TransAlta (TSX:TA): A Cheap Stock Trading at a New Multi-Year High

Description

Patient investors are finally getting excited again about a beaten-up Canadian utility stock that might finally have some light at the end of the tunnel.

A decade ago, **TransAlta** (TSX:TA)(NYSE:TAC) traded above $20 per share and paid an attractive dividend. Income investors thought the Alberta-based utility company's payout would be safe, but a series of misfortunes hit TransAlta, forcing it to cut the quarterly payout from $0.29 per share to $0.18 in 2014, and then again to just $0.04 in 2016, where it remained until the recent increase.

Investors bailed out as the situation went from bad to worse, and the stock eventually bottomed in early 2016 below $4 per share.

What happened?

High debt levels, falling power prices, an economic slump in Alberta, and opposition to coal-fired power generation put TransAlta on its heels. Fortunately, the company put a recovery plan in place that has resulted in reduced debt and a transition to green energy that will see TransAlta remain a major player and investors in Alberta for decades.

The company is receiving about $37 million per year from Alberta as part of a deal to help TransAlta convert its coal plants to run on natural gas. A new regulatory framework for the power industry in Alberta should also help, as producers will be paid for capacity, as well as the power they sell. The program is designed to provide power generation companies with the incentive to invest in green energy projects in the province.

Since 2016, TransAlta has made good progress on the transition and the share price has gradually recovered. The stock is back up to $10.20 per share in recent trading. That's the highest the shares have traded since June 2015.

Investors who bought at $4 are already sitting on some nice gains, but more upside should be on the way. The board recently raised the dividend to $0.0425 per share. This is a sign that the company has turned the corner, and as free cash flow expands in the coming years, investors should see the payouts continue to climb.

Value play

Fans of the stock suggest the share price should be much higher based on the value of the assets. TransAlta owns about 60% of **TransAlta Renewables**. The subsidiary acts as a drop-down vehicle for TransAlta's renewable energy assets and has operations in Australia and the United States, as well as Canada.

At the time of writing, TransAlta's stake in TransAlta Renewables would be worth about $2.7 billion. TransAlta's market capitalization is $2.9 billion.

An internal report at TransAlta suggests that the stock should trade several dollars higher than its current level if the market placed a value on the assets based on existing market valuations given to U.S.-based companies that are in the same segments.

Should you buy?

TransAlta has turned the corner, and the outlook for the company in the next few years should be positive. Free cash flow is expected to jump considerably beyond 2022, and that should support ongoing dividend hikes and a rising share price.

A takeover bid wouldn't be a surprise. If that occurs, investors could pick up a nice buyout premium.

If you have some cash sitting on the sidelines, TransAlta appears attractive today.

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