

Emerge Energy Services LP (EMES)

It's Not Over Yet: Maintaining Buy, TP to \$36

- Estimate Change
- Target Price Change

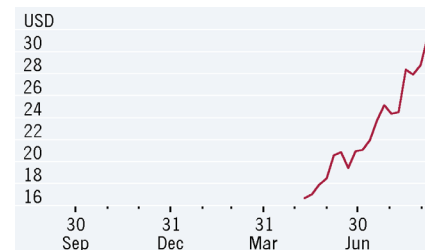
■ **Reiterating Our Buy** — On Aug 29th EMES released an 8-K disclosure that alluded to distribution potential of \$4/unit and a stabilizing frac sand price environment. Following a 13% run-up in price (and 85% since May's IPO), we find ourselves re-visiting the Emerge story and asking the question: Do we think the \$4.00/unit is achievable and would we still be buyers today? In short: Yes on both accounts. We remain at Buy/High Risk (1H) as in our view Emerge remains undervalued and offers investors a compelling combination of: **1)** ~26% NTM distribution growth (7% prev.) driven by additional sales at Barron and a stabilizing price environment; **2)** no GP IDR burden that we believe makes a compelling case for a take-out down the road; **3)** a structure not constrained by a MQD that offers operational flexibility; and **4)** additional growth opps from near-term JVs, partnerships, and/or sand mine/plant acquisitions.

■ **Dissecting a \$4/unit Distribution** — An ASP of \$52/ton and 3.2 million tons (~82% utilization at Barron & New Auburn) gets us to \$4/unit. The important question in our minds is not whether EMES will get to \$4/unit, which we believe it will, but rather if the high level of associated sand sales is sustainable over the longer-term given our view towards declining sand prices as supply catches up to demand. In our view, as long as liquids-directed drilling remains economical, market demand will increase and Emerge should be able to maximize their plant utilizations, even in a declining price environment. We have increased our sand sales forecast by ~40% based upon on **1)** a strong well count and higher sand usage per well that we believe has increased total market demand at a faster pace than originally estimated, and **2)** Emerge capturing both their market share of incremental demand and competitor share as customers switch vendors – a trend we believe has played an important role in EMES' ability to more than double their sand sales over the past 12 months.

■ **Increasing Estimates and TP** — We are increasing our target price to \$36.00 based upon a higher distribution outlook driven by YTD operational outperformance and a higher sand sales forecast - now ~40% above our original estimates. Accordingly, we've adjusted our valuation matrix for a lower target yield (9% vs. 10% prev.) and '14 EV/EBITDA multiple (9.0x vs. 9.5x prev.) to account for this higher growth outlook. See inside this report for our updated estimates and valuation matrix.

Buy/High Risk	1H
Price (06 Sep 13)	US\$31.46
Target price	US\$36.00
	from US\$26.50
Expected share price return	14.4%
Expected dividend yield	11.5%
Expected total return	25.9%
Market Cap	US\$730M

Price Performance (RIC: EMES.N, BB: EMES US)



Distributable Cash Flow (\$ Millions)	2013E	2014E	2015E	2016E	2017E
Adjusted EBITDA	\$77.9	\$101.6	\$91.9	\$82.2	\$71.3
Interest Expense	(10.4)	(5.8)	(6.0)	(7.5)	(7.5)
Maintenance Capital Expenditures	(1.8)	(2.8)	(2.8)	(2.8)	(2.8)
Other Cash Adjustments	0.3	0.3	0.3	0.3	0.3
Distributable Cash Flow	\$65.8	\$93.1	\$83.1	\$71.9	\$61.0
Total Cash Distributions	68.5	93.1	83.1	71.9	61.0
Total Distribution Per Unit	\$2.95	\$4.01	\$3.57	\$3.09	\$2.63
Growth in Distribution Per Unit	0.0 %	35.8 %	(10.8)%	(13.5)%	(15.1)%
Distribution Cash Flow Coverage:	1.00 x	1.00 x	1.00 x	1.00 x	1.00 x

