3 Reasons to Buy This Beaten-Up Power Generator

Description

Over the past year, **TransAlta** (TSX: TA)(NYSE: TAC) has been among the worst performers on the TSX. While the rest of the market was up more than 15%, shares in the beleaguered power generator were down more than 15%, thanks to unexpected costs and consistently missing the market's expectations on earnings. The company's bad year culminated back in February, when it announced it would cut its quarterly dividend from $0.29 to $0.16 per share.

For most investors, dividend cuts are the kiss of death. Once a company cuts a dividend, it's immediately transferred to a sinister and dark place, never to be heard from again. While I can understand that attitude from a current shareholder who holds a stock primarily for its income, I think investors who are looking for value shouldn't necessarily dismiss dividend cutters. Often, a dividend cut represents a company's darkest hour, and ends up being a terrific time to buy.

But is that the case for TransAlta?

Compared to Canada's other large power generation company, **Fortis** (TSX: FTS), TransAlta seems like a bit of a mess. Fortis has increased its dividend for 41 consecutive years. It is a model of consistency. It owns some of the best power-generating assets in Canada, and has successfully expanded into other markets, including the United States. Why would I ever recommend investors look at TransAlta instead of Fortis?

Here are three reasons.

1. Insider buying

Back in February, CEO Dawn Farrell increased her holdings in the company by more than 50%, buying 20,000 shares on the open market. Based on the share price back then, she dropped more than $250,000 of her own money betting on her company.

It wasn't just Farrell who increased her holdings. Three other insiders purchased shares right around the same time, buying 11,000 shares between them.

Generally, I view insider buying as a bullish signal. After all, who knows more about a company than senior management? Investors who buy in now are getting shares at right around the same price paid by these insiders. Sure, I'd like to see a bigger bet than 31,000 shares between four highly paid executives, but it still has to be interpreted as a bullish sign.

2. Safe dividend

Throughout 2013, management insisted that the company's dividend yield was safe. They were obviously wrong.

Now that the company has taken its medicine and cut the dividend, the quarterly payout is safer than it's been in years. Its current dividend is just a third of the last quarter's free cash flow, leaving the company ample room to invest in aging plants and pay down its debt load.

Investors will have to be satisfied with the company's 5.6% yield, since it's not likely to raise the dividend at any point soon. Still, for investors looking for income, this is a great entry point.

If investors are looking for a little more income in exchange for limited capital gains, they could look at the company's Series D preferred shares, which currently yield 6.2%.

3. Increasing power rates

Higher power rates are going to be a reality for Canadians going forward.

In Alberta, the company's largest market, most consumers choose to let their power prices float with the unregulated rate, meaning the company can easily pass on price increases to customers. In Ontario, where prices are regulated, prices are projected to grow 33% over the next three years, thanks to strong demand and the shuttering of existing nuclear plants. Things are looking up for the company's two largest markets.

This is welcome news for the company, which was accused of fixing prices in Alberta back in February. The allegations are currently being investigated, and will continue to weigh down the stock in the short term. This should be of little concern for long-term investors, but is still something to keep in mind.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:TAC (TransAlta Corporation)
2. TSX:FTS (Fortis Inc.)
3. TSX:TA (TransAlta Corporation)

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