Tortoise QuickTake Podcast

August 7, 2017

Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, a senior member of Tortoise provides 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 highlighting the top energy events of last week.

Let's take a quick look at performance across the energy sector last week. The energy sector represented by the S&P Energy Select Sector® Index fell by 1% while MLPs as represented by the Tortoise MLP Index® declined by 1.4%.

We are near the end of second quarter season earnings. Once again, cash paid to investors in the form of dividends or distributions by energy infrastructure companies increased by an average of 1.6% over the prior quarter.

The Tortoise MLP Index® yield is 7.4% as of Aug. 4, 2017. In our opinion, this absolute yield looks compelling when compared to the absolute yield of REITs at 4% and utilities at 3%.

Speaking of the earnings season, I'm not sure who had a worse week. Last week, Anthony Scaramucci or the management teams of Permian Basin oil producers. Last week, the aggregate market cap of pure-play Permian producers fell by approximately $9 billion as the stock prices declined by an average of 10% in one week. Why such a dramatic decline? Two reasons. First, Pioneer Natural Resources, one of the largest acreage holders and leading operators in the Permian, unexpectedly announced a change to its well design. The change will result in higher drilling costs partially due to the longer time it will take for Pioneer to drill each well. This announcement was a complete shock to the market creating some uncertainty about future Permian development. The second cause for concern related to the percentage mix of oil, natural gas and natural gas liquids from each barrel produced in the Permian. Last week, when reporting second quarter results, many Permian producers reported a lower than expected percentage of oil for each well drilled. This surprised investors as the trend had been toward a higher percentage of oil in each barrel produced. We believe this concern is a bit overblown and here is why. For example, prior to last week, the total daily production of a well in the Permian might be 1,000 barrels per day. This includes production of crude oil, natural gas and natural gas liquids. Sixty-five percent, or 650 barrels of total production came from oil so 35% of total production came from natural gas and natural gas liquids. Last week, many Permian producers raised their forecasted production of natural gas and natural gas liquids. However, they did not lower crude oil production estimates. Instead, in my example, the forecast now for the Permian well was adjusted higher to produce 1,100 barrels of crude oil, natural gas and natural gas liquids. Crude oil production isn't expected to decline as it remains 650 barrels but the percentage of oil compared to total production declines from 65% to 59%. This change in oil as a percentage of total production resulted in a significant sell-off in Permian producers so let's address a few questions regarding these issues.

Will the Permian remain a key oil supply basin? Yes, 50% of the U.S. oil rig count is operating in the Permian today. We believe the Permian has been and will be the dominant U.S. shale oil basin. The world's largest energy company Exxon Mobil stated on their conference call last week that their Permian assets rank among the top-tier investment returns in Exxon's global portfolio.

Do the reported results mean that the Permian is expected to produce less oil? No, the Permian is on pace to grow oil production by over 500,000 barrels per day in 2017. The Energy Information Administration forecasts 2018 production to grow by 600,000 barrels per day with the largest contribution of growth coming from the Permian. Longer term, the Permian remains the lowest cost oil basin in the U.S. Additionally, the Permian can produce oil at a lower cost than some OPEC countries. So, we believe that the Permian is essential to the global energy transformation that is underway. Looking forward, the Permian will be one of the low cost suppliers of crude oil to the rest of the world. At Tortoise, we still have strong conviction in the power of the Permian.

What we do expect is higher absolute volumes of oil, natural gas and natural gas liquids from each Permian well, which means additional energy infrastructure is even more essential to gather, process and transport the higher volumes.

Switching gears slightly. Have you seen oil prices lately? WTI hit $50 briefly last week. Since June 30th, crude oil prices have risen by 7%, closing last Friday at $49.50. The fundamentals supporting crude oil prices continue to improve. Since the end of March, U.S. crude oil inventories have declined by over 50 million barrels. In addition, demand is back. Not a lot of people are talking about it but last week the EIA reported record high gasoline demand. Falling supply and rising demand should continue to support higher crude oil prices. Now we need the stock prices of energy stocks and MLPs to catch-up with crude oil price movements.

Lastly, in regulatory news the Senate confirmed the nomination of two new FERC commissions last week. Now the Commission has a working quorum and can address the backlog of over 500 orders. This news is especially welcome by many natural gas pipeline operators in the northeast that are awaiting FERC approval.

Those are 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@tortoiseinvest.com.

The S&P Energy Select Sector® Index
The S&P Energy Select Sector® Index is a capitalization-weighted index of S&P® 500 Index companies in the energy sector involved in the development or production of energy products.

The Tortoise MLP Index®
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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