



## Power Your Dividend Portfolio With TransAlta Corporation and its 6% Yield

### Description

The last few years haven't been very positive for **TransAlta Corporation** ([TSX:TA](#))([NYSE:TAC](#)), one of Canada's largest power generators.

A multitude of things started going wrong. The company's fleet of aging coal power plants started to need unexpected and costly repairs. Power prices in Alberta, its main market, weakened as new supply hit the market. Results from its U.S. and Australian divisions were strong in local currency, but looked weak once they were converted back to Canadian dollars. Plus, competitors were helped by weak coal prices, a benefit not fully shared by TransAlta because it mines most of its own fuel.

This all culminated back in January 2014, when the company announced a slashing of its quarterly dividend, sending the once generous payout from \$0.29 per share all the way to \$0.18. As expected, the market still sent shares tumbling. Shares eventually hit a decade-low level of less than \$10 each before rallying some 20% to current levels.

What's the future for this embattled power producer? Can it recover to past glory, or is it a permanent relic of the past?

### Improvements

While the dividend cut made the headlines, TransAlta's management was busy making astute moves behind the scenes.

One of the first was the creation of **TransAlta Renewables Inc.** ([TSX:RNW](#)), which owns many of the parent company's hydroelectric and gas-powered assets via drop-down sales. There are still plenty of assets available to sell from the parent to the subsidiary, which gives the parent plenty of liquidity without having to tap bankers.

Management has also addressed the repair issues by signing a contract with a third party that takes care of the maintenance of most plants in exchange for a fixed fee. It might not be as profitable as handling everything in house, but at least it offers cost certainty.

Finally, the Alberta power market looks to be improving. Several aging coal-fired plants are scheduled to be taken offline in the next few years, with very little in excess supply coming on the market.

### **The future of coal**

As mentioned, the majority of TransAlta's assets are in coal power plants that are mostly located in Alberta. Federal regulations dictate that these plants will start to be closed down, which will start in 2019 and continue through the 2020s. By the end of the 2020s, approximately 3000 MW of coal-fired energy will need to be replaced.

At this point, the plan is simple. The combination of new supply and the conversion of old coal-fired plants to natural gas will easily make up for the loss of that supply. Sure, it'll cost money, but converting an old coal plant to a natural gas one is a lot cheaper than just building a new one.

### **Dividend sustainability**

While operational improvements are important, income investors are mostly concerned with the viability of the dividend.

At least in 2014, the dividend was well covered. TransAlta generated \$796 million in operating cash flow, while spending \$526 million in capital expenditures. That leaves \$270 million in free cash flow available to pay investors. Total dividends were \$181 million, a payout ratio of about 66%. That's a little high, but not terribly so for a stock with such a generous dividend.

The company has taken other steps to ensure the sustainability of the dividend. It has hedges in place to protect it from fluctuations in Alberta's electricity prices, and it has several new projects coming online over the next couple years, which are projected to add \$90 million annually in EBITDA. All in all, the dividend looks to be pretty solid.

TransAlta is a recovering company that is currently trading at a depressed price. Investors who buy now are not only positioned to enjoy nice capital gains as the company recovers, but also get paid a generous dividend to wait. That's a nice combination.

### **CATEGORY**

1. Energy Stocks
2. Investing

### **POST TAG**

1. Editor's Choice

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

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