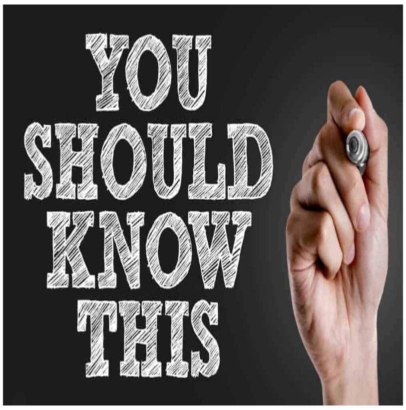

Gibson Energy Inc. (TSX:GEI) Has a Steady 7.2% Dividend With a Very Low Risk Business

Description

It's been a difficult year investing in energy stocks. Nearly all Canadian producers have seen their shares sink. Some, like **Encana Corp**, have seen shares fall by more than 50%. But it's not all bad news.

Over the past year, the stock of **Gibson Energy Inc.** (TSX:GEI) is up by a few percent. When you add in its 7.2% dividend, investors have experienced double-digit gains in 2018. With oil prices stuck around $50 per barrel, that's an impressive return.

How has Gibson outperformed nearly every peer this year? It's simple: they've dramatically reduced their exposure to commodity prices, focusing instead on providing critical services like refining, distribution, terminals, and pipelines. Their business model is crucial to the oil and gas industries regardless of what commodity prices do.

Transitioning to a low-risk business model

As a midstream player, Gibson Energy has been in an enviable position. It has a diversified asset base with heavy exposure to both Canadian and U.S. production. So weakness in one region—such as what we saw with oil prices in Alberta this fall—can be offset by more attractive economics elsewhere.

Over the next decade, Gibson anticipates growing cash flows by around 10% per year. While this may not seem like a huge reward for investors, the risk profile of the business appears fairly low, so the tradeoff is more than compensated for.

For example, by the end of 2019, 85% of cash flows will come from its infrastructure businesses. Nearly 90% of those cash flows come from investment-grade companies with decade-long contracts. So unless these customers decide to stop producing oil, Gibson likely has at least 10 years of reliable cash flows ahead of it, more than enough to service its 7.2% dividend.

But the company hasn't always had this low of a risk profile. In 2014, only 35% of cash flows came from the company's stable infrastructure segment. As stated earlier, that should rise to 85% of cash flows in 2019. Next year, 100% of all capital spending is dedicated to growing its infrastructure businesses, so stable cash flows should continue to rise.

Now is the time to take advantage

While it may take a few quarters, or even a few years, for the market to catch up to Gibson's new and improved business model, savvy investors can take advantage today by scooping up shares at a discount. Since November, Gibson stock is down around 15% due to pressures across the rest of the energy sector, even though Gibson's cash flows will hardly be impacted.

As long as oil companies keep producing oil, Gibson's assets will remain in demand. In 2019, the company anticipates a payout ratio of around 80%. Long-term, however, the payout ratio is targeted to be between 70% and 80%, suggesting Gibson's management believes cash flows should grow over time.

While it's unlikely Gibson energy will double or triple over the next five years, the stock has an extremely favourable risk to reward ratio. With a well-covered 7.2% dividend plus a transformed business model in which nearly all of its cash flows are stable and cemented into decade-long contracts, investors should be able to count on Gibson stock for attractive returns for many years to come.

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Date
2025/06/28
Date Created
2018/12/26
Author
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