



Brookfield (TSX:BAM.A) Just Bought This TSX Stock: Should You?

Description

As the **Toronto Stock Exchange** plunged more than 5,000 points in March, [smart money buyers](#) such as **Brookfield Asset Management** (TSX:BAM.A)([NYSE:BAM](#)) saw opportunity. On March 18, one of the lowest trading days of this year, Brookfield announced the acquisition of 1.1 million shares of **TransAlta** ([TSX:TA](#))([NYSE:TAC](#)) at \$5.64-\$5.74 per share.

This move increased Brookfield's ownership stake to 10.1%. The price has recently jumped back to the \$7 range, but should retail investors buy like Brookfield?

TransAlta Renewables

TransAlta generates 8,000 MW of power through a mix of 73 non-regulated power generating assets (coal, natural gas, and hydro) and a 60% managing stake in **TransAlta Renewables** (wind generation assets). Its assets are located primarily in Alberta (62% of assets) , but also in other parts of Canada, the U.S., and Australia.

Why is Brookfield interested?

Since March 25, 2019, Brookfield has become a strategic investor in TransAlta. In an initial agreement, Brookfield injected \$750 million of capital into TransAlta, in return for a convertible stake in TransAlta's hydro power assets.

Brookfield Renewables ([TSX:BEP.UN](#))([NYSE:BEP](#)) has a diverse portfolio of hydro assets, so significant synergies are obvious. The investment strengthened TransAlta's balance sheet, providing extra capital to execute its fleet greening initiatives (coal-to-gas conversion). Overall, TransAlta has become a true turnaround story, and thus far, the story looks good.

A turnaround story in the making

First, management has committed to producing 100% clean energy by 2025, including converting its coal-powered assets to natural gas. Brookfield's investment was a crucial boost to this strategy. The conversion is good for the environment and good for the company, as it should reduce the assets overall cost structure.

Second, its balance sheet has improved. The Brookfield investment will help TransAlta pay off a 2020 payable bond (worth \$400 million) without additional financing or dilution. Over the past few years, TransAlta has reduced its senior recourse debt by more than 50% to \$1.2 billion. Today, that debt sits at about \$1.7 billion of liquidity.

Last year, TransAlta added three new highly experienced directors (two nominated by Brookfield) and management appears more focused on accretion of value for shareholders. In 2020, the company has set \$80 million aside for stock buybacks, and management has committed to distributing 10 to 15% of its funds from operations(FFO) to shareholders in dividends.

Third, TransAlta has some nice growth opportunities. In 2019, it completed and commissioned \$340 million of wind projects. It has another \$400 million of renewable projects set for completion in 2020 and 2021.

These measures will boost EBITDA by around \$25 million in 2020 and \$40 million in 2021 and 2022. TransAlta also has 900 MW of potential projects for its present fleet, and another 2,000 MW of new renewable growth projects under consideration.

A cheap stock

TransAlta is a very cheap stock. While it was cheap — and rightly so — a few years ago, the company is in a significantly better position today. Management believes the market has drastically discounted the value of its thermal assets, although this segment still produces \$385 million of EBITDA annually.

Similarly, TransAlta's hydro segment will see its power purchase agreements roll out in late 2020. As society requires cleaner power, demand for TransAlta's hydro assets should garner a significantly higher market price than present. As a result, these assets could receive a significant value re-rating.

Buy like Brookfield

TransAlta is in a better position financially and strategically than in past years, albeit it does pose some risks. Its Alberta assets are non-regulated, and electrical demand and pricing could be impacted by the COVID19 crisis.

How accretive the transition from coal-powered plants to natural gas will be is another unknown. Yet, much of this uncertainty is already priced into the stock. The stock is trading at a 35% discount to its price in February with a price to FFO ratio of 2.6 times.

[Think very long term](#) with this stock — and counter to the market. Also think value. Over the next five years, you probably won't regret thinking like Brookfield and buying TransAlta down here.

CATEGORY

1. Dividend Stocks
2. Investing

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2. NYSE:BN (Brookfield Corporation)
3. NYSE:TAC (TransAlta Corporation)
4. TSX:BEP.UN (Brookfield Renewable Partners L.P.)
5. TSX:BN (Brookfield)
6. TSX:TA (TransAlta Corporation)

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