TransAlta Corporation: Time to Buy This Unloved Stock?

Description

TransAlta Corporation (TSX:TA)(NYSE:TAC) jumped 6% March 3 after delivering steady numbers for Q4 2016.

Let's take a look at the beleaguered power producer to see if it deserves to be in your portfolio.

Recovery mode

TransAlta went from being a $20 stock at the beginning of 2012 to a $4 stock in early 2016 as a perfect storm of low power prices, an oil crash, and negative sentiment toward coal-fired electricity generation hit the company.

Since then, the shares have been on the rebound, and more upside could be on the way.

Why?

TransAlta hammered out a deal with the Government of Alberta last year which eliminated uncertainty surrounding the province's plans to wean itself off coal-fired electricity generation.

The agreement with TransAlta and its peers sees the province paying impacted companies an annual fee from 2017 to 2030 to help them make the transition away from coal.

TransAlta is set to receive about $37.4 million per year to assist with its program of switching plants from coal to natural gas.

Alberta is also modifying its power market to pay producers for the capacity they have as well as the electricity they produce. This should motivate investment in new infrastructure to replace the capacity lost by shutting down some of the coal facilities.

Alberta gets a significant amount of its power from the existing coal plants, so it had to come up with a plan to ensure the capacity would be replaced.

TransAlta has committed to remain a major player in the market and intends to invest in new projects.

Efforts to strengthen the balance sheet continue. TransAlta finished 2016 with net debt of $3.89 billion, which is down from $4.25 billion at the end of 2015.

2017 outlook

TransAlta expects 2017 to be slightly better than last year as the South Hedland project is scheduled to come online and begin contributing to the revenue stream. The company is also set to receive its first transition payment from Alberta.

Weak power prices are forecast to persist in Alberta and the Pacific Northwest for the next year or two, but better days could be on the horizon in the medium term.

Dividend safety

TransAlta drastically reduced its dividend in recent years to preserve cash flow. The current quarterly payout of $0.04 per share should be safe and provides a yield of 2.1%.

Should you buy?

The stock remains unloved, but it might be time for contrarian investors to take a hard look.

Why?

The uncertainty surrounding the Albertan power market has been lifted, and TransAlta is making progress on its debt-reduction efforts.

On top of that, at the time of writing, TransAlta has a market capitalization of about $2.2 billion, but its ownership position of its subsidiary **TransAlta Renewables Inc.** (TSX:RNW) is worth about $2.1 billion.

So, the market isn't putting any value on the assets that have not been dropped down into RNW.

Tough market conditions will persist for the near term, but better days should be in the cards in the next five to 10 years. As such, investors with a buy-and-hold investing style might want to pick this stock up while it is still in the dog house.

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