



TransAlta Renewables Inc. (TRSWF)

Updated March 23rd, 2020 by Samuel Smith

Key Metrics

Current Price:	\$9.00	5 Year CAGR Estimate:	11.1%	Market Cap:	\$2.3B
Fair Value Price:	\$9.90	5 Year Growth Estimate:	3.2%	Ex-Dividend Date:	4/14/20
% Fair Value:	91%	5 Year Valuation Multiple Estimate:	1.9%	Dividend Payment Date:	4/30/20
Dividend Yield:	7.9%	5 Year Price Target	\$12	Years Of Dividend Growth:	0
Dividend Risk Score:	D	Retirement Suitability Score:	D	Last Dividend Increase:	0

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.

TransAlta Renewables' market capitalization is about \$2.3 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 full year 2019 results on February 28th, 2020. Comparable EBITDA rose by 2% year-over-year, adjusted funds from operations were flat year-over-year, and cash available for distribution came in at \$1.11 per share. Major expected tailwinds for 2020 performance include the commissioning of the Big Level and Antrim wind farms in December 2019, as well as additional dropdowns from TransAlta's Clean Energy Investment Plan and the pursuit of further transactions to expand their fleet.

Growth on a Per---Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
AFFOPS	---	---	\$0.94	\$0.86	\$0.92	\$0.95	\$1.05	\$1.00	\$1.11	\$1.13	\$1.10	\$1.29
DPS	---	---	\$0.17	\$0.58	\$0.61	\$0.66	\$0.68	\$0.71	\$0.71	\$0.71	\$0.71	\$0.74
Shares¹	---	---	114.7	114.7	164.5	223	235	257	275	275	275	386

TransAlta Renewables' history shows that its earnings-per-share are highly unpredictable due to real asset depreciation. 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. Looking ahead, we think that growth will face a slight headwind from the coronavirus outbreak, but not enough to threaten the dividend or the long-term growth outlook.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
P/AFFO	---	---	---	8.8	10.1	8.5	11.3	9.6	7.8	11.9	8.2	9.0
Avg. Yld.	---	---	---	N/A	6.7%	7.9%	6.1%	6.8%	9.1%	5.9%	7.9%	6.4%

Taking out the 2016 outlier higher price-to-adjusted-funds-from-operations multiple, from 2013 to 2018, TransAlta Renewables' average multiple was 9. While the coronavirus outbreak certainly isn't a tailwind for the company, it isn't much of a headwind either. As a result, we are holding our fair value estimate steady at 9 times AFFO.

¹ In millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	---	18%	68%	66%	69%	64%	71%	70%	65%	57%

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.

