Despite its Sell-off, Investors Should Be Wary of Capital Power Corporation

Description

Despite its reputation as a defensive hedge against economic uncertainty, the electric utility industry is facing a range of headwinds that are impacting the share prices of a number of industry players. One of the worst affected is **Capital Power Corporation** (TSX:CPX), which has had its shares plunge by nearly 20% over the last year. Analysts now claim that it is attractively priced, but nothing could be further from the truth.

Now what?

The key headwind affecting Capital Power is the move by Alberta's NDP government to reduce the volume of the province's electricity mix generated from coal-fired plants by over a third by 2030. This will hit Capital Power particularly hard because it is one of the largest electric utilities in Alberta and generates a considerable portion of its electricity from coal-fired plants.

In fact, half of its commercially owned plants in Alberta are coal fired, and after including the Sundance power-purchase agreement, 80% of its total first-quarter 2015 EBITDA came from coal-fired electricity generation. This makes Capital Power heavily exposed to the costs associated with modifying its operations to meet Alberta's climate change requirements. These could force the decommissioning of Capital Power's coal-fired plants in Alberta earlier than expected, and could incur significant costs to replace the capacity lost with more environmentally friendly means.

There is also speculation that it may halve the life of the recently commissioned Keephills 3 coal-fired plant, which cost Capital Power and its partner **TransAlta Corporation** $3 billion to complete. Its loss would have a marked impact on Capital Power because its 50% share of the output of Keephills 3 makes up 11% of its total first-quarter 2015 output, while it also generates about 7% of its total revenue. Not only would this have a marked impact on its financial performance, but it could also mean that Capital Power could be unable to recoup the full value of its initial investment.

This bad news comes at a time when Capital Power is already suffering from low electricity prices in Alberta. I also don’t agree with Capital Power’s upbeat assessment of the outlook for Albertanelectricity prices.

You see, the sharp collapse in oil prices that has forced energy companies to slash investments in Canada’s energy patch will more than likely cause Alberta to slip into a recession. This, in conjunction with the energy industry accounting for a fifth of the demand for electricity in the province, will keep a lid on electricity prices for the foreseeable future.

So what?

The government focus in North America on reducing greenhouse emissions will have an extensive impact on the electric utility industry. Companies like Capital Power, which rely on coal-fired electricity generation for a significant portion of their output, will be among the hardest hit.

This is because legislation will force them to make costly upgrades to coal-fired plants or even have them decommissioned before their commercial life has expired. The application of higher carbon levies will eat into their profitability, while forcing them to invest considerable capital in developing more environmentally friendly power generation.

As a result, I don’t believe that the recent tumble in Capital Power’s share price has created a buying opportunity. If anything, this represents the market baking in the risks that make it an undesirable investment at this time.

CATEGORY

1. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. TSX:CPX (Capital Power Corporation)

Category

1. Investing

Tags

1. Editor's Choice

Date
2025/08/25
Date Created
2015/07/13
Author
mattdsmith