Subject: FYI on New Fortress Energy
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Messages (0)

Description

New Fortress Energy ("NFE") is the WeWork of energy. It's business model entails sourcing low-cost stranded gas and moving it to developing downstream markets for uses such as power generation. Founded by Wes Edens of Fortress fame in 2014, it IPO'd earlier this year with a lofty $2.5Bn market cap despite having invested just ~$400Mn into the business. Through the first two quarters of the year, NFE has generated an operating loss of ~$100Mn, much worse than analysts' estimates (7 Buys, 2 Holds, 0 Sells) on bloated SG&A despite having less-than-200 employees. Further, it's original plan of being vertically integrated by building a Pennsylvania natural gas liquefier plant was squashed just two months into being public as a result of the debt markets demanding a 12%+ interest rate. If that wasn't enough, management has missed essentially all of its key project milestones due to regulatory setbacks. Despite all of this, shares are +22% YTD, providing NFE with an impressive $3Bn market cap despite 3Q19 EBITDA estimates continuing to fall (currently at a $15Mn loss). For context, competitor GLNG has a $1.5Bn market cap despite generating $300Mn+ of run-rate EBITDA. The sell-side is infatuated with management's 2021+ EBITDA projections, despite: 1. lacking any track record of generating a profit; 2. carrying a significant element of commodity risk since NFE is unintegrated and exposed to price shocks; 3. considerable counterparty risk since NFE's is targeting Third World countries such as Jamaica. This is the poster child of the QE bubble that I believe has begun to pop (for more on this topic, please see SoftBank's CDS). I value NFE at $4/share (75% downside), equivalent to 1x our estimate of tangible book value at 2Q20 ($650Mn). Even if you give management full credit for their '21 EBITDA projection of $350Mn, NFE is trading at 11x EBITDA, consistent with bellwether Cheniere. We see several potential catalysts: 1. significant earnings misses; 2. continued milestone pushouts; 3. inability to finance future growth projects as the debt market says "no", potentially resulting in large equity issuances; 4. tail risk events such as commodity price spikes and customer solvency issues in a deteriorating credit environment.

*NFE reports 3Q19 earnings on 11/11

*Note that insiders own 91% of the shares, limiting the average daily trading value to just under $3Mn.

<u>Introduction</u>

NFE is a vertically integrated liquefied natural gas ("LNG") company. They (are hoping) to develop, own and operate midstream infrastructure necessary to open new markets for small-scale LNG. The original plan called for the development of a liquefaction plant in PA to export liquefied Marcellus gas. Two months after the IPO, however, management was unable to secure financing, resulting in a net short gas position. As a result, it must now sell gas forward into the Caribbean markets while purchasing cargos through tenders, thereby increasing operational risk. Its current asset portfolio consists of an LNG import terminal servicing an owned merchant power plant in Mexico, two LNG import terminals in Jamaica with 20yr offtake secured to baseload power plants, and a Puerto Rico import terminal secured by a fuel supply agreement to a power plant that the IRP deems should be economically retired in 2025. I believe the Mexican and Puerto Rican assets deserve sizeable discounts since merchant assets are susceptible to displacement by renewable.

<u>Track Record</u>

Despite being EBITDA negative with insignificant tangible assets (just $190Mn of net PP&E), NFE is afforded a premium valuation ($3.5Bn EV). NFE has all of the symptoms of a story stock, including missing just about every milestone set by management:

- Roadshow (January ‘19): management stated it was days away from signing a contract in Dominican Republic. Never occurred
- On the 2Q19 earnings call in August, management claimed that “Puerto Rico is now days away from the terminal being completed”. Still delayed.
- On the March 18th business update call, NFE said that Jamaica’s Old Harbor should reach run-rate by May. On 2Q19CC, they said they were now expecting the project to be online by September. Still no volumes.
- Numerous comments during the roadshow that permitting for PA liquefaction was “substantially complete”. Permit not received until July.
- SG&A guide of $65Mn at the IPO. When 1Q19 looked high, they blamed the IPO. When 2Q19 was even higher, management said that “no one asks Bill Gates what his G&A was in the early days of Microsoft.”

<u>Growth Outlook</u>

I believe the next few quarters will prove fatal for NFE, as it will be forced to transition into an execution story that we are highly doubtful of given management’s constantly changing narrative. As an example, management’s decision to build power plants to fix its “long LNG” position has resulted in NFE now struggling to sell power. The solution? Attempting to build data centers of course. We have the following concerns with NFE’s growth projects:

1. In Puerto Rico, NFE’s contract (only 5 years) doesn’t have a minimal volume commitment. Looking at the dispatch curve, the best case scenario would be that these plants are intermediate units (running just 50-60% of the time). If the government succeeds in its renewable or energy efficiency targets, these units will likely dispatch even less than this. Despite these rising risks, management has raised its PR volume opportunity by a staggering 4x. Further, while NFE has not signed any small-scale contracts in Puerto Rico, they are indicating to analysts that a 50% win rate is achievable.

2. In Mexico, NFE is building a temporary power barge to be supplied with LNG, which will then be sold into the spot market. I believe there is a risk that power prices in Mexico may be levelized (while currently suspended, there had been a plan to build an interconnect to connect the Baja grid to the main Mexican power grid), which would make NFE’s project uneconomic.

3. In Ireland, Friends of the Irish Environment (FIE) won a lawsuit against Shannon LNG which caused the EU to suspend NFE’s permit pending further investigation (normally a 2-5 year process). NFE is now attempting to build a data center to bypass the need for a permit.

<u>Estimates & Valuation</u>

I’d note that even when giving management full credit for its questionable ’21 guidance (the year in which all of its projects under construction come on-line), shares are trading at 11x EBITDA, in-line with the likes of Cheniere. That being said, I believe NFE will be subject to meaningful negative estimate revisions by the sell-side, several of which have ’21 EBITDA estimates above management’s current guidance of ~$350Mn. This is ludicrous when considering that management has failed to put a single project into service on schedule since becoming a public company and volumes have consistently disappointed for projects already on-line. Earlier this year, NFE told investors repeatedly that they were days away from signing a Dominican Republic contract that never came to fruition. In addition, their confessed best prospect (Ireland) had its permit barred in the EU Courts and is facing significant local opposition. Current ’21 EBITDA guidance of $350Mn is now ~30% below the projection at the time of the IPO and the only reason it’s not significantly worse is the tailwind from unhedged gas volumes.

I’d also note that management has blown through its initial annualized SG&A guide of $65Mn, which is now run-rating at $128Mn annualized. While commentary indicates that the hiring ramp will continue (NFE’s website currently lists 7 senior positions as available), FY21 EBITDA assumes management can bring this back down to its initial guide. Thus, even if NFE can miraculously execute on its existing projects, ’21 EBITDA would still be just $263Mn (25% below guidance / consensus) if SG&A does not revert-back. This would imply a lofty 15x EBITDA multiple.

Ultimately, I believe that the considerable risks associated with NFE’s business model / individual projects will manifest in a substantial operational hiccup that will highlight the need for a valuation based on actual cash flow. I project NFE’s ’20 tangible book value will approximate ~$4/share, implying considerable downside.

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Catalyst

Continued missed targets causing the investor base to realize the risks involved with ascribing a $3Bn+ valuation to a company that doesn't generate cash.