Source: Citi Research

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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EMES.N: Fiscal year end 31-Dec						Price: US\$31.46; TP: US\$36.00; Market Cap: US\$730m; Recomm: Buy/High Risk					
Profit & Loss (US\$m)	2011	2012	2013E	2014E	2015E	Valuation ratios	2011	2012	2013E	2014E	2015E
Sales revenue	639.0	956.9	916.9	1,136.2	1,131.7	PE (x)	49.5	23.6	20.1	9.6	11.1
Cost of sales	-599.1	-890.6	-821.3	-1,015.0	-1,020.2	PB (x)	nm	47.6	15.1	23.1	51.5
Gross profit	39.9	66.3	95.7	121.2	111.5	EV/EBITDA (x)	31.5	16.4	11.1	8.3	9.2
Gross Margin (%)	6.2	6.9	10.4	10.7	9.8	FCF yield (%)	-0.9	-2.2	6.8	11.8	11.3
EBITDA (Adj)	26.4	52.3	77.9	101.6	91.9	Dividend yield (%)	0	5.9	9.4	12.7	11.4
EBITDA Margin (Adj) (%)	4.1	5.5	8.5	8.9	8.1	Payout ratio (%)	0	139	188	123	127
Depreciation	-7.8	-14.0	-17.9	-19.7	-19.8	ROE (%)	na	nm	114.4	189.6	nm
{001763}	0	0	0	0	0	Cashflow (US\$m)	2011	2012	2013E	2014E	2015E
EBIT (Adj)	18.6	38.4	60.0	81.9	72.1	EBITDA	26.4	52.3	77.9	101.6	91.9
EBIT Margin (Adj) (%)	2.9	4.0	6.5	7.2	6.4	Working capital	-13.5	-19.1	1.6	-5.3	0.1
Net interest	-4.7	-7.3	-10.4	-5.8	-6.0	Other	-3.8	-7.4	-23.6	-6.1	-6.4
Associates	0	0	0	0	0	Operating cashflow	9.2	25.8	55.9	90.3	85.5
Non-op/Except	0.9	-0.1	-12.9	0	-0.1	Capex	-15.7	-41.8	-6.2	-4.0	-2.8
Pre-tax profit	14.8	31.0	36.7	76.1	66.0	Net acq/disposals	0	0	0	0	0
Tax	0	0	-0.3	-0.3	-0.3	Other	0	0	0	0	0
Extraord./Min.Int./Pref.div.	0	0	0	0	0	Investing cashflow	-15.7	-41.8	-6.2	-4.0	-2.8
Reported net profit	14.8	31.0	36.4	75.8	65.6	Dividends paid	0	0	-68.5	-93.1	-83.1
Net Margin (%)	2.3	3.2	4.0	6.7	5.8	Financing cashflow	13.7	9.3	-48.7	-86.2	-82.7
Core NPAT	14.8	31.0	36.4	75.8	65.6	Net change in cash	7.1	-6.7	1.0	0.0	0.0
Per share data	2011	2012	2013E	2014E	2015E	Free cashflow to s/holders	-6.6	-16.0	49.7	86.3	82.7
Reported EPS (\$)	0.64	1.34	1.57	3.26	2.82						
Core EPS (\$)	0.64	1.34	1.57	3.26	2.82						
DPS (\$)	0	1.86	2.95	4.01	3.57						
CFPS (\$)	0.39	1.11	2.41	3.89	3.68						
FCFPS (\$)	-0.28	-0.69	2.14	3.71	3.56						
BVPS (\$)	0.18	0.66	2.08	1.36	0.61						
Wtd avg ord shares (m)	23.2	23.2	23.2	23.2	23.2						
Wtd avg diluted shares (m)	23.2	23.2	23.2	23.2	23.2						
Growth rates	2011	2012	2013E	2014E	2015E						
Sales revenue (%)	31.3	49.7	-4.2	23.9	-0.4						
EBIT (Adj) (%)	364.1	106.4	56.4	36.5	-12.0						
Core NPAT (%)	402.2	109.9	17.4	108.2	-13.4						
Core EPS (%)	402.2	109.9	17.4	108.1	-13.4						
Balance Sheet (US\$m)	2011	2012	2013E	2014E	2015E						
Cash & cash equiv.	10.8	4.0	5.0	5.0	5.0						
Accounts receivables	22.7	37.6	36.0	44.6	44.4						
Inventory	20.6	29.3	30.1	37.3	37.2						
Net fixed & other tangibles	100.3	150.6	138.9	123.2	106.2						
Goodwill & intangibles	0	0	0	0	0						
Financial & other assets	5.7	9.8	9.3	11.6	11.5						
Total assets	160.1	231.2	219.4	221.7	204.3						
Accounts payable	24.1	38.4	39.5	49.0	48.8						
Short-term debt	0	0	0	0	0						
Long-term debt	111.5	163.0	117.7	123.9	124.2						
Provisions & other liab	20.3	14.5	13.9	17.2	17.1						
Total liabilities	155.9	215.9	171.1	190.1	190.1						
Shareholders' equity	4.2	15.4	48.3	31.6	14.2						
Minority interests	0	0	0	0	0						
Total equity	4.2	15.4	48.3	31.6	14.2						
Net debt	100.7	159.0	112.7	118.9	119.2						
Net debt to equity (%)	nm	nm	233.4	376.0	839.2						

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For definitions of the items in this table, please click [here](#).

Changes to Estimates

We are updating our estimates to incorporate changes to our financial model to reflect the following:

- Q2 reported results and mgmt. commentary in the Aug 29th 8-K filing.
- Higher volumetric estimates for sand sales and slightly lower ASP in 2014.

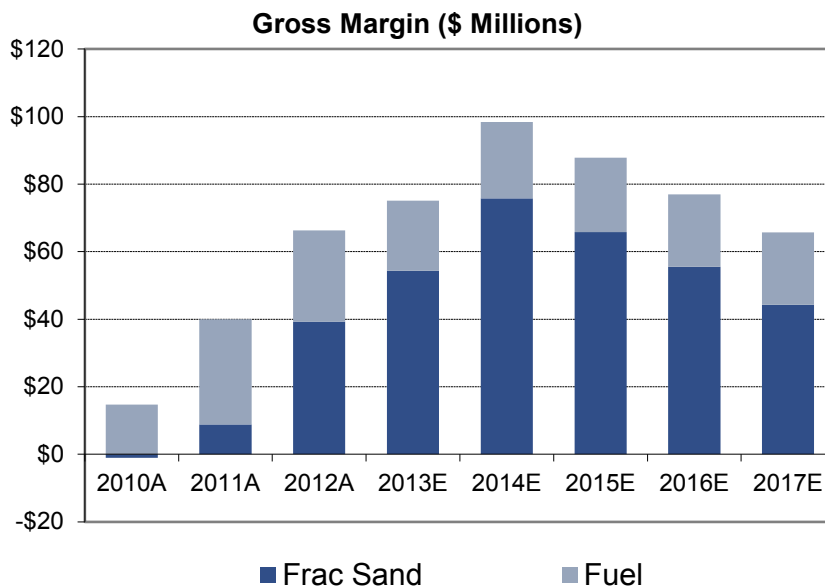
The impact to our overall financial estimates is included in the table below:

