NOTRE DAME INVESTMENT CLUB – 01/24/2023

Energy Transfer (NYSE: ET)

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Energy Hierarchy

ENERGY TRANSFER

Energy Transfer is a midstream industry leader in crude oil, natural gas, and natural gas liquids. ET's infrastructure serves to transport energy products from oil & gas drilling sites to downstream processing locations.

Upstream → **Midstream** → **Downstream**

Includes the exploration, drilling, and production of crude oil and natural gas. Success built on extensive seismic, logging, and drilling technologies

Processing, storage, and transportation of crude oil, natural gas, and NGLs. Facilities include pipelines, processing and LNG plants

Refinement, marketing, and distribution of crude oil and natural gas in their end-product form (gasoline, jet fuel, asphalt, etc.)

Company Overview

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ET's export terminals and pipelines move energy products throughout the U.S. and to more than 75 countries.

Diversified transportation and purification systems (miles of pipeline)

Crude Oil	Natural Gas	NGLs*	Refined Products
11k	90k	5.5k	3.6k

34% Stake in Sunoco ($SUN)

Gas station portfolio with 5,200 locations across 33 states

39% Stake in U.S. Compression Partners ($USAC)

Natural gas & electric motor-powered compression systems for pipeline transportation

Understanding MLPs

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ET operates as a Master Limited Partnership (MLP), providing the tax benefits of a private partnership with the liquidity of a publicly-traded company.

General Partners

The owners responsible for managing the day-to-day operations. They receive compensation based on the partnership's business performance.

Limited Partners (silent partners)

Investors who purchase "units" and provide the capital for the entity's operations. They typically receive quarterly distributions from the MLP.

Tax Benefits

1. MLP is treated as a limited partnership for tax purposes
2. A limited partnership has a pass-through tax structure where all profits & losses absorbed by limited partners
3. MLP pays no taxes on its revenues; instead, limited partners pay income taxes on their portions of MLP earnings

(Effective Tax Rate)

INVESTMENT CLUB: 20.7%

ENERGY TRANSFER: 2.5%

Investment Thesis

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1. Geographic monopoly on existing pipeline system enables stable cash flows due to regulations, ESG mandates, long-term demand, and increasing cost of capital.

2. The "Kelcy Warren discount" is unjustified as ET shifts from M&A-induced growth to de-leveraging and increasing dividend payments to unitholders.

3. The tailwinds of the Russo-Ukrainian War, LNG export opportunities, and artificial stock depression from institutional investors will benefit ET beyond the short term.

Recommendation: BUY
Price Target: $14.84
Upside: 14.1%

Recession-Proof Business Model

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As a pipeline company, Energy Transfer diverts its risk to its competitors, which yields strong, stable cash flows.

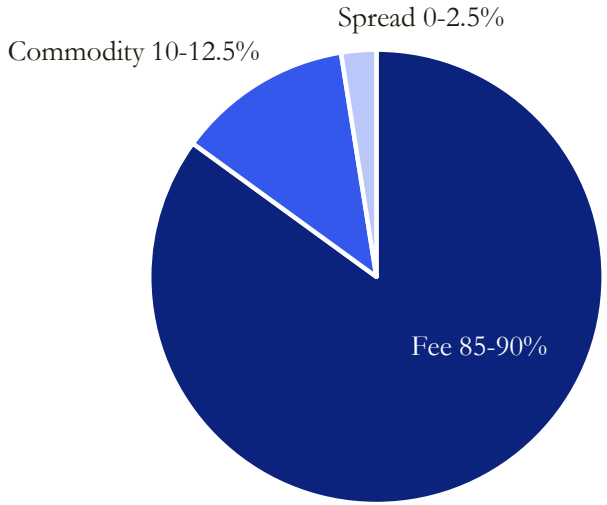
ET Contract & Revenue Breakdown (Q3 2022)

Segment	Contract Structure	% of Revenue
Crude Oil	Fees from dedicated acreage, minimum volume commitments	25%
Natural Gas Liquids (NGLs)	Fees from plant dedications, minimum volume commitments, frac-or-pay	21%
Refined Products	Fees from plant dedications, minimum volume commitments, frac-or-pay	29%
Natural Gas	Fees from dedicated acreage, minimum volume commitment, percent of proceeds	12%
Interstate & Intrastate Transport & Storage	Fees from reserve capacity, take-or pay, reservation charges	12%
Other	Non-contractual structure	1%

ET Contract Details

- Looks for ~20 year terms for contract agreements
- Fees which Energy Transfer can charge largely controlled by the Federal Energy Regulatory Commission (FERC)
- Includes inflationary escalators within contract terms based on the producer price index (PPI) from the prior year

ET Sources of EBITDA (2022)



