Canada's Next Great Energy Company

Description

The Canadian energy space spans a range of participants. Explorers, producers, pipeline operators and processors all fall under the industry's umbrella. Household names include Suncor, Imperial Oil, TransCanada Pipeline and Enbridge. There is another company that doesn't garner the same kind of "household name" prestige but is building a business that could one day place it into the upper tier of Canadian energy companies. The company is **Altagas** (TSX:ALA).

The current business

Altagas has been around since 1994 and falls more in-line with the business model offered by Enbridge and TransCanada than it does the explorers and producers of the Energy sector. Energy infrastructure is its game and the company is comprised of three distinct units: Gas, Power and Utilities.

Altagas' Gas related assets are part of the infrastructure that help the explorers and producers of Western Canada bring their product to market. The pipes and tanks that ALA owns act as a toll road for the natural gas and liquids that flow through them. This business is exposed to minimal commodity price risk because of the toll based nature of the model. The natural gas infrastructure division currently makes up about 46% of the company's EBITDA.

The Power business consists of 407MW of conventional and 148MW of renewable energy generation. This accounts for 17% of EBITDA.

3 Canadian utilities (Alberta/BC, Nova Scotia, Northwest Territories) and 2 newly added US utilities (Michigan and Alaska) make up the third portion of Altagas. The company delivers gas to 115,000 Canadian customers and 418,000 U.S. customers. This business generates about 37% of EBITDA.

Nice, but here's the good stuff

This reasonably diverse, yet stable, collection of assets has allowed Altagas to commit to a significant $2 billion capital program through to 2015 that is expected to result in EBITDA doubling.

The jewels of this capital spend are two run-of-river hydro projects that are currently under construction in NW British Colombia.

These projects were solidified during the depths of the financial crisis and were essentially part of an economic stimulus effort by the BC government.

The larger of the two, Forest Kerr, is expected to be complete by mid-2014. It will have 195MW of generation capacity and is costing about $725 million to build.

Where Forest Kerr gets really interesting is when we consider the 60 year (!) electricity purchase agreement (EPA) in place with BC Hydro. Not only is the EPA 60 years in length, but it's linked to CPI! $100 million in EBITDA is Forest Kerr's expected initial annual contribution to Altagas.

McLymont Creek is the other NW BC hydro project. Although smaller than Forest Kerr with capacity of just 66MW, it too carries the same 60 year, CPI linked EPA with BC Hydro. Assuming the financials are similar to Forest Kerr, McLymont could generate initial EBITDA of $33 million per year.

If you take $133 million and increase it at 2% per year for inflation, by the end of the 60 year period these two assets will be producing $428 million in EBITDA per year and will have generated more than $15 billion in EBITDA over their collective lifetimes. Altagas currently carries a market cap of just $3.7 billion. This is highly simplified, but regardless of how you spin the numbers, these contracts are very friendly for long-term investors.

Recent activity

Aside from the hydro projects, Altagas just announced that is has purchased Blythe Energy, the owner of a 507MW natural gas-fired power plant and 67 mile electric transmission line in Southern California. The company is paying $515 million for these assets which almost double current generating capacity.

The Blythe asset is contracted under a Power Purchase Agreement through to July 2020 and is expected to add $50 million in incremental EBITDA per year. The seller of the Blythe Energy Centre is a private equity group known as LS Power. They acquired the plant in 2011 from NextEra Energy.

Altagas has also entered into a JV with a Japanese entity by the name of Idemitsu Kosan, the country's second largest oil concern. These two will pursue energy (LNG and LPG) export opportunities from the BC coast. Given Japan's status as the world's largest importer of LNG and BC's abundant natural gas, this relationship seemingly has legs.

Considerations

At 23.9 times next year's expected earnings (according to Capital IQ), Altagas trades in-line with peer valuations. Though not absolutely cheap, the long-term cash generating capabilities offered by the company's collection of assets help justify the current valuation.

Debt is one area of potential concern as leverage has been added in recent years to partially fuel this growth. Again, the cash flows offered by the assets, and evenly spaced debt maturity profile, help to get past this item.

The Foolish Bottom Line

Whether it's sports or stocks, picking the "next one" is rarely an obvious choice. However, the moves that Altagas has made, and continues to make, give it the chance to move into the upper echelon of Canadian, even North American, energy concerns. To be sure, this is a name to have your eye on.

While Altagas is doing a great job accumulating a diverse portfolio of energy related assets, we think there is one source of energy that the market is currently overlooking. Click here and we'll send you our special free report that describes the impressive future prospects for this currently neglected fuel source and outlines two ways that you can hop on for the ride.

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Fool contributor Iain Butler does not own shares in any of the companies mentioned in this report at this time. The Motley Fool has no positions in the stocks mentioned above.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:ALA (AltaGas Ltd.)

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