Energy Transfer LP (ET)

Updated June 24th, 2020 by Samuel Smith

Key Metrics

Current Price:	$8	**5 Year CAGR Estimate:**	17.4%	**Market Cap:**	$22.3B
Fair Value Price:	$8.40	**5 Year Growth Estimate:**	7.4%	**Ex-Dividend Date:**	8/6/20[1]
% Fair Value:	95%	**5 Year Valuation Multiple Estimate:**	1.0%	**Dividend Payment Date:**	8/19/20[2]
Dividend Yield:	12.5%	**5 Year Price Target**	$12	**Years Of Dividend Growth:**	0
Dividend Risk Score:	C	**Retirement Suitability Score:**	A	**Last Dividend Increase:**	NA

Overview & Current Events

On October 19th, 2018 Energy Transfer Equity, LP (previously ETE) and Energy Transfer Partners, LP (previously ETP) announced the completion of a merger with ETE buying ETP. As part of the merger, ETE changed its name to "Energy Transfer LP" and the common units began trading under the "ET" symbol. The combined firm owns and operates one of the largest and most diversified portfolios of energy assets in the United States. Operations include natural gas transportation and storage along with crude oil, natural gas liquids and refined product transportation and storage totaling 83,000 miles of pipelines. Energy Transfer, a $22.3 billion market capitalization company, also owns the Lake Charles LNG Company, as well as stakes in publicly traded Sunoco LP (SUN) and USA Compression Partners (USAC). On September 26th, management announced its acquisition of SemGroup in a $5 billion deal.

ET reported Q1 FY20 results on May 11th. The company reported a $1.3 billion goodwill impairment due to decreases in commodity prices and market demand. Distributable cash flow covered the distribution by 1.72x during the quarter, yielding excess distributable cash flow of $594 million. Adjusted EBITDA was $2.64 billion, down $100 million year-over-year due to crude oil, natural gas liquids, and refined products inventory valuation adjustments totaling $213 million. Management announced steep additional cuts to growth capital expenditures and stated that it is unlikely that they will add any major organic growth projects to the backlog for 2021.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
CF/S	$0.73	$1.01	$0.91	$1.31	$2.12	$3.12	$3.20	$3.38	$2.06	$2.20	***$1.40***	***$2.00***
DPS	$0.54	$0.61	$0.63	$0.67	$0.80	$1.08	$1.14	$1.15	$1.22	$1.22	***$1.00***	***$1.30***
Units[3]	892	892	1,120	1,123	1,081	1,047	1,047	1,079	2,619	2,650	***2,650***	***2,650***

Energy Transfer operates a "toll booth" model of transporting energy, with natural gas being particularly interesting. Eventually the world may move away from fossil fuels, but for the foreseeable future that is not the case. In the meantime, natural gas is a cleaner, more efficient and often cheaper alternative – something we have seen play out in the last decade as U.S. electricity production has shifted dramatically away from coal and toward natural gas.

The partnership has a healthy backlog, with the expectation to spend several billion dollars in capital expenditures this year. However, the weak market in oil right now combined with plummeting demand from the coronavirus outbreak has caused us to forecast significant renegotiations for ET's contracts with clients and a corresponding decline in cash flows. We also expect the warnings from the credit agencies will force management to slightly reduce the distribution this year until they can better deleverage the balance sheet.

[1] Estimate
[2] Estimate
[3] Units in millions

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg P/CF	13.4	10.0	12.5	15.6	13.5	4.4	6.0	5.1	6.4	5.3	***5.7***	***6.0***
Avg. Yld.	6.2%	6.1%	5.9%	4.3%	3.1%	4.0%	8.6%	6.5%	9.2%	10.5%	***12.5%***	***10.8%***

Keep in mind that the 2009 through 2018 period represents the average Price-to-Cash Flow multiple, whereas Distributable Cash Flow will be our gauge moving forward. Notice that while Cash Flow per unit was solid and increasing during this time, the valuation investors were willing to pay has varied dramatically. For instance, the share price tripled from the end of 2012 through mid-2015, before dropping ~80% in late 2015 / early 2016. We believe ~6 times distributable cash flow is a reasonable multiple for pipelines in general and Energy Transfer in particular, taking into consideration the growth profile and steady business offset by the higher leverage profile and the current headwinds facing the business. Investor returns will be largely driven by the exceptionally high distribution yield.