ET is not a Commodities Business

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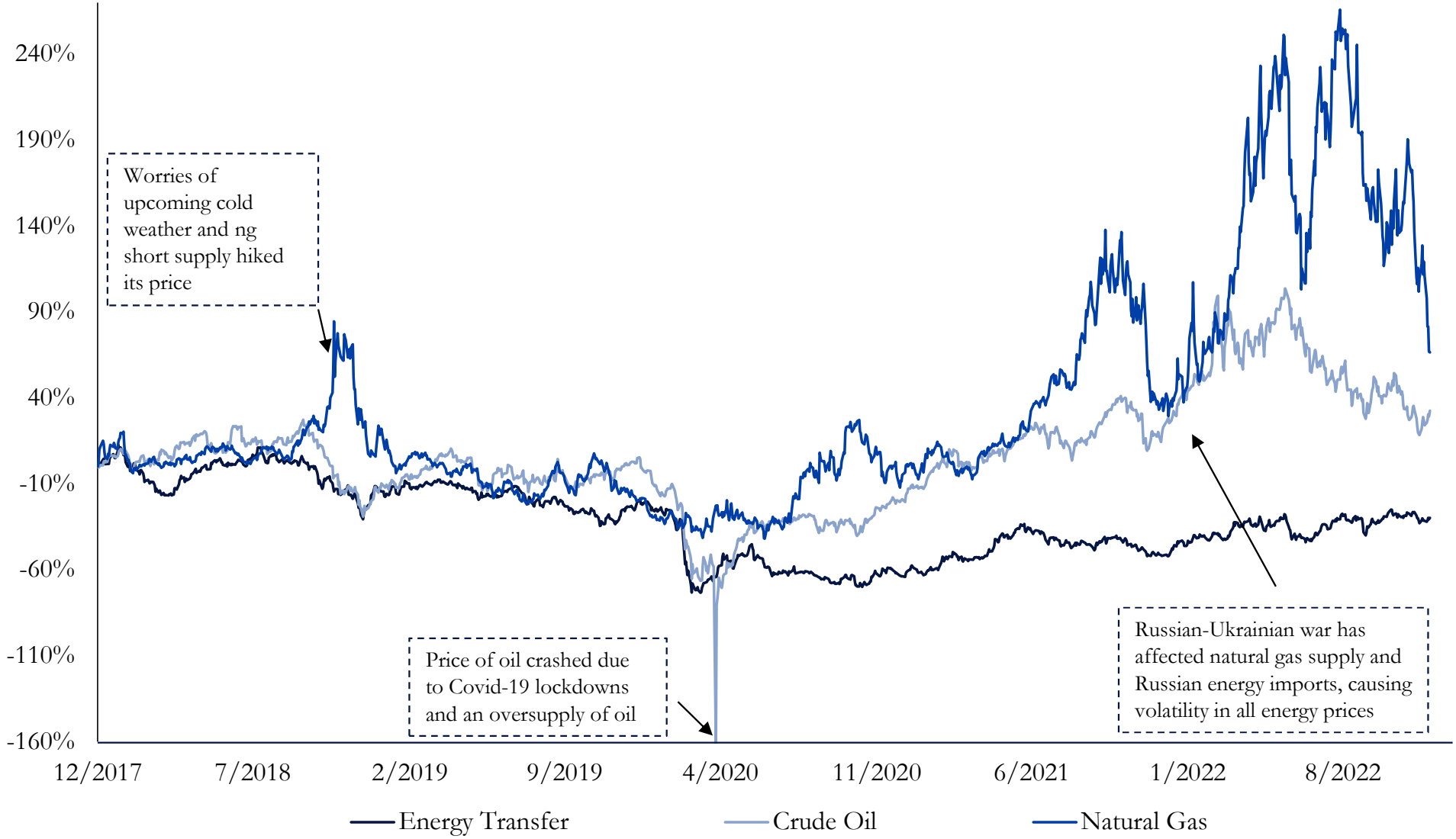
Although ET's unit price is correlated with the price of natural gas and crude oil, they are not exposed to the sharp price volatility that upstream and downstream firms endure as a result of their contract structure.



ET's Greatest Strength: Location

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Energy Transfer holds a significant locational advantage as it is the only midstream company that is connected to every major basin in the U.S., and their export facilities are strategically located at major ports.

Bakken Basin: Connected through the Dakota Access Pipeline

ET has the largest intrastate pipeline network in Texas – it proved to be profitable during Texas's 2021 winter freeze

Marcus Hook Terminal: NGL Exports

Lake Charles: Future LNG export terminal

ET accounts for **20% of the world's NGL exports**, which is greater than any single country or company

Nederland Terminal: NGL exports

Permian Basin: Largest oil basin in the U.S.

Houston Terminal: Crude Oil Exports

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Regulation Supports ET

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Despite regulation and ESG headlines making hydrocarbons a negative sentiment asset class, a lot of the regulation supports the midstream industry.

Supporting Pipeline Projects is Bad Press

- The government is extremely reluctant to approve new pipeline projects
- Continued regulation efforts increases the costs of capital for new pipeline projects
- Hard for companies to justify taking on new pipeline projects when the industry will ultimately be phased out

What does this mean for ET?

- The harder it becomes to develop pipeline projects the more valuable the current pipelines become
- As pipelines increase in value, so does the value of their service (i.e. higher re-contracting rates)
- The inflationary environment not only serves ET through contract escalators, but increasing the cost of capital for pipeline projects

Growth Stage to Cash Cow

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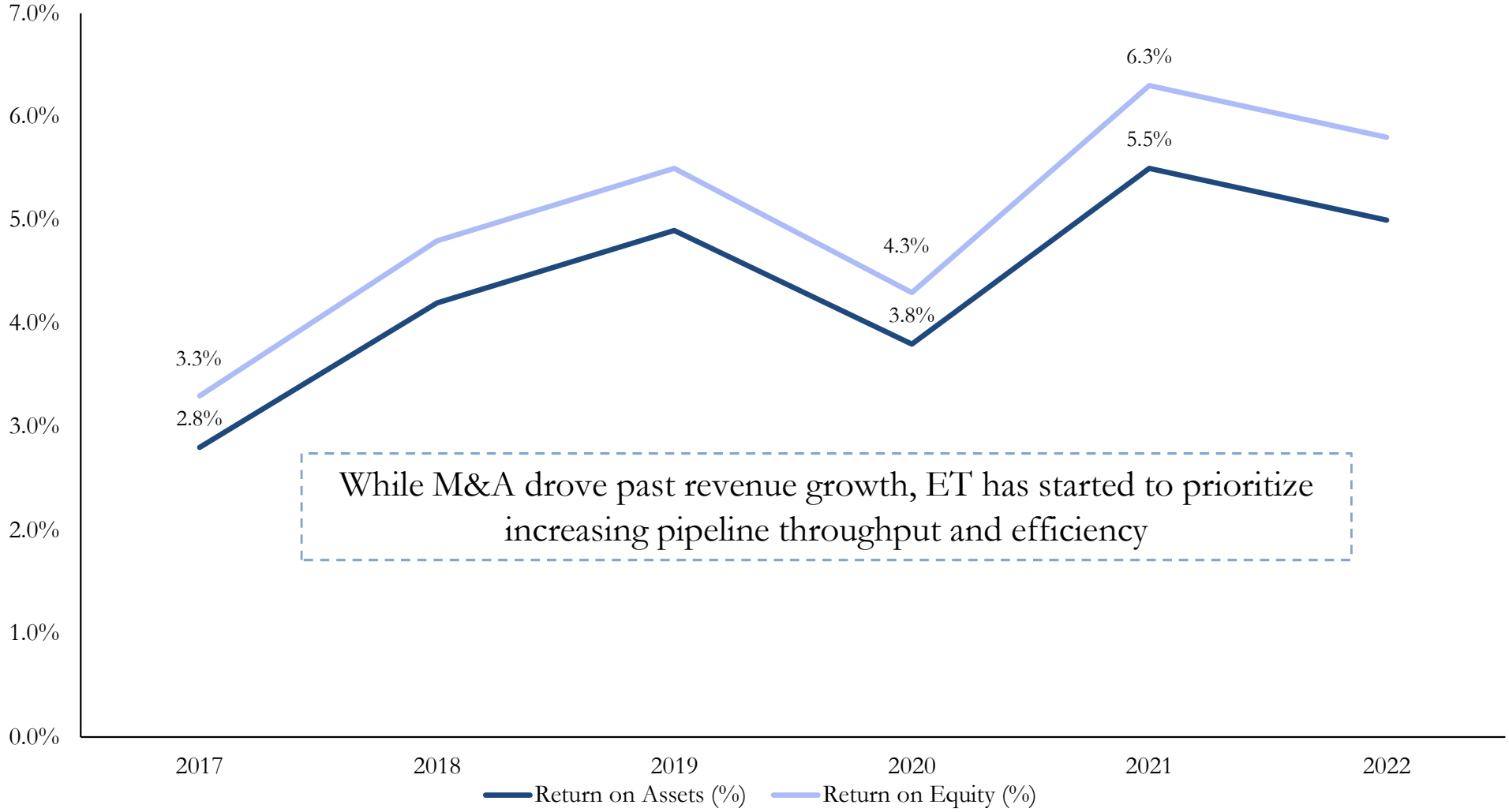
While Energy Transfer has historically prioritized rapid revenue growth over profits, the time has come for a shift which will ultimately benefit unitholders.

