



TortoiseEcofin's Kessens: Expect Double-Digit Returns From Energy

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Brian Kessens of Tortoise Ecofin, who oversees the closed-end Tortoise Pipeline and Energy and the Tortoise Power and Energy Infrastructure funds. Read the Q & A below as Brian says he expects double-digit total returns from midstream and other energy companies based on current high yields, supported by



Brian Kessens

stock buybacks and debt paydowns. The energy sector had a rocky time through 2020 and has rebounded sharply, but Kessens says valuations generally remain reasonable and that 'as the market starts to appreciate some of these growth opportunities, there's further upside ahead.'

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CHUCK JAFFE: Brian Kessens, president of the Tortoise Pipeline and Energy Fund and Tortoise Power and Energy Infrastructure Fund is here and we're talking about energy investing, this is The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator's brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. If you're looking for excellence beyond

indexing, The NAVigator's going to point you in the right direction. And today it's pointing us in the direction of Brian Kessens, portfolio manager for Tortoise Ecofin, who not only runs Tortoise Pipeline and Energy and Tortoise Power and Energy Infrastructure, he also runs the Tortoise MLP and Pipeline Investor Mutual Fund. If you want to learn more about him and the firm, it's TortoiseEcofin.com. If you want to learn more about investing in closed-end funds, business-development companies, and interval funds, go to AICAlliance.org, the website for the Active Investment Company Alliance. Brian Kessens, thanks so much for joining me on The NAVigator.

BRIAN KESSENS: Thank you, Chuck. It's great to be here today.

CHUCK JAFFE: The energy space has been really interesting, so let's talk about the different parts of energy that you like or maybe dislike. The beneficiaries of the reopening and what we've seen going on, and maybe the ones that haven't benefited.

BRIAN KESSENS: Yeah, for sure. We are big fans and think that an ongoing investment opportunity for pipeline companies in particular is really phenomenal right now. Pipelines, they operate real, long-life assets that are essential to the functioning of the economy. Historically the cashflows have been ultra-stable coming from fee-based sources, they have long-term contracts with high-quality counterparties. I think in particular if there's a silver lining from the pandemic, the cashflow's proved really stable during that time period. In fact, they were flat in 2020 versus 2019 levels, and I think that's one thing that the market is starting to appreciate. And then you mentioned the reopening or the reinflation trade, clearly right now we think we have a positive fundamental backdrop just from sharply improving demand. As we look at the more traditional components of energy, gasoline is about equal to pre-pandemic levels, diesel is actually above. Jet fuel does continue to lag, it's about 25% below right now, but it's the smallest part of the overall demand for refined products.

CHUCK JAFFE: We saw fluctuations in the demand, but yet the cashflows were stable on particularly the midstream companies. Is that where the real opportunities are for you? I mean, obviously we know from some of your funds you do MLPs as well, that's been a space where we saw a lot of fluctuation. But midstream companies right now, is that a particularly important opportunity?

BRIAN KESSENS: We think it is for the reasons that we articulated. In addition to that there's a couple other reasons that we like midstream now. They have changed their business model

and specifically how they're allocating capital. Where over the last part of the previous decade companies are spending a lot of cap-ex to keep up with the growing levels of production. Now they've largely built enough pipeline takeaway capacity from growing areas of supply, and they're able to reduce their cap-ex and return all of this free cashflow to investors in the form of a continued distribution where yields today are about 7%. In addition to that, they're buying back meaningful levels of debt, and now just starting to buy back stock as well. On top of that 7% yield, we think that you can get an additional 7% of total return through that debt pay-down and stock buy-back as well. I'd also add that it's not just midstream in the energy sector that has changed their business model, the upstream producers have changed their business model as well to be more focused on free cashflow. They have generally said that the current levels of production are sufficient enough to meet levels of demand, particularly with OPEC Plus adding to their overall production. And the US E&P sector by and large has reduced their cap-ex, and at current levels of crude oil prices of \$70, they are earning significant amounts of free cashflow that they're largely returning to shareholders as well in the form of debt paydown, dividends, and even variable dividends in some cases.

CHUCK JAFFE: Moving away from the classic energy plays over to the renewables and some of the newer energy companies. Are those going to provide the same kind of stable, what you expect cashflows that we get out of the midstream companies as we go towards the carbon capture companies or what have you?

BRIAN KESSENS: Great question, and it is going to take a long time to play out, but clearly we are moving towards more renewable sources or just generally just trying to reduce the overall carbon footprint that traditional energy has. And particularly to the pipeline companies, the biggest advantages that they have is they already have infrastructure in the ground, and they have relationships with the upstream and the downstream to be able to continue to satisfy the needs of those customers. In particular, we're seeing today companies are starting to transport renewable natural gas, which they can just drop into the pipeline. Renewable natural gas is essentially methane that's collected from dairy farms or landfills that would otherwise escape into the atmosphere, so being able to collect and transport that is a great opportunity. Those companies are also transporting renewable fuels like biodiesel. Biodiesel is very similar to the diesel trucks use to transport up and down the road. They can

drop that in if you will, just to the existing diesel steam. And then longer term out, you touched on it a little bit, is carbon capture. Along the Gulf Coast arguably is the world's best place to collect carbon just because there are a lot of single points where that carbon is emitted. If we can collect that and then transport it, maybe back to West Texas where you have some depleted oil wells and store it or sequester it in those wells, we think that is a great opportunity too. And there continues to be policy support for capturing carbon. And in even longer term to the extent that hydrogen becomes economical, you can transport hydrogen in pipelines, and in many cases, along with natural gas molecules that are currently being transported. We think that the future is bright not only for the existing commodities that are transported in pipelines but for these additional drop-in opportunities as well.

CHUCK JAFFE: We may have buried the lead here. Here we are talking about performance going forward without talking about what we have seen year to date, and it's been pretty stellar. This year has been good, the last 12 months have been great. 2020 was pretty rocky, but that's not entirely unexpected. So here we have these bounce-back levels that we've seen, and it's been pretty strong. Can that continue, and what's happened to valuations? We had a market that's at record highs, we've got the energy companies having had this strong bounce back, are we still able to find bargains or good values at least?

BRIAN KESSENS: Yeah, we think we are. You mentioned 2020 was a rough year. But starting in the fourth quarter of last year, coinciding probably not coincidentally with the successful vaccine that we found against Covid in November, we've had three consecutive quarters now of roughly 20% type returns. Yet that still leaves the sector well below historical multiples if you look at the EBITDA, whereas the broader market is now trading well above historical multiples. We estimate that the pre-cashflow yield right now for the sector is about 12%, and that's three times the yield of the broader market, just to give you some perspective. Our expectation going forward is we should at least expect low double-digit type total returns based on that 7% current income or yield, plus the additional 7% that we expect you should get from stock buy-backs and an overall debt paydown. In addition, we think that there's real opportunity for multiple expansion just given where the broader market is. And as the market starts to appreciate some of these growth opportunities, particularly what you alluded to with some energy transition ideas, we think there's further upside ahead.

CHUCK JAFFE: Brian, thanks so much for joining me to talk about it.

BRIAN KESSENS: Chuck, it's been my pleasure to be here today.

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