Tortoise QuickTake Podcast

January 23, 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.

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.

Last week, there was an historic event that impacted the energy sector; except for this event, there was no debate on how many people attended. What am I talking about? Over the weekend, the first ever OPEC monitoring committee meeting took place in Vienna. The committee designed to ensure compliance with the December OPEC agreement includes Venezuela, Oman, Russia, Algeria and Kuwait. Compliance appears to be going very well with the committee, reporting that over 80% of the original 1.8 million barrels per day of supply reductions have already taken place. This means that approximately 1.5 million barrels per day have been removed from global supply. According to the Saudi oil minister, full compliance with the OPEC agreement would bring global crude oil inventories back to the five-year average by mid-2017. We believe this is a real positive for crude oil prices going forward. The monitoring committee's next meeting will be on March 17th.

Speaking of prices, crude oil prices were unchanged last week, but prices are 97% higher than one year ago. Oil prices initially declined by 2.5% early last week. However, oil prices rebounded after the release of the International Energy Agency Monthly Oil Market Report that highlighted a decline in global inventories for the fifth consecutive month. Also, the IEA increased its 2016 and 2017 global demand estimates to 1.5 million and 1.3 million barrels per day, respectively.

In general, the markets were relatively unchanged last week with the S&P 500® Index down 0.13% and the Tortoise MLP Index® down by 0.25%. The S&P Energy Select Sector Index eked out a small gain, rising by less than one-tenth of a percent.

Alright, what happened in the energy sector? Starting with the upstream sector, keep your eye on the Delaware Basin. Where is it? The Delaware is a subset of the more commonly known Permian Basin. It is located in West Texas, but it extends into southern New Mexico. What is so special about the Delaware? Since 2012, the oil price required to earn an economic return has dropped by almost 50% to under $40 per barrel today, making the Delaware the latest hot basin. In 2016, over one-third of the record $51.5 billion of acreage transactions occurred in the Delaware. In 2017, the Delaware remains the location that everyone wants to be in. In the first 20 days of January, there have been over $10 billion of acreage transactions in the Delaware. Last week, two additional transactions occurred. First, Exxon Mobil put its seal of approval on the Delaware Basin, buying 250,000 acres for $6.6 billion. Exxon paid approximately $20,000 per acre to gain access to the Delaware. In addition to this, Noble Energy added to its acreage, announcing an acquisition of Delaware Basin producer Clayton Williams for approximately $3 billion. Lastly in upstream news, Laredo Petroleum, a producer in the Permian area known as the Midland Basin, announced its 2017 capital budget. Two trends that are likely to spread across other oil producers were highlighted in Laredo's release. First, Laredo's capital expenditures are expected to rise after a two-year hiatus. Laredo's capex is 53% higher in 2017 compared to 2016. Second, well costs continue to fall. Laredo expects to spend $6.4 million to drill 70 wells, compared to $7.5 million to drill 37 wells in 2016. Now, I know what you are thinking: U.S. production is going higher and we are going to have a repeat of 2014 when OPEC decided to fight for market share. While U.S. oil production likely increases, it will likely rise at a much slower pace. For context, between 2011 and 2014 the U.S. added almost 1 million barrels per day of new production each year. While U.S. production may increase, it should increase in hundreds of thousands of barrel increments, rather than millions; therefore, the U.S. is less of a threat to OPEC. If you don't believe me, several OPEC ministers addressed the possibility of higher U.S. production over the weekend, indicating that rising U.S. oil production will be absorbed by higher demand.

In the oil field services sector, the first initial public offering in 2017 in the energy sector priced last week. The Keane Group, the largest pure-play provider of well completion services in the U.S. with a focus on U.S. shale basins, raised over $500 million, issuing almost 27 million shares at an IPO price of $19 per share. Keane closed at $21.65 on Friday, representing a 14% increase in price. Also, Schlumberger, the largest oil field services operator in the world, kicked off the earnings season for this sector. A couple of notable items from Schlumberger's earnings: First, revenues in North America increased by 4% sequentially. This supports our premise that oil field services costs in the U.S. are on the rise. Second, Schlumberger noted that 2017 North America E&P investments will increase while international E&P investment will decline for the third successive year, which will further weaken the state of the international production base. Once again, this supports our premise that North America is the place to be when investing in the upstream energy sector.

News from the midstream sector was less prevalent. The largest midstream operator to report last week was Kinder Morgan. Kinder Morgan kicked off the midstream earnings season with an uneventful quarterly call. The most popular topic on the call was Kinder's financing of the Trans Mountain pipeline, a $6.8 billion expansion of the Trans Mountain pipeline that increases the pipeline's ability to transport Canadian oil from 300,000 to 890,000 barrels per day. Kinder's project backlog remains strong and its debt metrics are improving. Kinder's analyst date later this week will provide better insight.

Lastly, in downstream news, NRG Energy, Inc. was the best performer in the S&P Utilities Select Sector Index last week, rising by 10% after receiving a letter from well-known shareholder activist Elliott Management. Elliott has teamed with ex-TXU CEO John Wilder and is seeking operational and financial improvements as well as the consideration of strategic initiatives at the company. This letter also boosted the performance of NRG Yield, the Yieldco that NRG sponsors. NRG Yield shares rose by almost 8% last week. NRG was the only company in the energy sector to receive a letter of this kind last week.

Those are the 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@tortoiseadvisors.com.

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