ET Return on Assets and Return on Equity



While M&A drove past revenue growth, ET has started to prioritize increasing pipeline throughput and efficiency

Ownership

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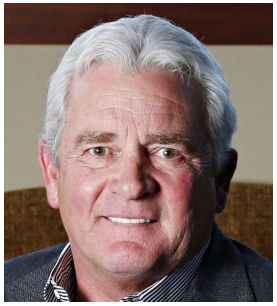
Kelcy Warren's aggressive growth strategy has left ET over levered and, thus, investors are cautious, but new management strategies will put that fear to rest.

The Kelcy Warren Effect



- **Kelcy Warren**, current executive chairman, and former CEO, built this company from the ground up, but his reckless acquisition strategy has left investors cautious and the stock depressed
- He aggressively built Energy Transfer from the ground up, but he used too much debt to do so, over levering ET

New CEOs and Incentives Invalidate the Effect

- On January 1, 2021, **Tom Long** and **Marshall McCrea III** overtook Kelcy Warren's role as co-CEO's, and they have instituted a strict deleveraging policy
- Additionally, ET has eliminated their Incentive Distribution Rights (IDR), which are common in MLPs. These essentially would award the general partner (Kelcy Warren) a greater share of profits as revenue increases. The elimination of IDRs demonstrates that ET's management is incentivized by their unit price
- 13% of units are owned by insiders
- Since January 2021, 29.4mm units (~$265mm) have been purchased by insiders
- Kelcy Warren owns 27.9mm units (~$251mm), purchased ~$37mm in November 2021

Balance Sheet Concerns

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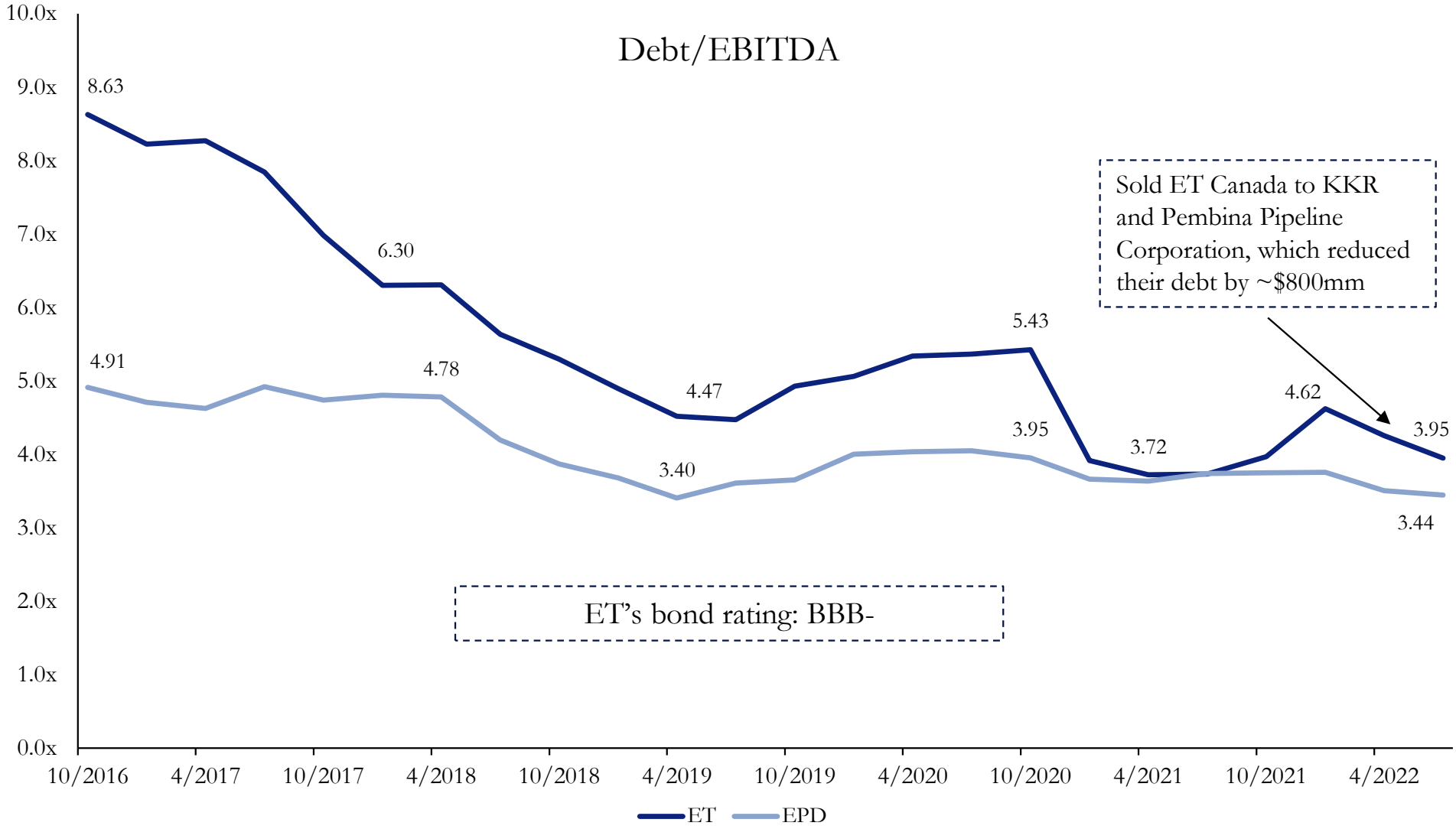
ET has historically been over levered compared to its peers, and management's deleveraging campaigns have brought their balance sheet closer to peers.



