Genesis Energy (GEL)

Updated February 20th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$16	**5 Year CAGR Estimate:**	17.6%	**Market Cap:**	$2.0 B
Fair Value Price:	$22	**5 Year Growth Estimate:**	2.0%	**Ex-Dividend Date:**	4/28/2020[1]
% Fair Value:	71%	**5 Year Valuation Multiple Estimate:**	7.0%	**Dividend Payment Date:**	5/13/2020
Dividend Yield:	13.8%	**5 Year Price Target**	$25	**Years Of Dividend Growth:**	1
Dividend Risk Score:	F	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	1.9%

Overview & Current Events

Genesis Energy is a diversified midstream energy limited partnership, which generates 37% of its operating income from offshore pipeline transportation, 36% from sodium minerals and sulfur services, 19% from onshore facilities and 8% from marine transportation. It has a market capitalization of $2.0 billion.

Genesis Energy has dramatically underperformed the market in the last five years, as shares have fallen -60% whereas the S&P has rallied 61%. The underperformance of Genesis Energy reflects 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 five out of the last seven years. Moreover, it has diluted its unit holders, as it has increased its unit count by 56% in the last seven years. Furthermore, it has markedly increased its debt load, with its interest expense currently consuming 76% 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 could 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 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 for many more 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 mid-February, Genesis Energy reported (2/19/20) financial results for the fourth quarter of fiscal 2019. The offshore pipeline segment grew its operating income 24% due to higher volumes of crude oil, but sodium minerals and sulfur services incurred a -23% decline in operating income due to excess soda ash inventory of customers of Genesis Energy. As a result, revenue fell -13% over the prior year's quarter. As this headwind is likely to persist for many quarters, the stock fell -12%, to a 10-year low. On the bright side, the distribution coverage ratio remained strong at 1.30 and thus management still expects to maintain the current quarterly distribution of $0.55 per unit for the foreseeable future.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
DCF/U	$2.50	$1.52	$1.94	$1.68	$2.07	$2.18	$2.81	$2.52	-$4.22	$2.93	***$2.80***	***$3.09***
DPU	$1.53	$1.65	$1.87	$2.07	$2.29	$2.47	$2.72	$2.65	$2.10	$2.20	***$2.20***	***$2.30***
Shares[2]	40.6	67.9	78.4	84.0	90.1	103.0	113.4	121.5	122.6	122.6	***123.0***	***150.0***

Genesis Energy has grown its DCF (distributable cash flow or "available cash before reserves") per unit at a 7.2% average annual rate during the last five years. However, the MLP has a markedly high leverage ratio (net debt/EBITDA) of 5.1. Due to the high leverage of the MLP and the extensive issuance of new units, we prefer to be conservative and assume only 2.0% growth per year on average over the next five years. Part of this growth should come from the deleveraging process, which will reduce interest expense to healthier levels.

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[1] Estimated date.

[2] 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
P/DCF	10.5	18.5	18.4	31.3	20.5	16.9	12.9	8.9	---	7.3	***5.7***	***8.0***
Avg. Yld.	7.2%	6.2%	6.0%	4.2%	4.4%	5.7%	8.1%	8.8%	9.4%	9.4%	***13.8%***	***9.3%***

Excluding the outlier years of 2013-2014, Genesis Energy has traded at an average P/DCF ratio of 13.3 during the last decade. However, as Genesis Energy currently has a high debt load, it is prudent to expect a lower DCF multiple. Using an 8.0 ratio for the MLP in 2025, the stock could enjoy a 7.0% annualized gain thanks to P/DCF expansion.

