



TransAlta's (TSX:TA) Stock Price Soars 25%: Should You Buy?

Description

TransAlta ([TSX:TA](#))([NYSE:TAC](#)) is up 25% in the past month, and investors are wondering if this is the start of an extended rally in the Canadian power producer's stock price.

Let's take a look at the current situation to see if TransAlta deserves to be on your [buy list](#) right now.

Recovery mode

TransAlta's recent bounce is a relief for long-time followers of the stock, who watched the company go through a multi-year slump that saw its share price plunge from a high of \$37 in 2008 to a below \$4 in early 2016. The rout started during the Great Recession and was extended through the worst days of the downturn in the energy sector.

TransAlta found itself with too much debt, falling revenue due to weak power prices, and an uncertain future in Alberta during negotiations with the province on plans to convert the coal-fired power generation facilities to natural gas. The company slashed the dividend twice from \$0.29 to \$0.18 and then to \$0.04 per share. That led to a sell-off in the stock, as income investors gave up hope and searched for other opportunities.

In the past four years, however, TransAlta has slowly recovered. The company has greatly improved the balance sheet. Net senior recourse debt fell from \$3.4 billion in 2015 to about \$1.4 billion in 2019 and is targeted at \$1.2 billion by the end of 2020.

An agreement between Alberta and the power producers helped remove concerns about TransAlta's future in the province. Under the deal, Alberta is paying TransAlta more than \$37 million per year through 2030 to help cover the transitions costs of moving away from coal.

TransAlta is on track to be a 100% green energy producer in the province beyond 2025. As part of the arrangement, TransAlta is committed to making investments in Alberta's power industry. A statement from the new government in 2019 said Alberta's electricity sector needs about \$12 billion in new investment.

Outlook

The 2020 guidance that came out in January indicates TransAlta is targeting free cash flow of \$325-\$375 million this year. The company intends to buy back up to \$80 million in shares and hiked the quarterly [dividend](#) to \$0.0425 per share.

Progress is being made on a number of capital projects that should see the company invest up to \$1.9 billion through 2023 at TransAlta and its subsidiary, **TransAlta Renewables**.

Opportunity

TransAlta's stake in TransAlta Renewables is worth about \$2.8 billion, yet TransAlta's market capitalization is just \$3 billion. Pundits have argued for some time that the stock is heavily oversold, and TransAlta's investor presentation in November provided a chart to support that theory.

The company said it should be trading at an additional \$6-9 per share based on multiples the market is giving to merchant U.S. power companies. TransAlta traded for close to \$8.50 per share at that point, so there could still be some significant upside if investors start to agree with the company's analysis. At the time of writing, the stock trades at \$10.80 per share.

Takeover potential

TransAlta could become a takeover target. The businesses churn out attractive cash flow that might be of interest to private equity firms now that it appears the company has turned the corner on its recovery plan.

In the event a bidding war emerges, investors could see a nice premium.

Should you buy?

Free cash flow should continue to climb, and that will support ongoing dividend hikes and buybacks. As a result, the stock should slowly rise in the coming years, even if a takeover doesn't occur.

If you are searching for a value stock to add to your portfolio, TransAlta deserves to be on your radar today.

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Date

2025/07/03

Date Created

2020/02/10

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