CorEnergy Infrastructure Trust (CORR) Summary

Critical energy assets structured as a REIT rather than as an MLP

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Key Takeaways

- **Market Capitalization:** $391 million
- **Long-time energy infrastructure investor with a novel structure for providing access to infrastructure investments.** CorEnergy provides sale-leaseback transactions to energy producers for vital, non-core assets.
- **Paying a 9% dividend yield:** The CEO says dividend stability is a more important goal than growth. He's singing a tune I like.
- **This is an interesting company with a credible strategy.** I'll be posting a rough valuation soon with a view to add this to an income portfolio.

Overview

David Schulte, President and CEO of CorEnergy, was co-founder of Tortoise Capital Management – an energy investment firm – and before that, a managing director of Kansas City Energy Partners. CorEnergy invests in energy infrastructure projects using a REIT structure (it was the first energy infrastructure REIT), which is friendlier from an investor and tax reporting perspective.

CorEnergy invests (CEO says "underwrites") projects that are non-core to an energy producer but are essential for the producer to market its products. Contracts are structured for 10-15 years and CorEnergy's engineers structure the deal in a way such that the life of the field is longer than the life of the contract (i.e., so that there will be the possibility of renewing the lease after the original lease expires). The CEO talks about "terminal value management" regarding this analysis.

The model works right now due to the low price of oil and gas causing producers to want to generate cash and receive tax benefits from engaging in sale-leaseback transactions. CEO says that his only competition is from $100 / barrel oil because when times are good, the energy producers need not engage in these sale-leaseback transactions. See the "Revenue" section for a list of projects.

CorEnergy is essentially providing a financing service to energy producers, which are cash-strapped and highly levered right now. This doesn't sound like a good business. However, CEO talked about the effects of two of their lease clients going bankrupt. CorEnergy holds assets that, while "non-core," are essential to the producer's business. Even though producers enter are leasing transactions, they are accounted for as operational, so have greater weight in bankruptcy proceedings. Also, if the bankrupt firms break leases and lose access to infrastructure, their operations would effectively cease, and if this were to happen, bondholders' claims would be worth much less. As such, bondholders pushed for CorEnergy's lease payment claims to be paid throughout the bankruptcy proceedings.

This is an interesting company and I'll do a rough valuation as soon as possible.

Value Drivers

Revenues

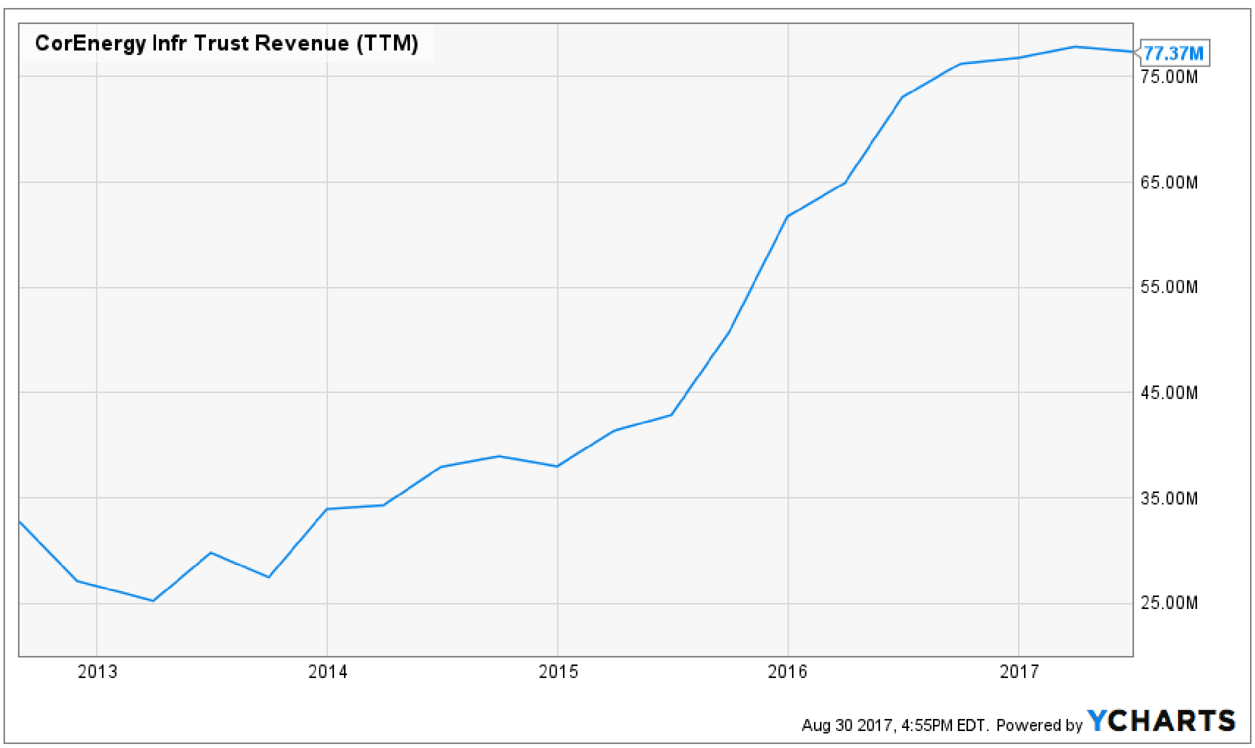
The projects below are the main ones held by the firm. You can see that the assets are similar to what you might expect owned by a master limited partnership (MLP), but without the partnership accounting and other headaches. The projects are generally small enough so that large banks are not interested in supplying capital, claims the CEO.

