Energy Transfer Equity (ETE)

Updated May 6th, 2018 by Josh Arnold

Key Metrics

Current Price:	$16	**5 Year CAGR Estimate:**	19.9%	**Quality Percentile:**	N/A
Fair Value Price:	$24	**5 Year Growth Estimate:**	4.2%	**Momentum Percentile:**	N/A
% Fair Value:	68%	**5 Year Valuation Multiple Estimate:**	8.2%	**Total Return Percentile:**	N/A
Dividend Yield:	7.5%	**5 Year Price Target**	$30	**Valuation Percentile:**	N/A

Overview & Current Events

Energy Transfer Equity was formed in 2002 and now has an interest in 71,000 miles of natural gas pipelines as well as retail fuel operations through ownership of Energy Transfer Partners as well as Sunoco. The company's market cap is $17.6B and it is on track for $48B in revenue this year.

ETE's recent Q4 saw distributable cash flow decline by about 12%. This was due primarily to incentive distribution rights waivers ETE has agreed upon with ETP. The former has waived some of its claims to IDRs from ETP as a way to alleviate funding concerns but in so doing, has deteriorated the financial performance of itself. However, with ETP's newest projects coming online and the outlook for growth picking up, ETE stands to gain significantly via not only the waived IDRs, but the resumption of collection for new IDRs as well. In other words, weakness should be temporary.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EBITDA	$1.48	$1.68	$1.56	$2.10	$3.12	$3.17	$4.19	$4.31	$4.88	$5.85	***$6.10***	***$7.50***
DPS	$0.48	$0.53	$0.54	$0.61	$0.63	$0.67	$0.80	$1.08	$1.14	$1.15	***$1.22***	***$1.80***

ETE's EBITDA has grown very nicely in the past decade in a departure from the MLP pipeline industry that has seen struggled to a large degree. ETE's unique structure makes it highly attractive from a safety and distribution standpoint, well illustrated by the fact that the yield on common units fell to 4.3% or below from 2013 to 2015, indicating a much higher valuation. ETE's valuation should rise again as its IDRs begin to flow in earnest again after 2019, but results may appear weaker than normal until then. ETE's IDRs on ETP's earnings are a very attractive asset to own now that the latter's own growth plans are beginning to materialize. ETE's principal risk is that ETP doesn't perform as well as projected, but there is still a significant margin of safety in ETE's earnings and payout. We see average growth of 4.2% in the coming years but that growth will be back loaded until after resumption of full IDRs, slated to begin in 2020.

The distribution should see significant growth as well from IDRs coming back online. ETE looks ready to continue its impressive streak of growth on the income front as well. We see the distribution rising to $1.80 in five years from $1.22.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
P/EBITDA	2.7	4.5	6.3	4.8	3.6	6.5	6.8	3.2	4.0	3.0	***2.7***	***4.0***
Avg. Yld.	7.0%	8.5%	6.2%	6.1%	5.9%	4.3%	3.1%	4.0%	8.6%	6.5%	***7.5%***	***6.0%***

ETE's valuation has seen several peaks and valleys in the past decade and today, we are certainly experiencing one of the valleys. ETE's EBITDA multiple peaked at 6.8 in 2014 and has since been decimated to today's level of just 2.7. The MLP complex is out of favor with investors for 2 reasons. One is the recent FERC ruling on recovering an income tax allowance on cost of service rates. The other is rising interest rates. However, this sort of valuation was seen in 2008 as well and resulted in outsized gains for ETE holders in subsequent years. We see modest growth driving a higher unit price but a return to a more normalized EBITDA multiple of 4 will produce a strong 8.2% tailwind to total returns. ETE is cheap by historical standards and with IDRs coming back from ETP in the near future, that return looks almost assured.

The higher unit price should lead the yield back down to more normalized levels around 6% going forward. That is a very good thing for new money as one can get a high yield and cheap valuation.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	25.3%	29.8%	25.5%	25.2%	16.3%	8.5%	9.3%	12.2%	15.4%	17.1%	***17.0%***	***23.0%***
Debt/A	79%	74%	64%	65%	67%	68%	65%	67%	72%	65%	***65%***	***67%***
Int. Cov.	2.9	2.5	1.6	1.7	2.3	1.8	2.1	1.6	1.6	2.0	***2.0***	***2.3***
Div/EBITDA	32%	32%	35%	29%	20%	21%	19%	25%	23%	20%	**20%**	**24%**
Std. Dev.	39.9%	26.7%	21.7%	26.3%	18.7%	17.8%	28.1%	41.5%	91.2%	19.9%	***22.0%***	***32.0%***

ETE's quality metrics have held up very well in the past decade as we've seen no significant deterioration. The company's debt is pretty conservative at two-thirds of assets; more than acceptable for an MLP. ETE's interest coverage is okay at 2 and we see improving fundamentals as a catalyst for higher interest coverage going forward. Management is committed to reducing leverage and improving its interest coverage in the coming years, something that should be afforded by rising earning capacity. The dividend is also well covered and should continue to rise going forward but keep in mind that will improve as well by the resumption of IDRs from ETP. In other words, ETE's outlook is very bright from here from a valuation and distribution basis.

ETE's competitive advantage is in its size and unique exposure to retail fuel sales. In addition, it has a very favorable IDR structure with ETP. Recession isn't of large concern for ETE given its toll fee model; it should perform well during the next economic downturn.

Final Thoughts & Recommendation

Overall we see ETE as very attractively valued here. The unit price has underperformed since 2015 as MLPs have fallen out of favor with investors, creating an opportunity in ETE. We see 19.9% total annual returns going forward, consisting of the current 7.5% yield, 4.2% growth and 8.2% tailwind from the valuation. ETE offers a unique combination of value and yield here, making it suitable for investors seeking a high current yield with room for growth. With nearly 20% total returns, we recommend ETE as a buy at current prices.

Total Return Breakdown by Year