Keyera Corp.

Q2 2014 results crush expectations

Keep enjoying the ride – target jumps to $88

KEY (T)	$82.79
Stock Rating:	Outperform (Unchanged)
Target:	Cdn$88.00 (Was $80.00)
Risk Rating:	Average (Unchanged)
Est. Total Return	9.7%

Stock Data:	
52-week High-Low (Canada)	$83.75 - $54.72
Bloomberg/Reuters: Canada	KEY CT / KEY.TO

(Year-End December 31)	2013a	2014e	2015e
AFFO/share - basic	$3.71	$4.74	$5.51
AFFO/share - f.d.	$3.71	$4.74	$5.51
P/AFFO	17.2x	17.5x	15.0x
D/EBITDA	2.2x	2.0x	2.1x
EV/Free-EBITDA	23.1x	16.6x	14.1x
Dividends	$2.24	$2.57	$3.07
Dividend Yield	3.5%	3.1%	3.7%
AFFO Payout Ratio	60%	54%	56%

Financial Data:	
Shares Outstanding (mln)	83.9
Book Value per Share	$11.65
Market Capitalization ($mln)	$6,949
Price/Book Ratio	7.1x
Net Debt ($mln)	$1,038
Net Debt/Enterprise Value	13%
Debt/15 AFFO	2.7x
Total Return	9.7%

Industry Rating:
Overweight - Energy
(NBF Economics & Strategy Group)

Company Profile:
Keyera Corp. operates in the Midstream sector and has three lines of business: Natural gas gathering and processing; natural gas liquids (NGL) gathering, processing and storage; and NGL marketing and crude oil midstream.

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HIGHLIGHTS

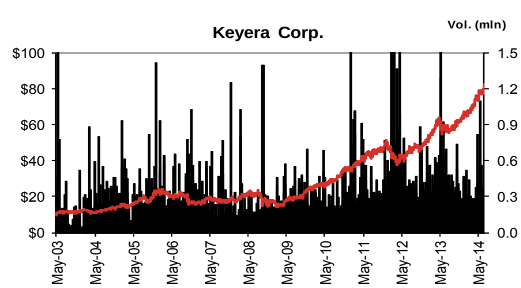
- **Q2 2014 results crush expectations**
  KEY reported adj. EBITDA of $129 mln (excl. non-recurring items), well above our estimate of $110 mln (consensus: $109 mln) with all three segments posting record margins, and >50% of the beat stemming from the fee-based segments (G&P and NGL Infrastructure); the remainder from Marketing (largely anticipated due to record iso-octane margins).

- **Projects – facing challenges, but mid-teens growth intact**
  KEY increased its 2014 organic growth capex budget by $100 mln to a range of $700-800 mln, partially reflecting cost escalations across the company's ~$1.7 bln portfolio of organic growth projects. That said, we continue to forecast attractive annual EBITDA growth of ~14% through 2017.

- **Estimates: moving to "full stride" fee-based contribution**
  With Q2 displaying the "full stride" earnings power of KEY's fee-based operations (G&P and NGL Infrastructure), our 2015e AFFO/sh (FD) increases $0.43 (9%) to $5.51 – an AFFO payout ratio of 56% (was 57%), including a 10% dividend increase forecast commencing Q4 2014, plus an additional 7.5% increase in Q2 2015.

- **Keep enjoying the ride – target jumps 10% to $88**
  In line with the step change to our fee-based estimates, our target jumps $8.00 (10%) to $88.00. Combined with a further ~$8/sh (~10%) of unrisked upside to our valuation stemming from unsecured growth opportunities, and a 12-month total return of 9.7% (group: 6.0%), we reiterate our Outperform rating and continue to recommend KEY as a core holding within the space.

Stock Performance



Source: Bloomberg

Q2 2014 results crush expectations

Keyera reported adjusted EBITDA of $129 million (excluding non-recurring items), well above our estimate of $110 million (consensus: $109 mln) with all three segments posting record operating margins, partially offset by higher G&A expense.

