Atlantic Power Takes a 5 Minute Major for Slashing Its Dividend

Description

Utility companies do not typically show up at the bottom of the performance barrel on the S&P/TSX Composite. **Atlantic Power** (TSX:ATP,NYSE:AT) is breaking this convention. Shares have plummeted by close to 51% thus far in 2013 and a quick snap back doesn't appear to be in the cards.

Slip slidin' away

The slide began after the company released Q3'12 results in early November. Negotiations to renew power purchase agreements (PPAs) with several of the company's Florida generating stations had not gone well and these assets had been put up for sale. Without the cash flow from these plants, the market began to question the sustainability of the dividend. The share price fell from above $14 to the $12 range.

The bottom fell out after Atlantic released Q4'12 results at the end of February. The deadly trifecta of weaker than expected Q4 results, lower guidance, and a 65% dividend cut sent shares spiralling from $10 down to $7 or so. The stock now sits at $5.56.

Opportunity?

At first glance, the stock has some appealing attributes. Atlantic trades at less than book value, well below its peer group average of 2 times book, and even with a slashed dividend, yields an attractive 7.2%.

The company faces some significant issues however:

- Management's credibility has taken a hit. Currently, shareholder rights lawyers are poking around to determine if management misled investors over the sustainability of the dividend. Additionally, investors are questioning whether the same thing that can happen to the Florida assets might happen to other assets in the portfolio. The PPAs for Atlantic power plants in New York and Ontario expire in September and December 2014 respectively. Management will do itself a favour by keeping the market tuned in to how the renewal discussions progress.
- Portfolio evolution is required to get the stock back to where it was. New assets must be

acquired. Trusting management is a key component to buying into this strategy of evolution.

- Standing in the way of portfolio evolution is the company's financial outlook. Significant debt maturities are coming down the pipe. $340 million of senior recourse debt and $46 million of convertible debentures mature in 2014/15 period. A further $680 million comes due in 2017/18. Given the hammering Atlantic shares have taken, issuing equity to repay this debt (or go after acquisitions) is an unappealing option at this time. As it stands, the company is likely to have to rely on debt markets to re-finance these maturities, and for growth. Debt investors can be an unsavoury bunch.
- Management has adopted a Shareholder Rights Plan to stave off a potential takeover. For potential investors, a takeover may represent one of the more prominent reasons to have an interest in this stock. An indication that insiders are buying the stock may help to offset this issue.

The Foolish Bottom Line

Management is projecting a payout ratio of 65-75% in 2013 and 75-85% in 2014. IF their forecast is accurate, the 7.2% yield appears safe. And, IF they are able to have some luck bringing attractive new assets into the portfolio, the stock could make a reasonable recovery, perhaps to the $10 to $12 mark, and trade more in line with peer book value multiples. Penalties do expire after all.

Given the element of financial risk that exists with the Atlantic Power story, it's not an idea that appeals to me. Facing new PPAs in Ontario and New York while significant debt is maturing could make for some restless nights. Not what you want out of a utility stock. Having no insight into whether management will be successful adding attractive assets to the portfolio is another deal breaker. Atlantic Power might look cheap, but it looks cheap for a reason.

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Date
2025/08/24
Date Created
2013/03/11
Author
tmfohcanada