Europe's Fuel Demand

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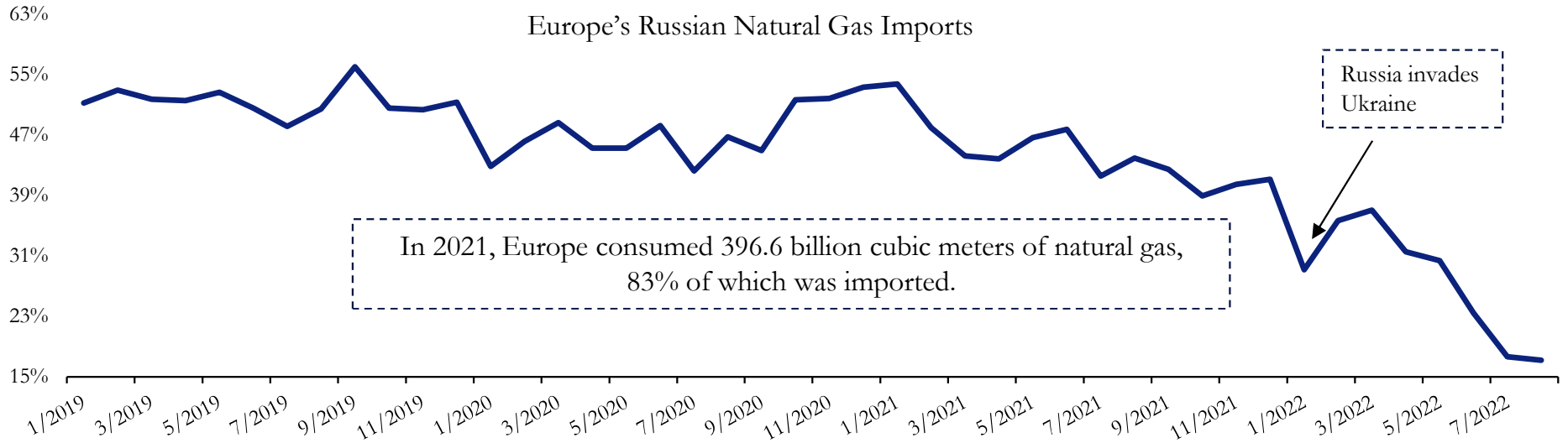
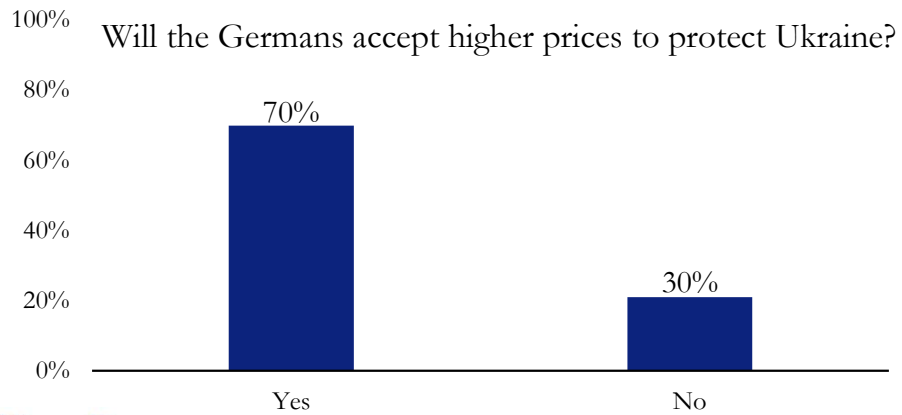
Europe, a historically strong importer of Russian energy, plans to eliminate all of these imports, which opens the door for Energy Transfer to increase their export portfolio and venture into an untapped market.

Europe hopes to phase out all Russian natural gas imports by 2027

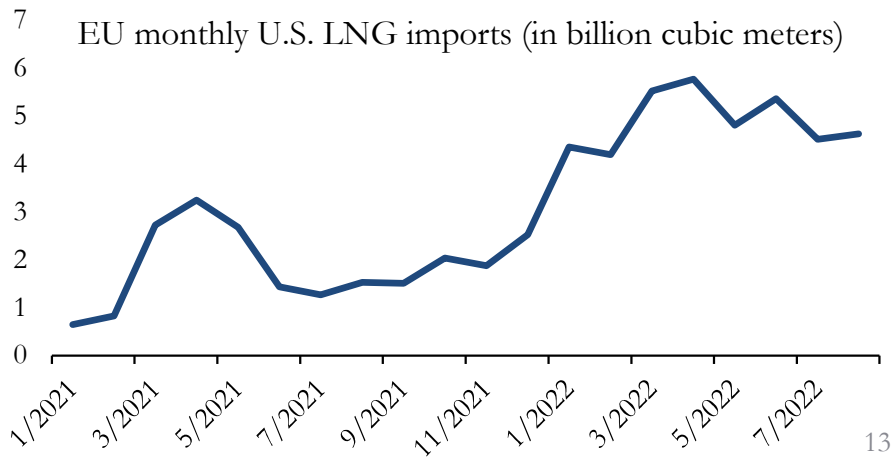


Decision strongly supported by the Germans



Source: ZDF

Creating an LNG Export Opportunity



Lake Charles LNG Export Terminal

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ET is currently executing LNG contracts for a major export facility with capacity to reach the entire globe.