AFFO RECONCILIATION

	Q2 2014A	Expected	Diff.	Per Sh
	($mln)	($mln)	($mln)	$/sh
Segments				
Gathering & Processing[1]	50.0	45.8	4.2	0.05
NGL Infrastructure	49.0	39.1	9.9	0.12
NGL Marketing[2]	51.3	40.3	10.9	0.14
Other Margins	0.4	2.1	(1.6)	(0.02)
G&A	(21.3)	(17.0)	(4.3)	(0.05)
Adj. EBITDA	**$129.4**	**$110.2**	**$19.2**	
Interest Expense	(13.7)	(14.4)	0.8	0.01
Cash Taxes	(6.8)	(9.4)	2.6	0.03
Decommissioning Liability & Other	0.7	-	0.7	0.01
FFO	**$109.6**	**$86.4**	**23.2**	**$0.29**
Maintenance Capital[3]	(28.6)	(45.0)	16.4	0.20
AFFO - FD	**$81.0**	**$41.4**	**$39.6**	**$0.50**
Per Share	**$1.01**	**$0.51**		

(1) Excludes $3-mln of revenues related to prior periods booked for fees charged at KEY's road at Simonette; Excludes $11-mln of recovered costs related to turnarounds.
(2) Excludes unrealized gains/losses on risk management contracts and non-cash inventory write-downs.
(3) Includes $11-mln of recovered costs related to turnarounds.
Source: Company Reports, NBF Estimates

Gathering & Processing (G&P) – contributed $50 million, $4 million ahead of our estimate as margins continue to benefit from organic gas gathering pipeline connections and rising utilization levels across the fleet of liquids-rich processing gas plants.

NGL Infrastructure – contributed $49 million versus our $39 million estimate, also reflecting rising utilization across KEY's array of fee-based infrastructure assets, as well as higher than expected margins post the commencement of the new contract year for services on April 1st.

NGL Marketing – contributed $51 million versus our estimate of $40 million. Recall, in our *"Q2 preview"*, we highlighted upside potential to our Marketing forecast stemming from record iso-octane gross profit margins of US$38/bbl during Q2 (long-term avg.: US$16/bbl).

Growth update – facing challenges, but mid-teens growth rate intact

Keyera increased its 2014 organic growth capex budget by $100 million to $700 to $800 million (from $600 to $700 mln), while advancing ~$1.7 billion of organic growth projects through 2017 (see table below), estimated to generate ~14% annual EBITDA growth.

KEYERA - GROWTH PROJECTS

	Net Capex	Online	EBITDA
Projects	($mln)		($mln)
Norlite	$420	Q2 2017	$63
Rimbey turbo expander	$210	H1 2015	$32
Wapiti raw gas and condensate pipelines	$180	Q3 2014	$27
Fort Saskatchewan C3+ expansion	$175	Q1 2016	$26
Fort Saskatchewan de-ethanizer	$155	Q1 2015	$23
Strachan sulphur projects	$115	H2 2015	$17
Josephburg rail terminal	$95	mid-2015	$14
Simonette plant modifications	$95	H2 2014	$14
Twin Rivers pipeline	$80	Q1/Q2 2015	$12
Alberta crude terminal	$75	Q4 2014	$11
Hull terminal refurbishment	$45	Q3 2014	$7
Fort Saskatchewan storage projects	$34	Q3 2015	$5
Wilson Creek gathering system	$26	Q2 2014	$4
Carlos pipeline offload	$23	Q2 2014	$3
Total	**$1,728**		**$259**
2013 EBITDA			$386
Pro-forma EBITDA			$645
4-yr CAGR			**14%**

Source: KEY, NBF Estimates

Norlite Diluent Pipeline – recall in May, KEY announced that it exercised its option to participate as 30% non-operating owner in Enbridge Inc.'s $1.4 billion (gross) Norlite Diluent Pipeline (online 2017). The scope of the project has been increased to a 24-inch (was 20-inch) diameter pipeline that will accommodate initial capacity of 224 mbpd with potential to expand to 400 mbpd. Of note, KEY's current diluent transportation system in the Fort Saskatchewan area will transport multiple sources of diluent supply into the Norlite system.

Rimbey Turbo Expander – during Q2, construction began on the $210 million, 400 mmcf/d Rimbey turbo expander (online H1 2015), increasing ethane extraction by up to 20,000 bpd.

Wapiti Pipeline – construction of the ~$180 million, sour gas gathering and condensate pipeline system connecting into the Simonette gas plant has resumed following challenging weather conditions and spring break-up (expected online Q3 2014).

Fort Saskatchewan C3+ Fractionation Expansion – KEY continues to progress detailed engineering work for its $230 million ($175 mln net) expansion of fractionation capacity at Fort Saskatchewan (online Q1 2016), which will more than double current C3+ (propane-plus) fractionation capacity to 65,000 bpd (from 30,000 bpd).

