Tortoise Energy Podcast

Tortoise

May 4, 2020

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

Good to be with you today, I am Quinn Kiley, Managing Director and Energy Portfolio Manager at Tortoise and I am happy to be with you for this week's Energy Podcast. The global population and economy continue to be negatively impacted by the COVID-19 pandemic. Local economies in Asia, Europe, and even here in the United States, have started to re-open. Early indicators from China suggest economic activity, excluding aviation, is close to a full recovery. China's crude oil consumption in late April exceeded levels from the same period in 2019. Energy securities have remained buoyant, despite lower oil and gas commodity prices. A week after the May West Texas Intermediate crude oil futures contracts settled in negative territory for the first time ever, prices for the June contract rose 28% after weak trading to start the week; roaring higher by 95% off the lows. The strength in energy may be due to rebounding demand in Asia and continued news of oil companies across the globe reducing production levels to react to the current oversupply situation. Norway announced production cuts last week, and public companies like ConocoPhillips and Continental Resources are shutting in production in certain areas. Broader markets were reacting to another fiscal stimulus bill intended to prop up the consumer and Federal Reserve Chairman Powell reiterating the Fed will do whatever it takes to support capital markets.

The markets were generally up for the week:

- The Alerian MLP Index finished up 4.5%, is up over 104% from the mid-March intraday lows, but remains down over -41% year to date
- Other energy stocks, represented by the Energy Select Sector SPDR (XLE), was up 4.9% for the week
- In broader markets, the S&P 500 lost -1% for the week and the ten-year treasury was flat

When I was last with you, I mentioned that the current environment may provide management teams an opportunity to conserve cash, whether to improve liquidity or to protect credit ratings. While we haven't heard from every energy company yet, we have heard from enough to know that cash conservation is occurring, and the market appreciated these moves. On the oil majors front, Royal Dutch Shell announced a 66% dividend cut, the first since World War II. Exxon Mobil announced in April that it would not increase its annual dividend for the first time since 2003. Chevron also announced a better than expected quarter, reducing cap ex, and held their distribution flat as well. On the midstream front the distribution news was mixed. Large cap names, like Enterprise Products Partners, TC Energy, Energy Transfer, and Kinder Morgan have maintained or slightly increased their shareholder payouts. Many mid and small cap midstream companies slashed their distributions, in some cases up to 90%. We note that those players closer to the well head, or those with more supply-oriented businesses, have been more aggressive on cutting. ONEOK, a leading midstream company, announced earnings last week. OKE does has some exposure to declining production and reported a slight miss in earnings. The company delayed several capital projects, bringing the total 2020 reduction in cap ex to $900mm. While the company performed well during the quarter, despite the contracted nature of their cash flows they pulled 2020 guidance given the uncertain economic outlook. Oilfield services and oil and gas producers operate in a more distressed parts of the energy value chain. As a result, we have begun to see bankruptcy announcements from names like oil producer Whiting Petroleum and services company Diamond Offshore, both of whom opted to restructure through Chapter 11. Towards the demand end of the energy value chain we have seen some relative strength. Cheniere Energy, the leading liquified natural gas exporter in the U.S., announced earnings last week. There has been a lot of chatter globally about LNG consumers cancelling orders. While Cheniere did see a handful of cancellations, their contracts still require payment. As a result, Cheniere posted better than expected earnings and held their 2020 guidance unchanged despite the economic impact of COVID-19. Williams Companies, a midstream natural gas company, will announce earnings today after the close. While we do not know results yet, their demand driven system of natural gas pipelines is performing well enough that they announced last week the company will maintain its dividend in May; perhaps indicating resilient earnings during the first quarter. Downstream

companies, like refiners, saw direct impacts of pandemic demand destruction. Valero Energy reported earnings last week. For the first quarter the company reported a $1.9 billion loss, driven mainly by a write-down in inventory values and associated working capital adjustments. Interestingly, utilization for the quarter was at 90%, highlighting the short duration of the pandemic's impact on the first quarter. More importantly, the company was forecasting a 71% utilization rate for the second quarter. This is generally in line with what we have heard from other industry reports that refinery run rates are near 68%. The stock rallied more than 14% after earnings as they announced reduced cap ex and that the industry is seeing demand for refined products begin to recover. In fact, the whole refining sector rallied as the EIA announced a bigger than expected draw from gasoline inventories. Overall, in our energy infrastructure universe we have seen dividend and distribution announcements from most of the group. First quarter payouts from midstream companies are down six percent quarter over quarter and down four percent year over year. 48% of the universe reduced payments for the quarter, 15% raised, and the remainder were unchanged.

