MLP Buybacks

You rarely see MLPs buying back their stock, by contrast to companies in most other industries. Buybacks provide a tax efficient way to return excess capital if the stock is undervalued. Because MLPs invest heavily in CapEx and generally distribute most of their free cashflow to LP unitholders there’s rarely any left over for buybacks. In fact, they regularly issue shares to raise capital to invest in projects.

Energy Transfer Equity (ETE) is an exception. In last week’s earnings call they announced a $2 billion buyback, to be executed opportunistically. This represents almost 6% of the market cap of the business, and is a tangible example of management’s stated view that ETE is under-priced. Meanwhile, ETE’s distribution is growing strongly, with a 30% year-on-year rise.

This doesn’t mean that ETE has any shortage of projects in which to invest. ETE receives part of the incremental cash generated from the capital expenditures at it’s underlying MLPs. In spite of the slowdown in North American shale development, ETE’s opportunities are such that they’re expecting to invest $7B in new projects at Energy Transfer Partners (ETP), $5B at Regency Energy Partners (RGP), and $2B at Sunoco Logistics (SXL) all of which will generate cash flows for ETE though its Incentive Distribution Rights.

In short, ETE can invest in new projects though its MLPs using the cash flow received at the ETE level to pay distributions, make acquisitions, or buy back its own stock. The prospects in energy infrastructure clearly look good from where they’re sitting. We are invested in ETE.