Lake Charles LNG®

Large Capacity with a Strategic Location

- Currently converting their import and regasification terminal into an export facility
- 152 acre-site
- 4 storage tanks with 425,000 m3 storage
- 2 deep water docks with 215,000 m3 capacity
- Located on the Calcasieu Ship Channel in Louisiana

Executed LNG Sale and Purchase Agreements (SPAs)

Company	Amount (mm tons/yr)	Timeframe (yrs)
Shell NA LNG	2.1	20
China Gas	0.7	25
SK Gas	0.4	18
Gunvor Group	2.0	20
ENN Energy	0.9	20
ENN Natural Gas	1.8	20

Energy as the New Tobacco

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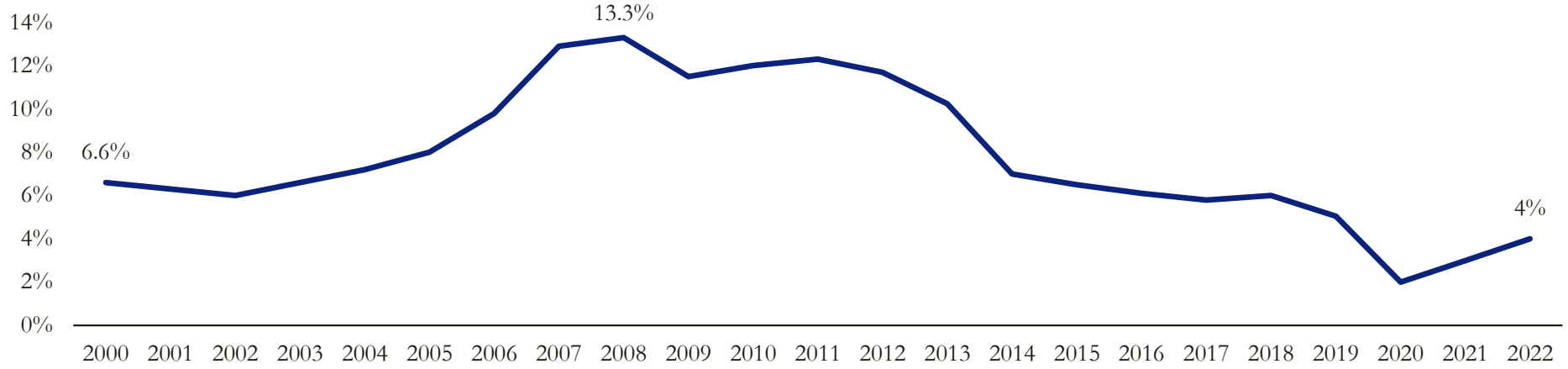
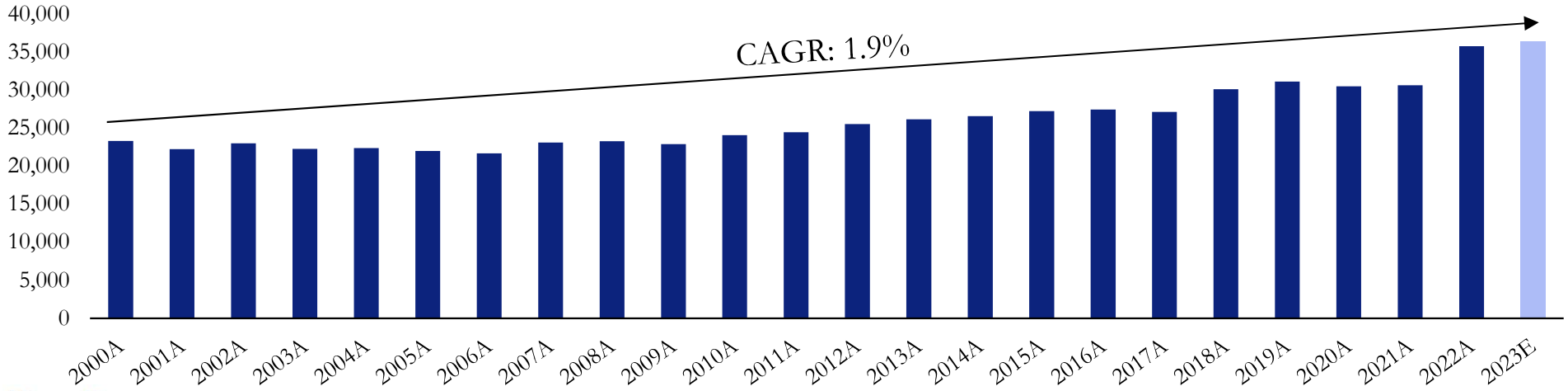
As the world looks for renewable sources of energy, investors have "thrown the baby out with the bathwater" with hydrocarbons: Crude oil and natural gas continue to grow in demand, yet investors turn the other cheek.

Energy Sector Weighting in the S&P 500 (2000-2022)



U.S. Natural Gas Demand (billion cubic feet)



Institutional Pressures

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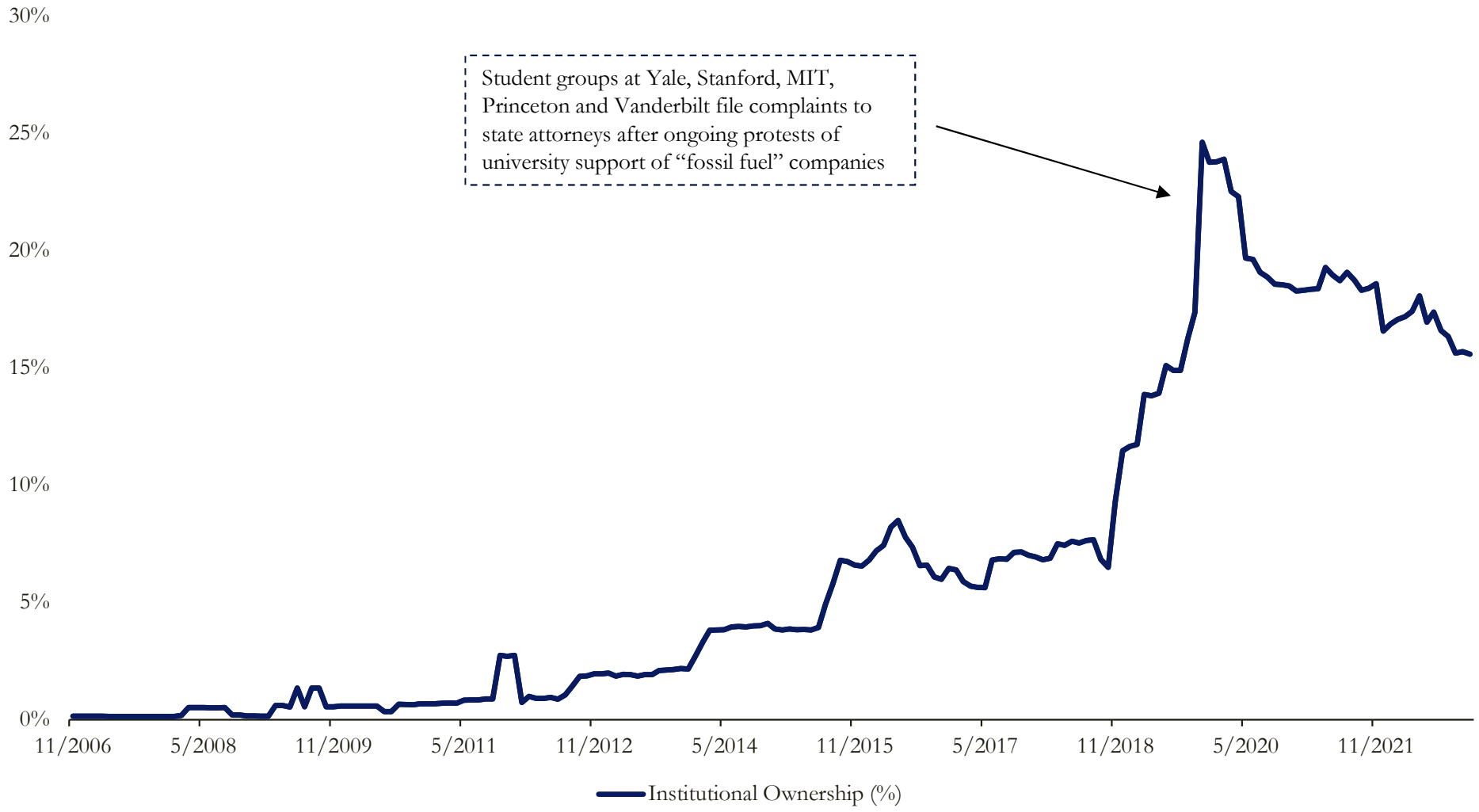
Student protests have not only forced massive divestments from the fossil fuel industry, but created fear among institutions for supporting any company associated with fossil fuels.

