Genesis Energy (GEL)

Updated August 17th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$23	**5 Year CAGR Estimate:**	21.5%	**Volatility Percentile:**	86.6%
Fair Value Price:	$34	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	16.9%
% Fair Value:	67%	**5 Year Valuation Multiple Estimate:**	8.3%	**Valuation Percentile:**	96.1%
Dividend Yield:	9.2%	**5 Year Price Target**	$42	**Total Return Percentile:**	97.4%

Overview & Current Events

Genesis Energy is a diversified midstream energy limited partnership, which generates 42% of its operating income from offshore pipeline transportation, 36% from sodium minerals and sulfur services, 16% from onshore facilities and 6% from marine transportation.

Genesis Energy has dramatically underperformed the market in the last two years, as it has plunged 36% whereas the S&P has rallied 31%. This underperformance has partly resulted from rising interest rates. As interest rates are on the rise, the distribution yields of MLPs have become less attractive and hence their valuation has come 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 consuming 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, as we mentioned in our previous research report in May, the dividend cut will probably prove a turning point for the stock. Since we recommended the MLP in May, it has rallied 10%. Thanks to the dividend cut, Genesis Energy now intends to reduce its leverage ratio from 5.0 to about 4.0 by the end of 2020 and raise its distribution by $0.01 every quarter for the next five years. Moreover, thanks to the rally of the oil price since last summer, U.S. oil production has reached record levels and is expected by EIA to post new all-time highs 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.

In early August, Genesis Energy reported (8/8/18) its results for the second quarter of fiscal 2018. The MLP missed the analysts' estimates mostly due to lower activity in its offshore segment. However, management stated that it expected improved performance in this segment in the future. Moreover, the sodium minerals and sulfur services segment is performing better than expected and is likely to remain strong for the foreseeable future.

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	***$4.90***	***$5.96***
DPS	$1.26	$1.40	$1.53	$1.65	$1.87	$2.07	$2.29	$2.47	$2.72	$2.65	***$2.10***	***$2.40***

As some headwinds that showed up in Q1, such as delays in the offshore segment, proved short-lived, EBITDA significantly improved in Q2. Thus we raised our EBITDA estimate for this year to $4.90. Genesis Energy has grown its EBITDA per share at an approximate 4.0% average annual rate during the last decade. 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	***4.7***	***7.0***
Avg. Yld.	7.6%	10.1%	7.2%	6.2%	6.0%	4.2%	4.4%	5.7%	8.1%	8.8%	***9.2%***	***5.7%***

Excluding the outlier year 2010, Genesis Energy has traded at an average P/EBITDA ratio of 10.6 during the last decade. However, as interest rates are likely to remain on the rise, they are likely to continue to exert pressure on the valuation of MLPs. Therefore, it is reasonable to expect a P/EBITDA ratio around 7.0 for Genesis Energy in 2023, particularly given its high leverage. In such a case, the MLP will enjoy an 8.3% annualized gain thanks to P/EBITDA expansion.

Safety, Quality, Competitive Advantage, & Recession Resiliency

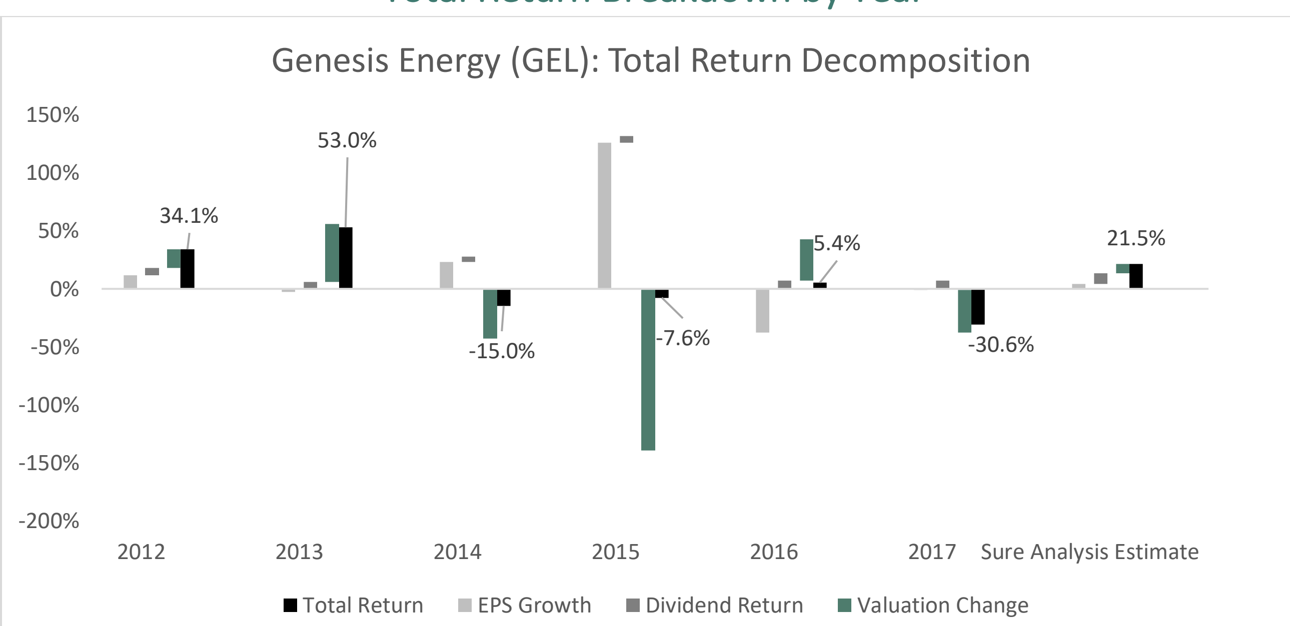
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	11.8%	11.3%	9.3%	10.3%	10.3%	7.8%	8.5%	6.8%	8.3%	7.0%	***7.0%***	***8.0%***
Debt/A	44.2%	46.1%	55.6%	54.2%	56.6%	61.6%	61.7%	63.0%	62.8%	71.7%	***73.3%***	***65.0%***
Int. Cov.	3.0	1.7	-1.1	2.4	3.2	2.7	2.6	5.2	1.7	1.4	***1.1***	***2.0***
Payout	44.7%	61.1%	219%	75.7%	77.0%	87.7%	78.7%	37.6%	66.2%	65.0%	***42.9%***	***40.3%***
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 not 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 an inflection 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 21.5% average expected annual return over the next five years thanks to 4.0% expected growth in its EBITDA per share, its 9.2% dividend, and 8.3% annualized expected expansion of its P/EBITDA ratio. While the stock has rallied 10% since our previous recommendation, we still rate it as a buy.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.