Perhaps more meaningful than equity holder payouts, virtually every energy company that has spoken publicly on the topic has reduced their 2020 capital expenditures. Last week Antero Resources and its midstream MLP both announced cap ex reductions. Unlike the previous energy swoon in 2015-16, producers are now being forced to reduce production to respond to weak market demand due to COVID-19. This allows to midstream players to correspondingly reduce their capital outlays, which is a different outcome from 2015-16. Year to date, we have seen multiple announcements of reduced capital plans from across the value chain. In many cases the cuts have been greater than 50% of previously announced plans. For the 40 midstream companies that have consensus estimates for cap ex, we have seen downward revisions of $9 billion or 18% through the end of April. As we have mentioned before on the podcast, these dividend and cap ex reductions improve the free cash flow outlook for these companies. Most companies have opted to reduce their net debt with the excess cash flow. We suspect that many companies will have the opportunity to purchase and extinguish bonds in the open market at prices below the obligations they owe, in other words below par value. This is a modest positive, but another example of levers companies can pull in these challenging markets.

Finally, there was news out from the Energy and Treasury departments that the administration is considering a lending program for small and mid-size energy companies. This was aided by the Fed's plan to lend to Main Street, which may include some energy companies. While there is nothing definitive at this time, this certainly played a part in the big rally in energy stocks we saw on Wednesday of last week. Those public energy companies we are familiar with may not benefit from these plans, but the oil and gas business is very fractured and the small operators do not have access to the capital markets so the program could be very helpful to these businesses. With sustained low commodity prices, we expect the second quarter to be financially difficult for many of the companies we follow and own. Despite this, midstream returned 48% in the month of April. How does a return like this happen in a negative fundamental environment? The sell-off in equities was much worse than the potential downside to the finances of these companies. As investor expectation begins to consider a potential economic recovery, the substantial fiscal and monetary policy reactions, and a recovery of commodity prices from extreme lows the energy equity market can snap back before we see a true recovery in economic activity. All of this is shocking to witness, to the downside and on the rebound. However, midstream valuations still provide a value opportunity for investors looking to buy the most stable cash flows in the energy value chain. The OPEC+ production cut took effect at the end of last week as well, another topic investors may be focused on.

Thanks for joining us and we will be back next week. Please stay safe and help us flatten the curve.

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.

The **Alerian MLP Index** is the leading gauge of energy infrastructure master limited partnerships (MLPs). The capped, float-adjusted, capitalization-weighted index, whose constituents earn the majority of their cash flow from midstream activities involving energy commodities, is disseminated real-time on a
price-return basis (AMZ) and on a total-return basis (AMZX).

Tortoise

The **Energy Sector Index** seeks to provide an effective representation of the energy sector of the S&P 500 Index. The Index includes companies from the following industries: oil, gas and consumable fuels; and energy equipment and services.

The S&P 500® Index is a market-value weighted index of equity securities.

Disclaimer: *Nothing contained in this communication constitutes tax, legal, or investment advice. Investors must consult their tax advisor or legal counsel for advice and information concerning their particular situation. This podcast contains certain statements that may include "forward-looking statements." All statements, other than statements of historical fact, included herein are "forward-looking statements." Although Tortoise believes that the expectations reflected in these forward-looking statements are reasonable, they do involve assumptions, risks and uncertainties, and these expectations may prove to be incorrect. Actual events could differ materially from those anticipated in these forward-looking statements as a result of a variety of factors. You should not place undue reliance on these forward-looking statements. This podcast reflects our views and opinions as of the date herein, which are subject to change at any time based on market and other conditions. We disclaim any responsibility to update these views. These views should not be relied on as investment advice or an indication of trading intention. Discussion or analysis of any specific company-related news or investment sectors are meant primarily as a result of recent newsworthy events surrounding those companies or by way of providing updates on certain sectors of the market. Tortoise, through its family of registered investment advisers, does provide investment advice to Tortoise related funds and others that includes investment into those sectors or companies discussed in these podcasts. As a result, Tortoise does stand to beneficially profit from any rise in value from many of the companies mentioned herein including companies within the investment sectors broadly discussed.*

© 2020 Tortoise