Siena Market Line
1st week of April 2015

Spectra Energy Partners

NYSE:SEP

Analyst: Kyle White
Sector: Energy

BUY

Price Target: $60.00

Key Statistics as of 4/02/2014

Market Price:	$51.93
Industry:	Oil & Gas Midstream
Market Cap:	$15.3 B
52-Week Range:	$47.01-$60.07
Beta:	0.48

Thesis Points:

- Relative valuation shows stock trading a discount to competitors
- Increasing North American natural gas demand provides high growth opportunities
- Solid balance sheet and increasing FCFs
- Strong support from partner, Spectra Energy Inc.
- Small downside, low risk

Company Description:

Spectra Energy Partners, LP operates as an investment arm of Spectra Energy Corp. Spectra Energy Partners, LP, through its subsidiaries, engages in the transportation of natural gas through interstate pipeline systems, and the storage of natural gas in underground facilities in the United States. As of December 31, 2007, it owned and operated 100% of the approximately 1,400-mile East Tennessee interstate natural gas transportation system that extends from central Tennessee eastward into southwest Virginia and northern North Carolina, and southward into northern Georgia; and a liquefied natural gas storage facility in Kingsport, Tennessee with working gas storage capacity of approximately 1.1 billion cubic feet (Bcf) and re-gasification capability of 150 million cubic feet per day. The company also owned a 24.5% interest in the approximate 700-mile Gulfstream interstate natural gas transportation system, which extends from Pascagoula, Mississippi, and Mobile, Alabama across the Gulf of Mexico and into Florida; a 50% interest in Market Hub, which owns and operates 2 salt cavern natural gas storage facilities, the Egan storage facility with gas capacity of approximately 20 Bcf, and the Moss Bluff storage facility with working gas capacity of 15 Bcf. The company transports and stores natural gas for local gas distribution companies, municipal utilities, interstate and intrastate pipelines, direct industrial users, electric power generators, marketers, and producers.

Thesis

In the current energy downturn, midstream oil and gas companies, or those involved in facilitating the transport of crude oil and natural gas, have largely been overlooked and unloved. Given the shield granted to these companies by the long-term, highly contractual nature of their business (north of 90%), it is interesting to note that many investors have still shied away from this industry. Over the next 20 years, natural gas consumption in North America is expected to increase by 40% of todays demand, meaning midstream companies will become more and more essential to many economies. Of all of these players, just a few stand out as notable in terms of current pricing and future growth prospects. Spectra Energy Partners, which is the child of Spectra Energy, and its previous parent Duke Energy. Incorporated as a MLP, the company is uniquely shielded from taxes, allowing greater distribution to shareholders, but this is common to many midstream companies. What separates it from the pack is low debt-to-equity at .5 (Industry median=1.35) operating margins of nearly 50%, high historical growth, (66.4% CAGR), and an attractive yield coming out of dividends at 4.4%. All of these provide an extremely attractive base for an investor, and with multiple projects in progress to pave the way for future growth, combined with a low risk profile and associated downside, makes Spectra Energy Partners a buy, with a one-year target price of $60.00.

Valuation

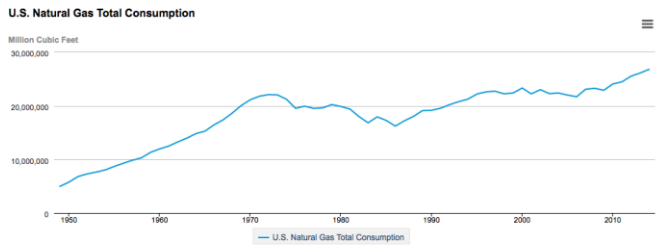
While for many stocks, PE ratio is a favorite among investors in determining valuation of a company; this is largely not the case for midstream companies and MLP's in general. Instead it is important to look at two key ratios; EV/EBITDA and P/DCF. Referring to the table below offers some insight to the relative valuation of SEP's immediate competitors.

