

## Equities

18 January 2011 | 7 pages

# Western Gas Partners, L.P. (WES)

## Alert: First 3rd Party Acquisition Highlights Growth Potential, Buy

**Acquisition** – WES is acquiring gas processing and gathering assets in the DJ basin of Northeastern Colorado from Encana for a total consideration of \$303.3 million. WES is paying an attractive 9.3x multiple for the assets, thus offering immediate accretion to distributions. We estimate the deal to be about 3% accretive immediately with further upside possible from growth opportunities.

**Asset Details** – The acquired assets are in close proximity and well integrated with Western's existing Wattenberg gathering system. We expect liquids rich areas such as DJ Basin to continue to see increased drilling activity as the continued differential between the price of oil and natural gas should incentivize production in these fields. This should offer WES additional organic growth opportunities around the acquired assets.

**Ample Liquidity & Leverage** – We estimate that WES should have liquidity of more than \$350 million after closing its equity offering in November, which provides the partnership sufficient liquidity to close this transaction. WES's Debt/Normalized EBITDA should be at a comfortable level of ~3.0x post this transaction. However, WES might eventually do an equity offering to give itself flexibility to execute future investments.

**Maintaining Buy** – This is WES's first third party acquisition that helps diversify the partnership's concentration risk from its General Partner (APC). We expect WES to keep growing distributions at a well-above average rate of ~13% over the next 12 months versus ~4% for the CITIMLP index. We note that APC continues to own \$1-1.5 billion of midstream assets, while the partnership maintains a best-in-class coverage ratio of 1.57x providing unit holders with good visibility for sustained growth.

Western Gas Partners, L.P. (WES.N; US\$31.12; 1H)

### ■ Company Update

**John K Tysseland**

+1-212-816-1442

john.tysseland@citi.com

**Sunil Sibal**

sunil.sibal@citi.com

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Figure 1. Accretion From Encana Acquisition

Western Gas Partners L. P. CIR Acquisition Analysis Model	2012 Prior Estimates	+\$303 Million Encana Dropdown @ 9.3x =	2012 + Encana DJ Basin Pro Forma
EBITDA	224.2	\$32.6	\$256.8
Interest Income	16.9	0.0	16.9
<b>Adjusted EBITDA</b>	<b>\$241.1</b>	<b>\$32.6</b>	<b>\$273.7</b>
Interest Expense	(21.0)	(9.1)	(30.1)
Cash Taxes	0.0	0.0	0.0
Other Cash Adjustments	0.0	0.0	0.0
Maintenance Capex	(38.1)	(4.9)	(43.0)
<b>Distributable Cash Flow</b>	<b>\$182.0</b>	<b>\$18.6</b>	<b>\$200.6</b>
<b>Distribution per Common Unit</b>	<b>\$1.64</b>	<b>\$0.05</b> 2.9%	<b>\$1.69</b>
Total Distributions to Common Unitholders	\$127.4		\$139.9
Total Distributions to General Partner	7.5		9.3
<b>Total Distributions</b>	<b>\$134.9</b>		<b>\$149.1</b>
<b>Distribution Coverage Ratio</b>	<b>1.35x</b>		<b>1.35x</b>
Total Common & Subordinated Units Outstanding	77.7	5.22	82.9

Source: Citi Investment Research and Analysis

## Western Gas Partners, L.P.

### Valuation

Our 12-month target price for Western Gas Partners, L.P. (WES) is \$33.50 per unit. For valuing WES we use an adjusted EBITDA multiple based on our 2011 estimates, which represent a full-year impact of the Wattenberg & White Cliffs acquisition. In 2011 we assume crude oil and natural gas prices average \$86/bbl and \$4.50/mmbtu, respectively. We then value the entire partnership based on a 14.0x EV/EBITDA multiple and deduct the net debt outstanding and general partner interest to arrive at our equity value. Our choice of the EV/EBITDA multiple is a function of the risk inherent in gathering and processing operations, the partnership's contract mix, projected coverage ratio in a downside case scenario, and general investor sentiment. The multiple that we assign to WES is a result of MLP's in general benefitting from strong fund flows and increased investor preference for income generating securities. We believe that investor demand for yield will continue to drive fund flows into MLPs, which is also likely to drive yields lower over the next 12-months if interest rates remain low. Gathering and processing MLPs currently trade with a 2010 EV/EBITDA multiple of ~12.5x and over the last four to five years, these MLPs have traded with a median EV/EBITDA multiple of 12.5x. We are valuing WES at 14.0x EBITDA, which is a premium to the peer-group average as we expect WES to deliver better than average distribution growth to unit holders based on future expansion opportunities and additional drop-down acquisitions from its general partner, Anadarko Petroleum. WES's cash flows and balance sheet strength are offset by its relatively high counterparty concentration, low relative yield, and a dependence on acquisitions to drive future growth.