Fort Saskatchewan De-ethanizer – during Q2, all major pieces of equipment were installed for the 30,000 bpd de-ethanizer unit at KEY's Fort Saskatchewan Fractionation Facility (online Q1 2015). The $155 million project (net; was $135 mln) is underpinned by a long-term fee-for-service agreement with a large producer in the Deep Basin area.

Strachan Sulphur Agreement – in mid-2012, KEY entered into a 10-year fee-for-service agreement with Suncor (TSX: SU) to provide sulphur processing services at its 275 mmcf/d Strachan Gas Plant. Project costs were revised upwards to ~$60 million (net; from $40 mln) – resulting in a revaluation of the project by both KEY and SU. However, after reviewing the economics of the project, KEY determined that the project remains attractive, and as such, has opted to proceed. Subject to regulatory approvals and 50/50 JV partner Sulvaris Inc. obtaining appropriate financing, the project could be placed into service in H2 2015.

Twin Rivers pipeline project – project scope has been increased to accommodate a second phase expansion that will involve extending the pipeline further southeast of the Brazeau River gas plant by 25 km. Project costs for both phases are expect to total $80 million with phase I operational in Q1 2015, and phase 2 commissioned in Q2 2015.

Josephburg Propane Rail Export Terminal – civil engineer work for the $95 million rail terminal at Josephburg, Alberta (near Fort Saskatchewan) commenced in Q2. The facility will export up to 40,000 bpd of propane (C3) by rail (online mid-2015). Recall, Kinder Morgan reversed its Cochin pipeline to import 95,000 bpd of condensate from the U.S. mid-continent into Alberta.

Simonette Gas Plant Expansion – KEY commenced construction of its ~$95 million expansion of the Simonette Gas Plant, which will boost capacity by 100 mmcf/d to 250 mmcf/d by H2 2014. KEY continues to work with producers surrounding its Simonette facility to underpin a future expansion that would include the addition of C2+ deep-cut capabilities.

Alberta Crude Terminal (ACT) – construction of the 40,000 bpd Alberta Crude Terminal (50/50 JV with Kinder Morgan) continued during the quarter, with the 12-inch condensate pipeline from ACT to KEY's Fort. Sask. Pipeline system now complete. Overall, the ~$75 million (net) project is expected to have limited capacity in Q3 2014 and will be fully operational in Q4 2014.

Elsewhere, KEY and Kinder Morgan continue to evaluate the potential to increase the terminal's loading capacity up to 125,000 bpd, including construction of a diluent recovery unit (enabling the loading of bitumen; a.k.a. RailBit). Based on estimated incremental gross capex of $150-200 million relating to the potential expansion, we calculate another ~$1.00/sh upside to our current valuation.

Estimate revisions – moving to "full stride" fee-based contribution

In line with the quarter, and including the Twin River Pipeline phase II expansion, our 2015e AFFO/sh (FD) increases $0.43 (9%) to $5.51 (was $5.08) – representing an AFFO payout ratio of 56% (was 57%), remaining well below the high-payout group average of 72%. Of note, we continue to forecast a 10% dividend increase to $2.84/share commencing Q4 2014, while now adding an additional 7.5% dividend increase to $3.05/share beginning in Q2 2015, followed by another 10% dividend increase to $3.36/share in Q4 2015.

2015 ESTIMATE CHANGES

	Previous	Revised	Change		Comments
	($000's)	($000's)	($000's)	%	
Operating Margin					
G&P	234,865	240,083	5,219	2%	Quarterly adjustments / Twin Rivers phase II ↑
NGL Infrastructure	207,717	237,601	29,884	14%	Quarterly adjustments ↑
Marketing	139,877	141,904	2,027	1%	Quarterly adjustments ↑
Other	27,800	27,800	0	0%	
	610,258	**647,389**	**37,131**	**6%**	
G&A	-44,000	-44,000	0	0%	
EBITDA	**566,258**	**603,389**	**37,131**	**7%**	
Net interest expense	-62,967	-62,789	179	0%	
Cash taxes	-37,500	-37,500	0	0%	
FFO	**465,791**	**503,100**	**37,309**	**8%**	
Maintenance capex	-35,000	-35,000	0	0%	
AFFO	**430,791**	**468,100**	**37,309**	**9%**	
per share (FD)	*5.08*	*5.51*	*$0.43*	*9%*	
Dividend per share	*2.91*	*3.07*	*$0.16*	*6%*	
AFFO Payout	*57%*	*56%*			
Net Debt	1,357,161	1,252,992	-104,169	-8%	
D/EBITDA	*2.4x*	*2.1x*	*-0.3x*		

Source: NBF Estimates

Target jumps 10% to $88; reiterate Outperform

In line with the step change to our fee-based estimates, our target jumps $8.00 (10%) to $88.00 – based on a risk-adjusted dividend yield of 3.50% (was 3.75%) applied to our 2015e dividend of $3.07/share (was $2.91/share), a 14.75x multiple (unchanged) of our 2015e free-EBITDA of $568 million and our discounted cash flow valuation of $91.50 (was $81.75).

