Tortoise QuickTake Podcast

November 6, 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 Brian Kessens with this week's QuickTake podcast.

The weekly inventory numbers last week were bullish yet again. Specifically, U.S. crude oil stocks dropped 2.4 million barrels. Driving the decline, imports fell by 550,000 bpd while exports increased by 210,000 bpd, exports again topping 2 million bpd. For all of October, crude oil draws amounted to 10 million barrels, impressive in a month where the seasonal norm is for a build. For example, last year, stocks built 19.7 million barrels; that's nearly a 30 million barrel monthly reversal. Products also drew last week, gasoline by 4 million barrels and distillate by 300,000 barrels. Also notable, is now the shape of both the WTI and Brent forward curves is one of backwardation, where current prices are higher than forward. The shape sought by OPEC, it provides little incentive for barrels to go into storage. Consequently, we expect continued counter-seasonal draws and higher crude oil prices.

And that's what we saw last week as WTI crude oil improved 3.2%. Energy stocks followed, led by producers up 5.5%, broad energy plus 1.8% and MLPs eked out a 0.7% gain.

Numerous companies reported third quarter earnings last week. Takeaways include: (1) as expected, Hurricane Harvey impacts were minimal and largely transitory; (2) midstream noted stronger balance sheets, higher coverage and lower equity needs; (3) producers focused on capital discipline, i.e., spending within cash flow and returning free cash flow to shareholders, even noting that production growth is unlikely to be accelerated in a higher crude oil price environment; (4) some Permian producers hinted at sourcing sand locally; (5) 2017 earnings guidance was largely maintained; (6) export volumes met expectations; (7) concern about lower oil "cuts" abated; (8) drilled laterals continued to go longer, with the longest Midland permitted lateral in 3Q lying with Concho Resources at 11,100 feet; and (last) just when you thought new play announcements were over, EOG introduced the Woodford Oil Window.

In Washington, the much anticipated tax reform proposal was released. Largely telegraphed, it met expectations with corporate rates dropping to 20% and a pass-through rate created and set at 25%. If passed, the bill should be helpful for all U.S. businesses, energy included. For MLPs, there was no change to the definition of qualifying income. The lower corporate tax rate on its own does reduce the relative tax advantage of MLPs versus C-corps. Yet, the pass-through 25% rate on taxable distributions is a significant improvement for many MLP investors versus the highest marginal rate. And note today, C-corps in the energy sector typically have an effective tax rate far lower than the 35% rate, with many C-corp pipelines paying no tax at all due to high levels of non-cash depreciation charges.

For renewables, we note the electric vehicle tax subsidy may disappear, potentially altering the growth trajectory of EVs in the U.S., and the production tax credit for wind projects would be diminished, reducing the incentive value for future wind projects. Of course, the current proposal will likely change before the bill is finalized and potentially approved. Don't spend your tax savings just yet.

Staying in Washington with the regulatory front, the Senate restored the FERC to its full roster of five commissioners after confirming Kevin McIntyre and Richard Glick to fill the two remaining seats, with McIntyre now designated FERC chairman. It's great to finally have a full slate of commissioners, given the growing decision backlog.

There was one midstream corporate acquisition last week. American Midstream Partners agreed to acquire Southcross Energy Partners to form a $3 billion partnership. The transaction results in a more integrated gathering, processing and transmission company focused on linking supply from the Eagle Ford Shale to growth markets along the Gulf Coast. We've noted that corporate M&A is a catalyst for the sector. While this deal is not the large scale deal that may prove to be a catalyst, we do think that this and continued consolidation is healthy for the sector.

Following distribution announcements from Enterprise Products Partners and Genesis Energy that unsettled the midstream market, the rest of the midstream distribution announcements were in line with expectations. 74 MLPs are out with quarterly distribution announcements: 35 increased, three cut and 36 were flat. Average growth, ex-cuts, came in at 2.0%.

All in all last week, macro fundamentals remain healthy as earnings demonstrated that U.S. energy production and demand growth remain vibrant, and global crude oil supply and demand continues to move toward better balance. While energy stock prices are not yet voting in accordance, eventually we think the weight of these fundamentals will translate into compelling returns.

This week, energy sector third quarter earnings continue in the last big earnings week, and the largest utility conference takes place. President Trump continues his 12 day trip to Asia, where he may pursue oil and gas alliances. We understand Cheniere Energy's CEO made the travel team, so don't be surprised if these deals relate to LNG exports.

And finally, we pay special recognition to all the veterans and current service members ahead of Veterans Day. We appreciate your selfless service to preserve our freedom. Our flag flies ever high, swelling in the wind for you. Talk to you again 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.