An Equity Note

Brandon Beylo

brandon@macro-ops.com

What's Inside:

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- *Bankruptcy History & Risks*
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Companies Mentioned:

- *Ferrellgas Partners (FGPR)*

Equity Note: A Micro-Cap Special Situations Play (FGPR)

Ferrellgas Partners, L.P. (FGPR) is an illiquid, micro-cap, post-bankruptcy special situation opportunity with ~$100/share in upside versus ~$13/share downside (~8-to-1 R/R).

FGPR is the second-largest propane distribution marketer and the largest propane tank exchange player in the U.S. You've seen a few "Blue Rhino" propane tanks before!

The company generates ~70% of its revenue from its retail business selling to end-users like residential homes and industrial/commercial customers.

FGPR's retail propane segment is a good business, generating ~47% gross margins, ~12% EBIT margins, and ~$300M in annual EBITDA.

There are a few reasons why this opportunity exists.

- **FGPR recently emerged from a complex Chapter 11 bankruptcy/restructuring**
- **The Common A units are traded on the OTC Pink (OTCPK) Exchange and are highly illiquid (~3.3K shares traded daily)**
- **FGPR is a ~$61M market cap company, making it uninvestable for most larger funds**
- **Most of its retail shareholder base held the stock for its dividend (it is an MLP), which the company cut (we believe, temporarily)**
- **FGPR's Unit B holders receive preferential treatment and have potential to dilute unit holders.**

Our **Variant Perception:** FGPR's core business (retail propane distribution and tank exchange) is a good business that should generate ~$250M - $300M in annual EBITDA over the next five years.

This will give the company enough FCF to pay its Unit B holders within 5 years without dilution risk. At that time, FGPR will reinstate the dividend for Unit A holders while unlocking massive equity value gains.

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FGPR's Bankruptcy & Post-Bankruptcy Turnaround

FGPR chartered a familiar path to bankruptcy.

The company tried expanding operations by spending nearly $1B buying one midstream well-water disposal business (Sable Environment for $124M) and one crude transportation company (Bridger Logistics for $837.5M)

The acquisitions were a disaster. By June 2020, the company defaulted on its $357M debt obligation.

This is where things get interesting. Seeing his father's business collapse, James Ferrell returned from retirement in 2016 to save the company.

And man, did he go to work. Ferrell gutted FGPR's entire corporate management team. He sold off the company's non-core assets. Finally, he led a complete restructuring of FGPR's balance sheet via Chapter 11 bankruptcy.

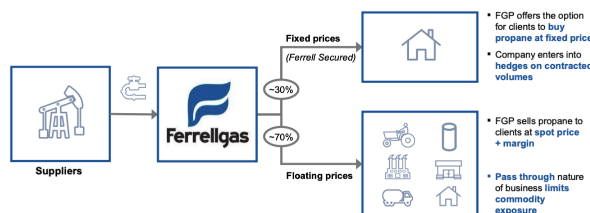
That brings us today with a company laser-focused on its core retail propane distribution and tank exchange businesses.

Next, I'll explain why FGPR's two remaining businesses are good assets.

Propane Is A Good Business

Propane is a basic necessity for many people (most notably in the Midwest). It's a reliable and generally cheaper heat source than electricity. Plus, it's clean burning and easily portable (versus, say, natural gas).

Let's dive into FGPR's two businesses, starting with propane distribution.



Propane Distribution operates as a duopoly between Amerigas (8% market share) and Ferrellgas (6% market share).

Small mom-and-pops own ~70% of the highly fragmented market. This gives Amerigas and Ferrellgas ample runway for growth via acquisitions as they roll up the industry.

You're probably wondering, "yeah, but what about commodity risk exposure?" Good question.

The company leverages floating prices for its residential business, comprising ~70% of revenues. In other words, FGPR sells propane at the spot price, then adds its margin on top.

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Then there's the tank exchange business. Blue Rhino owns 51% of the market. Amerigas is a distant second at 29% market share. Tank exchange provides counter-seasonality to FGPR's revenues.

I want to discuss FGPR's economies of scale before diving into the complex balance sheet.

Economies of Scale in Propane

FGPR benefits from economies of scale as the second-largest propane retailer and largest tank exchange operator. The company is one of the few (besides Amerigas) that boasts a nationwide scale and superior distribution.

The closer it gets to the customer, the lower its operating costs, thus raising margins.

Moreover, FGPR is investing in technology to optimize route efficiency. In other words, they can serve *more* customers on the same route, reducing costs.

Finally, FGPR becomes a top-of-mind acquirer candidate for the ~70% remaining market share dominated by fragmented mom-and-pops. Every new acquisition further drives the above economies of scale.

