Buy Alert: Why I'm Loading Up on Altagas (TSX:ALA) Shares Today

Description

Many dividend investors react viciously when one of their underlying holdings slashes the payout, choosing immediately to sell. A dividend cut simply isn't tolerated.

I prefer to do something different, however. I take a look at the underlying fundamentals and see just how healthy the company truly is. And my analysis quite often reveals that the dividend cut represents a bottom. Management is hesitant to slash the payout, and will only do so if it really helps improve the company.

This is of little consolation to those who already own the stock, but it's great news for value investors sniffing around for interesting bargains.

This exact scenario is playing out today with **Altagas Ltd.** (TSX:ALA) shares. I believe that Altagas, like dozens of stocks in similar situations before it, is poised to rebound nicely over the next few months, which should provide me with a good short-term return.

But the story doesn't end there. Here's why I think Altagas is a good long-term buy, too.

Valuation

I can't get over how cheap Altagas shares are. I've triple-checked the numbers just to make sure.

Management provided investors with a preview of 2019 back in December, the same day the dividend cut was announced. In hindsight, this may have been a poor move on management's part. Everyone focused on the bad news while ignoring expectations of a fairly solid year.

The company expects to earn between $850 and $950 million in funds from operations, which includes the lost earnings from assets that are currently on the auction block. To put this into perspective, Altagas has a current market cap of just $3.7 billion. This puts shares at just 4.3 times funds from operations.

That's insanely cheap.

Let's compare Altagas to another similar company, investor favourite **Algonquin Power and Utilities**. Algonquin should generate approximately $750 million in funds from operations in 2018 once the results are tabulated. It has a market cap of $6.8 billion, which gives it a price-to-funds from operations ratio of just over nine times.

In other words, Algonquin is more than twice as expensive as Altagas, which is a big difference.

Altagas isn't just cheap on an earning perspective, either. Shares trade at just 0.7 times book value. It's pretty rare to see a utility trade at a big discount to book value.

Naysayers argue that the reason why shares are below book value is that the company overpaid for WGL Holdings, the acquisition that started most of Altagas's current problems. But remember, approximately half the company still consists of Altagas's legacy assets. These assets should be worth a big premium to book value, as they've been written down over time.

A quick look at the balance sheet confirms it. At the end of 2016, Altagas has a book value of just over $21 per share, while the stock was comfortably over $30. I'd expect price-to-book value ratio to normalize at 1.5 times over the next few years.

Still paid to wait

Instead of focusing on the dividend cut — a move that will free up more than $1 billion in cash to put toward debt over the next few years — investors should look at the current payout, which is both generous and sustainable.

The current dividend is $0.08 per share each month, or $0.96 annually. This represents a 7% yield today, a solid payout.

Altagas has approximately 260 million outstanding shares. This means it'll pay out some $250 million in dividends this year, excluding the impact of its dividend reinvestment program. Remember, the company expects to do between $850 and $950 million in funds from operations in 2019, which gives shares a payout ratio of approximately 30%.

Simply put, you won't find many stocks with a 7% dividend that also have such a low payout ratio. Except for Altagas, you might not find any. That payout might be the most secure 7%+ dividend on the entire TSX.

The bottom line

Altagas has everything I look for in an investment. It has great assets, a sticky customer base, a solid dividend, and trades at a very reasonable valuation. Management still has to execute and solve some of the problems created by the WGL deal, but I'm confident they can deliver.

I urge other value-oriented investors to buy shares today, before this opportunity goes away. I am.

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