Safety, Quality, Competitive Advantage, & Recession Resiliency

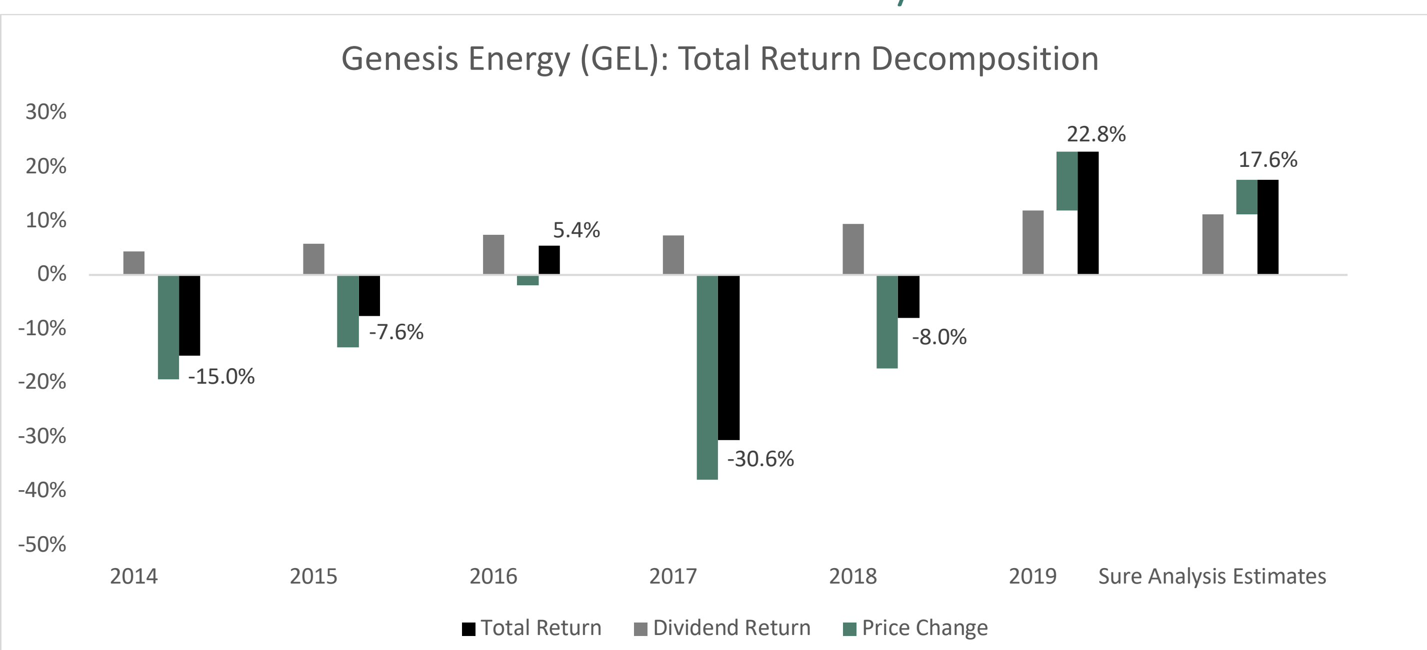
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	219%	75.7%	77.0%	87.7%	78.7%	37.6%	66.2%	65.0%	38.2%	75.1%	***98.6%***	***74.4%***

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 exceptionally high 17.6% average annual return over the next five years, primarily thanks to its 13.8% distribution yield. We rate the stock as a cautious buy for those who can stomach high stock price volatility.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	2101	2438	3367	4135	3846	2247	1712	2028	2913	2,481
Gross Profit	86	116	157	158	183	222	252	247	321	325
Gross Margin	4.1%	4.8%	4.6%	3.8%	4.8%	9.9%	14.7%	12.2%	11.0%	13.1%
SG&A Exp.	106	29	40	41	48	46	44	53	58	53
D&A Exp.	54	62	61	65	91	N/A	N/A	N/A	N/A	
Operating Profit	-27	83	115	111	133	139	206	164	259	264
Operating Margin	-1.3%	3.4%	3.4%	2.7%	3.4%	6.2%	12.1%	8.1%	8.9%	10.6%
Net Profit	-48	51	96	86	106	423	113	83	-6	96
Net Margin	-2.3%	2.1%	2.9%	2.1%	2.8%	18.8%	6.6%	4.1%	-0.2%	3.9%
Free Cash Flow	78	30	43	-205	-152	-206	-180	73	195	
Income Tax	3	-1	-9	1	3	4	3	-4	1	1

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	1507	1731	2110	2862	3211	5460	5703	7137	6479	6,598
Cash & Equivalents	6	11	11	9	9	11	7	9	10	56
Accounts Receivable	172	238	271	368	272	220	225	495	323	417
Inventories	55	101	87	85	47	44	99	89	74	65
Goodwill & Int. Ass.	445	418	400	388	408	548	530	507	465	441
Total Liabilities	837	938	1193	1764	1981	3439	3583	4423	4037	4,376
Accounts Payable	166	199	258	316	245	141	120	271	127	219
Long-Term Debt	610	659	851	1284	1581	2922	3091	3698	3432	3,429
Shareholder's Equity	669	793	916	1098	1229	2029	2130	2723	2453	2,225

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	-3.7%	3.2%	5.0%	3.5%	3.5%	9.7%	2.0%	1.3%	-0.1%	1.5%
Return on Equity	-7.5%	7.0%	11.3%	8.6%	9.1%	25.9%	5.4%	3.4%	-0.2%	4.1%
Shares Out.	40.6	67.9	78.4	84.0	90.1	103.0	113.4	121.5	122.6	122.6
Revenue/Share	51.81	35.88	42.97	49.25	42.71	21.81	15.10	16.69	23.76	20.24
FCF/Share	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.