Is AltaGas Ltd's (TSX:ALA) 14% Yield Too Good to Be True?

Description

AltaGas Ltd (TSX:ALA) could be the hottest dividend stock to own right now. How long it will last, however, is the big question. Investors typically become apprehensive when a stock starts paying more than 5% per year.

High yields are difficult to sustain, as normally companies don't normally plan to pay more than 5%.

However, because the yield is a calculation that involves both price and dividend payment, a sharp decline in price can often be the reason for a higher-than-normal yield.

And a dropping share price could be a symptom of problems with the business and be a concern as to whether the company can keep paying its dividend.

With a monthly payment of $0.1825 per share, AltaGas is currently paying investors a yield of around 14%. At that percentage, it could be the only dividend stock you need – if it's sustainable.

Can earnings support the dividend?

One way to look at whether Altagas can afford these payments is by looking at its earnings per share (EPS). Unfortunately, with a big loss in its most recent quarter, AltaGas is showing a negative EPS for the past 12 months.

What we can do instead is look at its track record over the past few years. In 2017, the company's EPS was $0.18 and well down from the $0.99 that it came in at for 2016.

Its earnings have bounced around over the years and unfortunately have not shown a lot of consistency, which makes it harder to predict its future earnings.

At the current rate, dividend payments will result in annual payments of $2.19 per share, which are well above even the highest EPS that the company has achieved over the past five years – $1.52 back in 2013.

Based on earnings, AltaGas' payout ratio is well above 100% and should be cause for concern, especially as conditions in the industry become more challenging. However, not only has the company pay a dividend during the downturn, but AltaGas even increased payouts during that time. However, that's not guaranteed to continue.

A look at cash flow

Another way that we can assess the company's payout ratio is by looking at free cash, which is ultimately what it has available to use for investments or to distribute to shareholders. Unlike income, it won't be skewed by non-cash items and could provide a more realistic picture of the company's financial strength.

Unfortunately, things aren't much better here, although the company has generated positive free cash in three of the past four quarters.

If we exclude the past quarter, during which the company had a big amount of cash used up for an acquisition, over the previous four quarters, AltaGas generated just $67 million in free cash, which is well shy of the more than $440 million in dividends that it paid out during that period.

Bottom line

AltaGas' dividend appears to be in a bit of danger, but whether a cut is around the corner is unclear. The company has focused on offering investors a growing dividend and so a cut is not something it would do without a lot of careful consideration.

However, for investors looking for safe, reliable dividend, I'd look elsewhere for smaller yields that are less likely to be cut.

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