Contrarian Investors: Is This Former Dividend Star Oversold?

Description

Investors are having a tough time finding value in the current market.

Let's take a look at **TransAlta Corporation** (TSX:TA)(NYSE:TAC) to see if it might be attractive right now.

Painful times

A perfect storm of high debt, falling power rates, and opposition to coal-fired electricity generation hit TransAlta hard in recent years.

As a result, management had to slash the dividend a number of times, sending long-term investors for the exits.

Five years ago, TransAlta traded for $20 per share. At the lowest point in early 2016, it slipped below $4.

Better days ahead?

Investors who had the courage to buy at that point are sitting on some healthy gains. The stock is back above $7 and better days might be on the way.

Why?

Management has done a good job of reducing debt. The company finished 2016 with net debt of $3.89 billion, which was down from $4.25 billion at the same time the previous year.

On top of that, a deal negotiated with Alberta has now cleared up any confusion regarding the future of the company's Alberta-based coal plants.

Under the agreement, Alberta will pay TransAlta about $37.4 million per year through 2030 as assistance to help the company transition away from coal.

Alberta is also switching the set-up of its power market to a system where it will pay power companies for their capacity as well as the power they produce. This should provide the incentive needed to attract investments in renewable energy.

The province relies on coal plants for close to half of its electricity, so new power generation will be required to replace the capacity lost due to the closing of some plants.

As part of its deal, TransCanada is committed to remaining a key player in the Alberta market.

Steady results

Power prices remain weak, but TransAlta expects 2017 results to be better than last year, as the South Hedland project comes online and the first transition payments kick in from Alberta.

The current quarterly dividend of $0.04 per share should be safe and provides a yield of 2.2%.

Value play

TransAlta owns a majority interest in **TransAlta Renewables Inc.** (TSX:RNW). At the time of writing, the RNW holdings are worth about $2.1 billion.

TransAlta's market capitalization is only about $2 billion, so the market is essentially putting no value on the assets that TransAlta still owns.

Should you buy?

Power prices are expected to remain weak for the medium term, and the oil industry is still struggling. That said, the long-term outlook for TransAlta should be positive.

If you have some patience, it might be worthwhile to pick up the stock while it is still unloved. TransAlta looks cheap today, and you can sit back and collect the dividend until better days arrive.

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