Figure 1. Changes to Estimates

Adjusted EBITDA (\$ in millions)	1Q:13A	2Q:13A	3Q:13E	4Q:13E	2013E	2014E	2015E	2016E	2017E
Current Estimates	\$17.2	\$17.4	\$21.2	\$22.2	\$77.9	\$101.6	\$91.9	\$82.2	\$71.3
Previous Estimates	\$17.6	\$17.1	\$18.8	\$18.5	\$72.0	\$76.7	\$68.7	\$61.0	\$49.6
Change (%)	(2.1%)	1.5%	12.8%	19.9%	8.3%	32.4%	33.8%	34.7%	43.7%
Distributions / Unit (\$)	1Q:13A	2Q:13A	3Q:13E	4Q:13E	2013E	2014E	2015E	2016E	2017E
Current Estimates	\$0.54	\$0.70	\$0.83	\$0.88	\$2.95	\$4.01	\$3.57	\$3.09	\$2.63
Previous Estimates	\$0.66	\$0.62	\$0.71	\$0.69	\$2.68	\$2.86	\$2.51	\$2.18	\$1.69
Change (%)	(17.7%)	13.3%	17.8%	26.0%	10.2%	40.1%	42.4%	41.8%	55.3%
Earnings / Unit (\$)	1Q:13A	2Q:13A	3Q:13E	4Q:13E	2013E	2014E	2015E	2016E	2017E
Current Estimates	\$0.42	-\$0.17	\$0.64	\$0.68	\$1.57	\$3.26	\$2.82	\$1.77	\$1.84
Previous Estimates	\$0.48	\$0.46	\$0.53	\$0.52	\$2.00	\$2.19	\$1.82	\$1.49	\$0.99
Change (%)	(12.1%)	(137.9%)	19.7%	30.7%	(21.5%)	49.3%	54.9%	19.0%	85.5%
Distributable Cash Flow (\$ in mil.)	1Q:13A	2Q:13A	3Q:13E	4Q:13E	2013E	2014E	2015E	2016E	2017E
Current Estimates	\$12.6	\$13.6	\$19.3	\$20.3	\$65.8	\$93.1	\$83.1	\$71.9	\$61.0
Previous Estimates	\$15.3	\$14.3	\$16.4	\$16.1	\$62.2	\$66.4	\$58.4	\$50.7	\$39.3
Change (%)	(17.7%)	(5.5%)	17.8%	26.0%	5.8%	40.1%	42.3%	41.8%	55.2%
Distribution Cash Flow Coverage	1Q:13A	2Q:13A	3Q:13E	4Q:13E	2013E	2014E	2015E	2016E	2017E
Current Estimates	NM	0.83x	1.00x	1.00x	1.00x	1.00x	1.00x	1.00x	1.00x
Previous Estimates		1.00x	1.00x	1.00x	1.00x	1.00x	1.00x	1.00x	1.00x
Change (%)	N/A	-16.6%	0.0%	0.0%	0.0%	0.0%	(0.0%)	(0.0%)	0.0%
Sand ASP (\$/ton)	1Q:13A	2Q:13A	3Q:13E	4Q:13E	2013E	2014E	2015E	2016E	2017E
Current Estimates	\$54.62	\$48.76	\$51.67	\$51.69	\$51.55	\$51.71	\$47.58	\$43.76	\$40.28
Previous Estimates	\$54.01	\$54.02	\$53.98	\$53.97	\$54.00	\$53.95	\$48.51	\$43.62	\$39.26
Change (%)	1.1%	(9.7%)	(4.3%)	(4.2%)	(4.5%)	(4.2%)	(1.9%)	0.3%	2.6%
Gross Margin on Sand (\$/ton)	1Q:13A	2Q:13A	3Q:13E	4Q:13E	2013E	2014E	2015E	2016E	2017E
Current Estimates	\$27.77	\$24.83	\$27.56	\$27.97	\$27.02	\$28.05	\$23.92	\$20.11	\$16.63
Previous Estimates	\$28.31	\$31.02	\$30.98	\$30.97	\$30.37	\$30.95	\$25.51	\$20.62	\$16.26
Change (%)	(1.9%)	(20.0%)	(11.1%)	(9.7%)	(11.0%)	(9.4%)	(6.2%)	(2.5%)	2.3%
Sand Sales (Millions of tons)	1Q:13A	2Q:13A	3Q:13E	4Q:13E	2013E	2014E	2015E	2016E	2017E
Current Estimates	518,452	633,565	645,000	685,000	2,482,017	3,195,000	3,360,000	3,520,000	3,600,000
Previous Estimates	473,400	484,000	537,000	544,000	2,038,400	2,243,000	2,409,000	2,609,000	2,609,000
Change (%)	9.5%	30.9%	20.1%	25.9%	21.8%	42.4%	39.5%	34.9%	38.0%

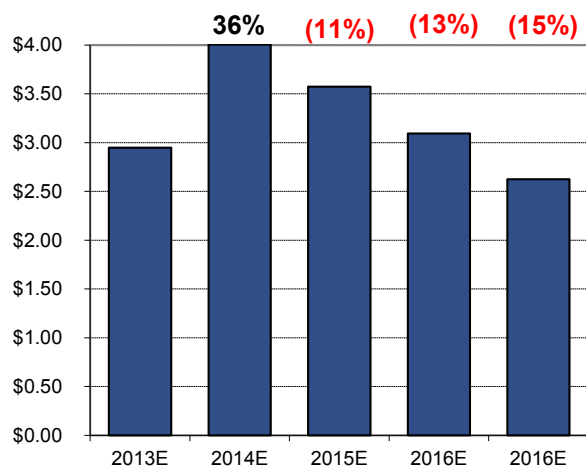
Source: Citi Research

Figure 2. Gross Margin Estimates



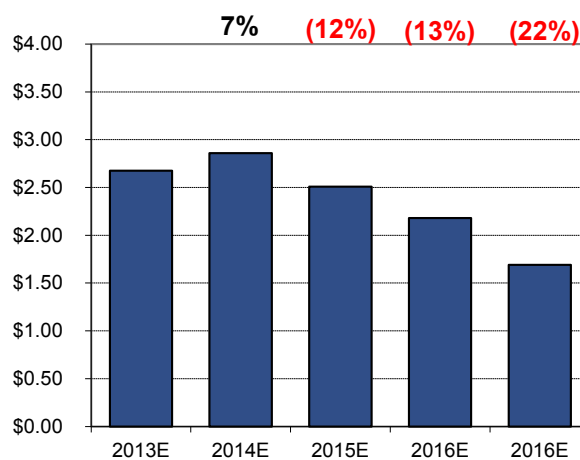
Source: Citi Research

Figure 3. New Distribution Estimates (\$/unit)



Source: Citi Research

Figure 4. Previous Distribution Estimates (\$/unit)



Source: Citi Research

Valuation

Our target price of \$36.00 is based on our matrix valuation approach. We use three different valuation methodologies to reach our target price. We believe this approach captures the different valuation philosophies in the market today. The reasonableness of our valuation is supported by a comparative analysis against the partnership's peer group, as illustrated in Figure 5. Comps include Hi-Crush (HCLP) on the MLP front, and US Silica Holdings and CARBO Ceramics (SLCA, CRR) on the C-Corp front, which we have tax-adjusted for another comp. As we do not have research coverage on these names, we have used FactSet consensus estimates for financial metrics.

