AltaGas Research

Description: A diversified energy infrastructure company in North America. It operates through three segments: Gas, Power, and Utilities.

Ticker: ALA.CA

Price: $14.21

Market Cap: C$3.9B

Performance: -47.0% Y/Y

Right off the bat we noticed AltaGas is a company that has been caught in a downtrend for years. Below is a picture of the 5 year chart.

The stock is down 47% Y/Y and down roughly 52% over the last 5 years. So this begs the question… what is ALA doing or plan on doing to turn things around for the business? We'll get into that shortly but first lets examine what Nat Gas has been doing in the meantime.

Below is the 5 year chart for ALA alongside Natural Gas' 5 year chart… virtually identical… or at least it seems until recently.

Nat Gas is down approximately 30% over the last 5 years but when we dive into the last year we begin to see some serious divergence between the price of Nat Gas and ALA.

Below is the 1YR chart:

Take a look at the last few months, specifically. Nat Gas spiked nearly 70% on the year while ALA was making new lows, down 40%. Why? We found three reasons. It all started on September 11th, when ALA announced plans to spin off its Canadian rate-regulated natural gas distribution utility assets and Canadian contracted wind power while retaining a significant minority equity interest in the business. ALA planned to hold 37%-45% of the new company, to be called AltaGas Canada, and analysts didn't believe the IPO was going to garner a $1B valuation like ALA expected. For example, Raymond James analyst Chris Cox estimated the IPO would raise $600M-$725M and this is a big deal for two reasons. One, investors were hoping the IPO would raise as much money as possible so ALA can help pay down their debts. Second, it helps investors better quantify the value of the business and from the looks of it the sum was greater than the parts in the investors' viewpoint. Fast forward to October 25th, and the IPO did happen and just like Cox called, ALA only brought in $635M in net proceeds from the offering at a 45% stake (the upperbound). If you look at the chart above, that was the beginning of the big slide.

Moving forward a few days and the next press release was ALA's Q3 earnings report that was announced on October 30th. The company reported:

- Normalized funds from operations were $117 million ($0.45 per share) compared to $143 million ($0.83 per share) in Q3 2017
- Net loss applicable to common shares was $726 million ($2.78 per share) compared to net income of $18 million ($0.10 per share) in Q3 2017
- Normalized net loss was $17 million ($0.07 per share) compared to normalized net income of $48 million ($0.28 per share) in Q3 2017
- AltaGas' Gas segment recorded normalized EBITDA of $65 million, an increase of 27 percent over the same period last year
- AltaGas' Power segment achieved normalized EBITDA of $128 million, an increase of $22 million as compared to the third quarter of 2017, primarily a result of the addition of WGL, partially offset by lower generation at the Northwest Hydro Facilities due to unseasonably cool, dry weather and the expiry of the Ripon PPA on May 30, 2018.
- The Utilities segment achieved normalized EBITDA of $32 million in the third quarter of 2018, a decrease of approximately $6 million compared to the same period in 2017. The decrease was mainly due to the impact of the WGL Acquisition for the period after transaction close, and the 2018 revenue impact related to the federal tax reduction at the U.S. Utilities, partially offset by higher rates and colder weather in Alberta.

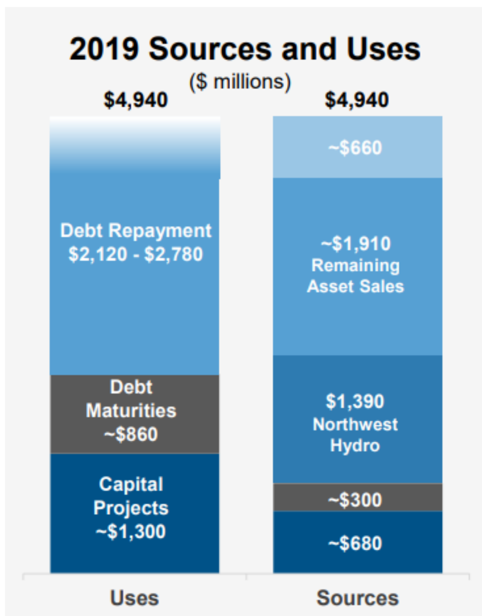
Overall, the quarter wasn't anything to write home about and surely wasn't enough to move the needle in the opposite direction.

Moving forward some more and this is where it gets a bit ugly. On December 13th, ALA announced they were cutting their dividend by 56% to $0.96 per share. In an effort to add more cash to their vaults, the company also agreed to sell its remaining 55% interest in the Northwest Hydro Facilities in British Columbia for C$1.39B (AltaGas sold a 35% stake in the operation to the same JV earlier this year). Furthermore, AltaGas also plans on partaking in an additional $1.5B-$2B in asset sales this year as part of a plan to regain financial strength and flexibility to fund future growth opportunities with a focus on its midstream and U.S. utilities business.

It is no secret that ALA is in full-blown transition mode. From asset sales, to cutting dividends, to spinoffs to raise money, refinancing loans, etc. they are doing everything they can to survive. Our concerns are the following:

1. Nat Gas exploded 70% and ALA dropped. What happens if Nat Gas tumbles on things like overproduction or slowing demand?
2. Net debt was $10.4 billion as at September 30, 2018, compared to $3.6 billion at December 31, 2017. This is mainly due to their acquisition of WGL.
3. Net debt-to-total capitalization ratio was 60 percent as at September 30, 2018, compared to 44 percent as at December 31, 2017

For 2019, this is how the company views how it will pay their debts and capex (most of the money coming from asset sales). How about 2020 and beyond?



As far as the natural gas landscape goes, firms and governments have been promoting the use of natural gas more due to the perception that its production is more environmentally friendly than other fossil fuels such as coal and oil. We aren't done yet, but right now what we have been looking at is transporters of the commodity with companies like Enbridge (ENB) but we are still doing some research. Our premise is that regardless of the price of the commodity these transporters will have business as long as there is demand and from the looks of it countries like China and Australia are anticipating that as they have begun exporting a ton. In fact, reports are surfacing that Australia is likely to overtake Qatar as the biggest gas exporter, before the US assumes the mantle in the mid-2020's.

Similar to how we are swinging Transocean (RIG), we'd do the same here. To us, the company is far too risky to invest in and we believe there are better risk/reward scenarios in other industries and sectors. Overall, we think its better to just capitalize on the volatility until it becomes more clear the company is in a better financial condition.