Chickasaw Capital Management

Weekly Midstream & Market Pulse

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This week saw the bulk of Midstream companies report their quarterly earnings, and judging by the Alerian MLP TR Index return of 2.99%, we would surmise market participants digested these reports with an appropriate balance of risk and reward. We'll be offering a more cumulative assessment of the Q1:2020 earnings at its conclusion, but will take the opportunity in this week's letter to weave some takeaways from companies into a broader update on trends we have been writing about and following since the beginning of this global crisis.

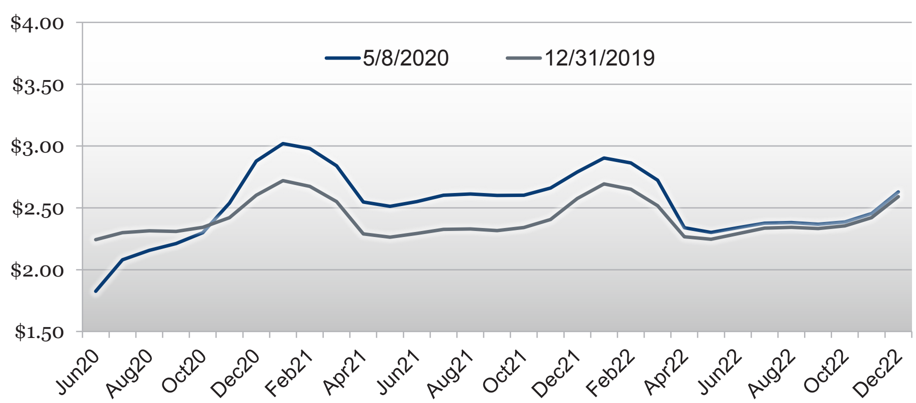
Midstream Commodity Commentary

Crude oil production and storage have been covered extensively in our weekly updates. Early in this crisis, we first estimated U.S. production could be down 2.0-2.5 million barrels per day (MMBpd) and used that as the basis for our company outlooks. We believe this forecast has been confirmed in the ensuing months since we initially published in mid-March, and, importantly, we believe it has been a valuable tool for our proactively positioning the Model Portfolio. The key difference in our thesis is we originally expected this decrease to happen throughout 2020, and then we began observing the production declines could happen sooner. Thus, the financial impact would essentially be the same, but the "pain" point on volumes is probably occurring quicker. Plains All American Pipeline LP (PAA, $8.38) referenced on their earnings call they estimate U.S. and Canadian production has responded rapidly to price signals and that 3.0-4.0 MMBpd is currently offline, split 2-2.5 MMBpd in the U.S. and 1.5-2.0 MMBpd in Canada. This confirmation continues to give us comfort in our company forecasting.

When discussing the potential for exceeding crude oil storage capacity limits, on April 19th we wrote, *"we could be maxed out on storage in Cushing, OK (the largest U.S. storage hub at ~91 million barrels) in 4-6 weeks with other onshore storage locations, similarly, filling in short order. However, the market is so dynamic, the 4-6 week window could come sooner or not at all"*. Roll forward 4 weeks, and it appears, at least in the near term, that the "not at all" scenario has taken place due to the production curtailments, as well as the ability and creativity of Midstream companies to find/develop additional storage capacity. Media and observers tend to write headlines that project the worst. We hope our commentary demonstrated that commodity markets remain fluid and do not necessarily reflect binary outcomes. As it relates to Midstream companies, this has benefited companies such as Magellan Midstream Partners LP (MMP, $42.95), Enterprise Products Partners LP (EPD, $17.80), Enbridge Inc (ENB, $32.04), PAA, and others, who disclosed the storage constraint situation has helped them in the long term and the short term by allowing them to both increase rates and extend the duration of current contracts, as well as participate in unanticipated contango profits.

Turning to Natural Gas and Natural Gas Liquids (NGLs), we believe they are presenting a neutral to more positive set up. In just February, the market narrative was natural gas would remain oversupplied in the U.S. due primarily to the excess gas on the market from associated gas[1] occurring in the production of crude oil. However, with the rapid fall-off in crude production and hence associated gas, the outlook for natural gas is much better aligned with current and future demand with the forward strip for natural gas reflecting higher prices. On its May 5th call, Williams Cos Inc (WMB, $19.47) said that their TransCo gas pipeline, which serves customers from the Gulf Coast to the Northeast, experienced record deliveries in Q1:2020. Additionally, there are new sources of domestic and global demand coming on line in 2021, which could increase the call on low cost U.S. natural gas production.

Natural Gas (HH) Future Curve



Source: Bloomberg, LP

NGLs have proven to be more resilient than market forecasters were predicting. Because NGLs exhibit a higher drilling and price correlation with crude oil, due to the substitution and enhancement properties they exhibit with crude and refined products, forecasters expected to see a similar drop off in NGL production as crude oil. But, as the results and commentary from integrated NGL value chain companies such as EPD and Targa Resources Inc (TRGP, $13.80) indicate, there remains a strong international appetite for U.S. NGLs, particularly propane, and therefore pipelines, fractionators and export docks have remained highly utilized. We have been discussing the high-grading of the portfolio into integrated Midstream players, and these initial results appear to confirm our thoughts and actions.

Geoffrey Mavar   Matt Mead   Robert Walker   Bryan Bulawa

(1) Associated gas refers to the natural gas found in association with oil within the reservoir. While producers may be targeting crude oil economics, they still have to dispose of the gas produced, which can put pressure on the realized price of gas when there is an oversupply.

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