# TransAlta Corporation: Is This Stock a Buy on Big News?

## Description

It's been a busy couple of days for **TransAlta Corporation** (TSX:TA)(NYSE:TAC).

It started on Sunday when Alberta premier Rachel Notley finally announced the details of the government's much-awaited climate change strategy. Highlights of the plan include a phased-in carbon tax of $30 per tonne, a cap on oil sands emissions starting in 2017, and, most importantly for TransAlta, a plan to end coal-powered electricity in the province by 2030.



TransAlta's management also made a company-specific move on Monday. It sold $540 million in Ontario and Quebec wind and hydro assets to its subsidiary company, **TransAlta Renewables Inc.** ( TSX:RNW).

Renewables is paying for the sale by selling $200 million worth of shares that TransAlta currently holds to AIMco, Alberta's Investment Management Corp. It'll also issue $215 million in unsecured debentures as well as $175 million worth of shares to the parent company.

By the time the transaction is completed, TransAlta's ownership stake will be approximately 65% in its subsidiary, down from 76% now. And, as part of the deal, Renewables just announced a dividend increase for January, when it anticipates the transaction will close.

There's been a lot of changes in TransAlta over the last couple of days. How do these changes affect the future of the stock? Let's take a closer look.

**Good news on the coal front**

TransAlta got good news from the Notley government. A $30 per tonne carbon tax is manageable, and the company already planned to move away from coal by 2030 anyway. Currently, the company generates approximately 5,000 megawatts worth of power from burning coal. Even before Notley's plan was finalized, the company projected that just 500 megawatts of power would come from coal-fired plants by 2030.

I think investors have this assumption that TransAlta is the power equivalent of a stubborn grandfather, hanging on to coal for dear life. Nothing could be further from the truth. Plans have been in place for years for the company to slowly wean itself off coal. Everybody–including TransAlta's management–realizes coal is not the fuel of the future.

Coal has a place today. The majority of Alberta's electricity is still generated by burning coal, and it just isn't economically feasible to switch immediately to renewables. Notley's government did the right thing by giving companies like TransAlta time to react.

It's little wonder why shares were up 10% on the news before retreating during Tuesday's trading session.

**TransAlta still has problems**

One of the factors holding TransAlta back was Notley's climate change strategy. Investors now have a better understanding of what the future is going to be like.

But TransAlta still has issues. The biggest is the company's balance sheet. The current debt load exceeds $4.5 billion, while total assets are just $10.8 billion. And the company also has close to $1 billion in preferred shares outstanding as well. The transaction with Renewables will reduce the company's debt by about $350 million, which is a good start.



The company would be smart to further cut the dividend to free up more cash to pay down debt. Currently, the dividend costs the company approximately $160 million per year.

TransAlta also ran afoul with the Alberta government by fixing prices back in 2011. It only settled with the province's regulators a few weeks ago, agreeing to a $56 million fine, $31 million of which is payable immediately, while the other $25 million isn't due until November 2016. The fine isn't much to a company with more than $10 billion in assets, but it still hurts.

And finally, TransAlta needs power prices to go higher in Alberta. During the most recent quarter the price of power averaged $26 per megawatt hour compared to $64 during the same quarter last year. The majority of its production is locked into long-term contracts, but those start unwinding in 2017. Investors are worried any new contracts will be at much lower prices, thus hurting profitability.

TransAlta recognizes there are problems, and the company is taking positive steps towards fixing them. Now that Alberta's climate change stance is clear, I think the company has a good chance of turning itself around. It'll likely take years, but the stock is cheap enough now that the potential upside could be huge.

**CATEGORY**

1. Dividend Stocks
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**TICKERS GLOBAL**

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2. TSX:RNW (TransAlta Renewables)
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