MIDSTREAM Monitor

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FEATURES

East Daley report scrutinizes midstream operations and financial statements to find

Hidden Risk

By **JOSEPH MARKMAN**, Hart Energy

The midstream space is laden with risk and promise for investors, a new report concludes.

Ready to invest—or do you think you need more details?

The analytical team at Centennial, Colo.-based **East Daley Capital Advisors Inc.** conducted its research convinced that a granular approach would better serve investors. Its new report, "**Dirty Little Secrets**," embraces the complexity of the sector by diving deep into the status and strategies of 23 of its leading companies.

"I didn't think people really understood the true risk of midstream companies," Jim Simpson, president of East Daley, told Hart Energy. "We kept hearing things like, 'pipelines are toll roads' and 'it's all fine.'"

In a general sense, that was true. But the fallout from crude oil's price crash in first-quarter 2015 proved that not *all* was fine and, as the industry recovers, still isn't.

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By digging deeply into the major players' operations and financials, East Daley found insights that upended certain components of conventional wisdom. For example, the Barnett Shale is known to have been on a decline. A typical investor might be inclined to avoid companies with considerable exposure to the Barnett. And in fact, Simpson acknowledged that East Daley expected companies in the report with Barnett exposure to experience a 25% drop in EBITDA this year compared to 2016.

See RISK, Page 3.

RISK from Page 1

But not all, and not EnLink Midstream Partners LP (NYSE: **ENLK**). Examining the company closely, East Daley found that its Barnett assets had minimum volume commitments. Drilling might be down in the Barnett, Simpson said, but EnLink is still in good shape for 2017 and 2018.

Overall, the outlook for the report's 23 companies is promising for 2017. Simpson said that collective EBITDA is expected to rise 7.1% this year compared to 2016. For those with crude oil risk, the increase is forecast at 8.5%. Natural gas risk is about 6.9% and NGL risk is 5.9%.

That kind of broad brushstroke will not help an individual investor devise a strategy, however. East Daley's granular approach can be seen in the market's recent reaction to Enbridge Energy Partners LP's (NYSE: **EEP**) announcement about expected EBITDA.

Enbridge lowered its 2017 EBITDA guidance by $300 million to about $1.8 billion. The reaction from investors was a 30% drop in share price from $25.90 on Jan. 26 to $18.20 on Feb. 7.

But East Daley, watching Enbridge's assets closely, saw it coming.

"They have some assets in areas that are just not seeing a lot of volume growth," Simpson said. "In fact, they're seeing no volume growth, only declines. And if you don't have minimum volume commitments, you eat those declines every day."

U.S. Army Corps Issues Permit To Complete Dakota Access Project

The Dakota Access Pipeline, under siege from environmental protesters for months, is on the verge restarting constuction after receiving the final easement necessary to complete construction on Feb. 8.

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The U.S. Army Corps of Engineers granted the permit for construction of a tunnel under Lake Oahe in North Dakota, the last piece of the $3.8 billion project. The Army signaled its intent to approve construction earlier in the week in both a court filing and a letter to chairs and ranking members of the House Natural Resources and Senate Energy & Natural Resources committees.

The action is not surprising, given President Donald Trump's executive order in late January that instructed the Army to accelerate its decision on the project. The 1,200-mile pipeline, from the Bakken Shale in North Dakota to Patoka, Ill., will have a capacity of 570,000 barrels per day.

Energy Transfer Partners LP now has all federal authorizations necessary to quickly complete construction of the pipeline, the company said in a statement. **—JOSEPH MARKMAN,** Hart Energy

New Markets: How Far We Have Come

PITTSBURGH—Where will the new markets develop for Marcellus and Utica gas? The answers may be surprising—and it may be best to remember how far the region has come from scarcity to abundance.

Stuart Nance, marketing vice president for Reliance Holding USA Inc.—the domestic unit of India's **Reliance Industries Ltd**., opened a panel discussion Jan. 26 at Hart Energy's eighth annual Marcellus Utica Midstream Conference by looking back 40 years, almost to the day. The panelists discussed two new markets for Appalachian production, ethane exports and domestic power generation.

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"I found in researching this topic that President Jimmy Carter came to Pittsburgh on a surprise visit on Sunday, Jan. 30, 1977," Nance said. "When he got here, this is what he found: There were emergencies that had been declared, schools were closed, factories were shut down and church services canceled all throughout Pennsylvania" because of curtailments by the gas transmission systems.

"We've come a long way; there's a lot of contrast," Nance observed.

He focused on ethane. He pointed to U.S. Energy Information Administration data that show domestic ethane production was below 1 million barrels per day (MMbbl/d) at the start of 2013 and is forecast to climb to 1.8 MMbbl/d by late 2018. Domestic consumption has steadily climbed, and exports—which were nonexistent before late 2013, will reach about 400 Mbbl/d by 2018. **—PAUL HART,** Hart Energy

FRAC SPREAD

NGL Might Be Cat's Pajamas, But Watch The Trends

By **JOSEPH MARKMAN**, Hart Energy

Don't say "'sup?" in your company's break room.

Really, your younger colleagues will suspend your swagger license, like, for days.

This isn't just about vernacular (look it up, kiddos) but attention to trends. Just as you wouldn't use "tubular" as a positive adjective a la "groovy," it's not a good idea to fully embrace the recent upward jolt in ethane prices.

