Magellan Midstream Partners (MMP)

Updated May 8th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$68	**5 Year CAGR Estimate:**	11.8%	**Quality Percentile:**	N/A
Fair Value Price:	$72	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	N/A
% Fair Value:	94%	**5 Year Valuation Multiple Estimate:**	1.4%	**Total Return Percentile:**	N/A
Dividend Yield:	5.4%	**5 Year Price Target**	$93	**Valuation Percentile:**	N/A

Overview & Current Events

Magellan Midstream Partners (MMP) has the longest pipeline system of refined products, which is linked to nearly half of the total U.S. refining capacity. This segment generates about 60% of its total operating income while the transportation and storage of crude oil generates 30% of its operating income. MMP has a fee-based model and thus only 10% of its operating income depends on commodity prices. That's why it exhibited impressive resilience in the downturn of the oil market that began almost four years ago. While most MLPs saw their earnings decline, MMP has grown its EPS 10% in the last four years.

During the last decade, MMP has invested $5 B in growth projects and acquisitions and has exhibited much better performance than the vast majority of MLPs. Most MLPs carry excessive amounts of debt, post poor free cash flows due to their capital expenses and dilute their unitholders to a great extent and on a regular basis. They also tend to have payout ratios above 100%. On the contrary, MMP has posted positive free cash flows for more than 10 consecutive years while it has a markedly strong balance sheet. In addition, it does not dilute its unitholders and maintains a healthy payout ratio, which is always below 100% and thus bodes well for future distribution hikes. All these attributes confirm the discipline of its management, which invests only in high-return projects.

FERC recently triggered a selloff in the MLP sector, when it announced that it was changing the income tax allowance for cost of service pipelines of MLPs. However, MMP is likely to be minimally affected by this change. Moreover, the MLP exceeded analyst estimates on both the top and bottom lines in Q1 and raised its guidance based on strong trends in its pipelines of oil and refined products. Furthermore, the management stated that it still saw ample room for future growth thanks to a series of growth projects, which will benefit from rising domestic output.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EBITDA/S	$3.76	$4.14	$2.36	$2.85	$2.99	$3.73	$4.96	$4.97	$5.05	$5.54	***$5.93***	***$7.57***
DPS	$1.36	$1.42	$1.46	$1.56	$1.78	$2.10	$2.51	$2.92	$3.25	$3.52	***$3.80***	***$5.00***

Thanks to the exceptional record of the management of MMP, it is reasonable to rely on its guidance for EBITDA per share of $5.93 this year. In addition, MMP has grown its EBITDA per share at a 9.7% average annual rate in the last five years (including this year). Moreover, its management expects to grow the annual distribution by 6%-8% per year over the next few years. Therefore, it is reasonable to expect the MLP to grow its EBITDA per share by at least 5.0% per year on average in the upcoming years, from $5.93 this year to $7.57 in 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
P/EBITDA	4.0	5.2	12.0	12.1	14.4	17.0	16.7	13.7	15.0	12.8	***11.5***	***12.3***
Avg. Yld.	7.4%	8.0%	6.0%	5.2%	4.6%	3.9%	3.2%	4.0%	4.7%	4.9%	***5.4%***	***5.0%***

Since early last year, the Fed has begun to raise interest rates aggressively. Consequently, the valuation of most MLPs has been under pressure, as their distribution yields have become less attractive. Nevertheless, thanks to its solid performance, MMP has been hurt much less than most MLPs. In fact, MMP is now trading at a P/EBITDA ratio of 11.5, which is only slightly lower than its 10-year average ratio of 12.3. As it is reasonable to expect the stock to revert towards its 10-year average valuation level over the next five years, the stock is likely to enjoy a 1.4% annualized gain thanks to expansion of its P/EBITDA ratio.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	19.7%	15.1%	16.3%	18.2%	17.8%	20.2%	23.0%	20.1%	17.5%	17.5%	***18.2%***	***20.0%***
Debt/A	51.8%	62.2%	60.5%	63.8%	65.7%	65.8%	66.0%	66.5%	69.1%	71.2%	***71.0%***	***69.0%***
Int. Cov.	7.5	2.6	4.3	4.9	4.9	6.0	8.0	6.7	5.9	5.5	***5.0***	***5.0***
Payout	36.2%	34.3%	61.9%	54.7%	59.5%	56.3%	50.6%	58.8%	64.4%	63.5%	***64.1%***	***66.1%***
Std. Dev.	34.2%	26.2%	15.8%	11.7%	16.4%	15.0%	19.6%	20.8%	20.6%	14.8%	***18.3%***	***17.0%***

MMP has grown its dividend for 63 consecutive quarters. In addition, in contrast to most MLPs, it has a strong balance sheet, it enjoys strong free cash flows and does not dilute its unitholders. All these facts are testaments to the strength of its business model and its great discipline to invest only in high-return projects. Moreover, thanks to its fee-based model, it proved markedly resilient during the downturn of the oil market that began in 2014.

On the other hand, investors should not jump to the conclusion that MMP is immune to recessions. In the Great Recession, its EPS fell 32%, from $1.64 in 2008 to $1.11 in 2009. As a recession has not shown up for nine consecutive years and interest rates are on the rise, investors should keep this risk factor in mind.

Final Thoughts & Recommendation

MMP is one of the safest and highest-quality MLPs around. It has raised its dividend for 63 consecutive quarters and has ample room to continue to raise it for years thanks to its promising pipeline of growth projects, its strong execution, its healthy payout ratio and its strong balance sheet. Thanks to its 5.4% dividend, a 1.4% annualized P/EBITDA expansion and at least 5.0% annual growth in its EBITDA per share, the stock can offer an 11.8% average annual return over the next five years.

Total Return Breakdown by Year