Figure 5. Industry Comparables

Ticker	Name	Price	S/O	Market Cap	'13 Est. Net Debt	Tax Rate	Adj. EV	'13 EBITDA	'14 EBITDA	EV / '13 EBITDA	EV / '14 EBITDA	'13 Debt / EBITDA	13 Est. Dividend/ Yield	
SLCA	US Silica Holdings, Inc.	\$24.11	53.2	\$1,283.3	\$188.8	27.9%	\$1,830.3	\$177.2	\$208.7	10.3x	8.8x	1.1x	\$0.38	1.6%
CRR	CARBO Ceramics, inc.	\$84.89	23.0	\$1,948.5	(\$38.1)	33.2%	\$1,910.4	\$161.5	\$211.0	11.8x	9.1x	(0.2x)	\$1.15	1.4%
	C-corps (Tax-adjusted)			\$1,615.9	\$75.3	30.6%	\$1,870.4	\$169.3	\$209.9	11.1x	8.9x	0.4x		
HCLP	Hi-Crush Partners LP	\$23.36	31.0	\$725.1	\$91.0		\$816.1	\$71.6	\$93.4	11.4x	8.7x	1.3x	\$1.93	8.2%
	Sand Comp Group			\$1,393.2	\$79.2		\$1,606.8	\$144.9	\$180.8	11.2x	8.9x	0.7x		
EMES	Emerge Energy Services	\$31.46	23.2	\$730.5	\$117.7		\$848.2	\$77.9	\$101.6	10.9x	8.3x	1.5x	\$2.80	8.9%

Source: Citi Research, FactSet Consensus Estimates for SLCA, CRR, and HCLP

Figure 5 illustrates that EMES pairs well against its sand group peers, as it trades cheaper on both a yield (8.9% vs. 8.2%) and EV/2014E EBITDA basis (8.3x vs. 8.9x). Part of this valuation gap is explained by EMES' variable rate distribution policy and its limited percentage of take-or-pay contracts. However, EMES benefits from: **1)** ~30% of gross margin derived from its Fuels segment, which is more stable relative to frac sand as it doesn't have the same high levels of ROIC; **2)** potential for organic growth from nearly 50% of excess capacity at the newly built Barron plant; **3)** potential for ~\$4 -5 million of additional margin on RINs; and **4)** higher yielding sand reserves for liquids-directed drilling.

Based on our valuation matrix, we get a valuation range from \$31.70 to \$43.42 with our highest valuation coming from our implied yield analysis and lowest through our discounted cash distribution analysis (Figure 6).

Figure 6. Valuation Matrix

Implied Yield Valuation	\$43.42
Discounted Cash Distribution Valuation	\$31.70
'14 EV/EBITDA Valuation	\$34.01
Average of Valuation Methods	\$36.37

Source: Citi Research

Discounted Cash Distributions: Our discounted cash distribution (DCD) valuation analysis uses our 5-year operational forecast that takes into account near-term growth opportunities, risk factors, and our view that frac sand margins will compress from ~\$30/ton today to ~\$16/ton in 2017. Our terminal yield and growth estimates take into account a more normalized yield environment and a slower pace of long-term industry growth. The long-term yield we use to value EMES is 9.0%, which is anchored by our 2017 MLP index yield estimate of 7% (300 basis points above a 10-year Treasury yield of 4%) plus 200 basis points. Based on terminal distribution growth of 0%, we derive an internal rate of return (IRR) of 9.2% and a DCD of \$31.70/unit (Figure 7).

Figure 7. Discounted Cash Distribution Valuation

Projected Cash Flows					
	2013	2014	2015	2016	2017
Distributions	\$2.95	\$4.01	\$3.57	\$3.09	\$2.63
Terminal Value	\$0.00	\$0.00	\$0.00	\$0.00	\$29.17
	\$2.95	\$4.01	\$3.57	\$3.09	\$31.80
DCD	\$31.70				

Source: Citi Research

Figure 8. Discounted Cash Distribution 2-Stage Growth Model

Discounted Cash Distribution Valuation Approach: Two-Stage Growth Model	
Current Distribution	\$2.80
Growth Rate in High Growth Period	(1.6%)
Length of Extraordinary Growth Period	4.01
Perpetuity Growth Rate	0.0%
Implied Cost of Equity	9.0%
PV of Cash Distributions	\$12.73
PV of Terminal Price	\$18.96
Implied MLP Valuation	\$31.70
IRR	9.2%

Source: Citi Research

Figure 9. Sensitivity Matrix

		Perpetuity Growth Rate				
		(1.0%)	(0.5%)	0.0%	0.5%	1.0%
Cost of Equity	8.0%	\$32.72	\$33.98	\$35.40	\$37.01	\$38.85
	8.5%	\$31.09	\$32.20	\$33.44	\$34.83	\$36.41
	9.0%	\$29.63	\$30.61	\$31.70	\$32.91	\$34.28
	9.5%	\$28.30	\$29.17	\$30.13	\$31.20	\$32.39
	10.0%	\$27.09	\$27.87	\$28.72	\$29.67	\$30.72

Source: Citi Research

Figure 10. EV/Ton of Sand Reserves

	EMES	HCLP	SLCA
Proven Sand Reserves	119.8	102.3	144.0
Enterprise Value	\$848.2	\$816.1	\$1,830.3
EV/Ton of Sand Reserves	\$7.08	\$7.98	\$12.71

Source: Company reports, Citi Research

EV/EBITDA Multiple: Our EV/EBITDA analysis is based on a 2014E multiple of 9.0x, which is in-line with its sand producer peer group average of 8.9x. Given the current windfall margins sand producers are earning due to previous supply constraints and record oil & gas drilling, we use a lower multiple than the 10.0x-11.0x that these producers are currently trading at. Our multiple-based approach derives a valuation of \$34.01/unit. Figure 11 illustrates EMES' EV/EBITDA multiple through 2017E, based on current pricing.

Figure 11. EV/EBITDA Valuation

	2013	2014	2015	2016	2017
EBITDA	\$77.9	\$101.6	\$91.9	\$82.2	\$71.3
Units Outstanding	23.2	23.2	23.2	23.2	23.2
Market Cap of LP	\$730.5	\$731.2	\$731.2	\$731.2	\$731.2
GP IDR Take	0.0%	0.0%	0.0%	0.0%	0.0%
Market Cap Adj for GP	\$730.5	\$731.2	\$731.2	\$731.2	\$731.2
Minority Interests	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Debt	\$117.7	\$123.9	\$124.2	\$137.4	\$137.5
Enterprise Value	\$848.2	\$855.1	\$855.4	\$868.5	\$868.6
EV to EBITDA	10.9x	8.4x	9.3x	10.6x	12.2x
Distribution	\$2.80	\$4.01	\$3.57	\$3.09	\$2.63
Yield on Current Price	8.9%	12.7%	11.4%	9.8%	8.3%
Yield on Target Price	7.8%	11.1%	9.9%	8.6%	7.3%
ASP (\$/ton of sand)	\$51.55	\$51.71	\$47.58	\$43.76	\$40.28
Costs, ex-logistics (\$/ton of sand)	\$24.53	\$23.65	\$23.65	\$23.65	\$23.65
Gross Margin (\$/ton of sand)	\$27.02	\$28.05	\$23.92	\$20.11	\$16.63
Sand Sales (tons)	2,482,017	3,195,000	3,360,000	3,520,000	3,600,000
Sand Plant Utilization	55.2%	71.0%	74.7%	78.2%	80.0%
Sand Plant Utilization (ex-Kosse)	63.6%	81.9%	86.2%	90.3%	92.3%

Source: Citi Research, FactSet for current price

Implied Yield: Our implied yield valuation analysis derives a valuation of \$43.42 and assumes the partnership will increase the distribution to \$3.91/unit annualized in 12 months from now with units trading at a 9.0% yield. Our target yield takes into consideration the current yield environment, the limited nature of Emerge's take-or-pay and efforts-based contracts, and the variable nature of spot margin pricing in the sands segment.

