



# Magellan Midstream Partners (MMP)

Updated February 1<sup>st</sup>, 2019 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b>	\$61	<b>5 Year CAGR Estimate:</b>	15.8%	<b>Volatility Percentile:</b>	36.7%
<b>Fair Value Price:</b>	\$75	<b>5 Year Growth Estimate:</b>	5.0%	<b>Momentum Percentile:</b>	36.1%
<b>% Fair Value:</b>	81%	<b>5 Year Valuation Multiple Estimate:</b>	4.2%	<b>Growth Percentile:</b>	33.2%
<b>Dividend Yield:</b>	6.6%	<b>5 Year Price Target</b>	\$96	<b>Valuation Percentile:</b>	80.6%
<b>Dividend Risk Score:</b>	D	<b>Retirement Suitability Score:</b>	B	<b>Total Return Percentile:</b>	89.8%

## 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 34% of its operating income. MMP has a fee-based model; only ~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 earnings-per-share 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 and has a strong balance sheet. In addition, it does not significantly dilute unitholders and maintains a healthy payout ratio. It is impressive that MMP has increased its unit count by only 1.8% in total in the last eight years. All these attributes confirm the discipline of its management, which invests only in high-return projects.

In late January, MMP reported (1/31/19) its financial results for the fourth quarter of fiscal 2018. Despite the collapse of the prices of oil and refined products in the quarter, adjusted earnings-per-share grew 19%, from \$1.04 to \$1.24, and adjusted distributable cash flow rose 4%, from \$308 million to \$320 million. The MLP achieved record distributable cash flow for the year thanks to strong demand for its pipelines and terminals and posted a very healthy 126% distribution coverage for the full year. Management expects to maintain a coverage ratio around 120% for the foreseeable future.

On the other hand, management disappointed the market with its guidance, as it now expects earnings-per-share of \$0.90 in the first quarter (vs. expected \$0.99) and guided for 5% annual growth of distributable cash flow in the upcoming years, which is less than the 5%-8% rate of previous guidance. The reduced guidance mostly resulted from the lower tariffs in the Houston crude oil distribution system. The stock lost 3.5% on the day of its earnings release.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>CF/S</b>	\$1.52	\$1.94	\$2.37	\$2.49	\$3.20	\$4.42	\$4.34	\$4.31	\$4.68	\$4.84	<b>\$5.00</b>	<b>\$6.38</b>
<b>DPS</b>	\$1.42	\$1.46	\$1.56	\$1.78	\$2.10	\$2.51	\$2.92	\$3.25	\$3.52	\$3.80	<b>\$4.00</b>	<b>\$5.00</b>
<b>Units</b>	213.2	225.0	225.4	226.2	226.7	226.7	227.4	227.8	228.0	229.1	<b>230.0</b>	<b>232.0</b>

MMP has grown its cash flow per share at a 4.5% average annual rate in the last decade, which includes the Great Recession. In the latest conference call, management somewhat lowered its guidance for the annual growth of distributable cash flow over the next few years, from 5%-8% to 5%. We thus lowered our forecast for the growth rate of cash flow per share in the upcoming years from 6.0% to 5.0% per year.



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## Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
P/CF	14.2	14.6	14.6	17.3	19.8	18.7	15.7	17.6	15.2	13.7	12.2	15.0
Avg. Yld.	8.0%	6.0%	5.2%	4.6%	3.9%	3.2%	4.0%	4.7%	4.9%	5.7%	6.6%	5.2%

MMP has corrected 15% in the last six months, mostly due to rising interest rates, which render its yield less attractive. As a result, MMP is now trading at a price-to-cash flow ratio of 12.2, which is lower than its 10-year average ratio of 16.1. In order to be somewhat conservative, we assume a fair price-to-cash flow ratio of 15.0 for this MLP. If the stock approaches our valuation level over the next five years, it will enjoy a 4.2% annualized boost to total returns.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	93.4%	75.3%	65.8%	71.5%	65.6%	56.8%	67.3%	75.4%	75.2%	78.5%	80.0%	78.4%

