TransAlta Corporation: Is the Sell-Off Finally Over?

Description

The past five years have been tough ones for shareholders of **TransAlta Corporation** (TSX:TA)(NYSE:TAC).

In fact, the stock is down about 70% over that time frame, and long-term investors who have held on for the ride are hoping the non-stop barrage of bad news is finally at an end.

Their wish could be coming true.

A recent surge in the shares is attracting contrarian attention, and that might be the spark the company needs to head significantly higher. Let's take a look at TransAlta to see what's going on.

Stock slide

Low electricity prices coupled with high maintenance costs on the coal fleet have plagued the company for several years, and those troubles caught up with TransAlta in early 2014 when, in an effort to shore up the balance sheet, management decided to cut the quarterly dividend from $0.29 to $0.18 per share.

That's not supposed to happen with utilities. TransAlta lost its status as a favourite among dividend investors.

Through the rest of last year management made good progress in reducing debt, and things looked like they were on the rebound in the first part of 2015. Then the NDP won the Alberta provincial election, and it has been one long nightmare ever since.

Taxes have increased and the new government has made it clear that coal-fired electricity generation is not a part of the long-term power plan.

After the election, many investors simply threw in the towel and headed for the exits. An Alberta Utilities Commission report released in July only made things worse when it accused TransAlta of manipulating power prices.

To top things off, the energy sector is laying off staff like there's no tomorrow, and a lot less people are using electricity in Calgary's fancy office towers.

Earnings

TransAlta reported Q2 2015 EBITDA of $183 million, down $30 million when compared with Q2 2014. Funds from operations in the quarter came in at $160 million, a $6 million increase over the same period in 2014. The company had a Q2 net loss of $0.47 per common share.

The performance for the second quarter wasn't great, but management thinks the second half of 2015 will be better.

Dividend safety

TransAlta pays a quarterly dividend of $0.18 per share. At the current price, the yield is 10.6% and the market is bracing for another reduction, but that might not happen.

The company spent $104 million in the quarter on capital expenditures and about $51 million on dividends. That means funds from operations covered both outlays. The dividend should be safe, but any time a dividend yield gets this high, there is a risk of a cut.

Value play

Despite all the problems, TransAlta is an attractive stock based on its low valuation. The company owns 76% of **TransAlta Renewables**, which has a market value of $2.1 billion. That means TransAlta's part is about $1.6 billion. At the time of writing, TransAlta only has a market cap of $1.9 billion, so investors are paying just $300 million for the coal generation business plus a handful of other assets that have not yet been dropped down into TransAlta Renewables.

Should you buy?

All the bad news is probably priced in. Most of the coal plants are already on a schedule to be shut down or converted to natural gas, and it is unlikely the government will be able to fast-track that process. The stock looks extremely undervalued, and any good news could send it significantly higher.

It's a contrarian bet, but one I'm comfortable making.

CATEGORY

1. Energy Stocks
2. Investing

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aswalker