The CEO said that his idea is to have geographically diverse asset bases as a form of risk control. MLPs prefer to concentrate purchases in a particular area, which allows them pricing power, but also generates the risk of concentration in a given basin.

Type	Asset	Description	Purchase Price	Location
Upstream	Pinedale Liquids Gathering System	Liquids gathering, processing & storage system for condensate & water production	$228MM	WY
Midstream	Grand Isle Gathering System	Subsea to onshore pipeline & storage terminal for oil & water production	$245MM	GoM-LA
Midstream	MoGas Pipeline	Interstate natural gas pipeline supplying utilities	$125MM	MO-IL
Downstream	Omega Pipeline	Natural gas utility supplying end-users at Fort Leonard Wood	$6MM	MO
Midstream & Downstream	Portland Terminal	Crude oil and petroleum products terminal with barge, rail and truck supply	$50MM[1]	OR

The firm has not done an acquisition since 2015 and the CEO said that he was anxious to do another. The company will use some debt as its leverage is below target, but it may use some equity as well. The part-equity funded expansion will increase profits, so dividends will increase enough to cancel out dilutive effects (as we saw in Realty Income, for instance).

The CEO has said his main goal is dividend stability rather than growth, so revenue was stagnant for some time.



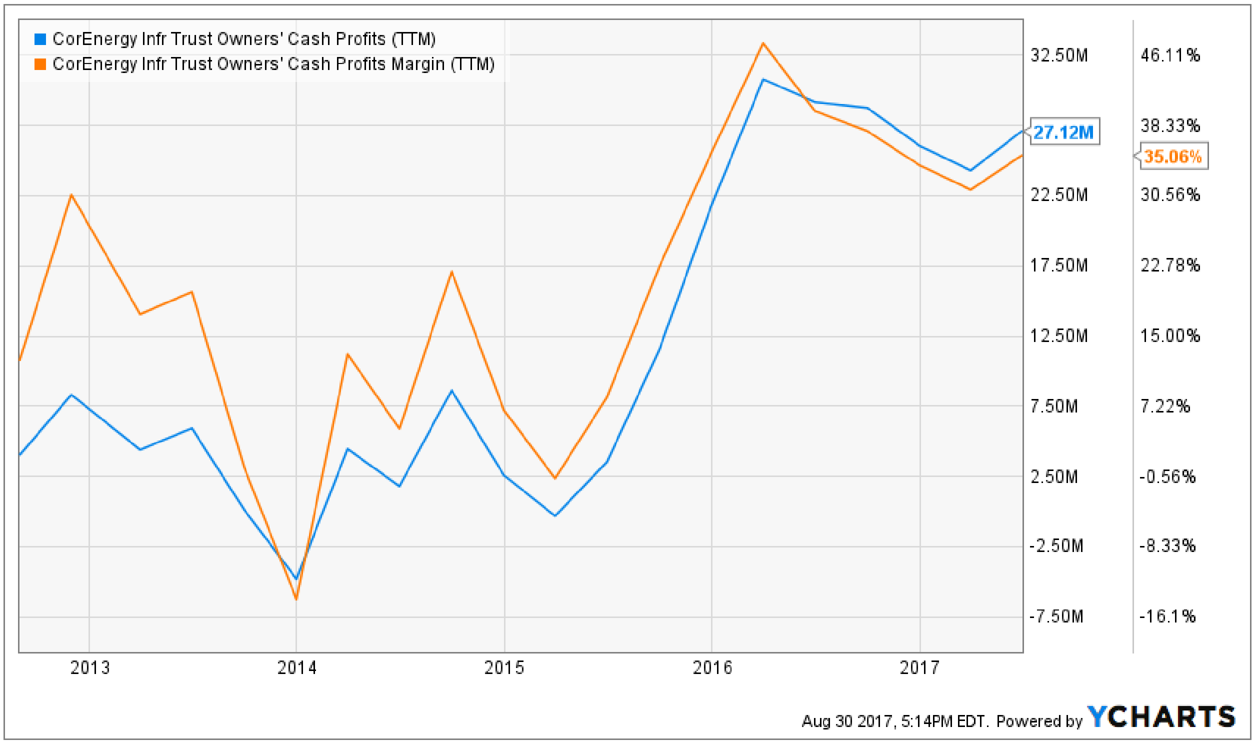
Value Drivers

The increase in 2016 revenues is coming from a new project – The Grand Isle Gathering System – acquired at the end of 2015

Energy producers are relatively inclined to enter into sale-leasebacks for non-core assets as a way to continue to operate in a low oil price environment. This means that CorEnergy is likely to be able to find more deals to do in the near term. The biggest risks is that the firm buys an asset that becomes unneeded if energy prices fall. CorEnergy invested in fracking wastewater wells and had to write those assets down as oil prices fell and the fields in which those wells were located dropped out of production. CEO said that he had learned his lesson regarding that. Refreshing to see a mea culpa from a CEO – suggests that the CEO is interested in improving over time.

