Midstream/MLP Energy

Recent midstream highlights and investor positioning ahead of 2Q23 earnings

Industry Overview

31 July 2023

Equity
Americas
Master Limited Partnerships

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Events since we published our 2Q23 earnings preview

Since publishing our 2Q earnings preview, 1) KMI reported in-line results (see our earnings review) but outperformed that week, as we believe investor expectations were lower than Street expectations. 2) The Supreme Court lifted the stop-work-order on the Mountain Valley Pipeline (MVP), allowing construction to resume and, presumably, ETRN to achieve its goal of having the pipeline online by year-end. 3) TC Energy announced a partial sale of its prized Columbia Gas/Gulf assets for a 10.5x EBITDA multiple (9.5x after tax leakage). KNTK noted it plans to monetize its 16% interest in the GCX pipeline soon. TRGP sold its 25% stake in the pipe for 10.75x in early '22, so KNTK's potential transaction multiple could be a good indicator of how higher interest rates have impacted pipeline valuations.

Positioning: Is recent OKE strength fundamentals based?

OKE has been the best performing stock in our universe, over the last month (+9%). Front month crude has moved up +16% during this period. And S&P 500 NGL players, OKE and TRGP, are the first names that are typically bought (sold) when crude rallies (falls). As we detail below, OKE has a busy calendar ahead, but we expect no major surprises. Regarding details about acquisition synergies on its 2Q call, OKE will likely highlight batching on both sets of liquids pipelines as commercial synergies, to enhance the combined entities' marketing business. Any change to the merger price will not be considered until after the vote on 9/21, in our opinion. Base Bakken volumes are strong YTD, but the basin rig count has fallen and '24 G&P rates are pressured. Last, Mexico Pacific seems to have proposed its cross-border pipeline to Saguaro, with the Sierra Madre pipeline, but OKE is unlikely to comment on Saguaro until Mexico Pacific sanctions the LNG facility.

Given OKE's strength, is TRGP's performance outsized?

As discussed in our 2Q23 revisions report, TRGP highlighted that 2Q would be its trough quarter so EBITDA estimates have trended down towards our estimate of $831mm (cons: $834mm). But more importantly, TRGP is likely to maintain its growth capex range of $2.0-$2.2bn, despite announcing 2 new processing plants set to come online in '25. And '24 is expected to have a similar capex range y/y with '25 decreasing. But with the stock up 8% m/m, investors are concerned about it being crowded into the print. With OKE outperforming TRGP over the last month, index buying into risk on energy equities could be more responsible for the move vs. active buying. Longer term, TRGP still trades at a discounted 7.9x '24 EBITDA multiple, which fails to fully reflect its premier Permian wellhead-to-water position.

ET: M&A concerns overshadowing stellar results

Investors have some concern ET will make an acquisition, that could potentially be dilutive. We believe acquiring asset packages like Lotus, Woodford Express etc. is more likely, and those recent acquisitions have been well received and strategically fit within ET's existing footprint. ET is also one of the few names we are above consensus for 2Q23 EBITDA (BofAe: $3.24bn, Cons: $3.2bn), as we believe fee floors will partially insulate the midstream segment from lower sequential NGL/natural gas prices and the crude segment benefits from a full quarter of the Lotus acquisition.

Capex: Capital expenditures

ET: Energy Transfer

ETRN: Equitrans Midstream Corp.

G&P: Gathering and processing

GCX: Gulf Coast Express Pipeline

KMI: Kinder Morgan Inc.

KNTK: Kinetik Holdings Inc.

LNG: Liquefied natural gas

M&A: Mergers and acquisitions

NGL: Natural gas liquids

OKE: ONEOK, Inc.

TRGP: Targa Resources Corp.