Figure 12. Implied Yield Valuation

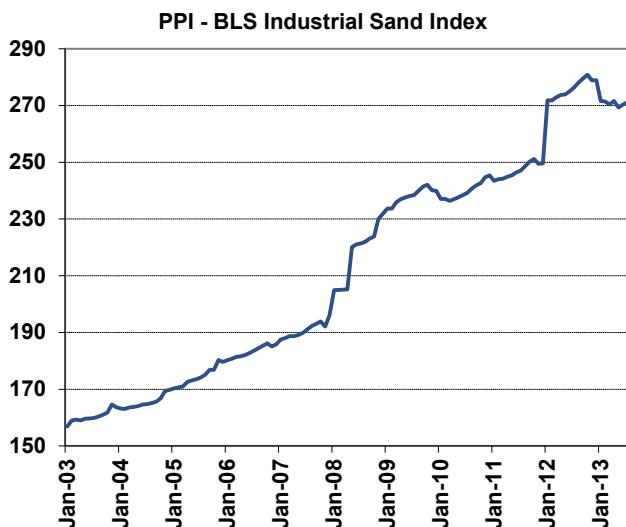
Target Yield	9.00%
Target Distribution (12-Month Forward Distribution x 4)	\$3.91
Implied Target Price	\$43.42

Source: Citi Research

Recent Sand Pricing Index Performance

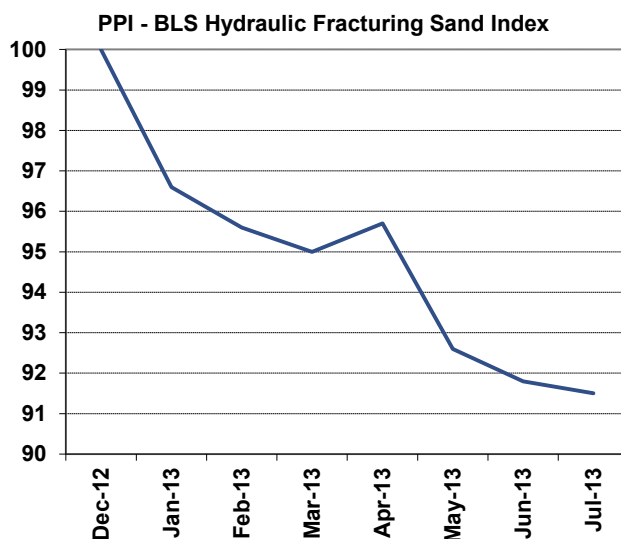
Frac sand margins have been historically volatile and the sand mining/processing is generally less transparent of a business model than say a refining MLP, where an investor can easily track crack spreads on a Bloomberg terminal. While a portion (~40% on NTM forecast) of Emerge's sales are done on a contract basis with fixed pricing, we note there will be a component of spot sales that will be subject to variable pricing that is difficult for investors to track on a real-time basis.

Figure 13. Industrial Sand Index (BLS)



Source: Citi Research, US BLS

Figure 14. Hydraulic Fracturing Sand Index (BLS)



Source: Citi Research, US BLS

Financial Model

Figure 15. Emerge Energy Services LP, Distributable Cash Flow

Years Ended Dec 31 (Dollars in Millions)	Historicals			Estimates				
	2010A	2011A	2012A	2013E	2014E	2015E	2016E	2017E
Adjusted EBITDA	(\$0.4)	\$26.4	\$52.3	\$77.9	\$101.6	\$91.9	\$82.2	\$71.3
Interest Expense	(8.0)	(4.7)	(7.3)	(10.4)	(5.8)	(6.0)	(7.5)	(7.5)
Cash Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Non-Cash Adjustments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Maintenance Capital Expenditures	(0.9)	(1.3)	(3.0)	(1.8)	(2.8)	(2.8)	(2.8)	(2.8)
Distributable Cash Flow	(\$9.3)	\$20.4	\$42.1	\$65.8	\$93.1	\$83.1	\$71.9	\$61.0
Cash Distributions:								
Common Units	\$0.0	\$0.0	\$43.1	\$68.5	\$93.1	\$83.1	\$71.9	\$61.0
General Partnership Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Cash Distributions	\$0.0	\$0.0	\$43.1	\$68.5	\$93.1	\$83.1	\$71.9	\$61.0
Total Distribution Per Unit	\$0.00	\$0.00	\$1.86	\$2.95	\$4.01	\$3.57	\$3.09	\$2.63
Y-O-Y Growth %					35.8 %	(10.8)%	(13.5)%	(15.1)%

Distribution Cash Flow Coverage:

Total Unit Coverage	NM	NM	NM	1.00x	1.00x	1.00x	1.00x	1.00x
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Source: Company reports, Citi Research

