Capital Power Corp.: Is This 7% Dividend Yield Safe?

Description

For high-yield hunters, **Capital Power Corp.** (TSX:CPX) stock presents an interesting opportunity.

The company's ~7% dividend yield is not only attractive, but it is also growing. In an environment where other investment options don't even offer half of what Capital Power is paying, it makes sense for income investors to seriously consider this power producer. Let's analyze the company's business potential and risks.

Capital Power's business

Capital Power is one the largest independent power producers in North America. Headquartered in Alberta, the company develops, acquires, operates, and optimizes power generation from a variety of energy sources.

Capital Power owns approximately 4,500 megawatts of power-generation capacity at 24 facilities and is pursuing contracted generation capacity throughout North America.

In recent years, Capital Power has expanded aggressively south of the border, snapping up natural gas power plants and building its wind farm in Kansas. Of 4,500 megawatts capacity, Alberta accounts for 53% of Capital Power's owned capacity, while the U.S. makes up 26% of the total generation.

Risks to Capital Power's business

Investors are seeking a discount for Capital Power's shares due to a policy shift in the government of Alberta from environmentally damaging coal power generation to cleaner methods of electricity production, including natural gas and renewable energy.

But this shift means Capital Power will not be able to produce electricity cheap; it used coal to generate more than half of Alberta's power in 2015. The company not only burns coal in most of its power plants, but it also mines the dirty fuel.

The other major risks to Capital Power's business model is that Alberta, which is a major consumer of its power generation, is changing the province’s electricity purchase system to a so-called capacity market, which will be more regulated than the free-market structure that prevailed under the Conservatives.

The government wants producers to bid for contracts to provide electricity by 2021, instead of relying on spot prices, which are more volatile and tough to pass on to consumers.

Is Capital Power a bargain?

Capital Power has positioned itself well to cope with the changing regulatory and business environment. The company is shifting fast to natural gas to produce power and is replacing its coal-run system. Its push to increase its footprint in the U.S. has increased its American share in total power generation to 26% share from 6%.

With an annual dividend yield of 6.74%, which translates into $0.42-a-share quarterly payout, Capital Power is a good high-yielding stock to have in any income portfolio.

After raising its dividend by 7.1% in July — its fourth consecutive annual increase — the company also announced that its plans to continue with the similar hikes at least by the end of 2020.

These planned increases signal that the company does not see any major threat to its business and feels confident to reward its investors going forward.

Trading at $24.79 with the trailing price-to-earnings multiple of 16.16, I think Capital Power is a good bargain and a risk worth taking to earn a juicy yield.

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Date
2025/07/05

Date Created
2017/11/09
Author
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