TransAlta Corporation: How Sustainable Is its 12.6% Dividend?

Description

Electricity provider **TransAlta Corporation** (TSX:TA)(NYSE:TAC) has the largest dividend yield of any company on the **S&P/TSX 60**, currently standing at 12.6%.

But that doesn't mean dividend hunters should pounce on TransAlta's shares. After all, the past 12 months should have taught us to tread carefully around big dividend yields. And TransAlta has slashed its dividend before. We all know it could happen again.

So, just how sustainable is TransAlta's payout?

A host of problems

TransAlta is dealing with numerous issues these days, and this does not bode well for the dividend.

To start, new premier Rachel Notley has indicated she wants to accelerate the phase-out of coal-based power plants in the province. This would be a serious concern for TransAlta, since the company generates 40% of its profit from coal. CEO Dawn Farrell hopes the premier will reconsider and points to skyrocketing power prices in Ontario as a warning. But Ms. Notley has a clear mandate from the people of Alberta and certainly intends to use it.

More recently, the Alberta Utility Commission found that TransAlta has manipulated power prices in previous years by shutting off power right when demand was highest. Industry analysts are suggesting that the fine amount to as much as $30 million.

Power prices have also been slumping. Last year the average price per MWh was $61 in Alberta, but so far this year the price has averaged $43. Similar drops in power prices have been seen in other provinces, too. Cheap natural gas is the main culprit, and this shows no signs of changing.

Cash flow isn't high enough

When judging a dividend's sustainability, the statement of cash flows provides some excellent hints. Unfortunately, in this case, it's a pretty grim picture.

Through the first six months of this year, TransAlta's free cash flow was negative $133 million, while its dividend payments totaled $61 million. To help make up the shortfall, the company raised over $200 million by selling an interest in its Australian business to **TransAlta Renewables Inc.** This kind of strategy cannot be sustained indefinitely.

You should expect a cut eventually

TransAlta doesn't make enough free cash flow to cover its dividend, and the long-term fundamentals for the business are poor. Even worse, the company has roughly $4 billion of net debt, a big number for a company valued at only $1.6 billion by the market.

Thus, sooner or later, TransAlta will have to reduce its payout. In the meantime, you should look elsewhere for reliable dividend stocks.

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Date
2025/08/24
Date Created
2015/09/14
Author
bensinclair