Figure 16. Emerge Energy Services LP, Operating Statistics

Years Ended Dec 31 (Dollars in Millions)	Historicals			Estimates				
	2010A	2011A	2012A	2013E	2014E	2015E	2016E	2017E
Operating Data:								
Frac Sand Segment								
Volumes Sold (Tons)			1,219,055	2,482,017	3,195,000	3,360,000	3,520,000	3,600,000
ASP (\$/Ton)			\$53.89	\$51.55	\$51.71	\$47.58	\$43.76	\$40.28
Costs (Ex-Logistics) (\$/Ton)			\$21.76	\$24.53	\$23.65	\$23.65	\$23.65	\$23.65
Gross Margin (Ex-Logistics) (\$/Ton)			\$32.13	\$27.02	\$28.05	\$23.92	\$20.11	\$16.63
Gross Margin (\$ mil)			\$39.3	\$69.0	\$91.7	\$82.6	\$73.1	\$62.2
% Of Cash Flow s			59%	69%	76%	74%	72%	68%
Fuels Segment								
Refined Product Sales - Purchases to sell Wholesale			165,807	163,694	185,000	185,000	185,000	185,000
Refined Product Sales - Transmix Production			118,822	116,187	116,000	116,000	116,000	116,000
Total Refined Products Sold (Mgal)			284,629	279,881	301,000	301,000	301,000	301,000
Avg. Margin for Refined Products Sold (\$/gal)			\$0.089	\$0.088	\$0.084	\$0.084	\$0.084	\$0.084
Terminal Throughput Volumes			293,053	281,666	300,000	300,000	300,000	300,000
Avg. Margin for Terminal Throughput (\$/gal)			\$0.025	\$0.025	\$0.025	\$0.025	\$0.025	\$0.025
RIN Credit (\$ mil) [Reduces Product Costs]			\$0.0	(\$3.1)	(\$1.5)	(\$0.9)	(\$0.7)	(\$0.7)
Gross Margin (\$ mil)			\$27.0	\$31.0	\$29.5	\$28.9	\$28.7	\$28.7
Avg. Margin (\$/gal)			\$0.114	\$0.113	\$0.109	\$0.109	\$0.109	\$0.109

Source: Company reports, Citi Research

Figure 17. Emmerge Energy Services LP, Consolidated Statement of Operations

Years Ended Dec 31 (Dollars in Millions)	Historicals			Estimates				
	2010A	2011A	2012A	2013E	2014E	2015E	2016E	2017E
Sand Sales	\$17.1	\$28.2	\$66.7	\$127.9	\$165.2	\$159.9	\$154.0	\$145.0
Fuel Sales	469.7	610.9	890.2	768.4	948.2	948.2	948.2	948.2
Other Revenue	0.0	0.0	0.0	20.6	22.8	23.6	24.8	25.2
Revenue	\$486.9	\$639.0	\$956.9	\$916.9	\$1,136.2	\$1,131.7	\$1,127.0	\$1,118.4
Sands - COGS	18.2	19.3	27.4	73.6	89.5	94.1	98.6	100.8
Fuel - COGS	455.0	579.8	863.2	747.7	925.5	926.1	926.7	926.7
Cost of Goods Sold	\$473.2	\$599.1	\$890.6	\$821.3	\$1,015.0	\$1,020.2	\$1,025.3	\$1,027.5
Sands Gross Margin	(1.1)	8.9	39.3	54.3	75.7	65.8	55.5	44.2
Fuel Gross Margin	14.7	31.0	27.0	20.8	22.7	22.1	21.5	21.5
Gross Margin	\$13.7	\$39.9	\$66.3	\$95.7	\$121.2	\$111.5	\$101.8	\$90.9
Selling, General & Administration	14.1	13.5	14.0	17.8	19.6	19.6	19.6	19.6
Other Expenses (Income)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Incremental EBITDA	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EBITDA (Operating Cash Flow)	(\$0.4)	\$26.4	\$52.3	\$77.9	\$101.6	\$91.9	\$82.2	\$71.3
Depreciation and Amortization	6.6	7.8	14.0	17.9	19.7	19.8	20.3	20.7
EBIT (Operating Income)	(\$7.0)	\$18.6	\$38.4	\$60.0	\$81.9	\$72.1	\$61.9	\$50.6
Other Expenses (Income):								
Interest Expense	8.0	4.7	7.3	10.4	5.8	6.0	7.5	7.5
Equity (Earnings) Loss in Unc. Subs.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loss (Gain) on Disposal of Assets	(9.6)	0.1	(0.0)	0.0	0.0	(0.0)	0.0	0.0
Other	(0.6)	(1.0)	0.1	12.9	0.0	0.1	12.9	0.0
Pre-Tax Income	(\$4.9)	\$14.8	\$31.0	\$36.7	\$76.1	\$66.0	\$41.5	\$43.1
Income Taxes	0.0	0.0	0.0	0.3	0.3	0.3	0.3	0.3
Net Income	(\$4.9)	\$14.8	\$31.0	\$36.4	\$75.8	\$65.6	\$41.2	\$42.8
Minority Interest in Net Income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjusted Net Income	(\$4.9)	\$14.8	\$31.0	\$36.4	\$75.8	\$65.6	\$41.2	\$42.8
General Partnership Interest in Net Income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Income to Common	(\$4.9)	\$14.8	\$31.0	\$36.4	\$75.8	\$65.6	\$41.2	\$42.8
Extraordinary Charges (Income)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjusted Net Income to Common	(\$4.9)	\$14.8	\$31.0	\$36.4	\$75.8	\$65.6	\$41.2	\$42.8
Diluted Earnings Per Unit	(\$0.21)	\$0.64	\$1.34	\$1.57	\$3.26	\$2.82	\$1.77	\$1.84
Average Diluted Common Units (MM)	23.2	23.2	23.2	23.2	23.2	23.2	23.2	23.2

Source: Company reports, Citi Research

Figure 18. Emerge Energy Services LP, Balance Sheet & Statement of Cash Flows

Balance Sheet		Historicals			Estimates				
Years Ended Dec 31 (Dollars in Millions)		2010A	2011A	2012A	2013E	2014E	2015E	2016E	2017E
Other Current Assets		41.5	5.7	9.8	9.3	11.6	11.5	11.5	11.4
Total Current Assets		\$47.7	\$59.7	\$80.6	\$80.5	\$98.5	\$98.1	\$97.8	\$97.1
Net Property, Plant & Equipment		\$71.8	\$85.9	\$129.6	\$117.9	\$102.2	\$85.2	\$67.7	\$49.7
Goodwill		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Long-Term Assets		15.1	14.5	21.0	21.0	21.0	21.0	21.0	21.0
Total Assets		\$134.6	\$160.1	\$231.2	\$219.4	\$221.7	\$204.3	\$186.5	\$167.8
Other Current Liabilities		50.4	20.3	14.5	13.9	17.2	17.1	17.1	16.9
Total Current Liabilities		\$50.4	\$44.4	\$52.9	\$53.4	\$66.1	\$65.9	\$65.6	\$65.1
Straight Debt		\$108.0	\$111.5	\$163.0	\$117.7	\$123.9	\$124.2	\$137.4	\$137.5
Deferred Taxes		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Minority Interest		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Long-Term Liabilities		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Liabilities		\$158.3	\$155.9	\$215.9	\$171.1	\$190.1	\$190.1	\$203.0	\$202.6
Common Stockholders' Equity		(23.7)	4.2	15.4	48.3	31.6	14.2	(16.5)	(34.7)
Total Liabilities and Stockholders' Equity		\$134.6	\$160.1	\$231.2	\$219.4	\$221.7	\$204.3	\$186.5	\$167.8

