AltaGas Ltd. (TSX:ALA) Stock Zooms After Slashing Dividends by 56%: Here's What You Should Do

Description

It was coming.

AltaGas (TSX:ALA), a hot dividend stock currently yielding a whopping 15%, confirmed the market's worst fears today as it cut dividends steeply as part of its just announced capital-allocation plans for 2019. AltaGas will still pay out a monthly dividend, but one that will equate to an annual dividend of $0.96 per share starting 2019. That's a deep 56% cut from the company's 2018 dividends.

Why AltaGas cut the dividend

"The board's decision to decrease the dividend was an extremely difficult one," said AltaGas's chairman of the board, David Cornhill. Management believes a cut was necessary to "improve financial strength and ensure greater funding flexibility."

That AltaGas has been struggling to deal with its debt load and cash burn for several quarters isn't news anymore. The company's troubles started with the humongous acquisition of WGL Holdings in July for nearly $9 billion.

That sum of money sent AltaGas's debt load spiraling, putting tremendous pressure on its cash flows. A huge loss last quarter also meant that AltaGas was paying more in dividends than the income and cash flows it earned, portending a dividend cut.

Where AltaGas management really faltered was its foresight. At the time of announcing the deal, AltaGas expected to not just maintain but *grow* dividends by 8-10% annually between 2019 and 2021.

As things stand now, shareholders in AltaGas have to do with a smaller dividend cheque in their mailboxes. Interestingly, AltaGas shares are up almost 11% this morning, as of this writing, following the announcement.

Why AltaGas stock is soaring

One reason why the market has welcomed the news is that AltaGas management had already hinted about a potential dividend cut during its last earnings call when it clarified a dividend increase won't be appropriate, and that it needs to find a sustainable dividend payout.

The recent suspension of its dividend-reinvestment program nearly confirmed a coming dividend cut.

That, and the company's expectations for 2019, seemed to have triggered hopes among investors that the worst could be over for AltaGas.

On the road to a stronger balance sheet

AltaGas paid nearly $6 billion in cash to WGL shareholders as part of the acquisition, which was funded with a bridge loan (a short-term loan) and equity offer. AltaGas is now banking on two avenues to pare down net debt on its balance sheet that stood at $10.4 billion as of Sept. 30:

1. A dividend cut, which should save it nearly $1.3 billion through 2023.
2. Asset sales, which have raised $3.79 billion till date and should raise another $1.5-2 billion in 2019.

Meanwhile, AltaGas plans to spend $1.3 billion on its midstream and U.S. utilities segments in 2019 and expects to earn normalized earnings before interest, tax, depreciation, and amortization (EBITDA) of $1.2-1.3 billion and funds from operations of $850-950 million.

What you should do with your shares

A dividend cut could pinch your pocket in the short term, but this could be the turnaround trigger patient investors in AltaGas have waited for. Long-term investors might want to stay invested for now and take cues from the next quarterly earnings release on WGL's integration and accretion to AltaGas's bottom line and cash flows. For income investors, AltaGas's dividend may have finally found sustainability.

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