Is the 45% Rally in 2019 Just the Beginning for This Unloved Canadian Stock?

Description

1. The rebound in the Canadian stock market in the first two months caught many investors by surprise, and those who are sitting on the sidelines with some extra cash are wondering where opportunities might still exist.

Let's take a look at **TransAlta** (TSX:TA)(NYSE:TAC) to see if it deserves to be on your buy list today.

Long time coming

TransAlta is finally showing signs of life after a multi-year downturn that saw the company slash its coveted dividend amid efforts to protect cash flow while it fought to steady the ship on stormy seas.

What happened?

High debt levels, falling power prices, the Alberta oil rout, and opposition to coal-fired electricity generation all hit TransAlta simultaneously. The stock dropped from $37 to $20 during the financial crisis, and continued to drift lower until finally bottoming out around $4 per share in early 2016.

Since then, it has bounced around as management worked through the difficult times, but the recent surge to levels not seen since 2015 is attracting new interest.

Earnings

TransAlta reported solid results for 2018. Funds from operations increased 15% to $927 million compared to the previous year. Free cash flow increased 60% to $524 million, or $1.83 per share.

The company made good progress on its coal-to-gas conversion program in Alberta in 20218 and the work continues. Under an agreement with the province, TransAlta is receiving about $37 million per year to assist with the transition.

Management also remains focused on the process of strengthening the balance sheet, with net debt falling by $220 million to $3.1 billion in 2018. TransAlta is ahead of its previously announced debt reduction plan.

Outlook

Power prices are expected to improve in the coming years and Alberta's decision to change its system to pay producers for both capacity and the power they generate should support ongoing investment in renewable power generation. TransAlta is committed to growing its renewable presence in the province.

According to the Q4 2018 earnings release, TransAlta remains on track to achieve its goal of being 100% clean power by 2025.

Opportunity

The company owns a 61% of **TransAlta Renewables** (TSX:RNW). At the time of writing, RNW has a market capitalization of $3.22 billion, which puts TransAlta's stake at just under $2 billion. At the current price of $8.10 per share, TransAlta's market capitalization is $2.3 billion. Pundits who follow the stock have suggested the market is not proving adequate value to the legacy assets held by TransAlta.

In addition, the solid free cash flow improvements could lead to a dividend hike sooner than expected. The existing payout provides a yield of 2%.

Should you buy?

The storm clouds appear to have cleared, and while work remains, TransAlta is on the mend. If you have a buy-and-hold investing style, it might be worthwhile to add the stock to your portfolio before the rest of the market starts to take notice.

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