This Dividend Stock Has an Incredible 9.5% Yield — but Is It Sustainable?

Description

In bear markets like this one, dividend investing can be a great approach to follow. Offering safety, stability, and a certain amount of protection from market downturns, dividend stocks can ease investors' nerves in turbulent times. But here's a dilemma that dividend investors face: should you go for the highest yield or the surest one?

Although it's possible to find stocks with yields north of 10%, usually these stocks have the highest payout ratios and the most erratic earnings. The sounder dividend stocks typically (not always) have lower yields–but also a prospect of dividend growth.

Occasionally, however, you'll find a mega-high-yielding dividend stock that can sustain the action. And **TransAlta Renewables Inc** (TSX:RNW) may just be one. Spun off from **TransAlta Corp** (TSX:TA)(NYSE:TAC) in 2013, TransAlta renewables specializes in delivering wind, hydro and gas-based electricity to clients in Canada and the U.S. The stock pays a dividend that yielded a whopping 9.5% at the time of this writing, putting it in the category of ultra-high-income stocks that often get investors wondering "is this too good to last?"

In TransAlta's case, the answer to that question isn't immediately obvious. Renewable energy is growing at 4.9% CAGR, and certain renewables like hydro generate steady profits for utility companies. This certainly puts TransAlta within a good industry. But is the stock itself good enough to keep those fat dividend payments coming? First, let's review the positives.

A solidly profitable enterprise

Based on its quarterly and annual reports, TransAlta is a profitable enterprise. It has generated positive net and operating income in all of the past four quarters, and has a high profit margin of 40%. The return on equity sits at 7.9%, which isn't that great, but if we're talking about dividends, it's ultimately cash flow that decides whether they'll keep coming. The biggest strike this company has against it financially is about $1 billion worth of debt, which dwarfs its $24 million cash holdings.

Erratic growth

TransAlta has a long-term trend of growing its earnings, but the trend is erratic, with many off quarters along the way. For example, in Q3, the company posted earnings of $12 million, down from its Q1 figure of $66 million. On the other hand, that $12 million figure for Q3 was up from a $72 million loss in Q3 2017, so on a year-over-year basis, growth has been strong. It's possible then that the up and down pattern observed when we look at TransAlta's quarters side by side is simply a byproduct of seasonal fluctuations in electricity usage.

A sky-high payout ratio

Now for the bad news.

TransAlta's payout ratio is at a sky-high 1.34, which suggests that the company isn't earning enough to cover its dividends. However, once again, it should be noted that this company's earnings fluctuate wildly, so it's possible that they will earn enough next year to keep up the distributions.

It should also be noted that TransAlta claimed in Q3 that it had $0.25 in cash available for distributions per share compared to $0.23 in declared dividends for the quarter. So even though dividends are outstripping earnings, the company can pay their dividends without borrowing money, for the time being.

Personally, I'd avoid this stock just because of the sky-high payout ratio, but it's not as risky as some ultra-high-yield stocks out there.

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