



Magellan Midstream Partners (MMP)

Updated May 6th, 2019 by Aristofanis Papadatos

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|---------------------------------|-------|
| Current Price: | \$62 | 5 Year CAGR Estimate: | 16.1% | Volatility Percentile: | 31.5% |
| Fair Value Price: | \$78 | 5 Year Growth Estimate: | 5.0% | Momentum Percentile: | 31.4% |
| % Fair Value: | 80% | 5 Year Valuation Multiple Estimate: | 4.6% | Growth Percentile: | 36.0% |
| Dividend Yield: | 6.5% | 5 Year Price Target | \$99 | Valuation Percentile: | 90.0% |
| Dividend Risk Score: | D | Retirement Suitability Score: | B | Total Return Percentile: | 95.7% |

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 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 in 2014. 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. MMP has a market capitalization of \$14.1 billion.

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 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 early May, MMP reported (5/1/19) financial results for the first quarter of fiscal 2019. Its earnings-per-share remained essentially flat over last year's quarter, as the favorable impact of higher commodity prices was offset by losses in derivative hedges. Nevertheless, MMP grew its distributable cash flow (DCF) by 23%, from \$258.9 million to a record level of \$318.0 million, partly assisted by a \$10.8 million gain from an asset sale. Thanks to favorable commodity prices and positive trends in crude oil pipeline shipments, management raised its annual DCF guidance, from \$1.14 to \$1.18 billion, and thus it now expects a distribution coverage ratio around 1.27. Accordingly, we have raised our estimate for the cash flow per share of this year by 3%, from \$5.00 to \$5.15.

Growth on a Per-Share Basis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|--------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| CF/S | \$1.52 | \$1.94 | \$2.37 | \$2.49 | \$3.20 | \$4.42 | \$4.34 | \$4.31 | \$4.68 | \$4.84 | \$5.15 | \$6.57 |
| DPS | \$1.42 | \$1.46 | \$1.56 | \$1.78 | \$2.10 | \$2.51 | \$2.92 | \$3.25 | \$3.52 | \$3.80 | \$4.00 | \$5.00 |
| Units | 213.2 | 225.0 | 225.4 | 226.2 | 226.7 | 226.7 | 227.4 | 227.8 | 228.0 | 229.1 | 230.0 | 232.0 |

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 reiterated its commitment to raise its distribution by approximately 5% this year and maintain a distribution coverage ratio of at least 1.20 for the foreseeable future. We continue to expect 5% annual growth in distributable cash flow per share and distribution per share over the next five years.

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 | 12.0 | 15.0 |
| Avg. Yld. | 8.0% | 6.0% | 5.2% | 4.6% | 3.9% | 3.2% | 4.0% | 4.7% | 4.9% | 5.7% | 6.5% | 5.1% |

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MMP is trading at a price-to-cash flow ratio of 12.0, 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 fair valuation level over the next five years, it will enjoy a 4.6% 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% | 77.7% | 76.1% |

