Why This Defensive Company May Be on the Verge of a Breakout

Description

Over the past year, those who have bought shares in **Algonquin Power & Utilities Corp.** (TSX:AQN)(NYSE:AQN) have had the opportunity to obtain a bargain at a price of less than $12 per share and a dividend yield in excess of 5%, reaping the rewards of capital appreciation in the process.

As shares have increased by more than 20% throughout 2017 amid a dividend increase and a major acquisition, the question for investors seeking the next investing opportunity is:

What stock do I buy next?

Enter **TransAlta Corporation** (TSX:TA)(NYSE:TAC). At a current price of $7.40 per share, TransAlta offers investors a dividend yield of almost 2.25%, as the company continues to turn out a significant amount of cash flow from operation (CFO). Throughout the first three quarters of 2017, the dividends paid represented no more than 12% of CFO, which is down from 15% from the full fiscal year of 2016.

In the business of electricity generation, the nature of operations is to operate at long-term breakeven prices and typically pay out a high amount of the cash in the form of dividends that is generated. In this case, however, the company chose to retain a large amount of the cash generated by the business and build the amount of cash and short-term assets on the balance sheet. Essentially, the amount of cash waiting to be deployed to the advantage of shareholders is growing and becoming more attractive by the day.

With close to $100 million available in cash and a current ratio (current assets/current liabilities) of 2.6 (excluding the current portion of long-term debt), the company is currently sitting on the potential to raise additional debt and buy back a significant number of shares. As of the most recent financial statements, the company was holding assets totaling $1.48 for every dollar of liabilities on the balance sheet.

By the time investors get to the shareholders' equity section, they will realize that there is actually tangible book value of $8.90 per share, which means that shares currently priced at $7.40 are trading at a discount of 17% to the value of the company in an orderly liquidation.

With a total number of shares outstanding held constantly for more than one year, the catalyst may just be around the corner.

The simple moving averages (SMAs) are showing a clear bottom and potential for a breakout, as the 10-day, 50-day, and 200-day SMAs are all in line with the current shares price, and the previous support level of $7 per shares seems to be re-establishing itself at $7.25.

Although this name is not for everyone, it is important to set proper expectations. As a defensive investment, this is a low-risk, medium-reward investment that will deliver throughout all phases of the economic cycle. With a dividend that can easily be increased, or a share buyback program undertaken, investors need to offer this name solid consideration as a permanent holding in their portfolios.

CATEGORY

1. Dividend Stocks
2. Investing

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