Genesis Energy (GEL)

Updated April 15th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$23	**5 Year CAGR Estimate:**	20.5%	**Volatility Percentile:**	72.6%
Fair Value Price:	$34	**5 Year Growth Estimate:**	3.0%	**Momentum Percentile:**	63.6%
% Fair Value:	68%	**5 Year Valuation Multiple Estimate:**	7.9%	**Growth Percentile:**	12.5%
Dividend Yield:	9.6%	**5 Year Price Target**	$39	**Valuation Percentile:**	97.7%
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Total Return Percentile:**	98.8%

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. It has a market capitalization of $2.8 billion.

Genesis Energy has dramatically underperformed the market in the last two years, as it has plunged 27% whereas the S&P has rallied 24%. This underperformance has partly resulted from higher interest rates. As interest rates have risen, 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 six years. Moreover, it has diluted its unit holders, as it has increased its unit count by 56% in the last six years. Furthermore, it has markedly increased its debt load, with its interest expense currently consuming 84% of its operating income. Consequently, when some turnarounds and Hurricane Harvey adversely affected its results, *the MLP was forced to cut its distribution by 31% in late 2017*.

Nevertheless, as we mentioned in our previous research reports, the distribution cut will probably prove to be a turning point for the stock. Thanks to the distribution cut, Genesis Energy now intends to reduce its leverage ratio from 5.1 to about 4.0 by the end of next year. It also raised its distribution by $0.01 per quarter in the five quarters following the distribution cut but it recently announced that it would keep the distribution constant at $0.55 per quarter for the foreseeable future. Moreover, U.S. oil production has reached record levels and is expected by EIA to keep posting new all-time highs in the upcoming years. 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 mid-February, Genesis Energy reported (2/20/19) financial results for the fourth quarter of fiscal 2018. The MLP grew its total segment margin by 6% over the prior year's quarter, from $175.4 to $185.5 million, thanks to sustained strong performance in soda ash business and volume growth in Louisiana infrastructure. Moreover, management sees strong demand for pipelines in Gulf of Mexico and thus expects improved performance in this segment over the next two years.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EBTDA/S	$2.29	$0.70	$2.18	$2.43	$2.36	$2.91	$6.57	$4.11	$4.08	$5.50	***$5.60***	***$6.49***
DPU	$1.40	$1.53	$1.65	$1.87	$2.07	$2.29	$2.47	$2.72	$2.65	$2.10	***$2.20***	***$2.40***
Shares	39.5	40.6	67.9	78.4	84.0	90.1	103.0	113.4	121.5	122.6	***124.0***	***140.0***

Management recently provided guidance for adjusted EBITDA in the range $685-$715 million for this year. Genesis Energy has grown its EBITDA per share at a 6.9% average annual rate during the last decade. Due to the high leverage of the MLP, we prefer to be conservative and assume 3.0% growth per year on average during the next five years.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
P/EBTDA	8.2	37.5	12.9	14.7	22.3	14.6	5.6	8.8	5.5	4.1	***4.1***	***6.0***
Avg. Yld.	10.1%	7.2%	6.2%	6.0%	4.2%	4.4%	5.7%	8.1%	8.8%	9.4%	***9.6%***	***6.2%***

Excluding the outlier years of 2010 and 2013, Genesis Energy has traded at an average P/EBITDA ratio of 9.3 during the last decade. However, as the MLP currently has a high debt load, it is prudent to expect a P/EBITDA ratio around 6.0 for Genesis Energy in 2024, particularly if interest rates continue rising. In such a case, the MLP will enjoy a 7.9% annualized gain thanks to P/EBITDA expansion.