	DCF	Market Cap	P/DCF	EV/EBITDA
Magellan Midstream Partners	0.8805	17.9	20.329	18.53
Energy Transfer Partners	1.8375	28.7	15.619	13.98
Spectra	1.005	15.3	15.224	4.79
William Partners LP	0.7248	28.6	39.459	35.83
Enable Midstream Partners	0.622	7.1	11.415	10.94

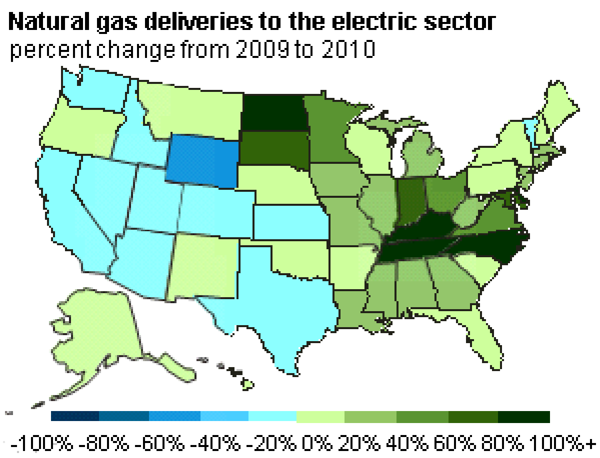
Reading from right to left we see the general competitive landscape immediately surrounding SEP. Obvious from the get go is that Spectra does not represent the largest company, nor the company that provides the largest cash flows to its investors. More importantly however, one must look at the multiples provided. In terms of P/DCF (price-to-distributed cash flows), Spectra is priced near the low end of what should be the considered range, with a median of about 17x. While Enable Midstream may seem cheaper at 7.1x, I believe the market is pricing correctly there, as recently, Enable has run into an assortment of cash flow problems, resulting in negative cash flow for the first time in several years, and a lower price, at least in my opinion, is justified. In terms of EV/EBITDA, the market is largely undervaluing the stock, which at 4.9x is far below the competitor's median of 16.25x. Based on research, I have found no evidence going forward that the operating margins the company has been experiencing, which are around 50%, should deviate materially, meaning that in the future the market should adjust the price of the stock upward to reflect a more realistic expectation in line with the companies competitors. Analysts predict future EV/EBITDA to be closer to 18x.

Growth in Natural Gas

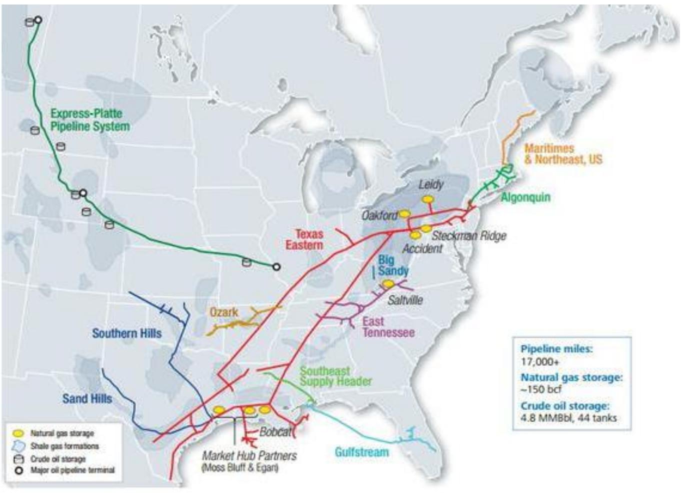
Beginning in in the mid 2000's the idea of natural gas becoming a key component of American industry and electric power generation was rapidly gaining hold in people's minds.



While demand has always been robust, the chart suggests relatively flat demand beginning in the mid 1980's. Starting in 2006 however the US began a renewed climb in its usage of natural gas largely due to economizing the process of extracting it from large deposits of geological shale located in states like Texas, Oklahoma, Pennsylvania, and Minnesota. It was during this time that after a series of spinoffs, SEP came onto the scene, controlling in large part all the transmission assets formally belonging to Duke Energy. The next few illustrations should give some idea of the enormous growth potential just over the horizon.



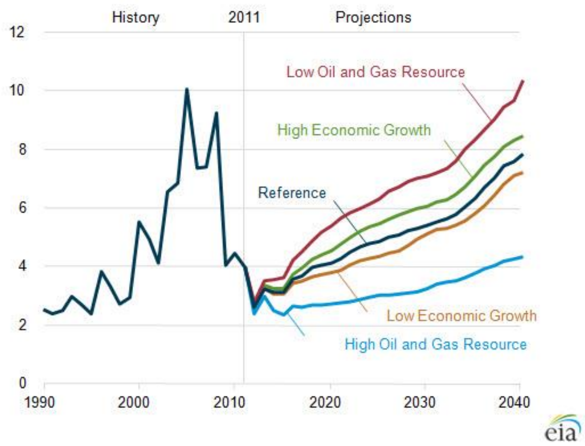
What we have above is a depiction of increase of natural gas usage in power generation circa 2010. Over the next 20 years, the average annual consumption of natural gas, in the US alone is expected to increase by an estimated 40%. World consumption is expected to follow this pattern very closely.



