



Is Warren Buffett Thinking of Buying TransAlta Corporation?

Description

There's no denying it; **TransAlta Corporation** ([TSX:TA](#))([NYSE:TAC](#)) is a cheap stock.

The company trades at a steep discount to its book value. Even after stripping out the intangible assets, book value is \$9.34 per share, more than double the current price of \$4.39. The company estimates free cash flow will be approximately \$1 per share in 2016, putting shares at just over four times free cash flow. Even from an enterprise-value-to-EBITDA perspective, TransAlta is about half the price of Canada's other large power producers.

Of course, there's good reason why shares are so cheap. The company estimates about 25% of its earnings come from coal-fired power plants in Alberta, a fuel which will be phased out of the province by 2030. Additionally, a newly issued carbon tax will make TransAlta's operations more expensive.

There's another issue too, and that's the debt. TransAlta owed approximately \$4.5 billion as of September 30, a number which will be lower because it closed a drop-down transaction with **TransAlta Renewables Inc.**, its greener subsidiary. Still, that's a high number, especially for a company with a market cap of \$1.25 billion.

The company is pulling out all the stops in trying to slay the debt, including cutting its once very generous dividend by more than 75% in January. The current payout is \$0.04 per share on a quarterly basis, good enough for a yield of 3.6%.

It's obvious at this point that TransAlta would be helped by no longer being a public company. Management could work on the turnaround plan without having to worry about appeasing investors. And if a larger company with deeper pockets took it over, it wouldn't be forced to sell assets to pay down the debt, even if the buyer of these assets is still 64% controlled by the company.

TransAlta's valuation also makes it attractive for a potential buyer. Even if the acquirer paid a handsome 50% premium to today's stock price, they'd still be picking up the company for less than book value and only at about seven times free cash flow.

In fact, there's one buyer who makes perfect sense. He specializes in picking up good assets on the

cheap. He's already familiar with the power generation business. And his pockets are deep enough that TransAlta's debt problems would automatically go away.

That man is Warren Buffett.

Why Buffett?

There are plenty of reasons why Buffett is a logical buyer for TransAlta.

Firstly, he has plenty of experience in the energy sector. **Berkshire Hathaway**-owned MidAmerican Energy provides power for 1.4 million customers in Iowa, Illinois, South Dakota, and Nebraska. Berkshire also owns PacifiCorp, which serves an additional 1.8 million customers in six western states. Buffett knows the power business well.

Berkshire has also partnered with TransAlta in the past. MidAmerican is a 50% owner of TransAlta's Sundance 7, a gas-fired power plant which is scheduled to come on stream in 2018. This partnership was announced back in 2012.

There's the valuation factor as well. Buffett likes buying predictable cash flow he can tuck away for a long time. Sure, you can argue that the Canadian coal side of TransAlta isn't very predictable, but there's much more to its business than just coal-fired power. As [I've argued before](#), TransAlta is so cheap that investors are getting it for less than what its stake in TransAlta Renewables is worth.

And finally, it's been widely rumoured that somebody is trying to buy TransAlta. CEO Dawn Farrell won't comment specifically on any rumours, but people familiar with the matter are telling the press the company has been having active discussions with buyers for months, with a deal almost being reached in October.

I don't know if Buffett is among these potential buyers. Even if he's not involved, there's a lot to like about TransAlta at these levels. Somebody could end up acquiring the company. And even if it isn't bought out, I still like TransAlta's chances to turn itself around.

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3. NYSE:TAC (TransAlta Corporation)
4. TSX:RNW (TransAlta Renewables)
5. TSX:TA (TransAlta Corporation)

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