Canadian Investors: Ride Out the Volatility With TransAlta Renewables (TSX:RNW)

Description

Boosted by the stimulus from the government and the central bank, the Canadian equity markets have recovered strongly from March lows. However, the economic indicators are still weak, with unemployment being on the higher side. Also, the financial risks associated with the outbreak of COVID-19 and geopolitical tensions could add more pain. So, I expect the markets to remain highly volatile for the rest of this year.

Given the uncertain outlook, I believe it is better to go defensive. **TransAlta Renewables** (TSX:RNW) will be an excellent defensive bet given its recession-resistant business model and stable cash flows. So far this year, the company has returned more than 0.5%, outperforming the S&P/TSX Composite Index, which has fallen by over 4% this year.

Operating metrics

TransAlta Renewables owns and operates 13 hydro facilities, 19 wind farms, and one natural gas plant in Canada. Along with these assets, the company also has economic interests in other diverse assets located in the United States and Australia. Together, these assets offer an electricity-generating capacity of 2,555 megawatts.

The company sells the energy generated from these assets through long-term PPAs (power-purchase agreements) to public power authorities, load-serving utilities, and industrial customers. So, the company's earnings and cash flows are largely stable.

Despite the pandemic, the company's adjusted EBITDA grew by 3.6% to $115 million in its recently completed quarter. Meanwhile, its adjusted funds from operations increased by 12.5% to $90 million.

Also, during the quarter, the company's energy production from renewable sources increased by 231 gigawatt hours. The increased output from solar and wind facilities in the United States and higherwind resources in Canada contributed to the company's production growth.

Liquidity and dividends

During the second quarter, TransAlta Renewables generated $71 million from its operating activities, which represents year-over-year growth of over 36%. Meanwhile, at the end of the quarter, the company's liquidity stood at $498 million. So, the company has ample liquidity to ride out this pandemic-infused crisis and also pay its dividends.

The company has been paying dividends monthly since September 2013. It has increased its dividends at a CAGR of 4%. Currently, the company pays dividends of $0.07833 per share every month, which translates to a yearly payout of $0.90 per share. So, the company's dividend yield currently stands at a healthy 5.8%.

Outlook

Amid the concerns over environmental pollution, the world is moving towards renewable resources to meet its energy requirement. Being an early mover, I believe TransAlta Renewables is well positioned to benefit from this favourable shift.

Recently, many companies have withdrawn their guidance due to the uncertainty over the impact of the pandemic. However, the company's management has reiterated its guidance for 2020. The management expects its adjusted EBITDA for 2020 to come in the range of $445 million to $475 million compared to $438 million in 2019.

Also, the weighted average remaining contractual life of its PPAs stands at 11 years. So, the company's outlook looks healthy and stable.

Bottom line

Currently, TransAlta Renewables trades at 23 times its estimated earnings for the next four quarters. Also, the company's forward enterprise value-to-EBITDA stands at 10.7. Given its recession-resistant business model, predictable cash flows, and attractive dividend yield, the company's valuation looks attractive.

Amid volatility, I believe TransAlta Renewables would be an excellent buy for investors who are not only looking to protect their capital but also earn regular dividends at a healthier yield.

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