



Income Investors: This Growing Defensive Play Is Down 22% and Yields 15%.  
Time to buy?

## Description

Despite reporting a 33% increase in quarterly revenue for Q3 2018, **Crius Energy Trust's** (TSX:KWH.UN) units got clobbered heavily on November 15 to trade 22% lower by November 19, resulting in the promising defensive investment's distribution yield hitting a staggering 15.55% on an annualized basis.

Could this be the best time to lock in these lucrative distributions?

## A troubled business

Crius Energy is a competitive provider of electricity and natural gas products to residential and commercial customers in 19 states and the District of Columbia in the United States with a client portfolio comprising over 1,350,000 customers by September this year.

The trust is facing turbulent times as a result of regulatory changes as well as a business restructuring process underway, as the company divests from a loss-making solar energy business during the year, while also undertaking cost-saving measures with the integration of a third-quarter 2017 acquisition of USG&E.

The trust witnessed a massive drop in gross margins last quarter, with the gross margin falling from 20.4% during a comparable quarter last year down to 14.72% for the third quarter of this year. Net income margin also declined to 2.14% of revenue last quarter from 9.26% last year. Even worse, operating cash flow generation was a negative US\$3.8 million for the quarter.

## Why the massive drop in margins?

The trust's municipal aggregation portfolio, which Crius intends to divest from, saw massive increases in wholesale cost factors due to regulatory changes, namely the Regional Transmission Expansion Plan and Renewable Portfolio Standards costs, which the company is not yet able to fully pass through

to customers due to contract structuring issues.

Lower contributions from the solar businesses also resulted in reduced gross earnings, while operating losses from the same business line and other non-recurring charges negatively impacted operating profitability.

## Distributions at risk?

The trust pays a \$0.0697 monthly distribution per unit that yields an unbelievable 15.55% at today's beaten-down unit price, which is a deep into unsustainable territory, but investors who hop into the units today could lock in a very lucrative yield should the distribution be maintained.

The distributable cash payout ratio hovers at 147% over the past trailing 12 months and has remained substantially above 200% over the past three consecutive quarters. In comparison, the payout ratio for year 2017 was 63.8%.

The payout ratio has remained elevated due to losses from the solar business and some non-recurring costs, but on a normalized basis, the ratio falls to just 86.7% for the past 12 months, which seems manageable if the company successfully meets its target US\$100 million annual adjusted EBITDA run rate by end of next year.

The company recently initiated a distribution-reinvestment program (DRIP) in October that will initially buy units on the open market for settlement, but the program may be a new window to conserve cash in the long run, as DRIP units will get paid from treasury in the future.

Crius has a very short dividend history, with distributions which were increased on average by 2% every quarter in 2016 and 2017 with just one increase in January 2018 by 1.9%.

I do not expect a distribution increase any time soon; rather, the risk of a distribution cut has never been greater.

## Is there stability in sight?

Crius is facing a significant net-negative customer churn that is expected to last throughout 2019. The trust is replacing the low-margin large commercial and municipal aggregations with higher value customers in the portfolio. By end of next year, Crius will have a smaller but higher-margin and better-quality customer portfolio.

The big question is whether this new portfolio will produce revenue and cash flow high enough to meet the current distribution level, which seems possible, but current investor sentiment has punished the units' valuation as the market prices in the risk of a shrinking business.

Stability may be found at a lower revenue and cash generation run rate.

## Investor takeaway

The elevated risk on Crius Energy Trust may not be welcome in a retirement income portfolio, where [relatively stable dividend stocks](#) are preferred. The high yield is so inviting, but there is no clear visibility to the distribution being maintained in the long run.

The units may suffer a distribution cut and this could severely hurt their market price, and investors may have to absorb both a reduced monthly income and take a hit on deployed capital. A contrarian buy could work out, but beware the capital risk.

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