Tortoise Capital Advisors

Tortoise QuickTake Podcast

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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.

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After an encouraging inventory report Wednesday, energy shook off volatility from early in the week and headed higher. While a build was expected for the week, we got the trifecta of crude draws, refined product draws and continued production declines. The production decline was especially positive because the 23 mbpd drop consisted of an 80 mbpd lower 48 decline to offset Alaska which regained production after last week's big decline. As a reminder production fell over 100 mbpd last week led by a big decline in Alaska due to an outage which we had expected to partially reverse.

So for the week, oil gained 3.4%
E&Ps were up 1.1%
MLPs were just slightly positive, up 30 basis points
and the S&P Energy Index fell slightly, just 20 basis points

So, Brian provided a great summary of earnings themes across the value chain last week, and after another week we've have a chance to tally the results and we can now provide the latest update on the combined midstream portfolio cash flow and distribution growth, a key indicator of the health of our portfolio. So where did the numbers shake out? Well similar to recent quarters, we continue to see solid metrics for the portfolio providing factual support to the resilience of a high quality, energy pipeline portfolio even in a tough energy environment. The weighted-average metrics are as follows: EBITDA growth was over 20% yr/yr, DCF per unit grew mid-teens and distributions grew low teens yr/yr. Coverage of distributions remains healthy at just over 1.2x. Contrary to common market views, coverage is actually up slightly over last year's number for the same quarter. As you might expect, coverage improved nicely for refined product and natural gas pipeline companies, while it was flat on average for crude oil pipelines and gathering & processing companies.

In spite of having avoided the recent distributions cuts in our MLP portfolios, and in fact, still seeing nice growth, we understandably continue to get a lot of questions on the potential for cuts. Just to provide some background, the vast majority of distribution cuts have come from the upstream and downstream MLPs. That said we have seen a couple of midstream cuts. In particular a few small, non-diversified gathering and processing MLPs which we didn't own. Looking forward we see the potential for a few more. Importantly this is not wide-spread but in certain company- specific cases it's not out of the question. The key issue is not so much the 2016/2017 coverage outlook but rather the ratings agencies and their threat of a downgrade to high yield which would force otherwise stable midstream companies to elect to temporarily reduce distributions in defense of investment grade credit ratings. Just to reinforce, we don't see this as a wide spread issue but we wanted to share our thoughts that this is not totally out of the question. To get a sense of who the market thinks may decide to take this approach, one simple screen is names yielding north of 10%. When looking beyond the immediate trading impact to a cut, we continue to see attractive long-term value in some of these names even if they were to cut. Especially for the general partners who may choose to cut to support the ratings at their limited partners. These names are more institutionally-held and they're not big holdings in closed end funds which would reduce the technical pressure that a limited partner may experience from potential retail investor and closed end funds selling in the event of a distribution cut.

Last week was fairly quiet on the news front. The big news was Linn Energy and Penn Virginia both becoming the latest victims of the commodity price collapse, and as widely expected, they filed for Chapter 11 protection Wednesday. In more positive news, Chesapeake completed a $153 million debt for equity swap indicating it remains committed for rightsizing its balance sheet and fighting to avoid the fate of Linn and PVR.

In capital markets, there is a little more to talk about and it was generally positive:

- First, Whiting Petroleum gave notice to mandatorily convert $476 million of convertible notes into common stock effective May 18th helping to shore up their balance sheet.
- Meanwhile, Laredo Petroleum issued 9.5 million shares of common stock for total proceeds of $106 million, improving their balance sheet as well.
- On the fixed income side, Cheniere Energy competed an 8 year bond deal, which priced with a 7% coupon Thursday. This was tighter than the initial talk of 7.25-7.5%, and the deal was 5x oversubscribed and upsized to $1.25 billion.
- Additionally Tesoro Logistics priced two debt traches, the first is a $250 million issuance due 2021, with a 6 1/8th coupon; the second was a $450 million offering, upsized from $350 with a 6 3/8 coupon due 2024.
- Finally, Boardwalk Pipeline completed a $550 million, 10 year issuance, upsized from $350 million, and it priced at a 437 basis point spread to the 10 year.

The fact that all three of these bond deals were upsized, signals that fixed income investors are shifting focus back to fundamentals, and they're looking to get more energy exposure through low risk pipeline credits.

Let me finish up with the latest on the Alberta wildfires. First, we'd like to continue to express our thoughts and prayers for those impacted by this tragic event. The fires continue to burn and a significant amount of production remains offline. We did see some progress this week with Canadian Natural Resources announcing they had restored normal production rates at the Horizon facility.

Along with oil sands curtailments, Nigeria remains plagued by militant-based interruptions which have reduced output over 300 mbpd the last few months, and a recent outage at the Exxon facility brings the total Nigerian supply offline to 700 mbpd. Considering these and other outages, one can see why we believe the oil market is significantly tighter than the current price level would indicate, and if demand remains at the very strong levels of the last several months, prices need to move meaningfully higher. Speaking of demand, last week in the latest IEA oil market report, the agency increased demand estimates for 2016 to 1.4 mbpd led by China and India.

Well that wraps up this week's report. Thanks for joining.

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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