



Can Wind Electrify Your Income Portfolio?

Description

For many years investors have been putting their hard earned dollars into various types of energy investments offering stable cash flows in search of high and sustainable yields. The vast majority of these investments were backed by the production, transport, or marketing of natural resources as well as the distribution and sale of conventional power. Now there is a new energy game in town that has recently been gaining popularity with investors – wind power.

The first commercial wind farm in Canada was completed two decades ago, but until recently the installed capacity was minor. However, over the last ten years the installed wind energy capacity has exploded rising from less than 500 MW to over 7,000 MW today. According to the Canadian Wind Energy Association, the currently installed wind energy capacity is enough power about 2 million homes or 3% of Canada's total electricity demand. So has commercial wind energy production as an industry finally come of age? Judging by a couple of recent IPOs, it appears to be catching the attention of investors.

The new kids on the block

Just since August of this year, there have been two public offerings of renewable energy company's promising stable cash flows primarily from wind power in order to support a lucrative dividend. First on the list was the partial spin-off of **TransAlta Renewables Inc.** ([TSX: RNW](#)) from parent company **TransAlta Corporation** ([TSX: TA](#)) ([NYSE: TAC](#)) which still owns 80.7% of the subsidiary. Shares were offered at \$10.00 per share in August and have been up by as much as 11.1% since the offering.

TransAlta Renewables operates 28 renewable power generation facilities and has one of the largest wind generating capacities among the publicly traded independent power producers in Canada. Of the 28 facilities, 12 are hydro with a generating capacity of 105 MW and the remaining 16 are wind facilities with a generating capacity of 1,008 MW. Last month, the company announced that it has agreed to acquire a 144 MW wind farm located in Wyoming which is its first project in the United States.

The other more recent entrant to the public marketplace is **Pattern Energy Group Inc.** (TSX: PEG). Unlike TransAlta Renewables, Pattern is currently a pure play on wind power with total owned capacity

of 1,041 MW. The offering was met with good investor demand as the company priced above the expected range of \$19 – \$21 per share and hit the markets at \$22.00 per share. The stock opened nearly 10% above the offering price and peaked at nearly 20% above the IPO price.

Pattern owns eight wind projects in three countries – Canada, Chile and the United States. Of the eight, two are still under construction which includes the company's second project in Canada as well as its only project in Chile. Both new facilities are projected to be in commercial operation during the first half of 2014 and will add approximately 385 MW of generating capacity.

Good dividend yields, but...

Both Pattern and TransAlta Renewables contemplated dividends as part of their offering prospectus. Pattern has initiated its quarterly dividend at a rate of \$0.3125 per share or \$1.25 on an annualized basis giving the stock a yield of approximately 4.8%. TransAlta Renewables is going with the monthly payout structure at a rate of \$0.0625 per share or \$0.75 on an annualized basis coming in with a juicy yield of approximately 7.0%.

Pattern recently shared its third quarter financial results in which cash available for distribution came in at \$6.3 million for the quarter and \$37 million for the first nine months. The number for the quarter would have fallen well short of the required cash to pay all Class A shareholders if the dividend would have been in place during that time, however cash available for the nine month period would have covered. Unfortunately, the short track record of the company makes estimating future cash flows difficult and we must turn to company forecasts to help formulate our opinion.

For 2014, the company is projecting cash available for distribution of \$55.4 million or \$1.56 per share which equates to an 80.1% payout ratio with a dividend of \$1.25 per share. So if you have faith in the projection, the dividend is covered. Looking further down the road, investors must be aware that during the public offering the company issued 15,555,000 Class B shares to the parent company. These shares are not eligible for dividend in 2014, but can be converted after 2014 to dividend eligible Class A shares once the project in Canada is completed. Once converted, the company will be required to have an additional \$19.44 million in cash available for distribution or a total of \$63.85 million per year if everything else remains the same putting future coverage in question.

TransAlta Renewables used previous its operating history to demonstrate its ability to pay in the offering prospectus. According to the company, it had \$103.33 million in distributable cash during the 12 month period ended March 31, 2013. Based on the current dividend the company would have paid out \$86 million or 83%. The company's third quarter report for the period ended September 30, 2013 showed cash available for distribution of \$20.05 million during the quarter and \$101.38 million for the nine month period so the dividend seems safe for now if management can maintain a similar or improved performance going forward.

Final thoughts

If you believe wind will produce the energy of the future, one of these new names may fit a more aggressive portfolio for both growth and income. However, it is early in the young life of these recently public companies and forward cash flows can be difficult to predict making neither a likely choice for conservatively managed portfolios.

Remember, the key to any dividend is sustainability and the share prices of these stocks will depend

on it. Trust me... You don't want to be the owner of a stock when management announces a cut or elimination of its dividend.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:RNW (TransAlta Renewables)

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