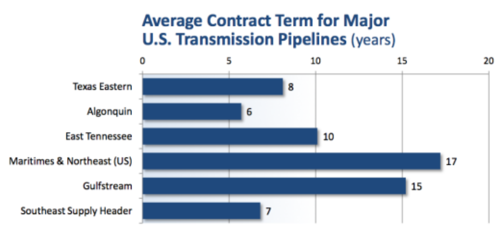
Source: Spectra Energy Partners, LP.

Not surprisingly, SEP has pipelines sourcing from both the most prolific plays within the country, and sourcing to the areas with the highest current demand, and that is likely just the beginning. As we have progressed technologically, natural gas has moved from a simple heating solution in the winter to a substance that can be used, and is largely considered a much more environmentally friendly means of electric power production, creating 50% less CO2 gas than conventional coal fired plants, and 25-30% less than conventional oil plants. As the US government and its environmental regulatory arm, the EPA begin to produce stricter environmental, one should expect to see some headwinds for companies like SEP who must consistently monitor outputs of greenhouse gases along their lines. Ultimately though they will likely benefit far more from increased investment in natural gas usage by utility companies due its high energy density and lower carbon footprint. This series of events is highly probable as increased effectiveness in extraction methods have largely oversupplied the market, leading to lower costs, and increased economic incentive to use natural gas a primary means of deriving power.

Figure 88. Annual average Henry Hub spot prices for natural gas in five cases, 1990-2040 (2011 dollars per million Btu)



Given that we are starting to see the high oil and gas resource future, it is not unfounded that we may see consumption outpace this 40% benchmark. In an effort to meet this future need, SEP and its partner Spectra Energy are currently engaged in 17 new projects in the US to expand the reach of its network and provide greater access in Greater New England, and much of Eastern Canada. Many of these projects are expected to reach completion in the 2016-2017 fiscal years. Smaller ancillary projects are also underway to expand access in the American southeast, allowing greater access to an already robust network. The following chart gives some insight into the sustainability of future cash flows bases on subscription renewal and contract length per region.



Future slated projects will likely continue to be pursued in areas that can negotiate the longest contracts. Most of these are concentrated in the Northeast as well as in the

Gulf where customers are on standby to receive shipments meant for global distribution. On top of this new growth in revenue, the company has had historically high renewal rates on existing contracts (2014, +99% renewal rates in key northeastern and Texan pipeline segments), meaning stable, and largely predictable cash flows moving into the future.

Balance Sheet

Many bears have made the above point of expansion a target for missteps going into the future, and therefore value destruction. Given the strength of the company's balance sheet and earnings I don't see that as a very likely outcome. Compared to it competitors, SEP maintains the lowest DE in the industry at 0.5, demonstrating effective stewardship of allocated capital within the company. It is worth mentioning that MLP's, as SEP is, don't use cash flows as a means of funding future projects, meaning that all project funding must be raised in either the form of stock issuances, or new debt. This is largely to the company's advantage though. Because of the company's tax advantages, the estimated cost of capital hovers around 7.2%, and combined with healthy cash flow streams, its unlikely that, even in the face of rising rates, the company will experience significant detriment in its ability to borrow.

Corporate Support

One of the major benefits of being is MLP is the relationship between the parent and the child. Spectra Energy Partners, which is the child of its larger parent Spectra Energy. Given the value of one to the other along with the fact that the two companies share the same CEO and CFO means that management will do everything within its power to maintain the long term success of SEP. As much as 55-60% of Spectra Energy's yearly earnings are derived via SEP due to the pure play approach to natural gas, and the business resistance to changing commodity prices. In line with the company's earnings contributions, SE distributes about 65% of both its maintenance and growth CAPEX budget to SEP, which remains at normal levels while other oil and gas companies are forced to pull back tightly all around them. An interesting note worth mentioning is that in some ways the two companies do compete with each other. SE which has other subsidiaries outside Spectra Energy Partners does engage in direct competition for contracts and other services, however, the long run result of this competition should leading to increased efficiencies at SEP as the vie for funding for future growth prospects.

