



Is TransAlta Corporation's 6.6% Dividend Sustainable?

Description

Since the beginning of 2010, it's been a pretty terrible period to be a shareholder in **TransAlta Corporation** ([TSX: TA](#))([NYSE: TAC](#)), one of Canada's largest power generators. Thanks to weakness in power rates, expensive unplanned maintenance, and a dividend cut in January, shares have sunk all the way from \$23 to today's price of \$11. That's not good.

Because of the massive sell-off, TransAlta shares have a very enticing yield of 6.6%, attracting all sorts of income investors. But as we all know, chasing yield can go very badly. Is a dividend cut in the cards for TransAlta? Let's take a closer look at the company.

Earning power

Lately, the company has had to deal with two issues — weak power prices in Alberta and increased maintenance costs on aging coal power plants.

Alberta doesn't have regulated rates like most other jurisdictions, which can work out well for power generators, especially during periods between 2004-2008, when demand from the oil sands helped drive up electricity rates for everyone in the province. But lately, things haven't been so good.

Now that other projects have brought additional capacity to market, prices have suffered. Combine that with several outages because of unplanned repairs over the last few years, and TransAlta has suffered.

Going forward, things should improve. Major capital projects have been completed, and management indicates that capital spending will be less in coming years. Essentially, all the heavy lifting is done, even if the company's assets are beginning to show their age. These decreases should pave the way to at least maintain the dividend.

One look at the company's results in 2014 indicates that, at least for now, the dividend is safe. Through the end of the second quarter, it had a free cash flow of approximately \$140 million, and paid out just \$100 million in dividends. That's partially helped by investors taking their dividends in the form of additional shares, which offers a 3% bonus to do so. Still, at this point, the dividend looks to be sustainable.

Of course, investors have to exercise a little bit of caution before trusting that the company can sustain the dividend. TransAlta has disappointed the market for so long that folks have the right to be skeptical.

The future of the company

The dividend is just one part of investing in TransAlta. How does it look from a fundamental point of view?

Based on the value of its assets, the stock is exceptionally cheap. Shares trade at just a little more than book value, cheaper than the company has traded at any point over the last decade. If you believe that the major repairs are finally done, shares could recover as earnings potential improves.

But can investors actually believe that? I could have easily made a similar argument in 2012 or 2013, and the company didn't recover. What makes 2014 any different? Sure, there's more of a margin of safety if you buy at book value compared to two times book, but ultimately TransAlta needs to get to the point where it has predictable earnings again for it to trade at a higher level. Only then will it move higher. And based on the age of its assets, I can see why the market is skeptical.

Plus, governments, consumers, and investors are at the point where they barely tolerate burning coal to generate electricity. If the technology existed to replace coal with solar or wind power at a reasonable cost, most people would be behind it. It's perceived as a dirty fuel, so investors stay away. The same phenomenon has plagued cigarette companies off and on for decades. TransAlta could eventually shrug that off, but for now the company has to deal with it.

The bottom line? The dividend looks to be safe — for now. The stock also looks to be cheap on a price to book value metric, but there's an awful lot of sentiment going against it. There are better choices out there.

We've got three terrific dividend stocks you need to see. Check out the report below.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:TAC (TransAlta Corporation)
2. TSX:TA (TransAlta Corporation)

Category

1. Energy Stocks

2. Investing

Date

2025/08/26

Date Created

2014/10/31

Author

nelsonpsmith

default watermark

default watermark