Safety, Quality, Competitive Advantage, & Recession Resiliency

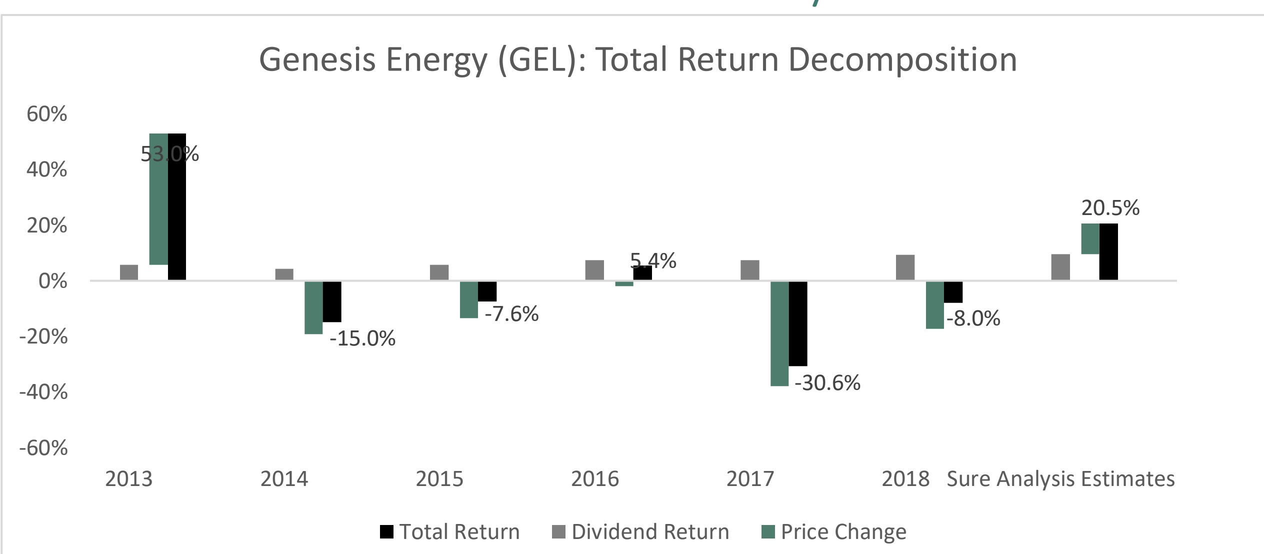
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	61.1%	219%	75.7%	77.0%	87.7%	78.7%	37.6%	66.2%	65.0%	38.2%	***39.3%***	***37.0%***

Given the volatile and lackluster performance record of Genesis Energy, it is evident that there is no meaningful competitive advantage in place. While Genesis Energy operates primarily with a fee-based model, its earnings are not resilient. In our view, the MLP invested too heavily and increased its leverage too much in the past. As such the financial burden of its debt exerts a strong drag on its results through high interest expense and excessive dilution of its unit holders. However, the distribution cut will likely prove to be a game changer for Genesis Energy. While most investors detest distribution cuts, they can 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.

Final Thoughts & Recommendation

Due to higher interest rates and its high leverage, which resulted in a distribution cut, Genesis Energy has dramatically underperformed the market in the last two years. However, this has led the stock to bargain territory. As a result, the stock offers an extremely high 20.5% average expected annual return over the next five years, primarily thanks to its 9.6% distribution yield. We thus maintain our buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	1435	2101	2438	3367	4135	3846	2247	1712	2028	2913
Gross Profit	130	86	116	157	158	183	222	252	247	321
Gross Margin	9.0%	4.1%	4.8%	4.6%	3.8%	4.8%	9.9%	14.7%	12.2%	11.0%
SG&A Exp.	40	106	29	40	41	48	46	44	53	58
D&A Exp.	68	54	62	61	65	91	N/A	N/A	N/A	N/A
Operating Profit	26	-27	83	115	111	133	139	206	164	259
Operating Margin	1.8%	-1.3%	3.4%	3.4%	2.7%	3.4%	6.2%	12.1%	8.1%	8.9%
Net Profit	8	-48	51	96	86	106	423	113	83	-6
Net Margin	0.6%	-2.3%	2.1%	2.9%	2.1%	2.8%	18.8%	6.6%	4.1%	-0.2%
Free Cash Flow	60	78	30	43	-205	-152	-206	-180	73	195
Income Tax	3	3	-1	-9	1	3	4	3	-4	1

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	1148	1507	1731	2110	2862	3211	5460	5703	7137	6479
Cash & Equivalents	4	6	11	11	9	9	11	7	9	10
Accounts Receivable	130	172	238	271	368	272	220	225	495	323
Inventories	40	55	101	87	85	47	44	99	89	74
Goodwill & Int. Ass.	461	445	418	400	388	408	548	530	507	465
Total Liabilities	529	837	938	1193	1764	1981	3439	3583	4423	4037
Accounts Payable	118	166	199	258	316	245	141	120	271	127
Long-Term Debt	367	610	659	851	1284	1581	2922	3091	3698	3432
Shareholder's Equity	619	669	793	916	1098	1229	2029	2130	2723	2453

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	0.7%	-3.7%	3.2%	5.0%	3.5%	3.5%	9.7%	2.0%	1.3%	-0.1%
Return on Equity	1.3%	-7.5%	7.0%	11.3%	8.6%	9.1%	25.9%	5.4%	3.4%	-0.2%
Shares Out.	39.5	40.6	67.9	78.4	84.0	90.1	103.0	113.4	121.5	122.6
Revenue/Share	36.36	51.81	35.88	42.97	49.25	42.71	21.81	15.10	16.69	23.76
FCF/Share	1.51	1.92	0.45	0.55	-2.44	-1.69	-2.00	-1.59	0.60	1.59

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.