Low Downside Risk

Perhaps the most appealing aspect of owning this stock is the apparent downside risk associated with it. As a hard asset company with relatively low debt when viewed in light of its peers, the company faces very little risk in terms of its capital structure moving into the future. The cost of capital, which they should be able to manage even in a higher credit environment is low at 7%, and with steady cash inflows from negotiated contracts means that interest payments should continue to be met, outside the possibility of a significant portion of SEP's long term customers no longer being able to make payments. While the stock has traded relatively flat over the TTM period, with some volatility, price targets from analysts, even on the low end down have the stock traveling south of $50. Very few companies out there can compete in terms of the stability of their cash flow or the sheer size of their asset footprint. In guidance management has been known to state that the oil and gas pipeline is highly competitive. However, given the size of the asset base at SEP's disposal, as well as there existing relationships with their customers, and the renewal rates that they have seen there; outside a major catastrophe, I don't expect to see a reduction in the competitive ability of this firm, reducing the overall risk associated with their cash flows.

Forecasts

Natural gas is quickly becoming a larger and larger part of both this and the worldwide economy. Consumption in the US and Canada will continue to risk, increasing the need for pipeline distribution in order to satisfy demand, but pipeline expansion to ports will also become increasingly critical as global demand increases. Energy poor economies like Japan and Europe may demand increases amounts of natural gas as relations with Russia become increasingly strained. Moving into the future we should expect to see further development in how exactly natural gas can be used from fueling ships and cars to being used in new industrial processes. At the heart of this movement is the midstream service offered by pipeline companies, and at the heart of that is Spectra Energy Partners, which will continue to climb for years to come.

CENTER FOR GLOBAL FINANCIAL STUDIES

Spectra Energy Partners, LP	SEP	Analyst	Current Price	Intrinsic Value	Target Value	Divident Yield	Target Return	NEUTRAL
		Kyle White	$52.11	$53.29	$59.14	5%	18.03%	

General Info

Sector	Energy
Industry	Oil, Gas and Consumable Fuels
Last Guidance	Feb-05-2015
Next earnings date	NM

Market Data

Enterprise value	$21,843.52
Market Capitalization	$933.35
Daily volume	0.86
Shares outstanding	295.33
Diluted shares outstanding	288.00
% shares held by institutions	77.02%
% shares held by insiders	0.04%
Short interest	0.16%
Days to cover short interest	1.96
52 week high	$60.07
52-week low	$47.01
5y Beta	0.46
6-month volatility	24.88%

Peers	Market Cap.
MarkWest Energy Partners, L.P.	$12,400.27
Magellan Midstream Partners LP	$17,909.82
DCP Midstream Partners LP	$4,212.73
Crestwood Midstream Partners LP	$2,748.13
Enable Midstream Partners, LP	$7,111.71
Boardwalk Pipeline Partners, LP	$3,897.67
Genesis Energy LP	$4,378.94
Martin Midstream Partners LP	$1,276.19
ONEOK Partners, L.P.	$10,530.79
Western Gas Partners LP	$9,150.96

Current Capital Structure

Total debt/market cap	27.89%
Cost of Borrowing	4.10%
Interest Coverage	477.31%
Altman Z	
Debt Rating	B
Levered Beta	0.84
WACC (based on market value weights)	7.12%

Management

Professional	Title	Comp. FY2012	Comp. FY2013	Comp. FY2014
Ebel, Gregory	Chairman of the Board of Spectr	$ -	$ 8,300,743.00	$ -
Reddy, John	Chief Financial Officer of Spectra	$ -	$ 2,800,412.00	$ -
Hedgebeth, Reginald	General Counsel of Spectra Ener	$ -	$ -	$ -
Rice, Patricia	Secretary of Spectra Energy Partn	$ -	$ -	$ -

Historical Performance

	SEP	Peers	Industry	All U.S. firms
Growth	12.8%	17.2%	8.8%	6.0%
Retention Ratio	35.7%	164.7%	37.4%	38.5%
ROIC		14.9%	35.2%	19.0%
EBITA Margin	48.1%	13.9%	17.9%	13.7%
Revenues/Invested capital	13.9%	65.4%	139.1%	202.3%
Excess Cash/Revenue	#DIV/0!	3.5%	10.6%	18.5%
Unlevered Beta	0.09	0.45	0.61	0.95
TEV/REV	12.4x	2.9x	3.1x	2.4x
TEV/EBITDA	18.8x	15.3x	14.7x	11.3x
TEV/EBITA	25.5x	20.0x	19.4x	15.4x
TEV/UFCF	11.9x	509.0x	39.6x	26.8x