CURRENT FRAC SPREAD (CENTS/GAL)

FEBRUARY 10, 2017	Conway	Change from Start of Week	Mont Belvieu	Last Week
Ethane	23.68		25.56	
Shrink	19.92		19.58	
Margin	3.76	-288.56%	5.98	-421.82%
Propane	81.70		86.04	
Shrink	27.52		27.05	
Margin	54.18	7.14%	58.99	13.06%
Normal Butane	121.55		126.63	
Shrink	31.16		30.62	
Margin	90.39	6.31%	96.01	22.57%
Isobutane	127.75		121.60	
Shrink	29.92		29.41	
Margin	97.83	0.01%	92.19	15.39%
Pentane+	119.15		119.05	
Shrink	33.32		32.75	
Margin	85.83	4.29%	86.30	21.63%
NGL $/Bbl	31.48	3.97%	32.14	12.50%
Shrink	10.98		10.79	
Margin	20.50	10.08%	21.35	25.29%
Gas ($/mmBtu)	3.00	-5.79%	2.95	-6.42%
Gross Bbl Margin (in cents/gal)	47.06	10.20%	49.75	25.05%
NGL Value in $/mmBtu (Basket Value)				
Ethane	1.30	23.66%	1.41	34.10%
Propane	2.84	2.41%	2.99	6.12%
Normal Butane	1.31	2.92%	1.37	14.03%
Isobutane	0.80	-1.41%	0.76	9.23%
Pentane+	1.54	1.26%	1.54	12.36%
Total Barrel Value in $/mmbtu	7.78	4.86%	8.05	13.07%
Margin	4.78	12.89%	5.10	28.58%

Price, Shrink of 42-gal NGL barrel based on following: Ethane, 36.5%; Propane, 31.8%; Normal Butane, 11.2%; Isobutane, 6.2%; Pentane+, 14.3%, Fuel, frac, transport costs not included. Conway gas based on Midwest region, Mont Belvieu based on Houston region. Shrink is defined as Btus that are removed from natural gas through the gathering and processing operation.

In the span of a week, ethane at Mont Belvieu, Texas, shot up 54% to a little over 27 cents per gallon (gal). At Conway, Kan., the jump was 49% to 25 cents/gal. Combine these hikes with the 27-month highs at both hubs for the hypothetical NGL barrel and a little giddiness is understandable.

It won't last.

It will take sustainable demand to maintain ethane prices at levels substantially above the 20 cents/gal mark where they have lingered for many months. Kendall Puig, of Colorado-based East Daley Capital Advisors Inc., believes it will be first-quarter 2018—fourth-quarter 2017 at the earliest—when the next three big crackers come online.

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But Puig, a contributor to East Daley's new "**Dirty Little Secrets**" report, has concerns that U.S. construction of export terminals is outracing overseas demand for LPG.

"If you look at the past few years, every time that a midstream company has brought on another terminal expansion, it's filled right away," she said. "Going into 2016, we finally saw global demand take a step back for a couple months, particularly in the Asian market. We saw terminal utilization drop quarter over quarter for the first time."

Then in fourth-quarter 2016, Phillips 66 (NYSE: **PSX**) added some 150,000 bbl/d of capacity. Propane exports looked strong in December and January, Puig said, but risk is increasing for the rest of the year.

"If you look at petrochemical demand growth, which has fueled a lot of this so far, it's tapering off," she said.

US Condensate Demand Could Double With Canadian Progress

Editor's note: *This report and others like it are available to subscribers of Stratas Advisors'* **North American NGL** *and* **North American Oil** *services.*

Favorable decisions made within the last few months by authorities in both Ottawa and Washington are advancing key North American crude oil pipeline infrastructure, that if completed successfully, should drive long-term gains in Canadian crude oil production, double incremental Canadian diluent demand forecast and kick off construction opportunities for diluted bitumen (dilbit) and diluent logistics including pipelines, diluent recovery units, storage and custom blending operations across North America.

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In November under the Trudeau administration in Canada, or in January under the Trump administration in the U.S., TransCanada Corp.'s (NYSE: **TRP**) Keystone XL, Enbridge Corp.'s (NYSE: **ENB**) Line 3, and Kinder Morgan Corp.'s (NYSE: **KMI**) Trans Mountain pipelines each received favorable treatments at their respective national or federal levels that improve the likelihood of these projects being completed. **—STRATAS ADVISORS**

TOP STORIES

Outlook Optimistic In The Northeast

PITTSBURGH—Marc A. Halbritter, senior vice president of business development for Blue Racer Midstream, said he's optimistic about the future, particularly in the Marcellus-Utica region.

Despite the steady decline in price for WTI, NGL and natural gas, which has led to a significant decrease in drilling, Halbritter said drilling activity has started to pick back up, noting "that's the first positive indication of what the future may hold."

Marcellus and Utica production is expected to lead growth among U.S. natural gas basins. It is estimated to show a 71% increase from January 2015 to 2021, according to Halbritter, who spoke in a panel at Hart Energy's recent Marcellus-Utica Midstream Conference.

"In fact, Marcellus [and Utica] production is expected to surpass the Bakken and Eagle Ford in the early 2020s or 2030s. That's the second positive indication that's expected to come from there," he said.

The improvement of the price basis differential on the natural gas side is also anticipated to drive production in the region, according to Halbritter.

—BRANDY FIDLER, Hart Energy

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