Why I’m Staying Far Away From Just Energy Group Inc.

Description

Normally, when I’m investing I pay little attention to the public perception of a company.

Take a look at Canada’s telecom sector as an example. If you took a survey of 10 of your friends, I’d bet at least half of them wouldn’t have nice things to say about their wireless, Internet, or cable carrier. They either charge too much, have spotty service, or don’t have the equipment they’re looking for. Companies like **BCE** and **Rogers Communications** consistently rank high when Canadians rank the companies they hate most.

And yet, these companies continue to deliver good results for shareholders. Why? The reason is simple. They each have a moat large enough that customers can’t help but to use their services. If a customer leaves BCE, they’re pretty much forced to use Rogers.

This becomes an issue when a company acts like there’s very little competition in a market that’s saturated. This is exactly what **Just Energy Group Inc.** (TSX:JE)(NYSE:JE) does, and it’s why I’m content staying on the sidelines and avoiding the stock.

The skinny

At some point or another, you’ve probably seen Just Energy sales reps in your neighborhood. Employees get sent door-to-door, offering customers either a fixed-rate or floating-rate plan on their power or gas bill, depending on the jurisdiction. Reps mostly sell one benefit to customers—the ability to save money each month compared with their current utility provider.

The issue with the company’s tactics is when customers get to the fine print and find out the original offer wasn’t nearly as sweet as the sales rep made it out to be. There are thousands of complaints on the Internet from frustrated customers saying just that. Sometimes reps even go as far as flat out lying about pretty basic stuff, like how much each unit of power would cost or the amount a customer would get charged to rent a hot water tank, furnace, or air conditioner.

The reason why reps act like this is simple. They’re compensated entirely by commission while doing door-to-door sales. That’s a pretty crummy way to make a living. So they lie, knowing that when the customer starts to complain, they'll be long gone.

It's easy for the company to blame these problems on a few bad apples. But by putting things like paying employees entirely on commission and imposing monthly quotas in the company's business model, management is all but encouraging its reps to act this way.

But does it make money?

It's not all bad for Just Energy.

At least from a free cash flow perspective, Just Energy is profitable. Over the last year it has generated $154 million in free cash, putting shares at just 7.5 times free cash flow. That's a cheap metric. It also pays a very attractive 6.4% dividend. And thus far in 2015, shares are up nearly 30%.

Still, it's obvious the market has no confidence in these results. The company cut its dividend twice in just over a year starting in 2013, slashing what was formerly a $0.102 per share monthly dividend more than 50% to $0.125 per quarter.

Free cash flow has been inconsistent as well. Over the last three years, it has posted negative free cash flow one year, while posting positive results for the other two years of $83 million and $122 million. Average the three years out, and the company has delivered free cash flow of $62 million per year. On a stock with a $1.15 billion market cap, that's not very attractive.

Stocks with inconsistent results and a flawed business model are not the kinds of businesses I want to own for the long term. For those reasons, I'm avoiding Just Energy.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

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