Altagas Ltd.: This Dividend-Growth Machine Is a Screaming Buy

Description

As the old adage goes, investors want to buy low and sell high.

It seems simple, but real life has a way of throwing a wrench into these plans. Stocks don't fall willy-nilly; they head lower because of very obvious things wrong with them. Even if there's nothing glaring, human nature dictates that investors will find a reason.

Altagas Ltd. (TSX:ALA) is one such stock, falling some 40% off highs set back in 2014. Shares of the Alberta-based utility peaked at just under $53 per share. These days, shares are barely above $30 per share, lows not seen since 2012.

Part of the reason why shares have fallen so much is the company's exposure to Alberta, of course. But even after an improvement in the price of crude oil, which helped out most other stocks with oversized exposure to the province, Altagas has been a notable exception. Shares have lagged behind the TSX Composite thus far this year.

But over the long term, I'm convinced Altagas is a decent value. Here's why investors who get in today are poised for nice returns over the next three to five years.

Good growth potential

Although the company's name would indicate otherwise, Altagas is a diverse utility with operations across North America. Approximately 20% of earnings come from the company's midstream division, which consists of natural gas pipelines.

Next up is the company's power business, which generates approximately 40% of its earnings. Most power generation capacity is located in Alberta, but the company also owns power plants in British Columbia, California, Colorado, Ontario, and North Carolina. Most power assets are natural gas fired, and production from these plants is immediately sold to local providers through power purchase agreements.

Finally, we have the company's natural gas utility business. This business serves nearly 600,000 customers throughout North America, primarily in Alberta, but also in British Columbia, Alaska, Ontario, and Nova Scotia. The utilities part of the company is responsible for approximately 40% of earnings.

All three divisions have nice growth potential. In total, the company plans to spend between $2.5 and $3 billion between now and 2020 building additional natural gas shipping infrastructure, new power plants, and upgrading its pipelines. These projects should add between $200 and $300 million to the company's EBITDA annually when completed.

Of particular interest to investors should be the $1.5 billion Altagas plans to spend on the shipping of natural gas. Canada is uniquely positioned to ship liquefied natural gas to places like Japan or Korea. Demand in these countries is expected to slowly increase over time, and that's good news for Altagas.

Priced well

Upon first glance, Altagas doesn't seem very cheap at all. The company has negative earnings over the last 12 months and posted negative free cash flow in 2015.

Both of those numbers don't tell the whole story. Spending on growth projects skews free cash flow numbers, and huge depreciation expenses hit earnings hard. The company uses funds from operations as a more accurate form of profitability.

In 2015 the company posted normalized funds from operations of $470 million, good enough for $3.41 per share. That was down a bit compared to the $3.71 per share in funds from operations generated in 2014, but that still means investors are only paying nine times funds from operations for shares today. That's a good price for a company with the quality of Altagas.

Great dividend

Altagas investors are getting paid quite well to wait for the company's valuation to go back up to normal levels. In 2011 the company paid $1.33 per share in annual dividends. In 2016 assuming no additional increases in the dividend, Altagas will pay out $1.98 per share.

It isn't very often investors get that kind of dividend growth from a company that currently pays a 6.4% yield.

Investors don't have to worry about a dividend cut either. The dividend payout was just 55% of funds from operations in 2015, and management is projecting that number to stay about the same for 2016.

Altagas is a cheap utility being unfairly punished for exposure to Alberta. Investors who get in now will benefit from the company's growth plan and additional demand from exporting natural gas to Asia, and they get paid a very attractive dividend to wait. Investing in Altagas at this point looks like a pretty easy move.

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1. TSX:ALA (AltaGas Ltd.)

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