TransAlta Corporation: Did Rachel Notley Just Kill This 12% Dividend?

Description

When Rachel Notley was elected premier of Alberta back in early May, investors were not optimistic about the prospects of **TransAlta Corporation** (TSX:TA)(NYSE:TAC). Their main concern was that Ms. Notley's environmental policies would hurt TransAlta's coal-fired electricity operations.

Now we have a clearer idea of what Ms. Notley's plans are. On Sunday she revealed her new strategy to curb Alberta's greenhouse gas emissions. The plan calls for a carbon tax of $20/tonne in 2017 and $30/tonne thereafter. It imposes an emissions limit of 100 megatonnes per year on the oil sands. And it mandates the phase-out of coal-fired electricity by 2030.

The plan has won praise from Prime Minister Trudeau, environmental activists, and even oil sands companies. But the plan has received sharp criticism from the opposing Wildrose Party, which claims that the measures will hit the pocketbooks of ordinary Albertans.

So what exactly does this mean for TransAlta? More specifically, is the dividend once again at risk?

A risky dividend already

TransAlta's dividend yields roughly 12% at current market prices, good enough for first place on the **S&P/TSX 60**. Such a high yield is usually a sign that investors are sceptical about a dividend's sustainability.

And in this case, investors have a right to be worried. TransAlta has lost $0.18 per share so far this year (on an adjusted basis), and its dividend exceeds free cash flow. Power prices in Alberta have decreased by nearly 60% in just the last year. If that wasn't enough, the company has nearly $5 billion in adjusted net debt.

So if the company's prospects worsen any more, you'd figure that the dividend must be slashed.

The effect of the legislation

Coal accounts for the majority of TransAlta's power production. Therefore, you would think that Ms.

Notley's plan is a serious problem for the company.

But this isn't as bad as it looks. TransAlta is already planning to close two of its Sundance facilities by the end of the decade. The other four facilities at Sundance, plus two of its Keephills operations, are slated for closure by 2029.

The carbon tax will likely make a bigger impact. TransAlta's emissions in 2014 exceeded 30 million tonnes of carbon dioxide equivalent last year. At $30 per tonne, the tax would amount to nearly $1 billion per year. But this tax will affect TranAlta's competitors as well, and much of the cost will be passed on to consumers. Besides, TranAlta is reducing its emissions and increasing its focus on renewable energy.

The real risk

TranAlta's recent struggles have centred on something else: low power prices. The effect has been largely mitigated by so-called Power Purchasing Arrangements (PPAs), which have locked in higher prices for most of the company's power. But the PPAs are slowly expiring, and as they do, TransAlta's cash flow and dividend will likely deteriorate. Income investors should probably look elsewhere.

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1. Dividend Stocks
2. Investing

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