

customers lost to attrition – the breaking of a contract due to an unexpected move or foreclosure – are included.

What else is missing? Just Energy pays commissions to brokers who sign up commercial customers. The company capitalizes the commission as an asset – “contract initiation costs” – and amortizes them over the multiyear life of the contracts. Amortized, as in the “amortization” that never appears in any kind of EBITDA. (The **Veritas** analysts note companies in other industries, even ones with significant customer churn, expense commission costs as incurred.)

What difference does this all make? Quite a bit. The **Veritas** analysts tracked the trailing 12 months EBITDA as adjusted by Just Energy, versus what they call “sustainable EBITDA” that includes the marketing costs and broker commissions.

Over the last six quarters, Just Energy’s trailing adjusted EBITDA has hovered between \$274-million and \$290-million. **Veritas’s** 12-month trailing sustainable EBITDA has dropped from \$214-million in the September quarter of 2011 to \$138-million at the end of 2012.

Veritas goes further, factoring in Just Energy’s interest payments to arrive at “sustainable cash flow” – which has dropped from \$150-million to \$75-million over the same period.

Unsurprisingly, Just Energy’s dividend payout ratio is very different, depending on what metric you put in the denominator. Compared to adjusted EBITDA – the first and most prominent of several ratios the company presents – the payout rate was 81 per cent in the three most recent quarters, up slightly from 75 per cent in the prior fiscal year.

Compared to **Veritas’s** calculation of sustainable cash flow, however, it’s 235 per cent for the most recent four quarters.

(The **Veritas** analysts say their estimate imply an 80 per cent payout should be 35 cents a share, or 60 per cent lower than the new 84-cent dividend.)

Veritas first issued one of its Accounting Alerts and warned about the sustainability of the dividend in October, 2010, when the shares were above \$15; Accountability Research Corp., another accounting-oriented firm, joined in last July when the shares were nearly \$12, suggesting they were worth \$6, instead. They are just below \$8 today.

Owen Mitchell, whose title at Just Energy is senior adviser, capital markets, says this analysis misses the point. Just Energy is a fast-growing company in the growing segment of deregulated energy, he says, adding a million customers a year.

It signs up a customer for five years, then locks in its supply prices for the same term, creating what it calls “embedded margin” – a total dollar value of profits over the lives of its contracts, including estimates of attrition. Adjusted EBITDA is a measure of profits it’s getting from these customers, regardless of how many it adds in the future (and, he notes, is what the company’s lenders use to measure compliance with loan terms.)

Mr. Mitchell presents a hypothetical scenario: If Just Energy were to add two million customers in the next year, its “embedded margin” would grow from \$2.2-billion to \$2.5-billion, or more than \$20 per share. But its marketing and commission expenses would be so high, “under **Veritas’s** valuation model, the value of the business would fall by half ... we think that’s counterintuitive.”

If he's right, Just Energy is a buy. However, Accountability Research has cut its price target to \$4, and **Veritas** says the company trades at 15.5 times its "sustainable EBITDA" estimate, making the shares "overvalued," in its opinion.

While Mr. Mitchell says the company believes adjusted EBITDA is "the best" metric, he adds investors are welcome to consider any number of measures of the company's profitability; if they stray to some of these other estimates, they may find the Just Energy story not nearly as compelling.