# Altagas Ltd.: Just How Safe Is this 7% Yield?

## Description

Income investing can be very rewarding.

It can help to provide for a more comfortable retirement than what would otherwise be expected.

Even if you aren't retired, creating and managing your own income or dividend portfolio can help offset some of your monthly expenses or provide additional income that can be put towards a bigger purchase, like that new car or a two-week vacation.



But income investing comes with its own set of pitfalls — namely, the need to balance income received today without sacrificing, as Warren Buffett would say, "precious capital."

You see, the dividend distributions that are paid out to investors in a corporation or income trust come at the expense of reinvestment in future growth in production.

After all, a company only has so much cash to go around, and if that cash is constantly leaving the company to pay shareholders, the company will have less cash available to invest in research and development, capital expenditures, as well as mergers and acquisitions.

If a company is forced to go beyond the "tipping point" of what is considered a sustainable dividend, it will inevitably start to erode the underlying value of the business.

Such is the risk of income investing.

**Altagas Ltd.** (TSX:ALA) is a desirable candidate for a dividend (or income) investor primarily owing to the company's alluring 7.05% dividend yield.

The question is, can the company sustain the current payout without leaving investors with a smaller company than when they purchased their shares?

Let's start by taking a look at the business.

Altagas is a North American diversified energy infrastructure business with a focus on owning and operating assets to provide clean and affordable energy to its customers.

The company has three segments which are led by the company's gas segment, which extracts natural gas from the ground, processes it, and delivers it to customers.

The company's power segment, also grounded in clean energy, has more than 1,688 MW of gross capacity and 20 MW of storage used for energy that is converted to power for the consumer.

Finally, the company's utility segment essentially distributes the natural gas final product to homes and businesses across North America.

The really nice thing about the nature of Altagas's operations is that it is a vertically integrated company, meaning it owns the process from start to finish, extracting the natural gas from the ground all the way to marketing and delivering it to the end user.

While this certainly gives the company greater control over its supply chain in that it doesn't have to worry quite as much about disruptions with third-party contractors, it also acts as a bit of a built-in hedge to natural gas prices.

This is because when natural gas prices are lower, as they have been for quite some time now, this effectively lowers the company's input cost in the selling and marketing side of things.



**But is the dividend safe?**

In 2017, the company is expected to pay $2.10 in dividends.

This does not exactly compare well to 2016 earnings per share (EPS) of just $0.99 in 2016, nor does it compare favourably to analyst expectations of $0.95 EPS for 2017.

That equates to a payout ratio of well over 100% — the threshold by which most investors would consider the dividend in dangerous or unsustainable territory.

But dividends are paid out the company's cash flow and not with earnings.

Unfortunately, the picture doesn't get much brighter here either.

Over the past five years, Altagas has persistently running a free cash flow deficit, meaning the company's cash from operations has not been enough to pay for ongoing capital expenditures.

For a while, the company addressed this shortfall by issuing debt to fund the dividend, but it appears it exhausted this avenue as a resource, as Altagas had to start repaying that debt in 2016; that much more cash is taken away from shareholders expecting to receive a dividend.

As a result, the company has been forced to dilute its current shareholders to the tune of $384 million in 2015 and even more, $596 million, in 2016.

**What does it all mean?**

To say nothing about the state of the company’s business, it appears management and the board of directors have bitten off more than they can chew with the current 7.05% payout.

Some may be willing to hang on and see what develops next, but personally, I would not go anywhere near a company attempting to “sustain” its dividend by issuing more common shares.

**CATEGORY**

1. Dividend Stocks
2. Energy Stocks
3. Investing

**TICKERS GLOBAL**

1. TSX:ALA (AltaGas Ltd.)

**PARTNER-FEEDS**

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA



**Category**

1. Dividend Stocks
2. Energy Stocks
3. Investing

**Date**
2025/07/27
**Date Created**
2017/07/28
**Author**
jphillips