TransAlta Renewables Inc. (RNW.TO)

Updated October 16th, 2019 by Samuel Smith

Key Metrics

Current Price:	$14	**5 Year CAGR Estimate:**	5.2%	**Volatility Percentile:**	30.7%
Fair Value Price:	$12	**5 Year Growth Estimate:**	1.5%	**Momentum Percentile:**	91.7%
% Fair Value:	114%	**5 Year Valuation Multiple Estimate:**	-2.7%	**Growth Percentile:**	7.5%
Dividend Yield:	6.9%	**5 Year Price Target**	$13	**Valuation Percentile:**	40.1%
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Total Return Percentile:**	33.2%

Overview & Current Events

TransAlta Renewables trades on the Toronto Stock Exchange (under the ticker RNW) and on the over the counter market (under the ticker TRSWF). Its history in renewable power generation goes back more than 100 years. In 2013, the company was spun off from TransAlta, who remains a major shareholder in the alternative power generation company.

All the figures in this report are in Canadian dollars unless otherwise noted. TransAlta Renewables market capitalization is about $3.6 billion. The company has maintained or increased its dividend every year since 2014. Its portfolio consists of 42 facilities powered by wind, natural gas, hydro, or solar. It generates about 47% of cash flow from natural gas (half from Canada and half from Australia) and 46% from wind.

TransAlta Renewables reported its second quarter results on August 8th, 2019. Comparable EBITDA increased by $13 million thanks to an increase in US Wind and Solar EBITDA from the Lakeswind wind and Mass Solar economic interests acquired in May 2018, an increase in Canadian Wind Comparable EBITDA due to insurance proceeds related to a 2018 tower fire at Summerview, and higher green attribute revenues and higher Comparable EBITDA at Canadian Gas. AFFO increased by $7 million due to higher Comparable EBITDA and lower interest expense, partially offset by higher sustaining capital expenditures, distributions paid to subsidiaries' non-controlling interest, insurance recovery, and higher tax equity distributions. CAFD increased by $6 million due to higher AFFO on owned assets.

Growth on a Per---Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
AFFOPS	---	---	---	---	$1.25	$1.14	$1.22	$1.27	$1.40	$1.33	***$1.35***	***$1.45***
DPS	---	---	---	---	$0.23	$0.77	$0.81	$0.88	$0.90	$0.94	***$0.94***	***$0.98***
Shares[1]	---	---	---	---	114.7	114.7	164.5	223	235	257	**275**	***386***

TransAlta Renewables' history shows that its earnings-per-share are highly unpredictable. However, it appears to generate stable cash flow that supports its dividend. So, we used the adjusted funds from operations per share metric in the table above.

TransAlta's portfolio is reinforced by long contracts as evidenced by its ~11-year weighted average contract life. The company has made ~$3 billion of acquisitions since 2013 but the rising share count has prevented its cash flow per share from rising much. From 2013 to 2018, its adjusted funds from operations per share increased by 1.25% per year. We're applying a growth rate of 1.5% per year through 2024.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
P/AFFO	---	---	---	---	8.8	10.1	8.5	11.3	9.6	7.8	***10.3***	***9.0***
Avg. Yld.	---	---	---	---	N/A	6.7%	7.9%	6.1%	6.8%	9.1%	***6.9%***	***7.5%***

[1] In millions

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Taking out the 2016 outlier higher price-to-adjusted-funds-from-operations multiple, from 2013 to 2018, TransAlta Renewables' average multiple was 9. We don't think the stock will stray far away from a multiple of 9, and that's the fair multiple we've chosen for the 2024 target. Notably, the company only began paying dividends in September 2013.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	---	---	---	18%	68%	66%	69%	64%	71%	***70%***	***67%***

Because dividends are paid from cash flow, we decided to calculate the payout ratio from adjusted funds from operations. Its dividend should continue to be sustained by cash flow, but don't expect it to increase meaningfully.

