Why Investors Should Avoid TransAlta Corporation

Description

Troubled Canadian electric utility **TransAlta Corporation** (TSX:TA)(NYSE:TAC) continues to attract the attention of bargain hunters because of its low price-to-book ratio and monster 7% dividend yield. While it may appear attractive on the surface, it is facing a number of headwinds that will derail its performance and cause it to struggle for the foreseeable future.

Now what?

A key issue faced by TransAlta is the pressure to move to cleaner renewable energy generation. This, coupled with fears over global warming, is causing governments to apply considerable pressure to the power-generating industry to reduce its carbon footprint.

In fact, in TransAlta's key market of Alberta, the government is in the process of implementing a range of policies to reduce the province's carbon footprint. These include doubling Alberta's carbon levy over the next two years as well moving to reduce the number of coal-fired power plants operating in the province. This includes reducing the amount of electricity generated by coal-fired plants from 40% to 12% by 2030.

These moves certainly don't bode well for TransAlta, which is the largest power supplier in Alberta generating 5,200 megawatts, of which, 69% comes from coal-fired plants that generate a third of its total EBITDA.

Any accelerated phase out of coal-fired power generation in the province also means the economic life of TransAlta's recently completed Keephills-3 coal-fired plant is essentially halved. This is bad news for TransAlta and its partner **Capital Power Corp.,** which, between them, invested over $3 billion in the plant that generates 450 megawatts of power. They won't receive the full benefit of their investment.

TransAlta is already struggling with low electricity prices in Alberta because of a supply glut, and with the province expected to fall into a recession because of the oil crisis, electricity prices will remain weak. This will also mean that demand in the province will decline, and is a significant problem for TransAlta because Alberta generates 40% of its EBITDA.

This is already having a sharp impact on TransAlta's financial performance. Its first quarter 2015 cash flow was almost halved when compared with the same period in 2014. Even more worrying is that the pressure to phase out coal-fired electricity generation in Alberta will increase TransAlta's costs and force it to write down the value of its assets in the province.

So what?

This is not the type of outlook that I seek when choosing a company to invest in, particularly with TransAlta already having completed a costly program of work to upgrade its coal-fired plants and reduce emissions. TransAlta is operating in what is typically perceived to be a defensive industry, and yet it is paying out more than double its net income in dividend payments.

For these reasons I don't believe that TransAlta's performance will improve for the foreseeable future, making it a stock that investors should avoid.

CATEGORY

1. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:TAC (TransAlta Corporation)
2. TSX:TA (TransAlta Corporation)

Category

1. Investing

Tags

1. Editor's Choice

Date
2025/07/04
Date Created
2015/07/02
Author
mattdsmith