Profits

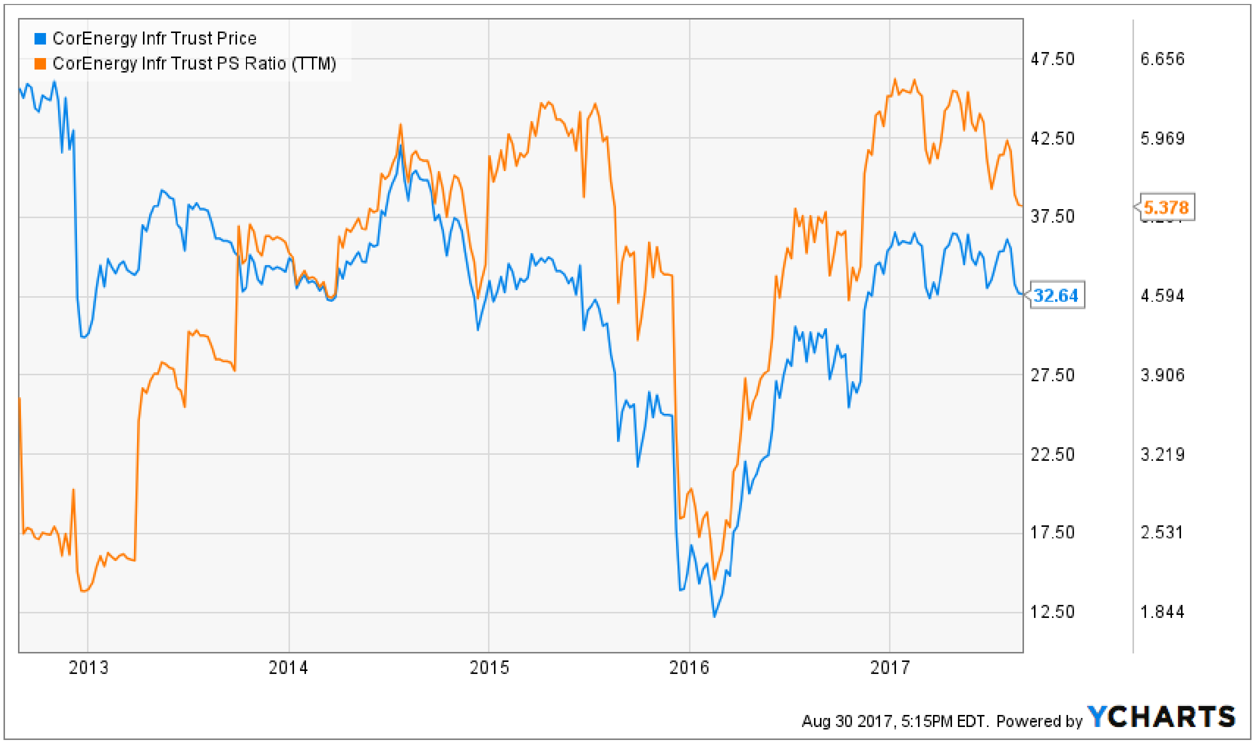
Note that the OCP measurements shown here simply use Total Depreciation and Amortization as a proxy for Maintenance Capital Expenditures. With other REITs, this assumption is not valid, and we suspect that actual profitability for CorEnergy is higher than what is shown here.



Market

Price and PS Ratio

A classic value investor would not be interested in such a high Price-to-Sales ratio, perhaps.



However, the dividend yield is very attractive – 9.2%:

Market

The CEO mentioned that the stock tended to trade with energy markets, even though the operations of the firm are largely immune to commodity price fluctuation. Indeed, the steep fall in oil prices in 2015-2016 corresponded with a fall in CorEnergy's price that would have made an excellent entry point.

Market

Options

The option market was closed by the time we did this write-up. The furthest tenor out was March 2018, and the implied volatilities look stupidly high. Certainly not a good candidate for a purchased call, but perhaps the pricing on a bond replacement would be attractive.

Considering the dividend yield, if the valuation holds up to scrutiny, we would probably prefer to invest in the underlying security rather than in the options.

Next Steps

- The CEO struck me as a very capable person who had realized there was a niche opportunity, both in terms of asset purchases and in terms of structure. I will do a valuation of this company with a view to adding it to an income portfolio.