Why TransAlta Corporation Remains an Unattractive Investment

Description

The last year has been challenging for **TransAlta Corporation** (TSX:TA)(NYSE:TAC) as it has faced a range of headwinds. Among them were the penalties levied by the regulator in Alberta for price manipulation and the introduction of tough new greenhouse emission policies in that province.

Despite these and other headwinds, some analysts believe that TransAlta offers a deep-value investment opportunity. This couldn't be further from the truth, and the company faces further difficult times ahead.

Now what?

TransAlta's 2015 results were poor. The company continued to bleed red ink, reporting a net loss of $0.09 per share. Furthermore, comparable EBITDA fell by almost 9% compared with 2014 and cash flow from operations plunged by 46% year over year.

The sharp decline in TransAlta's financial performance can be primarily attributed to significantly lower energy prices in its core market of Alberta, where 65% of its power-generating capacity is located. These markedly weaker prices were triggered by a sharp reduction in demand because of a significant decrease in activity in the oil patch due to the sustained weakness of crude.

There are signs that weak electricity prices will continue to adversely impact TransAlta's financial performance for the foreseeable future. The price of oil remains around US$40 per barrel. This is well below the price required for oil companies to generate sufficient cash flow to renew exploration and development activities.

TransAlta is also heavily exposed to the new climate change regulations introduced by the Albertan government, which intends to phase out coal-fired power generation by 2030. This will adversely impact TransAlta because a third of its EBITDA comes from coal-fired electricity generation in Alberta.

It will also force TransAlta to retire a number of coal-fired plants well before the end of their economic life, meaning that it will be unable to recoup the full value of the investment it made in those plants. Key among these will be the Keephills-3 plant, in which it and **Capital Power Corp.** invested $3 billion to complete it. This comes after the company recently completed a costly refit of its coal-fired plants to upgrade them to clean-coal technology.

Then there is the massive mountain of debt that TransAlta is carrying. It has net debt totaling $4.3 billion, or almost 10 times its cash flow from operations. Of this debt, $1.6 billion matures over the next three years, applying even greater financial pressure on TransAlta at a time when it is experiencing declining cash flows.

A stronger U.S. dollar also continues to weigh heavily on TransAlta with 52% of that net debt denominated in U.S. dollars. As a result, it is heavily exposed to a resurgent U.S. economy; any further gains in the value of the U.S. dollar and additional rate hikes by the Fed will increase the costs associated with that portion of its debt.

All of these financial pressures caused TransAlta to slash its dividend at the start of 2016 to almost a fifth of what it was previously. The dividend now yields a paltry 2.7%. If TransAlta comes under further financial pressure, another dividend cut would certainly be on the table.

So what?

Given the volume of headwinds that TransAlta is facing and the fact that these will impact its operations for some time to come, it will be difficult to see any recovery in its financial performance. This makes TransAlta an unattractive investment, particularly when there are far better opportunities available in other industries and sectors of the economy.

CATEGORY

1. Investing

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1. NYSE:TAC (TransAlta Corporation)
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Date
2025/08/24
Date Created
2016/04/21
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