Past Earning Surprises

	Revenue	EBITDA	Norm. EPS
Last Quarter	2.1%	9.9%	21.2%
Last Quarter-1	0.7%	9.3%	25.0%
Last Quarter -2	-5.0%	-3.2%	0.0%
Last Quarter -3	0.3%	8.2%	4.5%
Last Quarter -4	7.4%	25.1%	51.8%

Non GAAP Adjustments

Operating Leases Capitalization	100%	Straightline	10 years
R&D Exp. Capitalization	100%	Straightline	10 years
Expl./Drilling Exp. Capitalization	100%	Straightline	10 years
SG&A Capitalization	0%	N/A	N/A

Proforma Assumptions

Operating. Cash/Cash	0.0%
Unlevered Beta	0.60
Rev/Invested Capital	100.0%
Continuing Period Revenue Growth	3.0%
Long Term ROIC	20.2%
Invested Capital Growth	Equals to Maintenance
Justified TEV/REV	2.0x
Justified TEV/EBITDA	8.0x
Justified TEV/EBITA	12.0x
Justified TEV/UFCF	18.0x

Forecasted Profitability

Period	Rev. Growth	Adj. Op. Cost/Rev	Revenue	NOPLAT	Invested capital	UFCF
LTM	15%	37%	$2,269.00	$1,129.79	$15,532.00	$1,129.79
LTM+1Y	10%	37%	$2,496.25	$1,238.06	$15,551.86	$1,218.20
LTM+2Y	7%	38%	$2,670.67	$1,307.94	$15,549.80	$1,309.99
LTM+3Y	7%	39%	$2,856.25	$1,380.68	$15,546.96	$1,383.52
LTM+4Y	4%	40%	$2,964.93	$1,404.66	$15,547.86	$1,403.76
LTM+5Y	4%	41%	$3,096.82	$1,439.36	$15,547.26	$1,439.96
LTM+6Y	5%	42%	$3,252.23	$1,483.32	$15,594.11	$1,436.46
LTM+7Y	4%	43%	$3,367.39	$1,503.55	$15,598.92	$1,498.74
LTM+8Y	3%	44%	$3,480.55	$1,520.04	$15,600.75	$1,518.21
LTM+9Y	3%	45%	$3,592.55	$1,533.89	$15,599.76	$1,534.89

Valuation

	ROIC	WACC	EVA	Enterprise Value	Total Debt	Other claims	Equity	Adjusted Price
LTM	7.3%	7.1%	$24.30	$22,268.09	$6,092.00	$580.00	$15,596.09	$54.25
LTM+1Y	8.0%	7.1%	$140.16	$23,131.37	$6,092.00	-$178.48	$17,217.86	$59.89
LTM+2Y	8.4%	7.1%	$199.12	$23,433.83	$6,092.00	-$1,485.18	$18,827.00	$65.39
LTM+3Y	8.9%	7.2%	$266.23	$23,664.68	$6,092.00	-$3,121.90	$20,694.58	$71.73
LTM+4Y	9.0%	7.2%	$283.80	$23,840.80	$6,092.00	-$4,825.72	$22,574.52	$78.21
LTM+5Y	9.3%	7.3%	$310.29	$24,018.43	$6,092.00	-$6,662.53	$24,588.97	$85.33
LTM+6Y	9.5%	7.3%	$347.33	$24,178.45	$6,092.00	-$8,591.67	$26,678.11	$92.28
LTM+7Y	9.6%	7.4%	$357.33	$24,364.89	$6,092.00	-$10,638.78	$28,911.67	$99.89
LTM+8Y	9.7%	7.4%	$364.04	$24,511.78	$6,092.00	-$12,779.90	$31,199.68	$107.72
LTM+9Y	9.8%	7.5%	$364.58	$24,656.91	$6,092.00	-$15,013.32	$33,578.23	$113.70

Monte Carlo Simulation Assumptions

	Base	Stdev	Min	Max	Distribution
Revenue Variation	**0**	**10%**	**N/A**	**N/A**	**Normal**
Op. Costs Variation	**0**	**10%**	**N/A**	**N/A**	**Normal**
Market Risk Premium	**6%**	**N/A**	**5%**	**7%**	**Triangular**
Long term Growth	**3%**	**N/A**	**2%**	**17%**	**Triangular**
Terminal Value	**0**	**0.1**	**N/A**	**N/A**	**Normal**

Monte Carlo Simulation Results

	Intrinsic Value	1y-Target
Mean est.	$54.25	$59.89
σ(ε)	$0.32	$0.25
3 σ(ε) adjusted price	$53.29	$59.14
Current Price	$52.11	
Analysts' median est.		$57.64