Market Price

Total Debt / EBITDA	NM	4.2x	3.1x	1.5x	1.2x	1.4x	1.7x	1.9x
Debt / Enterprise Value	NM	NM	NM	14.0%	14.6%	14.6%	15.9%	15.9%
EBITDA / Net Interest Expense	NM	5.6x	7.2x	7.5x	17.7x	15.3x	11.0x	9.5x
Cost of Debt	NM	4.3%	5.3%	7.4%	4.8%	4.8%	5.7%	5.5%

Cash Flow Statement		Historicals			Estimates			
Years Ended Dec 31 (Dollars in Millions)	2010A	2011A	2012A	2013E	2014E	2015E	2016E	2017E
Cash Flow From Operating Activities:								
Net Income to Common	(\$4.9)	\$14.8	\$31.0	\$36.4	\$75.8	\$65.6	\$41.2	\$42.8
Depreciation and Amortization	6.6	7.8	14.0	17.9	19.7	19.8	20.3	20.7
Other Non-Cash Changes	0.0	0.0	0.0	0.0	0.0	(0.0)	0.0	0.0
(Inc.) Dec. in Net Working Capital	0.0	(13.5)	(19.1)	1.6	(5.3)	0.1	0.1	0.2
Cash From Operations	\$1.7	\$9.2	\$25.8	\$55.9	\$90.3	\$85.5	\$61.6	\$63.7
Cash Flows From Investing Activities:								
Acquisitions	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Capital Expenditures - Maintenance	(0.9)	(1.3)	(3.0)	(1.8)	(2.8)	(2.8)	(2.8)	(2.8)
Capital Expenditures - Growth	(1.1)	(14.4)	(38.8)	(4.4)	(1.2)	0.0	0.0	0.0
Other Items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Cash From Investing Activities	(\$2.0)	(\$15.7)	(\$41.8)	(\$6.2)	(\$4.0)	(\$2.8)	(\$2.8)	(\$2.8)
Cash Flows From Financing Activities:								
Increase(Decrease) in Long-Term Debt	\$0.0	\$0.0	\$0.0	(\$45.3)	\$6.2	\$0.3	\$13.1	\$0.1
Common Equity Offering (Unit Repurchase Prog.	0.0	0.0	0.0	65.0	0.6	0.0	0.0	0.0
Cash Distributions	0.0	0.0	0.0	(68.5)	(93.1)	(83.1)	(71.9)	(61.0)
Other	9.0	13.7	9.3	0.0	0.0	0.0	0.0	0.0
Net Cash From Financing Activities	\$9.0	\$13.7	\$9.3	(\$48.7)	(\$86.2)	(\$82.7)	(\$58.8)	(\$60.9)
Net Change in Cash	\$8.7	\$7.1	(\$6.7)	\$1.0	\$0.0	\$0.0	\$0.0	\$0.0
Cash -- Beginning of Year	0.0	6.3	10.8	4.0	5.0	5.0	5.0	5.0
Year-End Cash Balance	\$8.7	\$13.4	\$4.0	\$5.0	\$5.0	\$5.0	\$5.0	\$5.0

Source: Company reports, Citi Research

Emerge Energy Services LP

Company description

Emerge is a variable-rate distribution MLP formed by management and affiliates of Insight Equity to own, operate, acquire and develop a diversified portfolio of energy service assets. Cash flow generation at the assets have the potential to exhibit variability and thus so will distributions to LP unit holders. Emerge is organized in two business segments: Sands Operations and Fuels Processing and Distribution.

The Sands business, operating as Superior Silica Sands (SSS), primarily consists of mining and processing frac sand, a key component used in hydraulic fracturing of oil and natural gas wells. Emerge owns facilities with dry sand processing capacity of 5.2 million tons per year (tpy) and mines with over 16 years of proven reserves at 79.8 million tons. Two plants in Wisconsin, Barron and New Auburn, produce high proportions of 16/30, 20/40 and 30/50 mesh Northern White sand that is desirable for oil and liquids-rich gas drilling and provide most of the revenue for this segment. The Kosse plant, in Texas, produces 100 mesh sand that is used for dry gas drilling.

The Fuels segment, operating as Direct Fuels (DF) and Allied Energy Co. (AEC), primarily consists of acquiring, processing and separating transmix that results when multiple types of refined petroleum products are transported through a pipeline. Operations in this segment also include the wholesale distribution refined products. Emerge has facilities in Dallas-Fort Worth, TX and Birmingham, AL that have transmix processing and terminal tankage capacity of 184 million gallons per year (MM gpy) and 34 MM gpy, respectively. The partnership also owns a facility that is capable of producing 10 MM gpy of RIN-qualifying biodiesel.

In 2013, we expect Emerge to derive ~70% of cash flows from the Sand segment, with the other 30% from Fuels.

Investment strategy

We rate EMES with a Buy/High Risk rating (1H) and a target price of \$36.00. We believe that the partnership should provide investors an attractive total return based on its current implied yield of ~9% and our projected distribution growth of 26.0% over the next 12 months. Emerge is a variable-rate distribution MLP that we expect to derive 70 to 75% of cash flows from the mining and processing of Northern White frac sand used in liquids-directed drilling and 25% to 30% of cash flows from fuel processing of transmix, which results when multiple types of refined petroleum products mix together as they are transported sequentially through a pipeline.

In our view, the Fuels segment will remain stable and generate significant free cash flow while the Sands segment should experience variability from spot sales and the potential for shrinking margins over time as supply catches up with demand. Despite this variability, Mgt has shown success over the past year in securing new customers and sales. Contracts with major OFS customers currently accounts for ~40% of our NTM volume forecast. This success has been based on their high quality of reserves and direct rail loading capabilities from their plants that allow delivery of frac sand to nearly every shale play in N.A. EMES has a higher % in "coarseness" of their sand reserves than most competitors - in fact almost 2x that of its major MLP competitor according to mgt - which provides a cost-advantage and is ideal for liquids-directed drilling. This advantaged is partly offset by having to truck sand from their wet sand plant to their dry plant and loading facility. Mgmt has also negotiated a multi-year discount with Canadian National Railway Company

(which is uncommon) that should help them compete well in the NW Canadian and Marcellus/Utica markets.

