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Under the Boardwalk

The share price of Boardwalk Pipeline Partners LP (BWP on the New York Stock Exchange) was sawed in half on Feb. 10. A mortification it was, as Boardwalk was a pick to click in the issue of *Grant's* dated May 4, 2012. Compounding the hurt has been the reciprocal prosperity of Westshore Terminals Investment Corp. (WTE in Toronto), a pick *not* to click in the identical issue of *Grant's*—indeed, in the very same essay in which Boardwalk was featured. An analytical reassessment follows.

Boardwalk, you will recall, is the owner of a pipeline network through which traverses upwards of 12% of American natural gas production. The company's 14,450-mile network gathers and transports gas from the Gulf Coast into Kentucky and Ohio. When we wrote almost two years ago, the shares paid a 7.7% dividend yield. Now they yield 3.2%. To blame is the constructive havoc wrought by the immense new production in the Marcellus and Utica shale fields. This huge disruption we failed to reckon with.

What confers value on pipeline assets is the arbitragable differences in the price of gas between one region and another. Booming shale production, by shrinking those differences, has depressed long-haul transportation rates. On the Feb. 10 earnings call, Boardwalk projected that distributable cash flow—i.e., EBITDA less maintenance capital spending and interest expense—would fall to $400 million this year, down by $158.6 million in 2013. "Over the long run," said Boardwalk CEO Stanley C. Horton, "this strategy will maximize the value of our company and returns to our unit holders."

Ah, the "long run": It seems the income-seeking Boardwalk shareholder base had had the short run in mind all along. Anyway, the stock price of BWP plunged by 46%, to $13.01 per share, in a single day. The stock was owned by "index-huggers," relates an analyst we know, "and the moment you cut your distribution you are wiped out of all those indexes. So all the sharp-penciled index guys let the stock rip. They won't buy it or own it."

To hear Boardwalk tell it, the share price and the business are separate and distinct. Taking the long view, management is building a new pipeline—the Bluegrass—to transport gas from the Marcellus and Utica shale plays to industrial customers in Louisiana. Loews Corp., owner of 55% of Boardwalk, has pledged $300 million in subordinated debt for the project, a start but no more. Having to choose between taking an ax to the dividend or issuing more stock, management unsheathed the ax. It chopped the quarterly per-share dividend rate to 10 cents from 53.25 cents.

Possibly, the bad news is out. Perhaps the shale boom will usher in a new age of pipeline economics in which Marcellus gas moves south, in addition to Louisiana gas traveling north. In any case, Boardwalk's concentration of pipeline assets along the Gulf Coast is already serving it well. Factories are springing up along the company's existing route to profit by the very shale revolution that has crushed the Boardwalk dividend. In the fullness of time, the new factories are expected to furnish demand enough to boost the earning power of Boardwalk's assets.

With respect to the dividend, the bad news is almost certainly out—distributable cash flow covers the new, reduced payout by a factor of four. But the 3.2% yield wows no income-seekers, while the P/E of 15 (and a multiple of enterprise value to EBITDA of 9.9 times) attracts few value-seekers. If a cheap, long-dated call on Boardwalk existed, it might be just the thing, but none exists, cheap or otherwise. BWP, we therefore judge, is only semi-cheap and semi-interesting even at the current half-off price. It's a situation to be filed under the dual heading of "opportunities, distant, c. 2016," and "errors of judgment, big time, our own."

If Boardwalk is slumped near a cyclical low, Westshore (WTE in Toronto) may stand near a cyclical high. We underscore "may." Westshore, you'll recall, operates the largest coal-loading port on the west coast of the Americas at a manmade harbor at Roberts Bank, British Columbia. Most of the coal goes to China; in the third quarter of 2013, metallurgical coal, the type used in steel production, made up 62% of the Westshore tonnage.

Volumes shipped, rates obtained and cash flow earned have all been on the upswing. When we wrote, a share of WTE yielded 4.9%. It delivers just 3.6% today, as a surging share price—up by half—has outlegged even the rising distributions. We tip our hat to the bulls.

The source of this prosperity is the People's Republic of China. Regard-

ing the PRC as an economic accident waiting to happen, we wanted no part of Westshore in 2012. Nor do we today. To us, in 2012, China seemed overstuffed with debt. It seems more so now. Redundant steelmaking capacity and a record 102.7 million-ton stockpile of iron ore are among the more visible signs of distortion in the Chinese economy.

That mountain of iron ore may be stationary, but it isn't idle. According to Shanghai-based Mysteel Research, a lot of it—perhaps 40%—does duty as lenders' collateral. On Feb. 20, Bloomberg had this to say on the subject: "China's record imports of iron ore and copper, driven by traders who use them as loan collateral, risk repeating the vicious cycle of repayment difficulties and falling prices already seen in the steelmaking market. . . . Lenders seeking repayment are finding irregularities, including the same pile of materials used as collateral for multiple borrowings, China International Capital Corp. said. Money-market costs have surged, with the benchmark three-month Shanghai Interbank Borrowing rate jumping to 5.6% [on Feb. 19] from 3.89% in June 2013."

The price of metallurgical coal, as measured from the east coast of Australia FOB, has declined by 19%, to $111.20 per ton, since September. It's the lowest price since 2009. That decline notwithstanding, China's metallurgical coal imports dropped by 20.3% year-over-year, to 5.7 million tons, in January. Chinese steelmakers, the Nikkei Report noted last week, "are increasingly turning to cheaper, domestically produced coking coal."

You have to hand it to Westshore. For all the evident distress in China, the company is trying to increase, not decrease, its 2014 handling fees. In the third quarter of 2013, the rate was C$9.52 per ton, up from C$9.33 and C$7.35 in the third quarters of 2012 and 2011, respectively. In a Dec. 17 press release, the company announced it would ship 32 to 33 tons of coal in 2014, up from 30 tons in 2013, "at rates higher than 2013 as a whole." Good luck with that.

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