TransAlta Corporation: It's Time for This 14% Dividend to Be Cut

Description

TransAlta Corporation (TSX:TA)(NYSE:TAC) is the one company on the **S&P/TSX 60** with a dividend yield north of 10%–as of this writing, the company's quarterly payout yields an astounding 14.3%!

Of course, whenever a stock yields more than 10%, it's a sign that investors are expecting the dividend to get cut. And, as we show you below, this is exactly what TransAlta should be doing.

A number of headwinds

TransAlta's high yield isn't a result of an increasing dividend. In fact, the payout was chopped by 38% in early 2014. Instead, the company's shares have been plummeting; TransAlta's stock price has declined by over 50% in 2015. The decline has exceeded 75% over the past five years.

One reason for the weak stock price is for political reasons. New Alberta premier Rachel Notley has made curbing emissions a top priority, which doesn't bode well for coal producers such as TransAlta.

But TransAlta's real problem has been declining power prices, especially in Alberta. Just for context, power prices in Alberta averaged $26/MWh in the most recent quarter, which is down from $64/MWh one year earlier. The company has managed to cushion its fall through the use of hedging, but eventually these hedges will run out.

The numbers

Even with these hedges, TransAlta is having trouble covering its dividend. Through the first nine months of 2015, the company's comparable net earnings per share have totaled *negative* $0.18. Meanwhile, TransAlta's dividend still stands at $0.18 per share per quarter.

To help pay for the dividend, TransAlta has sold assets and increased its debt load. The company also has a reinvestment component, where shareholders can elect to purchase new shares with their dividend proceeds (at a 3% discount).

Why the dividend should be cut

If TransAlta cannot maintain the dividend over the long term, then the sensible thing would be to cut it now (or eliminate it altogether). Such a move would help preserve the balance sheet.

But suppose that TransAlta *can* preserve its dividend. In such a scenario, the company's shares are wildly undervalued. Thus TransAlta should be spending whatever money it can on share repurchases, rather than dividends. By making such a switch, the company would create much more value for shareholders over the long term (and in a more tax-efficient way).

Either way, TransAlta offers a perfect reminder that dividend investors shouldn't chase the highest-yielding stocks. Come to think of it, the same could be said for many other Canadian companies, too.

CATEGORY

1. Dividend Stocks
2. Investing

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