Institutional Ownership (% of Shares)



Primary Discovery

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Thesis is strongly supported by both equity research and ET's investor relations team.

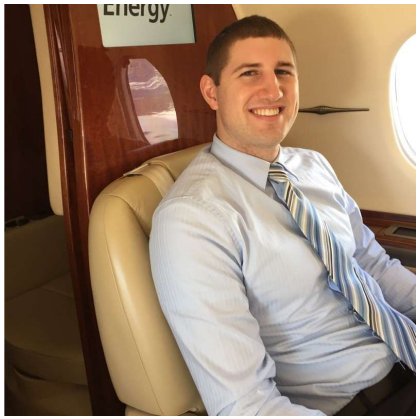
Energy Transfer Investor Relations

Bill Baerg, Brent Ratliff, Lyndsey Hannah – Energy Transfer Investor Relations Team

- "ET has built a hydraulic machine that can move products in all directions and do exports. It is built to have stable cash flows for years and years to come"
- "Heavy regulations create a tremendous barrier to entry"
- "Increasing our distribution is very important because Kelcy Warren doesn't take a salary"
- "California public retirement fund has divested from us due to publicity reasons, but midstream isn't really doing a lot of damage to the environment. We haven't taken on renewable projects because the returns are larger in other areas"

J.R. Weston, CFA

Associate Analyst, Raymond James Equity Research (MLP and Midstream Group)



- "Energy Transfer is the best looking midstream/mlp stock that we look at"
- "Whatever year you think we will be done using crude oil and natural gas – just add 30 years to that because they are necessary for life"
- "There aren't enough investors bidding for it to be at overall fair value"
- "Expected to create a spin-off c-corp vehicle that would attract more trading, thus raising the mlp unit price"

Attractive EV/EBITDA Valuation

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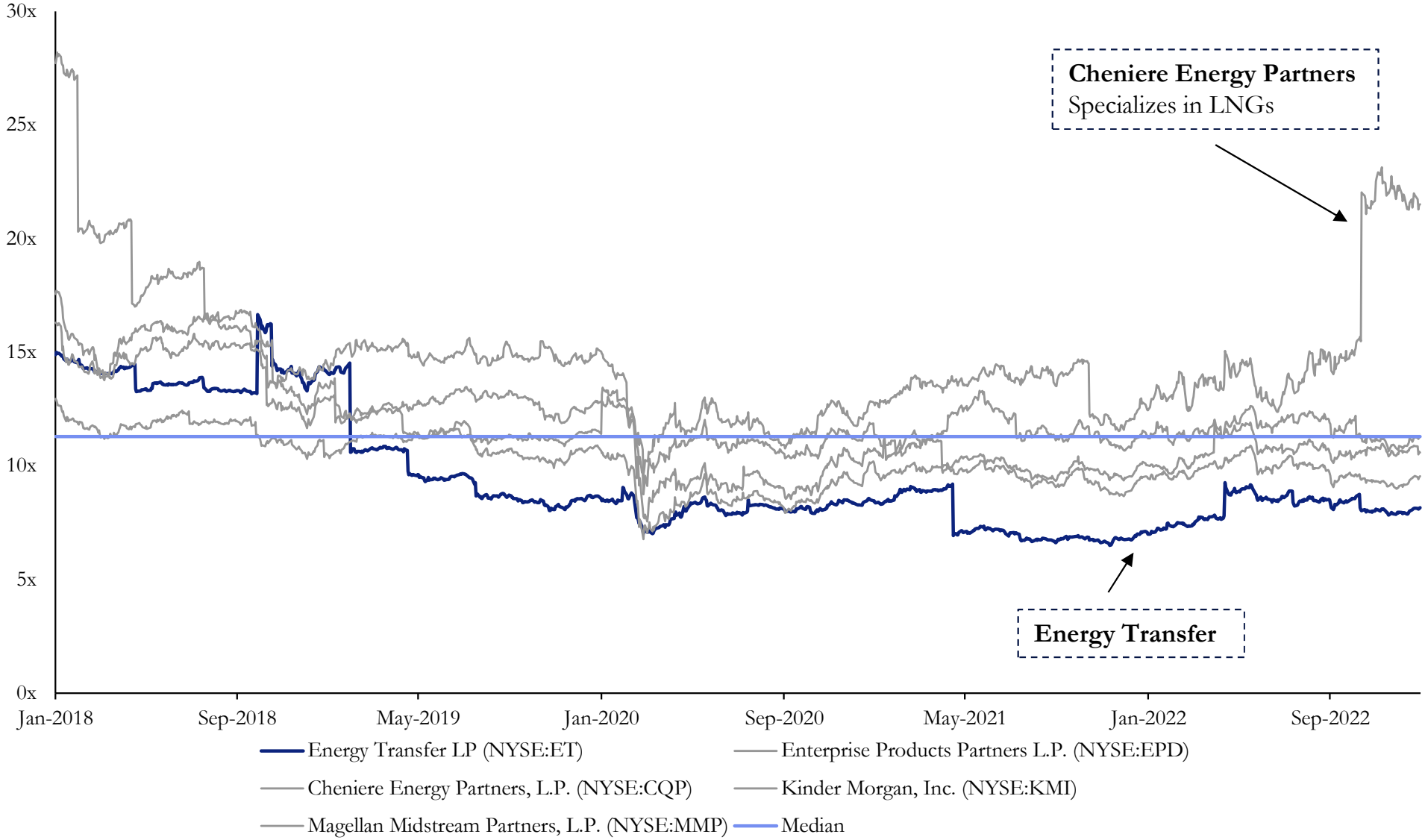
ET continues to be undervalued on an EV/EBITDA multiple when compared to both peers and past performance.



