TransAlta Corporation: A Beaten-Up Dividend Stock for Contrarian Investors

Description

Once in a while the market serves up an opportunity for savvy investors to buy a solid dividend stock at a very attractive price.

Here are the reasons why I think contrarian investors should consider **TransAlta Corporation** (TSX:TA) (NYSE:TAC) right now.

Tough times

The last few years have been rough ones for TransAlta's investors, and every time it looks like things are about to turn around, the company gets hit with more bad news.

In early 2014 the company cut its beloved dividend from $1.16 per share to $0.64 amid a perfect storm of unexpected maintenance costs at its coal facilities and low power prices in Alberta.

Turnaround efforts

Management spent the rest of last year righting the ship. By the end of 2014 the company eliminated $500 million in debt, and TransAlta plans to reduce its obligations by another $300-500 million this year.

The company has also signed an agreement with Alstom to look after 10 large maintenance projects scheduled for the Keep Hills and Sundance facilities. The deal should deliver direct cost savings of $34 million.

Low power prices in Alberta are set to continue for a while, but the long-term outlook should be better as legislated power purchase agreements are set to expire in the next five years.

Hedging positions and a strong $650 million portfolio of long-term growth contracts should be adequate to maintain the dividend, which currently yields better than 7%.

Blind-sided

The recent election win in Alberta by the NDP has knocked about 15% off TransAlta's stock price because analysts fear the new premier will force a shutdown of TransAlta’s coal facilities.

That’s unlikely to happen, given the fact that most of the plants are scheduled for conversion from coal to natural gas over the next 15 years, and the province doesn’t have adequate additional supply to replace the output if the facilities are mothballed.

Cost is another factor. Albertans might not be so keen on shutting coal plants down too quickly once they realize their electricity bills could double, which has happened in Ontario. The abandonment of coal-fired electricity production in favour of greener solutions is a noble endeavor, but it comes at a high price.

Compelling valuation

TransAlta reported free cash flow per share of $0.40 for the first quarter of 2015. Dividend payments were just $0.18 per share, so the distribution is still easily covered.

TransAlta currently trades for $10 per share. The company owns about 75% of **TransAlta Renewables** , and that translates into $1.8 billion, or about $6.40 per share of TransAlta’s total valuation.

This means shareholders are effectively paying about $3.60 per share or just 2.25 times an estimated $1.60 per share of annualized free cash flow to own TransAlta Corporation.

That’s a great deal and you get a 7% yield to boot. At the current price, the stock also looks like a huge takeover target.

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1. Dividend Stocks
2. Investing

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Date
2025/08/26
Date Created
2015/06/05
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