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Exhibit 1: Stocks mentioned
Prices and ratings for stocks mentioned in this report

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
ET	ET US	Energy Transfer LP	US$ 13.25	C-1-7
EPD	EPD US	Enterprise L.P.	US$ 26.45	B-1-7
ETRN	ETRN US	Equitrans Midstream	US$ 10.33	C-3-8
KMI	KMI US	Kinder Morgan	US$ 17.57	B-2-7
KNTK	KNTK US	Kinetik	US$ 35.55	C-1-7
OKE	OKE US	ONEOK Inc	US$ 67.22	B-2-7
TRGP	TRGP US	Targa Corp.	US$ 80.63	C-1-7

Source: BofA Global Research

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Price objective basis & risk

Energy Transfer LP (ET)

Our PO of $18 is derived from our discounted cash flow valuation, which implies a 7.5x 2024E EV/EBITDA multiple. We forecast a ten year outlook, which we believe is the limit of market recognition, and then forecast a terminal decline of 1.5% while using a 5.9% WACC.

Downside risks are: potential shutdown of Dakota Access pipeline for extended period as per court ruling, higher leverage, dilutive M&A transaction and lower sustained commodity prices. The tax treatment of ET depends on its status as a partnership for federal income tax purposes: should ET become subject to taxes, its performance could be materially affected. From a macro perspective, financial risks are rising interest rates and a stricter regulatory environment which would increase operating and maintenance expenses.

Enterprise Products Partners, L.P. (EPD)

Our PO of $31 is derived from our discounted cash flow valuation, which implies a 10.2x 2024E EV/EBITDA multiple. We forecast a ten-year outlook, which we believe is the limit of market recognition, and then forecast a terminal decline of 1.5% while using a 5.8% WACC.

Downside risks to our price objective are supply chain disruptions, the loss of key customers, and lower sustained commodity prices. Any of these risks could negatively impact volumes at EPD's pipelines and storage facilities and demand for gathering, processing and storage of crude oil, natural gas, NGLs, and petrochemicals.

Equitrans Midstream Corporation (ETRN)

Our PO of $9.00 is derived from our discounted cash flow valuation, which is 8.0x 2024E EV/EBITDA multiple. We forecast a ten year outlook, which we believe is the limit of market recognition, and then forecast a terminal decline of 1.5% while using a 8% WACC.

We continue to see risks some associated with the MVP JV project and current slate of associated projects. We acknowledge steady gas production in the Northeast and ETRN's entirely fee-based cash flows and advantaged position in the Marcellus/Utica. Upside risks to our PO: favorable progress on MVP completion withstanding new legal challenges, better than expected volume growth, faster than expected deleveraging, additional growth projects. Downside risks to our PO: further project delays, supply chain disruptions, increased customer credit risks, and slower than expected production ramp, any of which could negatively impact ETRN's natural gas pipelines and gathering systems. From a macro perspective, risks are elevated geopolitical uncertainty, an increasing interest rate environment, the need to access a relatively large amount of external capital to fund growth, and a stricter regulatory environment. ETRN is a C-corp structure and thus any changes to its tax characterization could impact cash flows.

Kinder Morgan Inc (KMI)
Our PO of $19 is derived from our discounted cash flow valuation, which implies a 10.3x 2024E EV/EBITDA multiple. We forecast a ten year outlook, which we believe is the limit of market recognition, and then forecast a terminal decline of 1.0% while using a 5.5% WACC.

Upside risks to our estimates are (1) higher commodity prices, (2) better long-term macro environment in the crude oil and refined products businesses, (3) stronger pipeline recontracting prospects and (4) tailwinds associated with energy transition opportunities.

Downside risks to our estimates are (1) US economic weakness, (2) slower oil and gas demand growth, (3) lower oil/gas prices, (4) higher than expected cash tax incidence at KMI and (5) weaker pricing at KMI's CO2 segment.

Kinetik Holdings Inc. (KNTK)
Our PO of $39 is derived from our Discounted Cash Flow Valuation which implies a 10.2x 2024 EV/EBITDA multiple. We forecast a ten-year outlook, which we believe is the limit of market recognition and then forecast a terminal decline of 2.5% while using a 7.5% weighted-average cost of capital (WACC).

