TortoiseEcofin QuickTake Podcast

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Hello, I am Matt Sallee, President of Tortoise.

Well, it's been a choppy first 5 months of the year. After coming out of gates strong energy sold off in March during the regional banking volatility. Things quickly recovered as the market digested the fact that energy companies don't need access to capital with their significant free cash flow but have since then have been trailing off with macro concerns around whether the Fed is done, the debt ceiling and looming recession potential. Through May month end the AMNA is down 2%, MLPs, as measured by the AMZ are up 5% and the S&P energy sector is bringing up the rear, down 11%. The fact that broader energy is down isn't surprising with crude off 15% YTD and natural gas down nearly 45%. In this context, the fact that midstream is holding up is encouraging.

Brian discussed the beginning of earnings season last month, but a lot of companies reported since.

Starting upstream with the producers, the key themes highlighted include:

- First, continuation of capital discipline and a focus on cost structure and operating efficiency
- Next, as the shale patch matures more focus is being placed on inventory depth which has spurred an increase in M&A activity as producers look to extend their development runway.
- Also, with commodity prices lower the variable dividend payments have declined relative to the last couple quarters but buybacks are continuing full speed.
- We touched on oil field services last month, but we are seeing an acceleration of activity declines and price softening.
    - On that point, crude rigs are down 8% year to date while gas rigs dropped 15% in May alone.

In our view, midstream was the bright spot in Q1 energy earnings and frankly one segment across nearly the entire S&P that is seeing earnings grow year over year. Some key points were:

- Buybacks continuing with about $1 billion completed during the quarter and companies pointing to opportunistic purchases during the March volatility. While the $1B isn't on pace to meet our full year $5B forecast we feel good about the activity as we expect things to be back end loaded given current uncertainty in the markets.
- Overall, the median EBITDA beat was 4% which is pretty good for fee-based infrastructure companies with notable beats from Cheniere, Williams, MPLX, Plains and Targa.
- We also had a couple companies raise full year guidance which is rare this early in the year and a couple others hinted at raises later in the year.
- The one pushback I have is a bit of capex creep which is being met with a lot of scrutiny.

Briefly, for utilities most prints were weak due to mild winter weather but generally guidance was maintained for the year. There is a lot of focus on plans to fund capex and potential asset divestures. Finally, we are seeing a modest uptick in pushback on rate increases after years of commodity disinflation offsetting rate base investment; a benefit that may be behind us as the global call on US LNG is expected to elevate gas prices in the future.

I mentioned M&A as a theme in the upstream space but in midstream Oneok (OKE) announced an agreement to acquire Magellan Midstream (MMP) on May 14th. Similar to my comments on capex creep, it's fair to say this deal was met with a fair bit of skepticism. The push back was two-fold. First, on the balance sheet the deal will result in leverage moving up towards 4.0x which is contrary to investors' desire for lower leverage which both MMP and OKE made significant progress over the last few years. The other concern is around the commercial logic of the deal with OKE being a powerhouse in the NGL business while MMP owns a high-quality refined products network serving the Midwest with the question being how do these seemingly disparate assets fit together. Both management teams are well respected, so we'll give them some benefit of the doubt but as an outsider looking in it isn't obvious. This was evident in the market reaction with OKE trading off 9% on the deal's announcement. Tortoise is in the process of releasing a deep dive on the transaction's ramifications for the asset class and its investors so be on the lookout in the coming days.

As of this recording, the debt ceiling legislation has moved from the House to the Senate and appears likely to pass according to the Washington consultants we subscribe to. What we find most relevant to energy infrastructure is modest improvement in the permitting process but also the Mountain Valley Pipeline permits which have some real teeth and just might be the final piece to get this troubled project complete.

I leave it there for now, thanks for listening.

Thank you for joining us. And stay tuned for our next episode. Have topics you want covered or other feedback to share? Write us at info@tortoiseecofin.com.

The **Alerian Midstream Energy Index** is a broad-based composite of North American energy infrastructure companies. 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 (AMNA) and on a total-return basis (AMNAX).

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).

Earnings Before Interest, Taxes, Depreciation and Amortization (**EBITDA**): EBITDA is a non-GAAP measure used to provide an approximation of a company's profitability. This measure excludes the potential distortion that accounting and financing rules April have on a company's earnings; therefore, EBITDA is a useful tool when comparing companies that incur large amounts of depreciation expense because it excludes these non-cash items which could understate the company's true performance.

Liquefied Natural Gas (LNG) is natural gas that has been cooled to a liquid state for shipping and storage - the volume in this state is about 600 times smaller than in it's gaseous state, able to transport for much longer distances when pipeline transport is not feasible.

Producers = The **Tortoise North American Oil & Gas Producers Index^{SM}** is a float-adjusted, capitalization-weighted index of North American energy companies primarily engaged in the production of crude oil, condensate, natural gas or natural gas liquids. The index includes exploration and production companies structured as corporations, limited liability companies and master limited partnerships, but excludes U.S. royalty trusts.

The **S&P Energy Select Sector Index** is a modified market capitalization-based index of S&P 500 companies in the energy sector that develop and produce crude oil and natural gas and provide drilling and other energy related services. Returns include reinvested dividends.

The **S&P 500® Index** is an unmanaged, market-value weighted index of stocks that is widely regarded as the standard for measuring large-cap U.S. stock market performance.

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