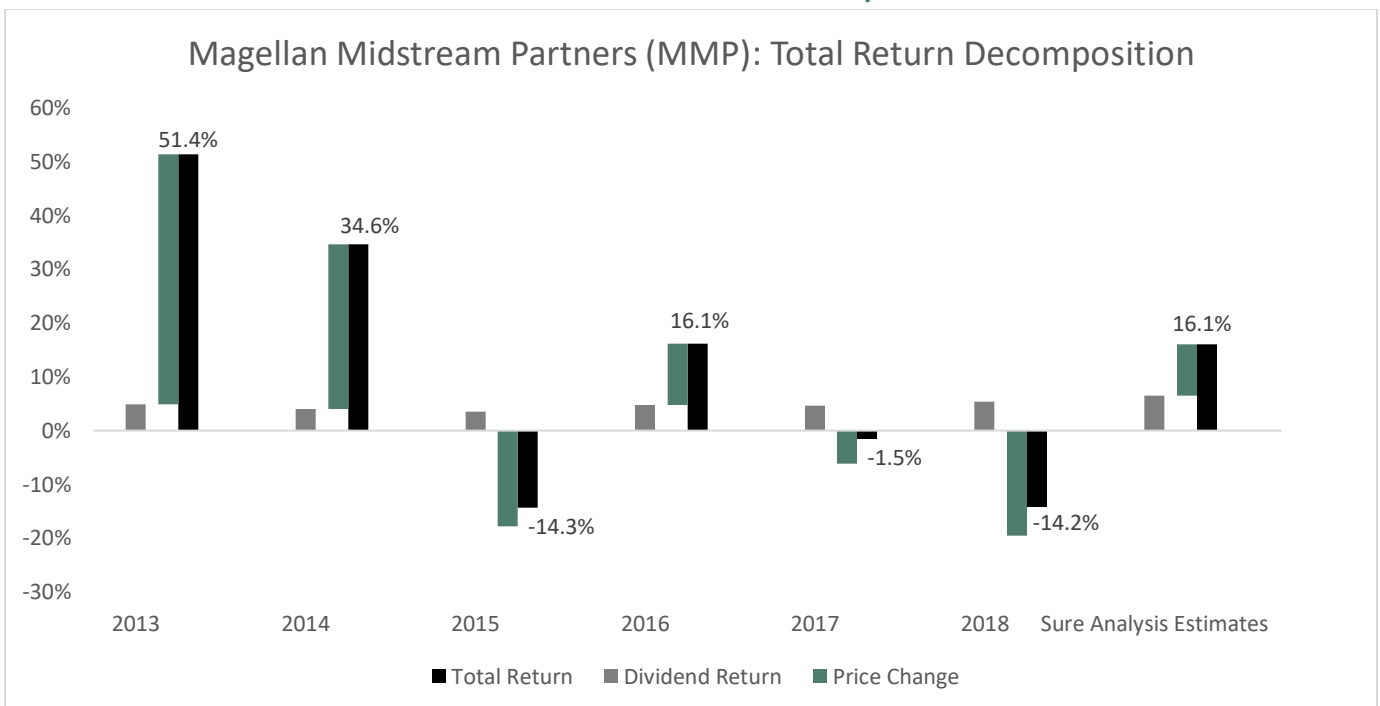
The competitive advantage of MMP comes from its fee-based model, its great scale and its discipline to invest only in high-return projects. MMP has grown its dividend for 67 consecutive quarters and has raised its annual dividend at a 12% average annual rate since 2001. In the latest conference call, 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 a whole decade and interest rates have risen in the last two years, 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 67 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. The stock is also attractively valued right now. As a result, it could offer a 16.1% average annual return over the next five years thanks to its 6.5% distribution yield, 5.0% annual growth in its cash flow per share and a 4.6% annualized expansion of its valuation level. MMP thus maintains its buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

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

Balance Sheet Metrics

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---------------------------------|------|------|------|------|------|------|------|------|------|------|
| Total Assets | 2601 | 3163 | 3718 | 4045 | 4420 | 4821 | 5501 | 6042 | 6772 | 7394 |
| Cash & Equivalents | 38 | 4 | 7 | 210 | 328 | 25 | 17 | 29 | 15 | 176 |
| Accounts Receivable | 38 | 73 | 92 | 82 | 103 | 116 | 84 | 84 | 106 | 139 |
| Inventories | 48 | 193 | 216 | 259 | 222 | 187 | 158 | 131 | 134 | 182 |
| Goodwill & Int. Ass. | 20 | 21 | 57 | 68 | 67 | 61 | 58 | 55 | 105 | 106 |
| Total Liabilities | 1347 | 1967 | 2248 | 2582 | 2904 | 3173 | 3633 | 4020 | 4680 | 5265 |
| Accounts Payable | 40 | 37 | 41 | 66 | 112 | 76 | 97 | 104 | 77 | 105 |
| Long-Term Debt | 1083 | 1680 | 1906 | 2152 | 2393 | 2685 | 2967 | 3440 | 4087 | 4524 |
| Shareholder's Equity | 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 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 3.6% | 4.4% | 9.1% | 10.7% | 10.3% | 12.6% | 16.3% | 14.2% | 12.5% | 12.3% |
| Return on Equity | 18.2% | 20.1% | 23.5% | 28.3% | 29.2% | 36.8% | 47.8% | 42.1% | 39.0% | 41.2% |
| Shares Out. | 133.5 | 213.2 | 225.0 | 225.4 | 226.2 | 226.7 | 226.7 | 227.4 | 227.8 | 228.0 |
| Revenue/Share | 9.68 | 8.87 | 7.11 | 7.74 | 7.82 | 8.58 | 10.37 | 9.60 | 9.67 | 10.98 |
| FCF/Share | 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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