DCF - Base

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$ in millions	2022E	2023E	2024E	2025E	2026E	2027E
Revenue	**$92,639.8**	**$94,633.9**	**$96,672.4**	**$98,756.4**	**$100,886.9**	**$103,065.0**
% Growth	*37.3%*	*2.2%*	*2.2%*	*2.2%*	*2.2%*	*2.2%*
(-) Operating Expenses	(86,618.2)	(88,482.7)	(90,388.7)	(92,337.2)	(94,329.2)	(96,365.7)
(+) Depreciation & Amortization	2,676.1	2,917.0	3,179.5	3,465.6	3,777.5	4,117.5
EBITDA	**8,697.7**	**9,068.2**	**9,463.2**	**9,884.8**	**10,335.2**	**10,816.7**
% Margin	*9.4%*	*9.6%*	*9.8%*	*10.0%*	*10.2%*	*10.5%*
(-) Depreciation & Amortization	(2,676.1)	(2,917.0)	(3,179.5)	(3,465.6)	(3,777.5)	(4,117.5)
EBIT	**6,021.6**	**6,151.2**	**6,283.7**	**6,419.2**	**6,557.6**	**6,699.2**
% Margin	*6.5%*	*6.5%*	*6.5%*	*6.5%*	*6.5%*	*6.5%*
(-) Taxes	(150.5)	(153.8)	(157.1)	(160.5)	(163.9)	(167.5)
% Effective Tax Rate	*2.5%*	*2.5%*	*2.5%*	*2.5%*	*2.5%*	*2.5%*
NOPAT	**5,871.0**	**5,997.4**	**6,126.6**	**6,258.7**	**6,393.7**	**6,531.7**
(+) Depreciation & Amortization	2,676.1	2,917.0	3,179.5	3,465.6	3,777.5	4,117.5
(-) Capital Expenditures	(3,076.0)	(3,352.8)	(3,654.6)	(3,983.5)	(4,342.0)	(4,732.8)
(-) Change in Net Working Capital	(1,130.4)	(19.6)	(20.0)	(20.4)	(20.9)	(21.3)
UFCF (excl. SBC)	**4,340.8**	**5,542.0**	**5,631.5**	**5,720.4**	**5,808.4**	**5,895.2**
FCF For Discounting	**4,340.8**	**5,542.0**	**5,631.5**	**5,720.4**	**5,808.4**	**5,895.2**
Discount Period		0.34	1.34	2.34	3.34	4.34
Discount Factor		0.97	0.90	0.84	0.78	0.72
PV of UFCF		**5,401.5**	**5,093.1**	**4,800.6**	**4,523.0**	**4,259.6**

Terminal Value	
Exit Multiple Method	
2027 EBITDA	$10,817.70
Exit Multiple	9.2x
Terminal Value	**$99,514.00**
Share Price	$15.31

Blended Share Price	
Gordon Growth Method	50%
Exit Multiple Method	50%
Blended Share Price	$14.84

Terminal Value	
Gordon Growth Method	
2027 FCF	$5,895.20
PGR	1.50%
Terminal Value	**$95,447.80**
Share Price	$14.36

What You Need to Believe

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1. Oil and gas industries are here to stay well beyond our suggested 10 year investment length, regardless of declining popularity and regulations.

2. The Kelcy Warren effect is unjustified, and the diversification of management, new LNG initiatives, and a push towards deleveraging will boost stock price.

3. ET has a geographical monopoly because of regulation concerns and the "bad look" of building pipelines. No other companies will make a push to enter into the space.

Recommendation: BUY
Price Target: $14.84
Upside: 14.1%

Thank You! Any Questions?

