Are SNC-Lavalin Group Inc. and TransAlta Corporation Top Takeover Targets?

Description

Merger and acquisition activity is heating up in all areas of the market as big companies with strong balance sheets tap ridiculously cheap capital to take advantage of strategic opportunities.

Much of the activity is located south of the border, but things are also starting to ramp up here in Canada, and two of the names that could become takeover targets are **SNC-Lavalin Group Inc.** (TSX:SNC) and **TransAlta Corporation** (TSX:TA)(NYSE:TAC).

SNC-Lavalin

The past five years have been quite volatile for shareholders of SNC-Lavalin.

The stock has been on a roller-coaster ride as the downturn in mining and energy markets and a series of corruption scandals have thwarted management's attempts to restructure the firm and regain investor confidence. Today the company still finds itself facing RCMP charges and a possible ban on bidding for government contracts.

Sometimes the market gets so scared by all the noise that it forgets to look at the numbers, and in the case of SNC-Lavalin, the investment case is compelling.

SNC currently trades for about $46 per share. The company is preparing to sell its stake in Highway 407, and analysts think that could be worth $3 billion, or about $20 per share. SNC also has about $2 billion in cash and short-term investments, worth another $13 per share.

This leaves roughly $13 per share for the rest of the business. The company earned $0.68 per share in Q1 2015. If we assume a very conservative $2 per share in earnings for the whole year, you are only paying 6.5 times earnings for the company.

SNC finished Q1 with a revenue backlog of $11.6 billion and the company has since won a major contract with the Canadian government to build and maintain Montreal's new Champlain Bridge. That suggests a ban is not likely in the cards.

SNC-Lavalin is a world-class company with a bright future, and it is ridiculously cheap right now.

TransAlta Corporation

TransAlta has also gone through a rough patch in the past few years. Low energy prices in Alberta and expensive maintenance work on its coal fleet combined to form a perfect storm at the beginning of 2014, and TransAlta was forced to slash its dividend to preserve capital.

The stock went into a free fall and now trades at just $10 per share. TransAlta had been on the rebound, but fears that the new NDP government in Alberta will force the early closure of TransAlta's coal facilities have sent the stock searching for new lows. Alberta relies heavily on these facilities for cheap power and there just isn't enough affordable alternative capacity available to fast track a wind-down of the plants, so I think the concerns are overblown.

Through all the turmoil, TransAlta's management has been working hard to reduce debt and the current hedging programs should ensure an adequate revenue stream to cover capital costs and the dividend.

The thing the market seems to be missing is the fact that TransAlta owns about 75% of **TransAlta Renewables,** and that stake is worth about $6.50 per share of TransAlta's valuation.

TransAlta reported free cash flow of $0.40 per share in the first quarter. This means you are only paying $3.50 per share for $1.60 per share of annualized free cash flow.

That's a crazy deal and it won't go overlooked for long.

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1. NYSE:TAC (TransAlta Corporation)
2. TSX:ATRL (SNC-Lavalin Group)
3. TSX:TA (TransAlta Corporation)

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