Genesis Energy (GEL)

Updated August 26th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$20	**5 Year CAGR Estimate:**	16.1%	**Volatility Percentile:**	31.9%
Fair Value Price:	$28	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	50.0%
% Fair Value:	90%	**5 Year Valuation Multiple Estimate:**	2.1%	**Growth Percentile:**	54.9%
Dividend Yield:	11.0%	**5 Year Price Target**	$26	**Valuation Percentile:**	89.2%
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**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. It has a market capitalization of $2.5 billion.

Genesis Energy has dramatically underperformed the market in the last five years, as shares have fallen 60% whereas the S&P has rallied 41%. This underperformance has partly resulted from higher interest rates, which have rendered the distribution yields of MLPs less attractive and their debt more burdensome. However, the underperformance of Genesis Energy has mostly 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 75% 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, 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 5.0 to about 4.0 in the upcoming years. 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.

In early August, Genesis Energy reported (8/6/19) financial results for the second quarter of fiscal 2019. Just like in the previous quarter, the MLP was negatively impacted by some non-recurring events. Its soda ash operations experienced lower production volumes due to a longer than expected move of a longwall mining machine. As a result, Genesis Energy grew its adjusted EBITDA only 6% over last year's quarter, from $164 to $174 million. Moreover, the company incurred production disruptions in the Gulf of Mexico due to Hurricane Barry in early July. While there was no asset damage, third-quarter results will be negatively affected. On the bright side, management still expects to maintain the current quarterly distribution of $0.55 per unit for the foreseeable future thanks to a strong 1.39 coverage ratio.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EBITDA/U	$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[1]	39.5	40.6	67.9	78.4	84.0	90.1	103.0	113.4	121.5	122.6	***124.0***	***150.0***

Due to the aforementioned non-recurring headwinds, management now expects adjusted EBITDA towards the low end of its previously guided range $685-$715 million for this year. Genesis Energy has grown its EBITDA per unit at a 6.9% average annual rate during the last decade. Due to the high leverage of the MLP and the extensive issuance of new units, we prefer to be conservative and assume 3.0% growth per year on average over the next five years.

1. In millions.

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.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
P/EBITDA	8.2	37.5	12.9	14.7	22.3	14.6	5.6	8.8	5.5	4.1	***3.6***	***4.0***
Avg. Yld.	10.1%	7.2%	6.2%	6.0%	4.2%	4.4%	5.7%	8.1%	8.8%	9.4%	***11.0%***	***9.2%***

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 Genesis Energy currently has a high debt load, it is prudent to expect a lower P/EBITDA ratio. Using a 4.0 ratio for the MLP in 2024, the stock could enjoy a 2.1% annualized gain thanks to P/EBITDA expansion.

Safety, Quality, Competitive Advantage, & Recession Resiliency

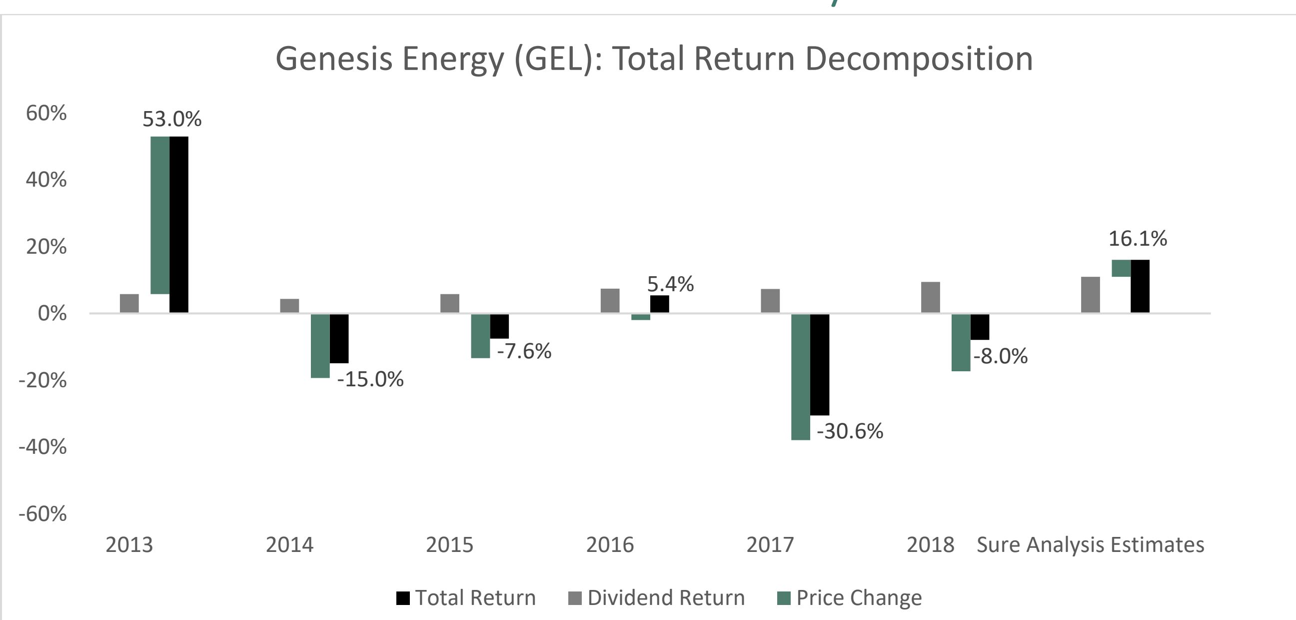
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	61.1%	219%	75.7%	77.0%	87.7%	78.7%	37.6%	66.2%	65.0%	38.2%	***39.3%***	***37.0%***

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 a result, 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 poor business performance and its high leverage, which resulted in a distribution cut, Genesis Energy has dramatically underperformed the market in the last five years. However, this has led the stock to bargain territory. As a result, the stock could offer an extremely high 16.1% average annual return over the next five years, primarily thanks to its 11.0% distribution yield. We rate the stock as a cautious buy for investors who can stomach high stock price volatility.

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.