### Risks

We rate Western Gas Partners, L.P. High Risk based on the consideration of key risk factors that include: 1) balance sheet strength, 2) distribution coverage, and 3) operating strategy. WES's balance sheet is slightly more leveraged than its peer group after the Wattenberg acquisition with a Debt/EBITDA of 3.7x (vs. ~3.6x for the MLP average). We estimate this to improve to ~3.0x by the end of 2010 assuming the partnership issues \$150 to \$200 million of equity. The partnership's distribution coverage is strong at 1.55x. From an operating perspective WES derives its cash flows from primarily fee-based gathering and processing arrangements. However, volumes are dependent on drilling activity and in particular Anadarko Petroleum's drilling activity. Long-term growth will depend upon drop-down acquisitions that will require a significant amount of external financing. If the capital markets deteriorate and financing acquisitions become more challenging then the partnership's growth is likely to slow considerably. Therefore, we believe WES warrants a High Risk rating. Risks to the MLP achieving our 12-month target price include: 1) declining gathered volumes, 2) reduced drilling activity around the partnership's assets, and 3) unit price volatility due to equity issuances. If the impact on the partnership from any of these factors proves to be greater than we anticipate, the MLP may not reach our target price. Conversely, we believe the units could materially outperform our target price if drilling activity is much better than expected or drop-downs are done on attractive terms. Timely access to capital markets for financing acquisitions/drop-downs is an ever-present risk.

## Appendix A-1

### Analyst Certification

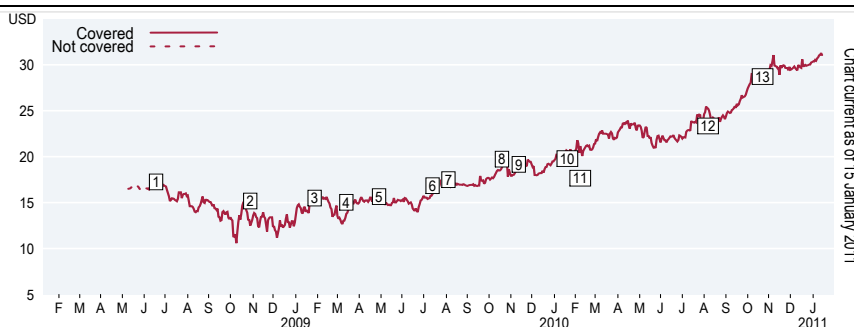
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Analyst: John K Tysseland  
Covered since June 18 2008



	Date	Rating	Target Price	Closing Price
1	18-Jun-08	*2H	*18.50	17.09
2	29-Oct-08	2H	*14.50	12.49
3	28-Jan-09	2H	*15.50	15.23
4	13-Mar-09	2H	*15.00	13.78
5	29-Apr-09	2H	*16.00	15.17

\* Indicates change

	Date	Rating	Target Price	Closing Price
6	14-Jul-09	2H	*16.50	15.94
7	5-Aug-09	2H	*18.50	16.95
8	20-Oct-09	*1H	*21.50	18.83
9	12-Nov-09	1H	*21.00	18.42
10	20-Jan-10	1H	*23.50	20.60

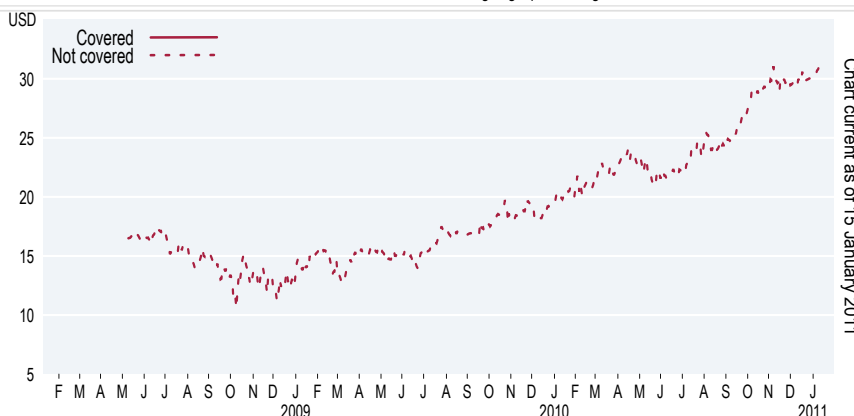
	Date	Rating	Target Price	Closing Price
11	7-Feb-10	1H	*25.00	20.44
12	6-Aug-10	1H	*29.00	25.24
13	22-Oct-10	1H	*33.50	29.10

Rating/target price changes above reflect Eastern Standard Time

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