Energy Transfer Equity (ETE)

Updated August 13th, 2018 by Josh Arnold

Key Metrics

Current Price:	$18	**5 Year CAGR Estimate:**	16.8%	**Volatility Percentile:**	98.8%
Fair Value Price:	$24	**5 Year Growth Estimate:**	4.2%	**Momentum Percentile:**	50.9%
% Fair Value:	75%	**5 Year Valuation Multiple Estimate:**	5.9%	**Valuation Percentile:**	94.1%
Dividend Yield:	6.7%	**5 Year Price Target**	$30	**Total Return Percentile:**	93.8%

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 and Sunoco. The company's market capitalization is $21 billion, and it is on track for $48 billion in revenue this year.

Energy Transfer Equity reported Q2 earnings on 8/8/18 and results were strong. Distributable cash flow increased 70% over last year's Q2, thanks primarily to the company's distributions from Energy Transfer Partners. However, apart from a nice Q2 report, the big news is the proposed merger between the two partnerships. On 8/1/18, the partnerships announced that Energy Transfer Partners is to be acquired by Energy Transfer Equity sometime in the fourth quarter of this year, for a consideration of 1.28 units of the latter for each current unit of the former. The deal will eliminate Energy Transfer Equity's incentive distribution rights but will be immediately accretive once the deal is complete. In total, we see this merger as a significant positive for holders of both partnership's units.

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***

Energy Transfer Equity's EBITDA has grown very nicely in the past decade in a departure from the MLP pipeline industry that has struggled to a large degree. The partnership'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. The partnership's acquisition of the Partners business will be immediately accretive and should improve distributable cash flow. The partnership will lose its incentive distribution rights on the Partners business, but that cash will become part of the consolidated structure. In addition, Equity still has its slate of upcoming projects to be completed. We see average growth of 4.2% in the coming years, but there could be upside to that forecast once we get additional clarity on the Partner acquisition.

The distribution should grow meaningfully in the coming years given the cash that would have flowed from Partners to Equity via incentive distribution rights will now be consolidated immediately following the acquisition. 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	***3.0***	***4.0***
Avg. Yld.	7.0%	8.5%	6.2%	6.1%	5.9%	4.3%	3.1%	4.0%	8.6%	6.5%	***6.7%***	***6.0%***

Energy Transfer Equity's valuation has seen several peaks and valleys in the past decade and today, we are certainly experiencing one of the valleys. Its EBITDA multiple peaked at 6.8 in 2014 and has since been decimated to today's level of just 3.0. The MLP complex is out of favor with investors for two 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 unit holders in subsequent years. We see modest growth driving a

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

higher unit price but a return to a more normalized EBITDA multiple of 4 will produce a 5.9% tailwind to total returns. 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%***

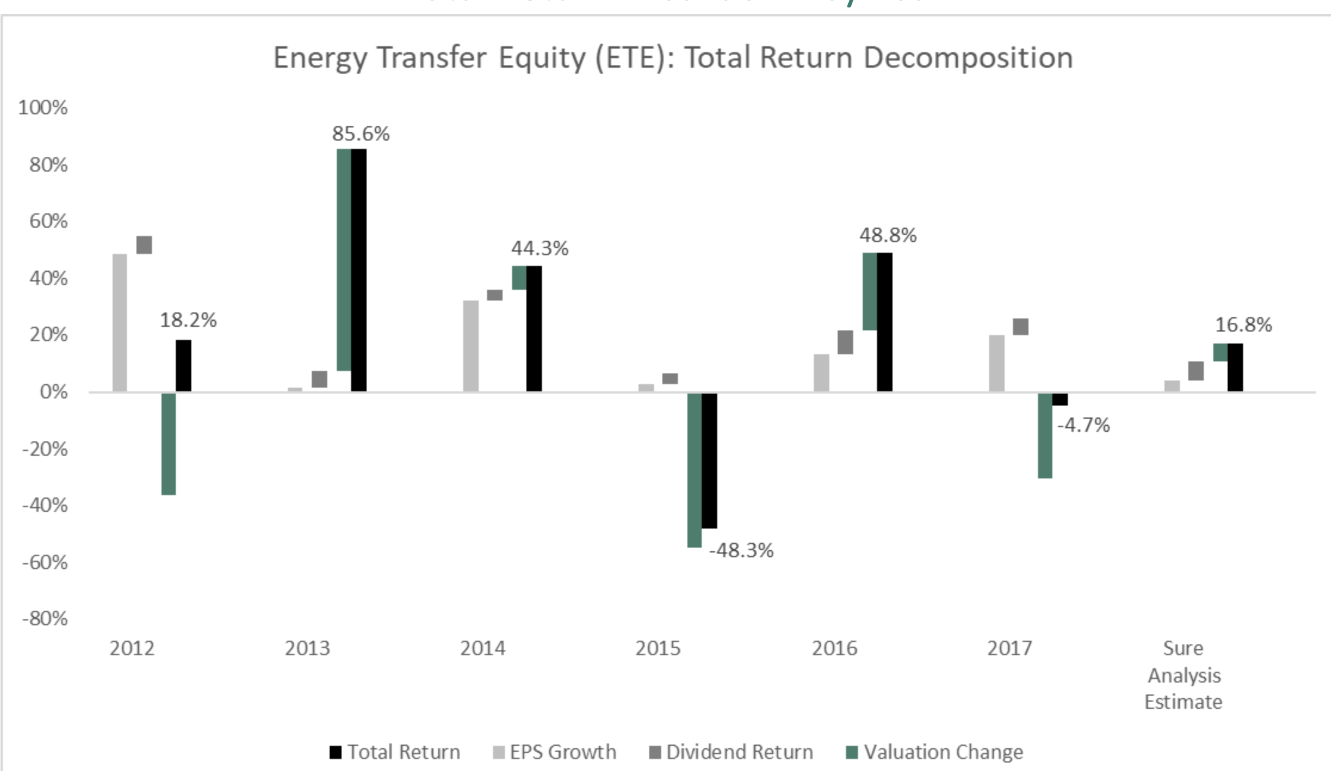
Energy Transfer Equity's quality metrics have held up very well in the past decade as we've seen no significant deterioration. The company's debt is pretty conservative at two-thirds of assets; more than acceptable for an MLP. Interest coverage is okay at 2 and we see improving fundamentals as a catalyst 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 and the Partners acquisition. The dividend is also well covered and should continue to rise going forward, but keep in mind that will improve as well after the acquisition.

Energy Transfer Equity's competitive advantage is in its size and unique exposure to retail fuel sales. Recessions are not a concerns given its toll fee model. The partnership should perform well during the next economic downturn.

Final Thoughts & Recommendation

Overall, we see Energy Transfer Equity as attractively valued here. The unit price has underperformed since 2015 as MLPs have fallen out of favor with investors, creating an opportunity. We see 16.8% total annual returns going forward, consisting of the current 6.7% yield, 4.2% growth and 5.9% tailwind from the valuation. Energy Transfer Equity offers a unique combination of value and yield, making it suitable for investors seeking a high current yield with room for growth. Given the very high projected returns and the acquisition of Energy Transfer Partners, we rate the units a buy.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.