billion pre-tax non-cash impairment charge. Yes, recent service acquisitions haven't worked out so well, bye to goodwill. The company also guided to improving international performance in 2020 while North America will be softer. Management noted its key focus is to improve return on capital by growing free cash flow. As such, expect Schlumberger to be work toward margin improvement. Mahomes managed to start walking around after simply getting his kneecap popped back into place. Expect oilfield service margin improvement to be a tougher challenge.

What was Mahomes doing running a quarterback sneak in the first place, already having a very tender left ankle? Questionable call by the Chiefs offensive brain trust, and there were two questionable calls last week by energy management teams.

First, in corporate acquisition news, Parsley Energy agreed to acquire Jagged Peak Energy for $2.3 billion in an all-stock deal. The exchange ratio implied an 11.2% premium to Jagged Peak's previous close. Rationale for the transaction included overlapping acreage in the Permian's Delaware basin that can drive $40 to $50 million in annual operating synergies. Parsley expects the purchase to be accretive to cash flow generation and to increase the percent of oil to total production. While we think upstream consolidation in the current environment makes sense, we were surprised to see Parsley as a buyer, viewing the company as more of a seller. Further, we think stock for stock combinations of small to mid-caps are much less compelling than all cash acquisitions by larger producers.

Second, DTE Energy announced an agreement to acquire a natural gas gathering system in the Haynesville Shale for $2.25 billion plus a $400 million milestone payment. While predominantly a regulated utility company, DTE management desired to make a big midstream acquisition and this asset fits that description. The associated revenues are backed by long-term contracts with Indigo Natural Resources. Who's Indigo? The company is one of the largest private producers and the largest natural gas producer in Louisiana. Indigo also has a strong balance sheet with leverage at 1.0x debt / EBITDA. DTE intends to finance the acquisition with an equal mix of mandatory convertible equity and debt. The transaction is immediately accretive and accelerates achievement of DTE's five-year investment plan to invest $4-$5 billion in midstream. This transaction continues a trend of traditional utilities, along with private equity, acquiring midstream assets. Specific to DTE, we understand the intent to grow midstream, yet we think Haynesville gathering assets may not have been the best way to grow DTE's midstream footprint given this is a new basin for DTE and the Haynesville is a basin hard pressed to grow production in the current low natural gas price environment. Given management's strong track record, for now, they likely get the benefit of the doubt.

With my mind on the pigskin, I almost forgot performance. Crude oil was softer by 1.7% with natural gas inching slightly higher. MLPs shed 0.5% and broader energy slid 1.5%. I wish energy valuations were as easy to snap back into place as a kneecap.

This week, energy earnings ramp in a bigger way with several large cap leaders reporting. We're expecting constructive reports. Oh, and as for Mahomes, we probably won't see him for three weeks. Yet don't worry, Tortoise will be here next week right on schedule.

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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