Magellan Midstream Partners (MMP)

Updated August 14th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$70	**5 Year CAGR Estimate:**	11.4%	**Volatility Percentile:**	51.5%
Fair Value Price:	$74	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	45.3%
% Fair Value:	95%	**5 Year Valuation Multiple Estimate:**	1.0%	**Valuation Percentile:**	68.9%
Dividend Yield:	5.4%	**5 Year Price Target**	$94	**Total Return Percentile:**	74.7%

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 59% of its total operating income while the transportation and storage of crude oil generates 33% of its operating income. MMP has a fee-based model and thus only about 10% of its operating income depends on commodity prices. That is why it has 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 at a 10% average annual rate in the last four years.

During the last decade, MMP has invested $5.4 billion 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. It is impressive that MMP has spent $5.4 billion on growth projects in the last decade but has raised only $0.26 billion of equity (5% of its capital needs) over this period. This is in sharp contrast to what the vast majority of MLPs does. All these attributes confirm the discipline of its management, which invests only in high-return projects.

In early August, MMP reported (8/2/18) its results for the second quarter of fiscal 2018. The MLP exceeded the EPS analysts' estimates ($1.05 vs. consensus of $1.01), mostly thanks to an increase of $46 million in the operating income of its crude oil segment to a quarterly record of $152 million. Moreover, MMP raised its tariffs by 4.4% in the middle of the year and raised its guidance for its distributable cash flow of this year by 2%.

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	***$5.98***	***$7.63***
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 strong performance of MMP in Q2, we have slightly raised our estimate for its EBITDA per share this year, from $5.93 to $5.98. In addition, MMP has grown its EBITDA per share at a 9.9% average annual rate in the last five years (including this year). Moreover, in the last conference call, management reiterated its guidance for 8% annual distribution growth and 5%-8% annual growth of distributable cash flow 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.

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	***11.7***	***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%***

As the Fed is raising interest rates aggressively, the valuation of most MLPs has come under pressure. 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 11.7, 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 1.0% 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%	***17.5%***	***20.0%***
Debt/A	51.8%	62.2%	60.5%	63.8%	65.7%	65.8%	66.0%	66.5%	69.1%	71.2%	***71.4%***	***69.0%***
Int. Cov.	7.5	2.6	4.3	4.9	4.9	6.0	8.0	6.7	5.9	5.5	***4.5***	***5.0***
Payout	36.2%	34.3%	61.9%	54.7%	59.5%	56.3%	50.6%	58.8%	64.4%	63.5%	***63.5%***	***65.5%***
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%***

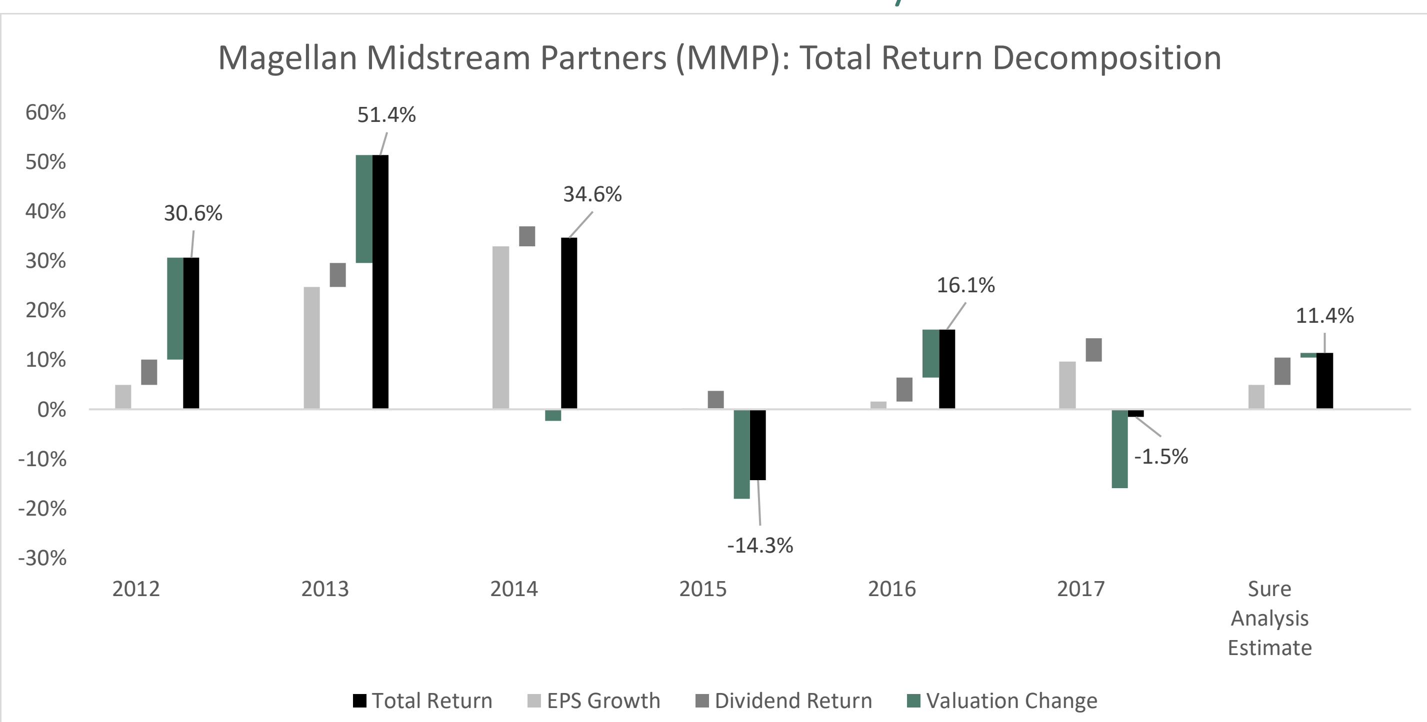
MMP has grown its dividend for 64 consecutive quarters and has raised its annual dividend at a 12% average annual rate since 2001. In addition, in contrast to most MLPs, it has a strong balance sheet, it enjoys strong free cash flows and does not dilute its unitholders. All these facts are testaments to the strength of its business model and its great discipline to invest only in high-return projects. Moreover, management recently stated that it did not expect to issue any equity to fund current growth projects. Furthermore, thanks to its fee-based model, MMP 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 occurred 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 64 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 1.0% annualized P/EBITDA expansion and at least 5.0% annual growth in its EBITDA per share, the stock can offer an 11.4% average annual return over the next five years. Because of this, MMP units earn a buy recommendation at current prices.

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.