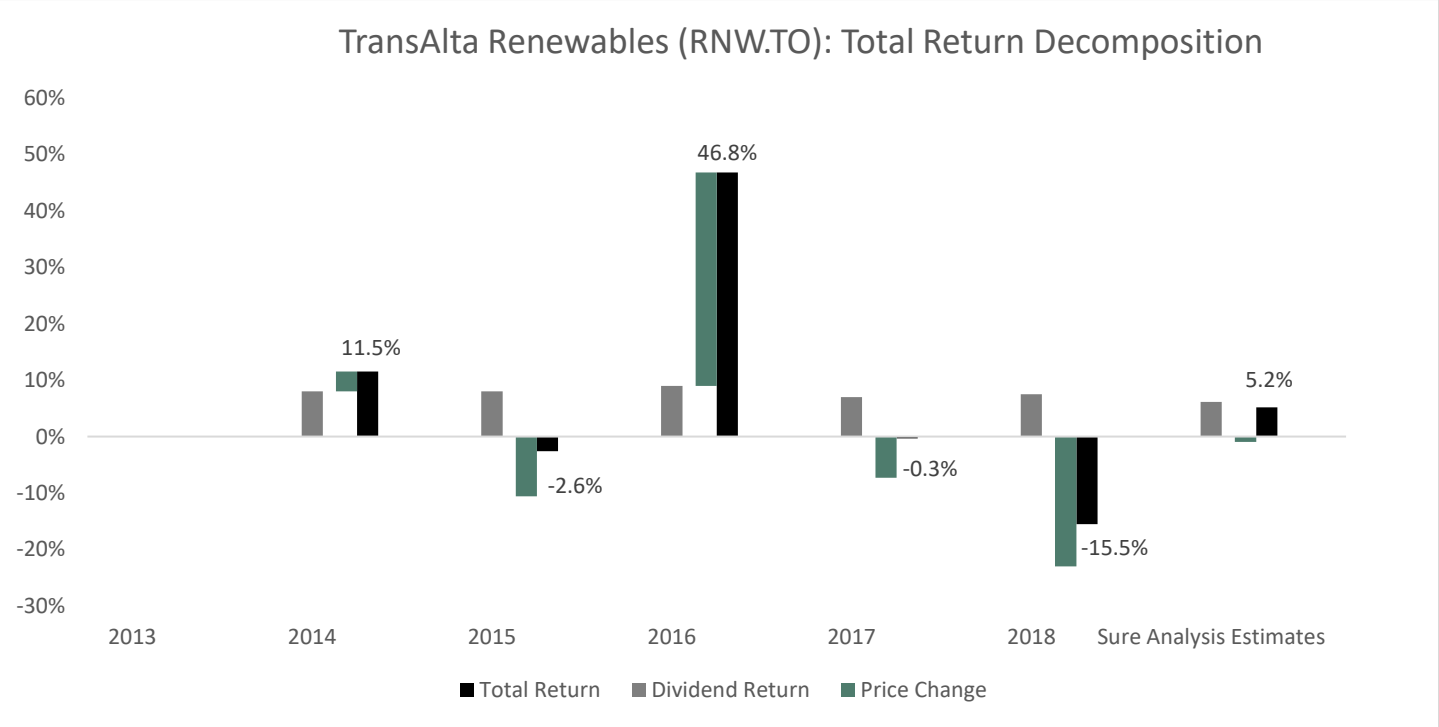
As the largest wind power generator in Canada, the company may have some competitive advantages, such as being an experienced developer and operator of wind facilities in Alberta. TransAlta Renewables hasn't been through a recession by itself. However, in the last recession, TransAlta stock fell about 50% from peak to trough, which aligned with its earnings per share decline of 46% from 2007 to 2009. That said, investors should note that TransAlta managed to increase its dividend per share by 16% from 2007 to 2009. Seeing that TransAlta Renewables is a slow-growth company, it's very likely that its multiple and share price will be dragged down severely in a recession.

At the end of the first quarter, TransAlta Renewables' debt-to-equity ratio was 58%, while its debt-to-asset ratio was 36%. Its trailing 12-month interest coverage ratio is 3.1, so, the company's balance sheet is alright.

Final Thoughts & Recommendation

TransAlta Renewables is a good income stock but has little growth based on its relatively short history trading on its own. Over the next five years, we estimate total returns of 5.2% for the stock, coming from a current yield of 6.9% and some growth, partially offset by multiple contraction. We rate the stock a hold at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue					259	459	462	220	245	233
Gross Profit					236	362	364	207	232	220
Gross Margin					91.1%	78.9%	78.8%	94.0%	94.4%	94.5%
D&A Exp.					79	115	122	74	77	74
Operating Profit					96	154	145	85	107	92
Operating Margin					37.1%	33.6%	31.4%	38.5%	43.5%	39.4%
Net Profit					---2	9	236	32	50	49
Net Margin					--- 0.8%	2.0%	51.1%	14.6%	20.5%	20.8%
Free Cash Flow					267	252	322	---49	115	135
Income Tax					21	38	35	14	20	14

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets					3835	3628	3747	2263	2014	1964
Cash & Equivalents					15	20	73	3	19	24
Accounts Receivable					87	111	115	42	37	36
Inventories					4	6	6	0	0	4
Goodwill & Int. Ass.					113	103	124	113	105	99
Total Liabilities					1774	1431	1351	563	947	923
Accounts Payable					31	41	47	36	31	31
Long---Term Debt					1042	1043	932	373	685	658
Shareholder's Equity					2026	2161	2355	1659	1028	1003
D/E Ratio					0.51	0.48	0.40	0.22	0.67	0.66

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets					--- 0.1%	0.2%	6.4%		2.4%	2.4%
Return on Equity					--- 0.1%	0.4%	10.5%		3.7%	4.8%
ROIC					--- 0.1%	0.3%	7.2%		2.6%	2.8%
Shares Out.					114.7	114.7	164.5	223	235	257
Revenue/Share					1.16	1.95	1.80	1.92	2.14	2.04

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FCF/Share	1.20	1.07	1.25	---0.43	1.00	1.18

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