Tortoise QuickTake Podcast with Ed Russell and Greg Ebel

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Welcome to a special edition of the Tortoise QuickTake Podcast. Thank you for joining us. Today, Tortoise's Managing Director Ed Russell, talks with Spectra Energy's CEO, Greg Ebel, about Spectra and his thoughts on the broader midstream energy sector.

Ed Russell – Managing Director, Tortoise Capital: Greg, thanks for joining us today. I just have a few questions for you. Based on your current share price, what do you think the market's saying about Spectra Energy Corp. and Spectra Energy Partners, their distributions, and the market's general outlook compared to your peers?

Greg Ebel - Chief Executive Officer, Spectra Energy: Sure. Thanks, Ed. I appreciate being here. We are outperforming year-to-date versus the peer group, and I'd expect that to continue.

So, I think this says a few things. First, I think the market overreacted in 2015 to the entire energy sector being challenged. And it's not one entire sector. So, we're starting to see that shake out.

Secondly, I think the market is starting to differentiate between energy players and between different segments of midstream, favoring those companies that, like SE, have a lower risk profile and SEP as well, and I think we helped bolster that sentiment with our three-year plan, and I'd reiterate a three-plan for both SE and SEP that we rolled out in early February.

First of all, very few other midstream companies have three-year plans that are out there public, and ours was actually stronger, the three-year plan, 2016 to 2018, than the one we laid out for investors in 2015 to '17, both for SE and SEP. So, I think the market is starting to recognize companies like SE and SEP with stronger dividend and distribution coverage. We're actually up 20% to 30% over the plan we laid out in 2015 for three years.

And the market is starting to recognize companies like SE and SEP with better liquidity and capital markets access, which implies a more competitive cost of capital and better relative returns and opportunities. I think the market has also started to recognize that SE and SEP are the kind of companies that they like to see because they've got solid investment grade positions and again, I believe that this differentiating view will be further recognized by investors as the year goes along and into 2017 if a "lower for longer" commodities cycle persists.

Ed Russell: Okay. Great. Now, you mentioned your three-year plan. When I look at both SE and SEP, you're both, as of this recording, trading under a 5.5% yield. What's your thoughts on the company's current share price, and is there anything out there that the market is missing when they're coming to that price?

Greg Ebel: Well, I think it is missing a few things, and let me focus on four areas because, you're right, the stock's done pretty well. Both of the units have done pretty well, but I would argue, I'm sure you're not surprised, that I think the price is not where it should be. There are four things that I think the market still needs to recognize and will over time.

The first one is the quality of the $6 billion to $8 billion of projects at SEP and SE, respectively, that we actually have in execution as we speak. Eighty-percent of those projects are demand pull; in other words, they're supported by end-users like utilities, industrials, power generators at SEP and 75% of the projects at SE overall are also demand pull . That's one.

Two, through project execution, like everybody in the sector, particularly on the pipeline side, we see a tough regulatory and citing environment , but we've been able to continue to have a solid track record of delivering our projects within the time plans that we've laid out for our customers. You can see that in projects in past years like New Jersey-New York, OPEN, UnionTown to Gas City, Dawn Parkway , and projects that are in execution today on track as well. Just this year alone, or in the last six months call it, Nexus, which is a key project moving Marcellus and Utica gas into Ontario, received key customers' utilities regulatory approval for those contracts.

The Sabal Trail Project, which is probably the largest project we're executing on now, which is a multibillion dollar project into Florida with both FPL, NextEra and Duke. It just received its FERC certificate earlier this quarter, and therefore it's on plan to meet its in-service date.

Then in the Northeast, in New England, our AIM project and Atlantic Bridge projects are in construction and proceeding as planned; even having gone through re-hearing on AIM. Atlantic Bridge just received its notice of the schedule on the environment front from FERC, very much in line with what we had expected.

So, I think those are key points.

A third thing is the strong investment grade or collateralized customers. So, not only is Spectra Energy and Spectra Energy Partners good investment grade entities, but our customers are too. Ninety-percent of SE and 95% of SEP customers are either investment grade or collateralized. Again, I think this underlines the strength of our demand pull customers. We deliver where the product goes; in other words gas and oil where it's used and consumed not just from the supply area. So, you've got to have both ends of that play. Not all companies have SE or SEP's substantial first and last mile advantage.