We see near-term organic growth opportunities from almost 50% excess capacity at their recently built Barron plant and believe the partnership is well positioned to capitalize on the current shift by OFS to a “preferred supplier” market that will allow them to continue to win new business away from competitors based on their quality of sand and logistics attributes.

Valuation

Our target price of \$36.00 is based on our matrix valuation approach. We use three different valuation methodologies to reach our target price. We believe this approach captures the different valuation philosophies in the market today. Based on our valuation matrix, we get a valuation range from \$32 to \$43 with our highest valuation coming from our implied yield analysis and lowest through our discounted cash distribution analysis.

Our implied yield valuation analysis derives a valuation of \$43.42 and assumes the partnership will increase the distribution to \$3.91/unit annualized with units trading at a 9.0% yield. Our target yield takes into consideration the current yield environment, the limited nature of Emerge’s take-or-pay and efforts-based contracts, the variable nature of spot margin pricing in the sands segment, and the potential for additional growth through acquisitions and/or a take-out down the road.

Our EV/EBITDA analysis is based on a 2014 multiple of 9.0x which reflects our view towards near term-upside to cash flows given the current windfall margins sand producers are earning due to previous supply constraints and record oil & gas drilling. Our multiple-based approach derives a valuation of \$34.01/unit.

Our discounted cash distribution (DCD) valuation analysis uses our 5-year operational forecast that takes into account near-term growth opportunities, risk factors, and our view that frac sand gross margins will compress from ~\$34/ton today to ~\$16/ton in 2017. Our terminal yield and growth estimates take into account a more normalized yield environment and a slower pace of long-term industry growth. The long term yield we use to value EMES is 9.0%, which is anchored by our 2017 MLP index yield estimate of 7% (300 basis points above a 10-year treasury yield of 4%) plus 200 basis points. Based on terminal distribution growth of 0%, we derive an internal rate of return (IRR) of 9.2% and a DCD of \$31.70/unit.

Risks

Our Buy/High Risk rating on Emerge Energy Services LP is based on the consideration of key risk factors: 1) variable rate distribution policy, 2) high degree of uncertainty for future frac sand margins that could come under pressure if supply is over-built, and 3) a high level of customer and contract concentrations in the sands segment. On average, EMES generates ~70% of cash flows from frac sand, with the remaining 30% from Fuels processing and distribution. The core customers for the EMES’ WI facilities are major oilfield services companies engaged in hydraulic fracturing. Two customers, Schlumberger and Baker Hughes, together account for ~83% of the sand volumes produced by the New Auburn Plant, or ~40% of our total NTM volume forecast. In 2012, the top three customers accounted for 84% of revenues in the Sand segment. Risks to the MLP achieving our 12-month target price include the following: 1) a trend towards vertical integration of proppants by E&P and/or OFS customers, 2) a dramatically lower crude price environment where liquids-directed drilling decreases thereby impacting sales volumes and

margins on frac sand, and 3) a near-term over-build of frac sand capacity given the high prices of frac sand and high ROIC available to new entrants today. If the impact of these factors proves to be greater than we anticipate, the MLP may not reach our target price. Conversely, the units could materially outperform our target price if frac sand margins improve (or at least hold steady) and/or volumes on the partnership's processing plants exceed amounts we have forecast.

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

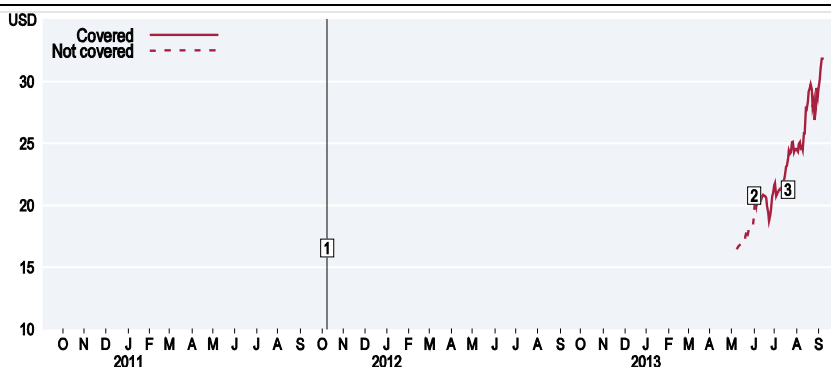
IMPORTANT DISCLOSURES

Emerge Energy Services LP (EMES)

Ratings and Target Price History

Fundamental Research

Analyst: John K Tysseland
Covered since June 3 2013



	Date	Rating	Target Price	Closing Price
1	8-Oct-11	Stock rating system changed		

* Indicates change

	Date	Rating	Target Price	Closing Price
2	3-Jun-13	*1H	*21.00	19.72

	Date	Rating	Target Price	Closing Price
3	19-Jul-13	1H	*26.50	23.76

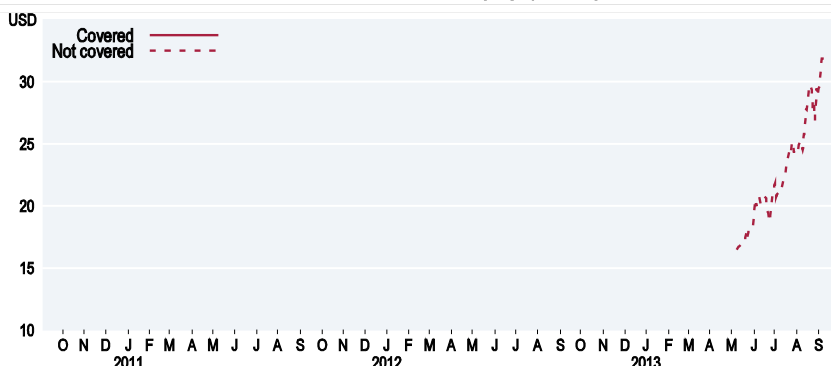
Rating/target price changes above reflect Eastern Standard Time

Emerge Energy Services LP (EMES)

Ratings and Target Price History

Best Ideas Research Relative Call (3 Month)

Analyst: John K Tysseland
Covered since June 3 2013



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Citigroup Global Markets Inc. or its affiliates has received compensation for investment banking services provided within the past 12 months from Emerge Energy Services LP.

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Citigroup Global Markets Inc. or an affiliate received compensation in the past 12 months from Emerge Energy Services LP.

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Citi Research Equity Ratings Distribution

Data current as of 30 Jun 2013

	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
Citi Research Global Fundamental Coverage	48%	40%	12%	6%	88%	6%
% of companies in each rating category that are investment banking clients	53%	50%	45%	58%	51%	49%

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