Genesis Energy (GEL)

Updated May 9th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$21	**5 Year CAGR Estimate:**	24.2%	**Quality Percentile:**	N/A
Fair Value Price:	$34	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	N/A
% Fair Value:	61%	**5 Year Valuation Multiple Estimate:**	10.3%	**Total Return Percentile:**	N/A
Dividend Yield:	9.9%	**5 Year Price Target**	$41	**Valuation Percentile:**	N/A

Overview & Current Events

Genesis Energy is a diversified midstream energy limited partnership, which generates 44% of its operating income from offshore pipeline transportation, 34% from sodium minerals and sulfur services, 15% from onshore facilities and 7% from marine transportation.

Genesis Energy has dramatically underperformed the market in the last two years, as it has plunged 40% whereas the S&P has rallied 31%. This underperformance has partly resulted from rising interest rates. As the Fed has begun to raise interest rates aggressively since early last year, the distribution yields of MLPs have become less attractive and hence their valuation has been under pressure.

The underperformance of Genesis Energy has also resulted from its poor business performance. The MLP has spent hefty amounts on capital expenses but the performance of its investments has been poor. As a result, it has posted negative free cash flows in four out of the last five years. Moreover, it has diluted its unitholders, as it has almost doubled its unit count in the last six years. Furthermore, it has markedly increased its debt load, with its interest expense currently eating 95% of its operating income. Consequently, when its results were adversely affected by some turnarounds and Hurricane Harvey last year, *the MLP was forced to cut its dividend by 31%*.

Nevertheless, thanks to this dividend cut, Genesis Energy now intends to reduce its leverage ratio from 5.0 to about 3.75 by the end of 2020. In addition, it plans to raise its distribution by $0.01 every quarter for the next five years. In this way, it will restore its previous distribution in about five years. However, the most important aspect is the improving business landscape. More precisely, thanks to the rally of the oil price since last summer, U.S. oil production is expected to reach record levels this and next year. This oil boom will be prominent in the Gulf of Mexico, where Genesis Energy generates a great portion of its earnings thanks to the services it provides to deep-water oil producers. As this trend is likely to remain in place for the foreseeable future, the MLP will enjoy a strong tailwind in the upcoming years.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EBTDA/S	$2.82	$2.29	$0.70	$2.18	$2.43	$2.36	$2.91	$6.57	$4.11	$4.08	***$4.25***	***$5.17***
DPS	$1.26	$1.40	$1.53	$1.65	$1.87	$2.07	$2.29	$2.47	$2.72	$2.65	***$2.10***	***$2.80***

Genesis Energy has grown its EBITDA per share at an approximate 4.0% average annual rate during the last decade. Its Q1 results were negatively affected by its offshore segment's turnarounds and delays, which were beyond its control. While such factors are non-recurring in nature, the management of Genesis Energy expects them to persist at least for another quarter. Therefore, given its Q1 results and extrapolating them to the remainder of this year, it is reasonable to expect EBITDA per share around $4.25 this year. Moreover, it is reasonable to expect the MLP to continue to grow its EBITDA per share by about 4.0% per year on average over the next five years.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
P/EBTDA	3.1	8.2	37.5	12.9	14.7	22.3	14.6	5.6	8.8	5.5	***4.9***	***8.0***
Avg. Yld.	7.6%	10.1%	7.2%	6.2%	6.0%	4.2%	4.4%	5.7%	8.1%	8.8%	***9.9%***	***6.8%***

Due to the depressed EBITDA in 2010, the P/EBITDA ratio was extreme in that year. If this outlier year is excluded, Genesis Energy has traded at an average P/EBITDA ratio of 10.6 during the last decade. In the long run, one can reasonably expect the valuation level to revert towards its historical average. However, as interest rates are likely to remain on the rise for the foreseeable future, they are likely to continue to exert pressure on the valuation of MLPs. Therefore, it is reasonable to expect a P/EBITDA ratio around 8.0 for Genesis Energy in 2023, particularly given its high leverage. If the stock reaches this valuation level in 2023, it will enjoy a 10.3% annualized gain thanks to the expansion of its P/EBITDA ratio over the next five years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	11.8%	11.3%	9.3%	10.3%	10.3%	7.8%	8.5%	6.8%	8.3%	7.0%	***6.0%***	***8.0%***
Debt/A	44.2%	46.1%	55.6%	54.2%	56.6%	61.6%	61.7%	63.0%	62.8%	71.7%	***72.7%***	***65.0%***
Int. Cov.	3.0	1.7	-1.1	2.4	3.2	2.7	2.6	5.2	1.7	1.4	***1.1***	***2.0***
Payout	44.7%	61.1%	219%	75.7%	77.0%	87.7%	78.7%	37.6%	66.2%	65.0%	***49.4%***	***54.2%***
Std. Dev.	45.3%	42.2%	23.5%	21.9%	17.9%	23.4%	21.2%	23.3%	44.3%	18.9%	***24.0%***	***24.0%***

While Genesis Energy operates primarily with a fee-based model, its earnings are far from resilient. The reason is that the MLP invested too heavily and thus increased its leverage too much in the past and hence the financial burden of its debt exerts a strong drag on its results through high interest expense and excessive dilution of its unitholders. However, the dividend cut will likely prove a game changer for Genesis Energy. While most investors detest dividend cuts, the latter often mark a turning point, as they increase the financial flexibility of the company and boost the earnings via lower interest expense. This was certainly the case for Kinder Morgan, which bottomed on the exact day it cut its dividend.

Final Thoughts & Recommendation

Due to rising interest rates and its high leverage, which resulted in a dividend cut, Genesis Energy has dramatically underperformed the market. However, this has led the stock to bargain territory. As a result, the stock offers an extremely high 24.2% average expected annual return over the next five years thanks to 4.0% expected growth in its EBITDA per share, its 9.9% dividend, and 10.3% annualized expected expansion of its P/EBITDA ratio.

Total Return Breakdown by Year