Appendix

Annotated Stock Chart

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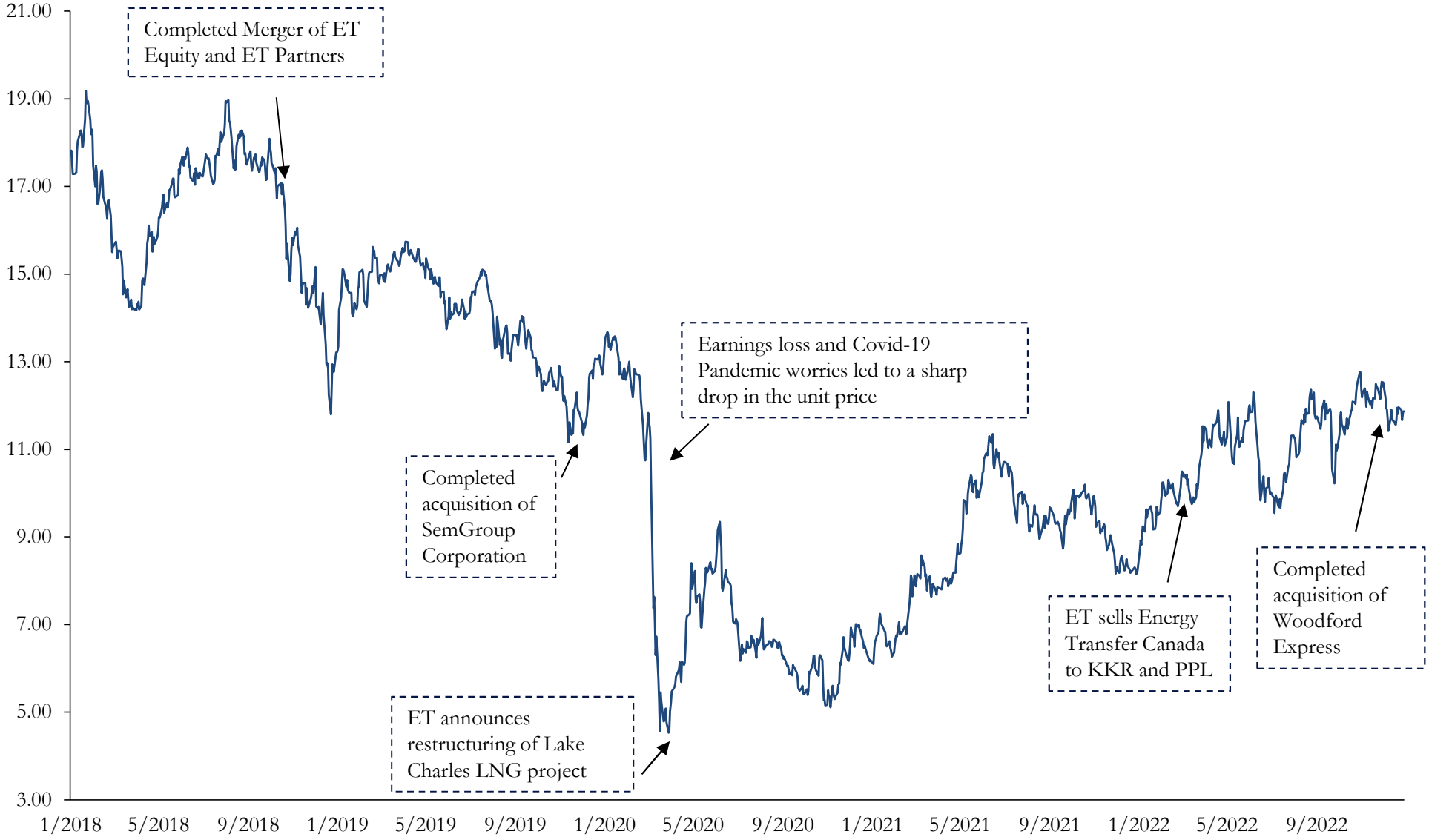
ET's unit price is down 33% over the past 5 years and is still recovering from the pandemic, resulting in a opportunity for growth.



ESG Initiatives

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ET has implemented many ESG initiatives that have not only reduced their emissions, but also increased their revenues.

Dual Drive Technologies

- Patented technology that allows their compression systems to switch between a natural gas engine and an electric motor
- Reduces emissions of nitrogen oxide, carbon monoxide, carbon dioxide, and other gases
- In 2021, used electricity 80% of the time, reducing emissions by 766,788 tons of CO2 (150,000 cars)
- ET sells this technology to other firms within their industry, reducing emissions and growing profits

Carbon Capture & Sequestration (CCS)

- Process of reducing the carbon dioxide emitted during their processes by capturing and storing the emissions
- Captured 86,328 metric tons of carbon dioxide in 2021
- Sell their carbon dioxide emissions to food and beverage companies, providing easy and stable cash flows
- Working on using their underutilized pipelines to transport the CO2

Pipelines in a Renewable Economy

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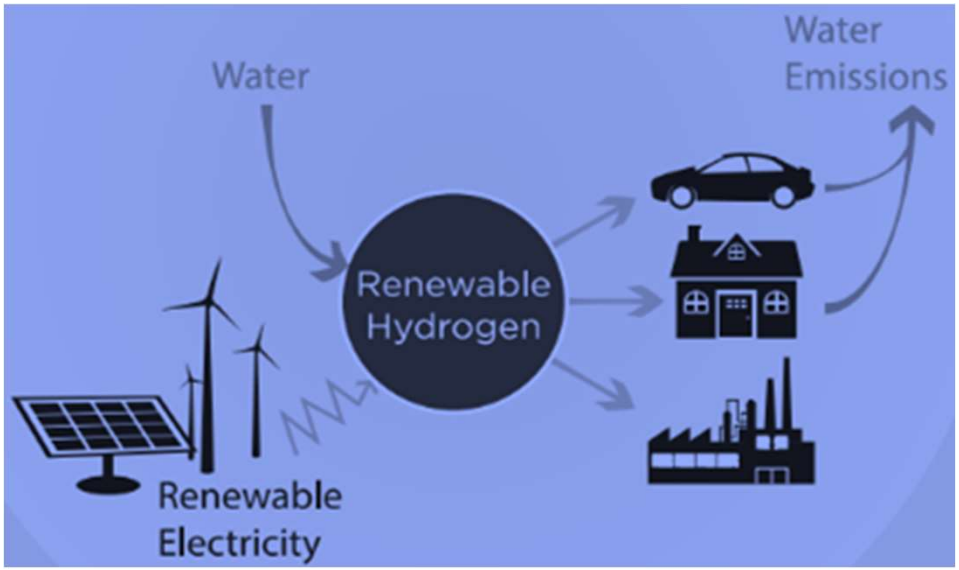
Although midstream has seen lower valuations as renewables have become the certain future, pipelines play a role in that future.

Renewable Hydrogen



- Energy Transfer is looking to expand its business to hydrogen pipelines
- Gaseous hydrogen can be transported through pipelines in a similar manner to natural gas
- Although existing infrastructure would need to be modified to withstand higher temperatures and pressures, pipelines can be converted to transport hydrogen
- Using existing infrastructure is a cost-effective approach to transporting renewables, making hydrogen an appealing source of energy

Why Hydrogen?

- Midstream companies, including Energy Transfer, have discussed transporting a mix of both blue and green hydrogen in its natural gas pipeline system
- Current technology allows for a 20% blend of natural gas and hydrogen within pipelines, but has improved over time

The Future of Fuel

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Political Risk for fossil fuels is overblown by unreasonable expectations for the implementation of renewable energy.

An EV-filled Future

Irrational Consensus Helps ET

- Everyone knows clean energy is the future, yet no one knows how/what sources of energy will be implemented on a large scale
- General consensus makes fossil fuels a negative sentiment asset class, largely responsible for energy companies being valued at significantly lower multiples
- U.S. Energy Information Administration (EIA) projects petroleum and natural gas demand will continue to grow until 2050
- ET already possesses strong export business and strategic NGL export locations which can help expand LNG business
- Natural Gas and NGLs significantly more environmentally friendly than crude oil

ET Revenue Growth