Then the fourth thing is I'd say is just the steady, reliable dividend and distribution growth as SE and SEP through '18 with better coverage levels than previously provided to investors. It's very much a differentiator as many of our peers actually lowered expectation in 2016 and beyond.

Ed Russell: Great. That's very helpful. My last question is in regard to your outlook for 2016, and this may be a little unfair, but talk a little bit about it from the perspective of the entire midstream pipeline/MLP, midstream MLP sector. Can you give your thoughts on what you see happening here in the coming year?

There's a couple of things that we talk about, and you addressed one very specifically for Spectra was counterparty risk for the midstream sector, but the other thing that's obviously on people's mind is commodity price volatility and what effect that'll have on the sector on the whole. Can you just share some of your general thoughts about the outlook for '16?

Greg Ebel: Sure. Maybe the first thing I would say is that we've probably done a disservice to—the industry has done a disservice and maybe investors - of calling this sector midstream. Midstream is not a single sector. You may be in the gathering and processing side; so you're very close to the well head. You may be supply push pipes, or you may be demand pipes, and you may be gas, NGL or oil. We're largely gas pipes and largely demand side driven. So, that's a very different element many people find in the sector.

I think it will be challenging for the sector for several reasons. First of all, some for M&A reasons. There are some tough transactions out there and I think that creates a bit of a challenge for some of our peers and the sector. Some folks are going to be challenged because they've got a lot more commodity exposure than either they or their investors perhaps both realized. Some are going to be more challenged because they're too close to the well head. Again, I think you don't want to just be on the supply side. You've got to be where the lights are, or you're going to have some challenges.

Some folks are going to be challenged because of difficulty accessing capital markets, whether it's debt capital markets or equity capital markets. Not everybody has a Spectra Energy structure, which we think over time has served us very well by having both common equity and MLP equity; combine that with investment grade balance sheets and that's a very fortunate spot to be in.

Again, I think because of some of those challenges I think some people have in the MLP sector and in the midstream sector, it really let's strong players like SE and SEP have better competitive advantages, to take advantage of those opportunities to serve our customers with organic growth, which we talked about earlier, and perhaps pick up assets at lower than historic prices. Although, to be clear, neither Spectra Energy or Spectra Energy Partners needs to do that to hit its plan, but we have had good success in the past in finding opportunities to pick up assets in sometimes challenging markets and be able to make those work for us. So, I think that's going to be an important part of this.

You mentioned commodity. Again, I would point out that SE and SEP have very little direct or near-term commodity price exposure. And again, this is due to the fact that we're largely demand-driven in our portfolio, and the contract structures of our pipelines are very long dated. I think in the U.S. we run 10 or 11 year average contract life, and you're not taking on the volume or the commodity risk.

We have one element of commodity exposure and that's at DCP, which is a joint venture with Phillips 66, a very minor exposure for us and importantly, that entity has probably, since late-2014, taken very strong measures to ensure that it can live through a downturn - cost reductions which have been pretty substantial, contract realignment; in other words, getting more fee-based as opposed to commodity-based revenues, and both debt and capital reductions. So overall, they've taken their break-even price for NGL, they're the largest producer of NGLs in the country, down to $035 from $0.60 to $0.65 say 18 months ago .

So, that's the only exposure we would have, but I think you'll find a lot of other folks may have more than that. I guess the bottom line is that both SE and SEP, and I can probably say it in three words, are stable, reliable, and disciplined - stable in various cycles, economic or commodity. We go where the lights are and hence, have 95% renewal rates on our pipes; reliable in the dividend and distribution, that our growth promises are realistic and steady. It's been the same $0.14 per share per year at SE and a penny a quarter per unit per quarter at SEP since 2014. That has not changed.

And then disciplined. We have a proven balance sheet, financial management, and capital deployment regardless of whether it's organic or occasionally through M&A. I think that conservative approach has really left us in a pretty strong position.

Ed Russell: Well, Greg, thank you for joining us. We appreciate it. This is part three of a three part special podcast that we did and we hope that everyone appreciates it. Thank you.

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