



Why AltaGas Ltd. (TSX:ALA) Will Cut Its Dividend

Description

The idea that financial markets are much smarter than you or I is an old concept, and one which holds a significant amount of truth. The culmination of millions of transactions provides for a market price for a piece of a business – one which may or may not turn out in the long run.

In the case of **AltaGas Ltd.** ([TSX:ALA](#)), an ever-increasing dividend yield has remained a signal from financial markets that investors simply don't believe in. Given that the yields on many junk bonds do not reach double digits, whenever a dividend yield exceeds the double digits, most investors take note.

Should AltaGas be considered “junk” by financial markets? I don't think so; rather, I believe the market is pricing in a dividend cut due to the relative unsustainability of the company's dividend currently relative to its cash demands in the years to come.

As most folks who follow AltaGas know, the company's acquisition of Washington D.C.-based WGL for US\$4.5 billion has placed a significant financing burden on the company. As it turns out, AltaGas appears to have bitten off a bit more than it could chew at the time, recently forced to spin off the firm's utility business (one of the parts of the company I liked the most) for less than it initially expected (approximately \$239 million rather than the \$276 million number initially announced).

As fellow Fool Kay Ng, who has followed AltaGas closely [has noted](#), management has certainly cooled at the idea of a dividend hike, or perhaps even maintaining its current distribution, stating “given where the stock is yielding. [It] ha[s] determined... that growing the dividend at this time is not appropriate” and that it needs to assess “what constitutes a sustainable and ultimately growing dividend for the reshaped AltaGas...”

AltaGas' yield sits at nearly 14% – even if the company cut its dividend distribution by 75%, investors would receive a relatively juicy 3.5% yield, freeing up a substantial amount of cash flow to pay down debt, which should be the primary goal of the company's management team in the near term.

Bottom line

In June, I invited investors to consider the potential that [considerable downside existed](#) with AltaGas pertaining specifically to the company's balance sheet and cash flow considerations with respect to the more-than-100% payout ratio at the time. At a time when many were calling for \$30 target prices, my model showed a target price of around \$20, making me overly bearish on the medium-term outlook for this company.

At its core, I believe AltaGas is moving in the right direction – perhaps doing too much and perhaps too quickly. The company's balance sheet has simply gotten ahead of its cash flow needs, and a dividend cut is in order. We all know it. The market knows it. Investors (should) expect it.

Don't get caught off guard when it happens. Depending on how cheap AltaGas gets following its cut, I would consider buying around the \$10-\$12 level.

Stay Foolish, my friends.

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

2025/09/29

Date Created

2018/12/06

Author

chrismacdonald

default watermark