Tortoise Capital Advisors

Tortoise QuickTake Podcast with Matt Sallee

January 25, 2016

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.

Welcome to the Tortoise QuickTake podcast highlighting our views on the top energy events of last week. I am Matt Sallee, Managing Director and Portfolio Manager at Tortoise Capital Advisors.

Well, for the holiday shortened week last week, it sure was a long one. Not to be outdone by the prior two weeks, volatility REALLY spiked the 3rd week of January. After falling 12% in two days and hitting a new low down 60% from the 2014 peak, MLPs snapped back Thursday and Friday to close the week slightly ***positive***. Seriously? You can't make this stuff up.

To help give some context around the volatility…the first week of the year saw an average daily price swing of 2%. Week two, that increased to 3%. Last week the average daily price swing was nearly 6%.

So to summarize, for the week:
Oil gained 9.4%
E&Ps were up 6.4%
MLPs picked up 1.6%;
and the broad S&P Energy Index increased 1.9%

As you can imagine the question we are constantly being asked is what is driving the volatility. Unfortunately I don't have a perfect explanation but I can tell you market prices have totally dislocated from fundamentals at this point and are being driven by fear and technicals in our view.

Crude has continued to slide (absent the last two days) and MLP correlation with oil has increase to .9 since the fourth quarter compared to .4 long term. Along with the continued oil drop and extreme negative sentiment, we are seeing technical pressure from short selling, deleveraging, fund liquidations and a dearth of buyers. As an example MLP open end funds and exchange traded products raised a meager $2.5B in 2015. This compares to $17.5B in 2014.

So where does that leave us on MLP valuation? As of the close on Friday the 22nd, MLP yields stood at roughly 11% for the index; over three standard deviations wide of the 10 year average and five standard deviations wide of the 5 year average.

And at a 8.5x median EV / EBITDA multiple, MLPs are currently at a 20% discount to utilities on a tax adjusted basis. We think this is pretty attractive especially since MLPs have had 3x the distribution growth of utilities since 2013.

Speaking of distribution growth, contrary to market fears, distributions aren't being cut across the board, in fact they have grown nicely for our midstream portfolios. So far over half of our MLP portfolio has reported has reported Q4 distributions and on a weighted average they increased roughly ~3% sequentially over the third quarter and over 12% compounded annual run rate. Huh. Maybe the MLP model isn't dead after all!

In earnings news Kinder Morgan and Schlumberger reported earnings last week…

Now, If you look at public filings you will see that we aren't a big holder of Kinder Morgan however they do have an extensive suite of assets and their earnings report provides a good read through for other MLPs.

This quarter really highlighted this difference between core and non-core assets. Their core segments did well during the quarter including natural gas and refined product pipelines. As an example, volumes in the refined product segment were up 2% year over year in Q4 and 3% for the full year. And their natural gas pipeline segment volumes beat our estimate by 1% in spite of mild weather and volumes for the full year were up 6% over 2014.

However, this was offset by their non-core oil assets, their oil production business and their bulk terminals where low commodity prices and weak coal demand hurt cash flows.

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We did view their capex reduction positively given that most of it came out of the oil production business where returns are unacceptable in the current environment.

On that note, we believe right sizing of growth budgets relative to current outlook will be a key theme on Q4 earnings, which we view positively.

Management teams really want to avoid issuing equity and debt at current distressed levels and delaying discretionary growth is an effective way to limit external capital needs during the dislocated markets.

Some examples include Kinder Morgan, Plains, Oneok, Targa and most recently today, Williams, who on average have reduced capital budgets 40% from 2015 levels.

Admittedly these companies are likely on the high end of reductions given their particularly elevated cost of capital.

While we haven't had any E&P earnings reports yet, we expect even more pronounced capex reductions here. Thus far 13 public E&P companies have announced capital plans for 2016 with an average 30% capital reduction versus 2015, while still generating flat year over year production.

In oil field service earnings, Schlumberger reported results in-line with expectations. Specifically, North American revenues were down 14% quarter over quarter, with margins falling to 7.1%. We expect other services firms to report lower revenue and thinner margins as well, and we expect pressure pumping and other land services companies to potentially report results lighter than consensus based off Schlumberger's statement about pricing become more unsustainable.

Operationally, Schlumberger is reducing its workforce by 10,000 and streamlining overhead, infrastructure and its asset base. We would not be surprised if other services firms take similar measures. Finally, Schlumberger announced a $10 billion share repurchase program signaling they see significant value at current trading levels.

Capital market activity remained slow last week, but we did have two investment grade rated bond issuances from pipeline companies Williams and TransCanada and a small equity offering from Synergy Resources, a DJ Basin producer.

That wraps up this week's podcast. Thanks for listening.

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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