Is Altagas Ltd.’s 7.5% Dividend Yield Safe?

Description

Altagas Ltd. (TSX:ALA) shares have been on a slippery slope since peaking in the summer of 2014. After seeing the share price drop almost half during this period, investors are right to question the stability of this top dividend-yielding stock.

In 2017 alone, Altagas shares have fallen more than 15%, while the **Reuters’s** North American utilities index surged by the same amount during the same period.

Altagas has three business segments — gas, power, and utilities — and a well-diversified geographical presence. Its gas infrastructure runs more than two billion cubic feet of gas per day.

Altagas has been trying to grow organically through acquisitions. Its $8.4 billion deal to buy the U.S.-based **WGL Holdings Inc.** (NYSE:WGL) is pending with the U.S. regulatory authorities.

This acquisition is likely to add some high-quality assets to Altagas’s portfolio. WGL maintains a diversified energy infrastructure, including gas utilities, pipelines, and it aligns well with Altagas’s strategy of growing by adding high-quality, contracted assets.

Drag on shares

Other than a cyclical slump in natural gas prices, I think the uncertainty about the WGL deal is the biggest drag on Altagas shares. Some investors aren’t sure if the company will be able to overcome the regulatory obstacles in Washington.

And they’ve the reasons to be suspicious, especially because President Trump is re-negotiating the NAFTA deal, and because investors have already seen **Exelon Corp.’s** US$6.8 billion purchase of **Pepco Holdings** rejected twice before finally being cleared by the District of Columbia Public Service Commission in 2016.

So, there is an uncertainty discount being attached to the company’s share price.

Before you make a buying decision, let's see if Altagas is already producing enough cash to justify its hefty dividend yield.

The first thing which separates Altagas shares from speculative picks is its stable dividend growth over the past five years. From 2011 to 2016, the company delivered a compound annual dividend growth rate of 9%, while maintaining one of the lowest payout ratios among its peers.

On the basis of normalized funds from operations, the company's payout ratio has been between below 60% during the past five years; I think that is a pretty safe zone.

Should you buy Altagas?

Despite its share undeperformance, investors didn't get a bad deal if you take dividend payouts into the consideration. During the past five years, the company has been able to compensate investors by delivering a 6% total annual return.

With a 7.5% dividend yield, Altagas provides a good long-term opportunity for dividend investors. There is no doubt that we still have a considerable uncertainty about the WGL deal. I think Altagas shares have more room to fall as we get closer to the merger deadline in in the second quarter of 2018. Until then, it's wise to look for a better entry point and keep Altagas shares on your watch list.

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Date
2025/07/05
Date Created
2017/08/17
Author
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