



## TransAlta Corporation: This Risky Stock Could Be a Huge Winner

### Description

These days, coal-fired power is about as sexy as Enron stock.

This sentiment is hurting everything from the producers who mine the commodity to the power producers who use coal as a fuel. **TransAlta Corporation** ([TSX:TA](#))([NYSE:TAC](#)) has been perhaps the hardest hit out of all the power producers as a result.

The company hasn't been helping itself out either. Over the past few years, its fleet of aging power plants has been plagued by expensive outages, both planned and unplanned. And although it does lock in the majority of its revenue via power-purchase agreements, it has still been affected by low power prices, which seem poised to stay in Alberta for the foreseeable future.

Even dividend investors have been hurt by TransAlta. After paying a consistent dividend for longer than a decade, TransAlta finally bit the bullet in 2014 and slashed the quarterly dividend from \$0.29 per share to \$0.18.

And yet after all that bad news I bought shares of this beleaguered power producer. Here's why I think shares will someday be worth much more than they are today.

### The death of coal? Not so fast

It's obvious the best choice over the long term is to get rid of coal. Ontario has already done it, and other jurisdictions look likely to pass their own coal bans over the upcoming years. The environmental impact of coal is too large to ignore.

But at the same time, coal is a huge source of energy. Take Alberta as an example. According to the government of the province, a whopping 55% of its power needs come from coal. Out of the 80,000 gigawatt hours produced in the province, more than 44,000 came from coal.

Coal-fired production isn't terribly easy to reproduce, either. Yes, coal plants can be converted to natural gas, but their output usually goes down after conversion. And coal is a cheap fuel that helps keep prices down for consumers. Natural gas is only temporarily cheap, and it will cost untold millions

to convert.

It's helpful to look at Ontario's example of how difficult it'll be to get rid of coal completely in Alberta. It took Ontario 11 years to fully get rid of coal, and it only accounted for 25% of the province's electricity. Ontario might have been the easiest place in Canada to make such a conversion.

### **TransAlta shares are very cheap**

Because of all the uncertainty surrounding coal, TransAlta shares have sold off to the point where they're very cheap.

Let's look at them from a book value perspective first. The stated book value at the end of September was more than \$15 per share. But since much of TransAlta's assets are in power plants that have slowly been depreciated, it's easy to make the argument that the replacement value of the assets is closer to \$20 per share.

From a free cash flow perspective, shares are equally as cheap. Through the first three quarters of the year, the company generated \$0.71 per share in free cash flow. It's on pace to generate \$0.95 per share in free cash flow for 2015, which puts shares at over 6.3 times projected free cash flow over the year.

You won't find another power producer that cheap in Canada, at least based on those two metrics.

There are still issues the company has to work through. It would be prudent for management to slash the 12% dividend on the common shares. And it was recently slapped with a \$56 million fine from the Alberta government for its part in a price-fixing scandal. The company's debt also needs to be reduced.

But these are fixable problems, provided the newly elected NDP government in Alberta doesn't do anything rash. It is currently coming up with a climate plan, which Premier Notley will present at United Nations talks in Paris at the end of November. The NDP has promised a phase out of coal power plants, but without a firm date.

With such a high percentage of Alberta's power being generated from coal-fired plants, I'm betting the phase out will be very reasonable. If it's good news, it could be the beginning of TransAlta shares marching much higher. All they need at this point is a positive catalyst.

### **CATEGORY**

1. Dividend Stocks
2. Energy Stocks
3. Investing

### **TICKERS GLOBAL**

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

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nelsonpsmith

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