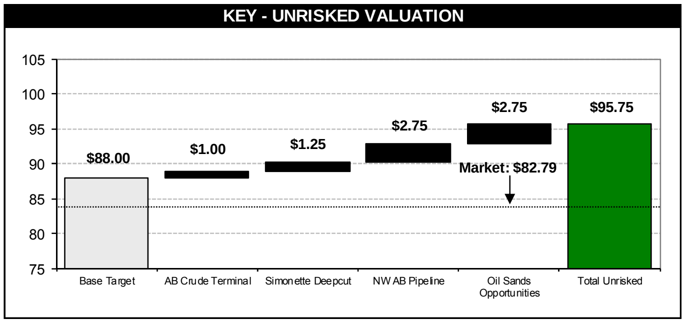
VALUATION SUMMARY

Methodology	Metric	Valuation
DDM	3.50%	$85.75
EV/Free-EBITDA	14.75x	$86.75
DCF Model	6.81%	$91.50
Equally Weighted Avg.		**$88.00**

Source: NBF Estimates

Based on an estimated ~$1.5 billion of additional NGL and oil sands related unsecured growth opportunities, we estimate a further ~$8/share of unrisked upside (~10%) to our current valuation. Combined with a 12-month total return of 9.7% (group: 6.0%), we reiterate our Outperform rating and continue to recommend KEY as a core holding within the space.

KEY - UNRISKED VALUATION



Source: NBF Estimates

KEYERA - SUMMARY TABLE	2014e		2015e	
	Previous	Revised	Previous	Revised
Natural Gas Processed (mmcf/d)	**1,172**	**1,158**	**1,264**	**1,264**
SUMMARY INFORMATION ($mln)				
Average Shares (mln)	*82.0*	*82.0*	*84.9*	*84.9*
Ending Shares (mln)	*84.4*	*84.4*	*85.4*	*85.4*
Fully Diluted Shares (mln)	*82.3*	*82.0*	*84.9*	*84.9*
Operating Margin				
Gathering & Processing	200.1	205.6	234.9	240.1
NGL Infrastructure	171.5	190.2	207.7	237.6
NGL Marketing	144.3	156.2	139.9	141.9
Other Margins	9.9	16.8	27.8	27.8
Total Operating Margin	525.9	568.9	610.3	647.4
EBITDA	**455.5**	**522.6**	**566.3**	**603.4**
FFO	372.9	430.0	465.8	503.1
Maintenance Capital	72.3	41.9	35.0	35.0
AFFO	300.6	388.1	430.8	468.1
Dividends	210.9	210.9	246.9	261.0
Growth Capital	770.4	748.8	445.0	500.0
Adj. Free Cash Flow (1)	-469.8	-360.8	-14.2	-31.9
Equity Issued (net)	369.0	381.4	74.1	78.3
Ending Net Debt	1,170.1	1,038.4	1,357.2	1,253.0
D / EBITDA	2.6x	2.0x	2.4x	2.1x
D / Total Capital	47%	44%	49%	46%
CF / D (2)	37%	44%	37%	44%
CF / Interest (3)	7.4x	8.2x	8.4x	9.0x
PER SHARE AMOUNTS				
Net Debt	**13.87**	**12.30**	**15.90**	**14.66**
EBITDA	**5.56**	**6.38**	**6.67**	**7.11**
Cash Flow	**4.53**	**5.25**	**5.49**	**5.93**
AFFO/SH - Fully Diluted	**3.65**	**4.74**	**5.08**	**5.51**
Dividends	**2.57**	**2.57**	**2.91**	**3.07**
FFO payout ratio	57%	49%	53%	52%
AFFO payout ratio	70%	54%	57%	56%

(1) AFFO less growth capital.
(2) CFO before changes in working capital divided by average 2-year total debt
(3) CFO before changes in working capital plus net interest expense divided by interest on debt less interest income.
Source: Company Report, NBF Estimates

A conference call will be held on August 7, 2014 at 10:00 AM EST. Interested participants may dial in at 1-888-231-8191.