Contrarian Investors: This 2018 Dud Could Be a Massive Winner in 2019

Description

2018 was not a good year for **AltaGas** (TSX:ALA).

The demise all started in January 2017, when the company announced it would acquire Washington-based WGL Holdings, a natural gas distributor that serves approximately one million homes in Maryland, Virginia, and America's capital. WGL also has a growing midstream pipeline business, and various power-generation assets spread out across the continental United States.

Analysts almost all agreed the $8.4 billion price tag — which included nearly $3 billion worth of assumed debt — was too much. AltaGas execs disagreed, telling investors the deal would add approximately 10% in earnings immediately and continue that growth until at least 2021. This would also support higher dividends.

Although shares were weak after the acquisition was announced, AltaGas's stock settled into a trading range a little less than $30/share. Then it announced the sale of certain non-core assets to help pay for the deal. Interesting pieces of the business like a gas-fired power plant in California and a stake in **Tidewater Midstream** were sold. In total, these transactions raised $560 million.

As time went on, it became more and more obvious the WGL transaction wouldn't be as lucrative as initially promised. Shares first slid to the $25 range and then fell to below $20. They declined even further as the rest of the market fell, and investors realized a dividend cut was inevitable. Shares were paying a 15% annualized dividend for a short time before management finally bit the bullet and slashed the payout 56%.

The dividend cut announcement caused a brief rally, but that was short-lived. Shares have continued their march downwards, falling to $13.32 as I write this, their lowest level since 2003. Investors are still worried about the large debt load taken on with the WGL acquisition; the total debt on the balance sheet now surpasses $10 billion.

AltaGas shareholders are going to be happy when 2018 concludes. Barring a big rally between now and the end of the year, the stock will lose more than 50%.

2019 rally?

While the market focused entirely on AltaGas's struggles, something interesting happened. Shares fell so much that they've become very attractive to value investors.

In the first nine months of 2018, AltaGas generated $1.98 per share in funds from operations (FFO), which puts it on pace to earn $2.64 per share in FFO for the entire year. That puts shares at just five times that metric, which is incredibly cheap. Most other utility companies trade for approximately 10-15 times FFO.

2019 is projected to be even better. FFO should fall between $850 and $950 million, or between $3.16 and $3.53 per share. The dividend will come in at $0.96 per share, giving the stock a payout ratio in the 30% range. You won't find many stocks in the sector with a payout ratio that low, especially ones that have a 7.2% dividend yield.

Slashing the dividend isn't the only way management plans to cut debt. It plans to sell a portion of its Canadian assets to investors while holding the rest. These are the crown jewels, so to speak. This move alone is expected to raise approximately $1 billion. Cutting the dividend will also help management cut debt by more than $1 billion between 2019 and 2023.

Finally, the company's much-anticipated Ridley Island Propane Export Terminal will come online in 2019, along with other midstream assets. This will add to the bottom line.

And, perhaps most importantly, selling pressure should subside shortly after dividend investors finish dumping their shares and value investors swoop in.

The bottom line

AltaGas and its shareholders would like to forget 2018. It was probably the worst year in company history. But as a new year approaches, investors taking a fresh look at the stock see a company trading comfortably under book value and at a low price-to-FFO ratio. It pays a 7.2% dividend too — a payout that will easily be covered going forward.

In a struggling market filled with cheap stocks, AltaGas is one of the cheapest. Value investors should take notice.

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