Class A/B Structure and Balance Sheet Complexities

There are five aspects of FGPR's balance sheet to know:

- **$700M in Preferred Units**
- **$219M Credit Facility**
- **$167M future non-cancelable leases**
- **4.9M Class A Units**
- **1.3M Class B Units**

Year Post-Emergence	*Conversion Factor*
Y1	1.75x
Y2	2.00x
Y3	3.50x
Y4	4.00x
Y5	5.00x
Y6	6.00x
Y7	7.00x
Y8	10.00x
Y9	12.00x
Y10	25.00x

Let's focus on the Class B Units. As part of the reorganization, FGPR issued 1.3M Class B Units owed $357M in distributions from the operating (parent) company.

There are two ways they can pay Unit B holders:

- **Pay $357M at a 15.85% IRR within the first 5 years post-emergence**
- **Pay $357M after 5 years-post emergence with escalating B-to-A Conversion Factor (see conversion factor on right).**

The first option leaves FGPR with ~$563M in required distributions to Class B unitholders. But there's no dilution.

Option 2 has a broader range of potential outcomes. Suppose it takes FGPR ~5 years post-emergence to pay the $357M owed to Unit B holders.

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In that example, FGPR would *only* pay Unit B holders $357. But, the Unit B holders would convert each of their units into 5 Class A units. Hence, the dilution risk.

Speaking of risk. It's important to note that FGPR is facing a litigation suit that *could* result in the company owing ~$139M to the former subsidiary Bridger Logistics. We'll account for this in our valuation below.

What Is Our Range of Expected Outcomes?

First, let's break down cash flow to see how FGPR pays the Class B unitholders.

The company generated ~$318M in EBITDA last year. Deducting interest expense and maintenance capex gets us $136M in Distributable Cash Flow. Then subtract another $24M payment to the preferred unitholders.

Finally, you're left with **~$112M** in FCF available to Unit A and B holders.

FGPR will use this $112M to pay Unit B holders the $357M owed.

Let's use two scenarios for our valuation, both of which assume FGPR loses the litigation and pays the $139M.

Scenario 1: FGPR Pays Unit B Holders 5 Years Post-Emergence, Uses 50% FCF For Dividends

In this scenario, we assume that it takes FGPR 5 years post-emergence to pay the $357M to Unit B holders without the 15.85% IRR. This triggers the 5-to-1 convert, which adds ~6.5M shares to the Class A pool (11.4M total).

Then, we'll assume FGPR uses 50% of its FCF to pay a dividend or ~$5/share. **That's ~$61/share** (300% upside) in equity value, assuming an 8% dividend yield (around historical average).

Scenario 2: FGPR Pays Unit B Holders $357M w/ 15.85% IRR in 5 Years

Our second scenario assumes FGPR pays Unit B holders $563M (15.85% IRR) in total distributions in 5 years. There's no dilution effect here, and FGPR retires the Unit B shares.

2022E EBITDA (M)	$318.00
EV/EBITDA MULTIPLE	8.5
ENTERPRISE VALUE	$2,703.00
PLUS + CASH	$200.00
LESS DEBT	-$1,475.00
LESS PREFERRED	-$700.00
LESS UNIT B	-$370.00
CLASS A EQUITY VALUE	**$358.00**
SHARES	4.9
PER SHARE VALUE	$73.06

FGPR then distributes ~40% of its FCF in dividends to Class A holders, or ~$9/share.

This gets us ~$114/share in equity value (~800% upside) at an 8% dividend yield.

Finally, we can cross-check our valuation by using an 8.5x EV/EBITDA exit multiple and treating the $357M at 15.85% IRR as debt. That gets us ~$73/share in equity value (see right).

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These two scenarios are *incredibly* enticing.

But remember, there is a non-zero chance the company becomes worthless as it defaults on its new debt structure.

Concluding Thoughts: Aligned Incentives, But Lots of Hair

What's the incentive for management to extinguish the Class B units quickly at a 15.85% IRR, given the company's highly leveraged balance sheet?

CEO James Ferrell owns 5% of the Class A units. The company's employees (via an Employee Stock Ownership Plan, or ESOP) own another 24% of the Class A units.

In other words, the entire company – from management to technicians – is incentivized to retire the Class B units without triggering dilution. Why would Ferrell, who owns 5% of Class A, voluntarily dilute himself and his potential stake in future cash flows if the cash is available?

Dilution is just one of the many risks in this investment. Even if the company retires the Class B units on schedule, they could decide to deleverage more quickly, leaving less FCF for unitholder distributions.

Portfolio Updates

Sells

- **SOLD** Long Bonds (ZBM2022)
- **SOLD** Long Wheat Futures (ZWN2022, ZWZ2022)
- **SOLD** CRK DOTMs
- **SOLD** ENB DOTMs

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