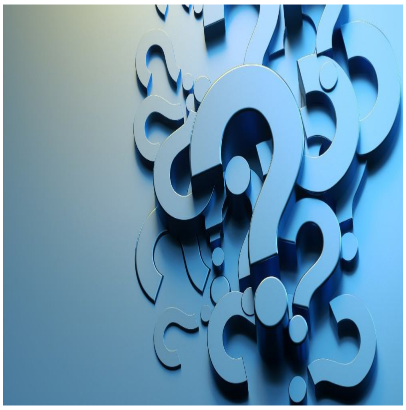

Is TransAlta Stock a Screaming Buy Today?

Description

TransAlta (TSX:TA)(NYSE:TAC) looks extremely cheap right now. Here's why value investors might want to add this cheap stock to their portfolios before the market figures out the discount.

Are TransAlta's troubles over?

TransAlta is a power generation company based in Alberta. The stock used to be a darling among dividend investors for its reliable and attractive distributions. Unfortunately, the company ran into several challenges. The financial crisis dealt the first blow. That was followed by the crash in Alberta's energy market, plunging power prices, and negative investor views on coal-fired power.

High debt levels and falling cash flow forced TransAlta cut its quarterly dividend from $0.29 to $0.18 in 2014 and then again to $0.04 per share in 2016. As income investors bailed out, the stock tanked from $37 in 2008 to $4 per share in early 2016.

Since then, the share price has gradually drifted higher. Debt is under control and cash flow is improving. TransAlta reported $106 million in free cash flow for Q3 2020.

TransAlta's board raised the dividend to $0.0425 in March last year and recently announced another increase to $0.045. While that's still a long way off the previous levels, things are moving in the right direction.

Conversion of the coal-fired plants to natural gas remains ahead of schedule. TransAlta will shut down its coal mine and discontinue firing with coal by the end of the year, hitting the target four years earlier than originally forecast.

Should TransAlta stock trade a lot higher?

TransAlta stock trades neat $10.50 per share at the time of writing, giving the company a market capitalization of $2.9 billion.

The interesting thing is that TransAlta owns roughly 60% of the shares of its subsidiary **TransAlta Renewables** (TSX:RNW). The huge surge in RNW stock in recent weeks pushed the current valuation to $6.35 billion.

If TransAlta cashed out, its stake would be worth roughly $3.8 billion. That's more than 30% higher than TransAlta's current market capitalization. The company expected to exit 2020 with net recourse debt of $1.2 billion. Total debt at the end of Q3 was $3 billion.

In the September investor presentation TransAlta provided an analysis that showed it had an implied value gap of at least $5 per share based on the values attributed to its RNW stake and the value of its hydro-electric assets.

RNW is up 50% since the start of September. TransAlta is up 25% over the same timeframe.

Is TransAlta a takeover target?

Brookfield Asset Management (TSX:BAM.A)(NYSE:BAM) made investments in TransAlta in 2019 and added to the position during the crash last March. Under the initial investment agreement Brookfield would buy TransAlta shares in the open market to increase its stake to 9%. As of September 30, 2020 it held a 12% position in the company.

Brookfield Asset Management has $75 billion in funds to deploy. The company just announced plans to take its property subsidiary private. A move to buy all of TransAlta wouldn't be a surprise.

Should you buy TransAlta stock now?

Trying to figure out a fair value for the stock is difficult, but it could be anywhere from $13 to $20 per share depending on how you run the numbers and whether or not a takeover premium would be included.

If you have some cash available searching for a value play, TransAlta deserves to be on your radar.

CATEGORY

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2. NYSE:TAC (TransAlta Corporation)
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4. TSX:RNW (TransAlta Renewables)
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