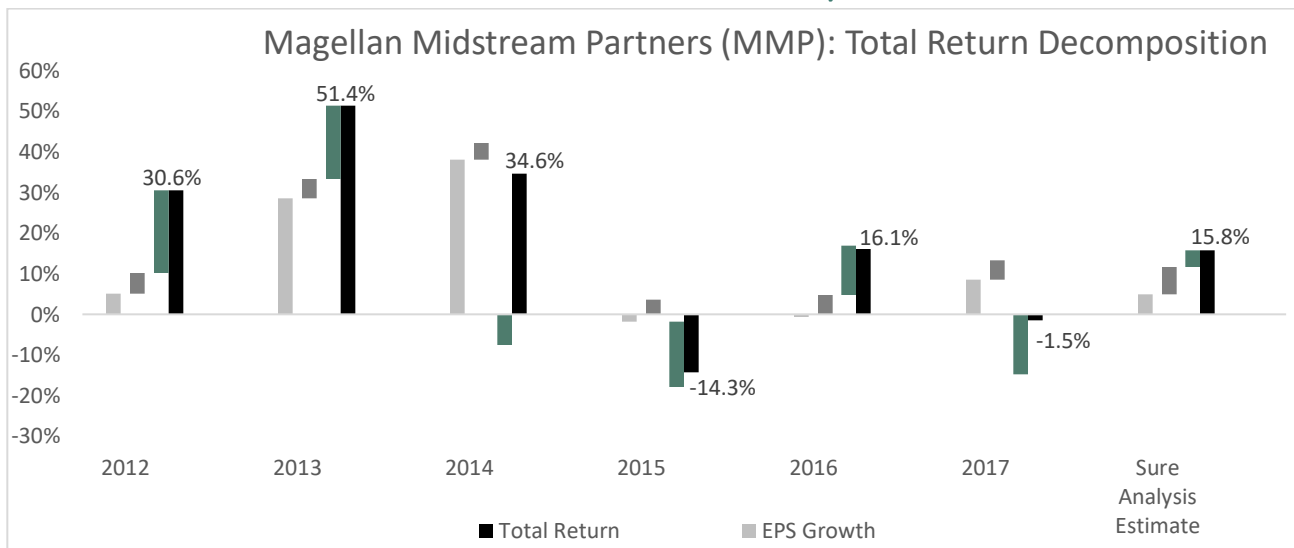
MMP has grown its dividend for 66 consecutive quarters and has raised its annual dividend at a 12% average annual rate since 2001. In the latest conference call, management remained confident that the MLP will maintain a distribution coverage ratio of at least 1.2 in the years ahead. All these facts are testaments to the strength of its business model and its great discipline to invest only in high-return projects. Moreover, management has stated that it does not expect to issue any equity to fund current growth projects. Thanks to its fee-based model, MMP proved 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 earnings-per-share 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 66 consecutive quarters and has ample room to continue to raise it for years thanks to its promising pipeline of growth projects, healthy payout ratio and strong balance sheet. Due to its 15% correction in the last six months, the stock has become markedly attractive and can offer a 15.8% average annual return over the next five years. As a result, MMP units earn a buy rating.

## Total Return Breakdown by Year



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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.



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## Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Revenue</b>	1214	1014	1557	1749	1772	1948	2360	2188	2205	2508
<b>Gross Profit</b>	512	476	607	736	787	974	1265	1218	1183	1294
<b>Gross Margin</b>	42.2%	47.0%	39.0%	42.1%	44.4%	50.0%	53.6%	55.6%	53.7%	51.6%
<b>SG&amp;A Exp.</b>	73	84	95	99	109	132	148	150	147	166
<b>D&amp;A Exp.</b>	87	98	109	121	128	N/A	N/A	167	178	197
<b>Operating Profit</b>	352	295	403	516	549	699	955	901	858	932
<b>Operating Margin</b>	29.0%	29.1%	25.9%	29.5%	31.0%	35.9%	40.5%	41.2%	38.9%	37.2%
<b>Net Profit</b>	86	127	312	414	436	582	840	819	803	870
<b>Net Margin</b>	7.1%	12.5%	20.0%	23.7%	24.6%	29.9%	35.6%	37.4%	36.4%	34.7%
<b>Free Cash Flow</b>	163	53	174	378	292	352	744	449	290	550
<b>Income Tax</b>	2	2	1	2	3	5	5	2	3	4

## Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Total Assets</b>	2601	3163	3718	4045	4420	4821	5501	6042	6772	7394
<b>Cash &amp; Equivalents</b>	38	4	7	210	328	25	17	29	15	176
<b>Accounts Receivable</b>	38	73	92	82	103	116	84	84	106	139
<b>Inventories</b>	48	193	216	259	222	187	158	131	134	182
<b>Goodwill &amp; Int. Ass.</b>	20	21	57	68	67	61	58	55	105	106
<b>Total Liabilities</b>	1347	1967	2248	2582	2904	3173	3633	4020	4680	5265
<b>Accounts Payable</b>	40	37	41	66	112	76	97	104	77	105
<b>Long-Term Debt</b>	1083	1680	1906	2152	2393	2685	2967	3440	4087	4524
<b>Shareholder's Equity</b>	68	1196	1455	1463	1516	1647	1868	2022	2092	2130

## Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Return on Assets</b>	3.6%	4.4%	9.1%	10.7%	10.3%	12.6%	16.3%	14.2%	12.5%	12.3%
<b>Return on Equity</b>	18.2%	20.1%	23.5%	28.3%	29.2%	36.8%	47.8%	42.1%	39.0%	41.2%
<b>Shares Out.</b>	133.5	213.2	225.0	225.4	226.2	226.7	226.7	227.4	227.8	228.0
<b>Revenue/Share</b>	9.68	8.87	7.11	7.74	7.82	8.58	10.37	9.60	9.67	10.98
<b>FCF/Share</b>	1.30	0.46	0.79	1.67	1.29	1.55	3.27	1.97	1.27	2.41

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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