Safety, Quality, Competitive Advantage, & Recession Resiliency

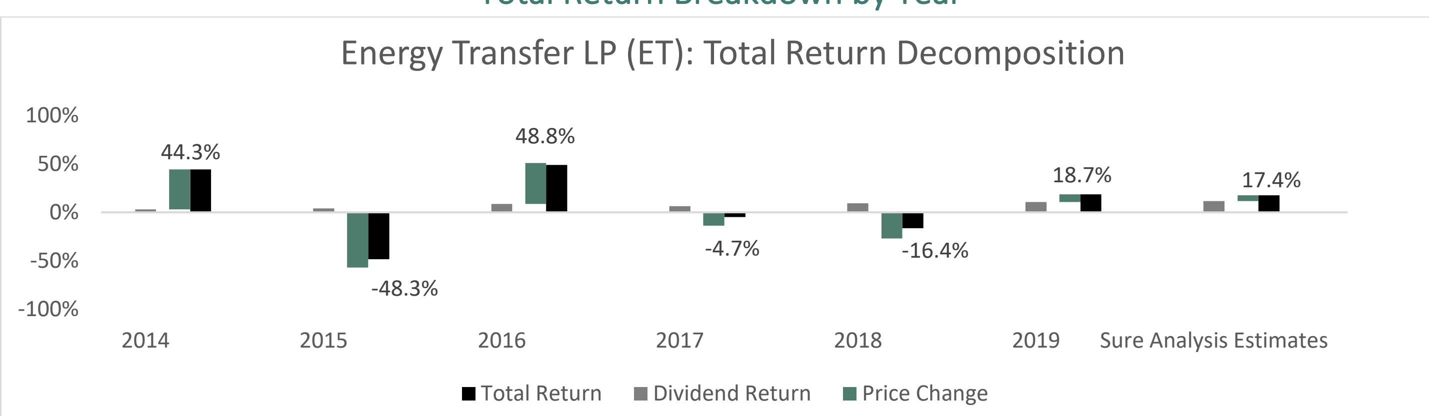
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	74%	60%	69%	51%	38%	35%	36%	34%	59%	56%	***71%***	***65%***

Energy Transfer is making strides in the safety department. Since the merger, Moody's has revised its credit rating to stable (Baa3 investment grade) and the company has told investors that it anticipates funding the majority of its growth capex with retained cash flow – reducing its reliance on the debt and capital markets. Today, the credit agency defined Debt-to-Adjusted EBITDA levels are getting close to their desired range of 4.5x to 4.0x. Additionally, Energy Transfer anticipates a distribution coverage ratio of nearly ~1.8x moving forward, which translates to a distribution payout ratio in the 50%-60% range. That's more or less typical for a well-established common equity firm, but far better than average for an MLP. That being said, there is considerable uncertainty hanging over the company right now due to plunging oil prices. As a result, the distribution and the balance sheet could be in danger if cash flows fall far enough due to contract defaults/renegotiations. Given the accelerated yields on ET debt and preferred units, we believe that the distribution will likely be cut this year as management will be forced to begin putting more cash towards debt retirement.

Final Thoughts & Recommendation

Energy Transfer is a fairly risky bet given the current headwinds facing the space and its somewhat elevated leverage. That being said, in normal conditions the business model is quite safe and is somewhat recession resistant. Furthermore, units are selling at a very cheap price right now, so we rate them a speculative buy. However, conservative investors should maintain small exposure.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	6556	8190	16964	48335	55691	36096	31792	40523	54087	54213
Gross Profit	2454	3021	3876	5755	7277	7428	8099	9557	12429	14486
Gross Margin	37.4%	36.9%	22.8%	11.9%	13.1%	20.6%	25.5%	23.6%	23.0%	26.7%
SG&A Exp.	233	253	527	533	611	548	656	599	702	694
D&A Exp.	406	586								
Operating Profit	1044	1237	1360	2072	2840	2626	2891	3760	5779	7351
Operating Margin	15.9%	15.1%	8.0%	4.3%	5.1%	7.3%	9.1%	9.3%	10.7%	13.6%
Net Profit	193	310	304	196	633	1189	995	954	1694	3592
Net Margin	2.9%	3.8%	1.8%	0.4%	1.1%	3.3%	3.1%	2.4%	3.1%	6.6%
Free Cash Flow	(422)	(432)	(2193)	(1086)	(2206)	(6094)	(4449)	(4015)	99	2043
Income Tax	14	17	54	93	357	(123)	(258)	(1833)	4	195

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	17379	20897	48904	50330	64279	71189	78925	86246	88246	98880
Cash & Equivalents	86	126	372	590	847	606	467	336	419	291
Acc. Receivable	689	680	3057	3658	3378	2400	3557	4504	4009	5038
Inventories	366	328	1522	1807	1467	1636	2055	2022	1677	1935
Goodwill & Int. Ass.	2861	3111	8725	8158	13447	12904	11182	10884	10885	11321
Total Liabilities	11131	13509	32554	34051	41965	47591	56494	56266	57396	65035
Accounts Payable	449	512	3107	3834	3349	2274	3502	4685	3493	4118
Long-Term Debt	9381	11371	22053	23199	30485	36968	44052	44084	46028	51054
Total Equity	121	53	2113	1078	664	(932)	(1694)	(1196)	20559	21827

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	1.3%	1.6%	0.9%	0.4%	1.1%	1.8%	1.3%	1.2%	1.9%	3.8%
Return on Equity	319.5%	357.0%	28.1%	12.3%	72.7%				17.5%	16.9%
Shares Out.	892	892	1,120	1,123	1,081	1,047	1,047	1,079	2,619	2,650
Revenue/Share	7.35	9.18	15.90	43.09	51.06	33.91	29.48	35.21	37.01	20.55
FCF/Share	(0.47)	(0.48)	(2.06)	(0.97)	(2.02)	(5.73)	(4.12)	(3.49)	0.07	0.77

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

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