Upside risks to our price objective are 1) higher commodity prices, 2) increased rich gas production on KNTK's contracted acreage, 3) winning acreage dedications at pace faster than modeled.

Downside risks to our price objective are 1) US economic weakness and/or commodity prices, 2) slower Permian production growth, 3) inability to win new acreage dedications.

ONEOK Inc (OKE)
Our PO of $69 PO is derived from our discounted cash flow valuation, which implies a 10.3x 2024E EV/EBITDA multiple. We forecast a ten-year outlook, which we believe is the limit of market recognition, and then forecast a terminal decline of 1.5% while using a 8.0% WACC.

Upside risks to our estimates and price objective are: (1) stronger and sustained commodity prices, (2) faster oil and NGL demand growth, (3) increased oil producer capital spending, (4) quicker than expected deleveraging, (5) favorable commodity price differentials and (6) lower corporate taxes.

Downside risks to our estimates and price objective are: (1) materially lower commodity prices, (2) lower oil and NGL demand growth and (3) decreased oil producer capital spending in the Bakken which may translate to lower/flat volumes.

Targa Resources Corp. (TRGP)
Our PO of $95 is derived from our discounted cash flow valuation, which implies an 8.7x 2024E EV/EBITDA multiple. We forecast a ten year outlook, which we believe is the limit of market recognition, and then forecast a terminal decline of 1% while using a 6.6% WACC.

Downside risks are: 1) another downturn in commodity prices and producer activity in TRGP's core basins, 2) slower-than-expected volume ramp on TRGP's assets, 3) sustained weakness in commodity prices leading to deterioration of counterparty credit quality and (4) reduced oil & gas producer capital spending.

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BofA Securities is currently acting as financial advisor to ONEOK Inc in connection with its proposed acquisition of Magellan Midstream Partners LP, which was announced on May 14, 2023.The proposed transaction is subject to approval by shareholders of ONEOK Inc and Magellan Midstream Partners LP.This research report is not intended to provide voting advice, serve as an endorsement of the proposed transaction, or result in the procurement, withholding or revocation of a proxy.

US - Pipelines and MLPs Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Energy Transfer LP	ET	ET US	Neel Mitra, CFA
	Enterprise Products Partners, L.P.	EPD	EPD US	Neel Mitra, CFA
	Kinetik Holdings Inc.	KNTK	KNTK US	Neel Mitra, CFA
	Kodiak Gas Services, Inc.	KGS	KGS US	Neel Mitra, CFA
	Targa Resources Corp.	TRGP	TRGP US	Neel Mitra, CFA
	The Williams Companies, Inc.	WMB	WMB US	Neel Mitra, CFA
	Western Midstream Partners, LP	WES	WES US	Neel Mitra, CFA
NEUTRAL				
	Kinder Morgan Inc	KMI	KMI US	Neel Mitra, CFA
	ONEOK Inc	OKE	OKE US	Neel Mitra, CFA
	Plains All American Pipeline, L.P.	PAA	PAA US	Neel Mitra, CFA
	Plains GP Holdings, L.P.	PAGP	PAGP US	Neel Mitra, CFA
UNDERPERFORM				
	Equitrans Midstream Corporation	ETRN	ETRN US	Neel Mitra, CFA
	MPLX LP	MPLX	MPLX US	Neel Mitra, CFA
RSTR				
	Magellan Midstream Partners, L.P.	MMP	MMP US	Neel Mitra, CFA
RVW				
	Golar LNG Limited	GLNG	GLNG US	Neel Mitra, CFA

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Important Disclosures

Equity Investment Rating Distribution: Energy Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	84	61.76%	Buy	65	77.38%
Hold	28	20.59%	Hold	20	71.43%
Sell	24	17.65%	Sell	15	62.50%

Equity Investment Rating Distribution: Global Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

[R1] Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster[R2]
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

[R2] Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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