



Time to Buy TransAlta Stock?

Description

Shares of **TransAlta** ([TSX:TA](#)) are on an upward trend after several years of setbacks. Investors who missed the rebound off the lows are wondering if this former dividend star deserves to be on their buy list.

TransAlta overview: A utility company on the upswing

TransAlta is a utility based in Alberta with power facilities in Canada, the United States and Australia.

Investors traditionally viewed TransAlta as a safe [dividend stock](#) that provided generous and reliable payouts, but a combination of high debt and falling energy prices in 2014 forced management to cut the quarterly distribution from \$0.29 to \$0.18.

Income investors bailed, and the stock went into a downward spiral, made worse by another dividend cut that took the payout down to just \$0.04. By the time all the dust settled, TransAlta's share price was less than \$4 in early 2016. The stock had been as high as \$37 at its peak in 2008.

It isn't easy to buy when a company is in trouble, but investors who mustered the courage to get in at \$4 are now sitting on decent gains ... and more upside could be on the way.

Why?

Over the past six years, management has done a good job of shoring up the balance sheet through a series of non-core asset sales and dropdowns to the company's majority-owned subsidiary **TransAlta Renewables** ([TSX:RNW](#)).

TransAlta's balance sheet is now in excellent shape, and the company expects to generate \$455 million to \$555 million in free cash flow in 2022.

An important agreement with the Alberta government in late 2016 has also helped the recovery. Under an off-coal deal, the province agreed to pay TransAlta \$37.4 million per year from 2017 to 2030 to help

the utility transition its facilities from coal to natural gas. TransAlta completed the transition off coal in Alberta at the end of 2021, nine years ahead of the provincial government's requirement.

TransAlta expects to end coal-fired power production in the United States in 2025.

These investments and other [ESG](#) initiatives that include gender equality on the board by 2030 and net-zero emission by 2050 should bring more retail and institutional interest to the stock in the next few years.

Dividend growth and share buybacks

Power prices have recovered and TransAlta is starting to move more cash back to shareholders. The board raised the dividend in each of the past three years. The new quarterly payout is still just \$0.05, but the company is moving in the right direction.

TransAlta is also buying back stock under a share repurchase plan.

Is TransAlta stock undervalued?

TransAlta trades for \$14.40 per share at the time of writing and has a [market capitalization](#) of about \$3.9 billion. The company's 60.1% ownership of TransAlta Renewables is currently worth about \$2.85 billion, so the market is only giving TransAlta-owned assets and facilities that have not dropped down to the subsidiary a valuation of \$1 billion.

This seems cheap and it might be a reason **Brookfield Asset Management** (TSX:BAM.A) has quietly built up a 13% stake in the company in the past few years. The alternative asset manager has a knack for finding value.

Should you buy TransAlta now?

TransAlta has turned the corner on its recovery plan and is generating strong free cash flow. The easy money has arguably been made, but investors with a buy-and-hold strategy should still consider adding the stock to their portfolios.

The dividend is growing and Brookfield Asset Management could potentially move to buy TransAlta outright in the next few years. If that happens, investors would likely receive a nice premium. Otherwise, the stock should slowly grind higher on improved earnings and cash flow driven by strong power prices and the addition of new assets.

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