Should You Add This 10% Yielding Stock to Your Portfolio?

Description

Rising interest rates have provided some fertile ground for investors looking for dividend stocks. There are numerous companies paying healthy yields, so investors have a lot of choices and alternatives for companies to add to their portfolios.

But sometimes high yields can signal problems with the business, or potential fragility with the dividend payout. In situations like this, it pays to do some homework to determine whether these are opportunities or traps.

AltaGas Ltd. (TSX:ALA) is certainly appealing at first glance. The company has a yield of over 10% at the current depressed share price. A yield like that can be tempting for income investors, especially when GICs are still not yielding a whole lot at the moment.

But the depressed share price does have investors concerned, especially when the high dividend yield seems to forecast potential weakness for the dividend.

AltaGas generates clean energy through its natural gas and green energy businesses. The company has operations in both the United States and Canada, with a particular focus on expanding its U.S. operations. This strategy gives it a degree of geographic diversification.

AltaGas has a large amount of its production contracted over long periods, giving it earnings visibility over a significant period with around 80% of its EBITDA guaranteed through medium- to long-term contracts.

The company does seem to have positive expectations for its business going forward. As recently as Q2 2018 the company believes that it can grow funds from operations by 15-20% over the next year.

Even with its whopping dividend of over 10%, AltaGas believes that its dividend is sustainable. This is good news for income investors. The company looks to maintain a payout ratio of 50-60% of Funds from Operations (FFO).

Although its dividend is concerning at such a high yield, the company believes that it has enough earnings visibility, with 85% or more of its EBITDA contracted, and that it can maintain the dividend.

As is the case with many utility companies, AltaGas does have a lot of debt. Much of this debt comes from acquisitions such as the recently-closed WGL Holdings Inc. acquisition. These acquisitions make the balance sheet more fragile, but are also avenues for predictable growth and asset diversification.

At this point, I think it might be worth buying a little AltaGas for your portfolio. I would not recommend establishing too large a position, as the share price has done nothing but go down over the past few years. However, the company has regulated earnings from its utility businesses, which should help stabilize the dividend for the coming years.

AltaGas poses a risk. A high dividend could signal a cut, although management has been clear that it intends to maintain the dividend. For higher-risk investors looking for extra yield, AltaGas might be a decent choice.

It might be a good strategy to hold the stock for the dividend while waiting to see if its strategy, such as its regulated utility expansion in the U.S., is enough to grow its business and maintain its dividend.

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