Dividend Watch: Cenovus Energy Inc. and TransAlta Corporation

Description

The NDP election win in Alberta has investors wondering if they should continue to put their money into stocks that have significant operations in the province.

During her campaign, NDP leader Rachel Notley indicated she would review energy sector royalty programs and push to reduce the province's reliance on coal-fired electricity production.

Cenovus Energy Inc. (TSX:CVE)(NYSE:CVE) and **TransAlta Corporation** (TSX:TA)(NYSE:TAC) will fall directly in the new premier's sights and dividend investors are concerned that the big payouts at the two companies might be in jeopardy.

Let's take a look at both Cenovus and TransAlta to see if the dividends still look safe.

Cenovus

Before the election, Cenovus' CEO Brian Ferguson told Bloomberg that he doesn't think there is any room for royalty increases in Alberta. With the energy sector just starting to see some green shoots of a recovery, the last thing energy producers want is to pay more royalties.

Cenovus is working hard to adjust to the new era of low oil prices. The Q1 2015 numbers came in pretty rough, but the company is making decent progress in its efforts to reduce costs and preserve capital.

Earlier this year, management decided to issue $1.4 billion in stock to shore up the balance sheet. The company also cut its workforce by 15% and offered investors a 3% discount to take shares in lieu of cash for the dividend payment.

The incentive was well received, with roughly one-third of investors taking the offer. The success of the program saved Cenovus about $81 million in the first quarter.

The company continues to increase production and reduce operating costs at its flagship ChristinaLake and Foster Creek oil sands sites.

Oil prices have recovered significantly in the past month. If the gains hold, Cenovus should be able to maintain its dividend. The distribution currently yields about 5.2%.

TransAlta

A large part of TransAlta's electricity production comes from its Alberta-based coal fleet.

In fact, roughly half of Alberta's electricity is supplied by coal-fired power plants. Federal regulations that go into effect this summer have outlined the eventual elimination of coal use right across the country. The current rules would allow TransAlta to run its coal plants through their full 50-year operating lives.

Notley and her government could decide to accelerate the phase-out process.

Investors should be careful about running for the exits because TransAlta has a diversified asset base that includes its majority stake in **TransAlta Renewables**. As one hand takes away, the other might give back.

While eliminating the use of coal is ideal, the people of Alberta should be prepared to pay the price. In Ontario electricity prices have doubled since the province embarked on its mission to phase out coal.

TransAlta is doing a great job of reducing debt and securing revenue streams through hedging contracts. With $650 million in committed long-term growth contracts and expected EBITDA improvements of $40-60 million per year, cash flow should be adequate to maintain the $0.72 dividend that currently yields 6.5%.

Should you buy?

Investors should be cautious about buying Alberta-based shares until more clarity is given on the potential policy changes. At the moment, both Cenovus and TransAlta should be capable of maintaining the payouts, but the stocks are volatile and chasing the extra yield might not be worth the risk.

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1. Dividend Stocks
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2. NYSE:TAC (TransAlta Corporation)
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