Veresen Inc. Investors Are Gambling on its 9.4% Dividend

Description

Since its founding, **Veresen Inc.** (TSX:VSN) has operated like many other midstream players. It owns and operates 6,000 kilometres of regulated transmission pipelines as well as 1,300 kilometres of other transportation assets for natural gas liquids. It also has various commodity processing plants along with 13 power plants operating under contracts that average another 17 years. These assets typically produce reliable streams of income.

With one move, however, Veresen is putting that all in jeopardy.

A new type of business

Typically, many midstream companies secure contracted volumes before building begins. This gives them cash flow visibility and calculable returns as long as the construction comes in on budget. However, Veresen's $7 billion Jordan Cove terminal, a natural gas project, is being built with the anticipation of demand rather than secured bids.

The biggest allure of the project is that it can connect isolated gas production sites to Asian markets. A **Moody's Corporation** report on North American LNG projects praised the Jordan Cove project, saying that it is "differentiated from its Canadian neighbors [as it provides] the proposed gas-linked contracts that Asian offtakers are seeking." Only time will tell if buyers appear.

"I have got a $5 billion market cap and I am looking at a $7 billion capital project," the company's CEO said in an interview with the *Financial Post*. Today, that market cap is down to just $3.1 billion. "I am going to spend a lot of money to get this project and its high-risk dollars."

Other growth initiatives are still dependent on Jordan Cove

The Jordan Cove project, though the biggest, isn't the only growth project that Veresen has. In November of last year, it completed a $1.4 billion acquisition of the Ruby Pipeline. This pipeline provides direct access to the U.S. West Coast through the proposed Pacific Connector Gas Pipeline, which would supply the proposed Jordan Cove LNG terminal.

The company believes that this "should provide stable, long-term contracted cash flows with significant expected growth." Still, it is heavily reliant on demand for the Jordan Cove terminal.

Don't buy shares for the income

If you are buying shares because you are attracted to its high 9.4% yield, chances are you will be disappointed. It appears as if Veresen is completely dependent on the success of a single project, which is not something income investors are typically excited about. Even if the Jordan Cove project is a long-term success, there is no reason to believe that the first few years of operation will be smooth sailing. With no secured buyers yet, Veresen may have to slowly build up demand.

If the project is a success, however, the stock would clearly have room to double or more. By 2019, Veresen management anticipates being able to spend 95% less in capital expenditures. This would equate to massive free cash flow.

If you're comfortable with taking on capital appreciation risk, Veresen is still a viable option with plenty of upside. If you're looking for a reliable source of high-yield income, however, an investment just wouldn't make sense until the success of the Jordan Cove project is better assured.

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