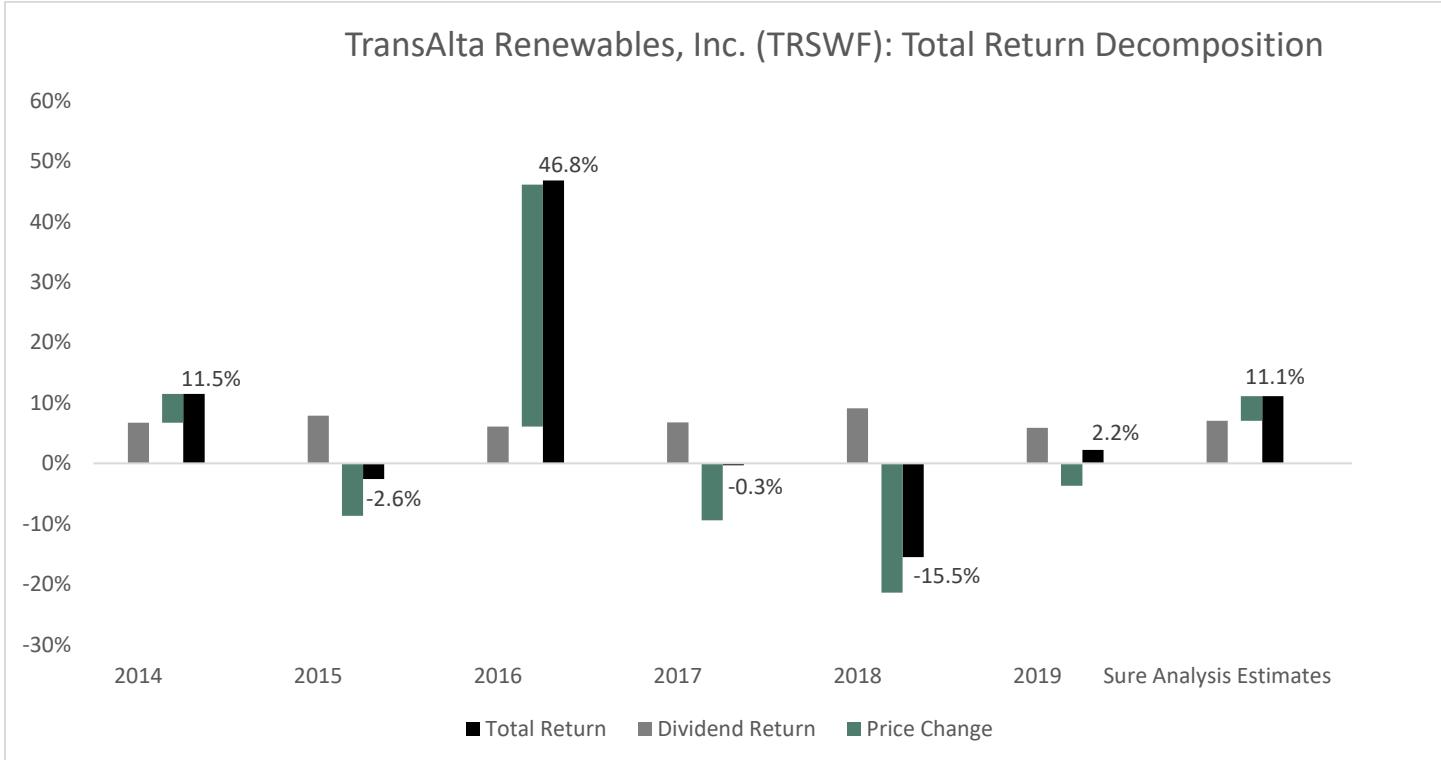
As the largest wind power generator in Canada, the company may have some competitive advantages, such as being an experienced developer and operator of wind facilities in Alberta. TransAlta Renewables hasn't been through a recession by itself. However, in the last recession, TransAlta stock fell about 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.

TransAlta Renewables' debt-to-equity ratio is currently a little over 50%, while its debt-to-asset ratio is ~33%. Its trailing 12-month interest coverage ratio is ~3x, so, the company's balance sheet is sound, though not necessarily a strength.

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 11.1% for the stock, coming from an attractive and sustainable current yield of 7.9% and some growth and multiple expansion as well. We rate the stock a buy at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	220	245	233	236	259	459	462	446	220	245
Gross Profit	166	191	174	178	183	279	278	276	166	191
Gross Margin	75.5%	77.7%	74.5%	75.4%	70.7%	60.8%	60.2%	61.9%	75.5%	77.7%
D&A Exp.	74	77	74	75	79	115	122	136	74	77
Operating Profit	85	107	92	94	96	154	145	128	85	107
Operating Margin	38.5%	43.5%	39.4%	39.8%	37.1%	33.6%	31.4%	28.7%	38.5%	43.5%
Net Profit	32	50	49	195	(2)	9	236	179	32	50
Net Margin	14.6%	20.5%	20.8%	82.6%	-0.8%	2.0%	51.1%	40.1%	14.6%	20.5%
Free Cash Flow	(49)	115	135	180	267	252	322	300	(49)	115
Income Tax	14	20	14	31	21	38	35	8	14	20

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	2,263	2,014	1,964	3,336	3,835	3,628	3,747	3,702	2,263	2,014
Cash & Equivalents	3	19	24	2	15	20	73	63	3	19
Accounts Receivable	42	37	36	62	87	111	115	90	42	37
Inventories	0	0	4	3	4	6	6	7	0	0
Goodwill & Int. Ass.	113	105	99	92	113	103	124	114	113	105
Total Liabilities	563	947	923	1,310	1,774	1,431	1,351	1,389	563	947
Accounts Payable	36	31	31	14	31	41	47	37	36	31
Long---Term Debt	373	685	658	797	1,042	1,043	932	939	373	685
Shareholder's Equity	1,659	1,028	1,003	1,989	2,026	2,161	2,355	2,268	1,659	1,028
D/E Ratio	0.22	0.67	0.66	0.40	0.51	0.48	0.40	0.41	0.22	0.67

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.4%	2.4%	7.4%	-0.1%	0.2%	6.4%	4.8%			2.4%
Return on Equity	3.7%	4.8%	13.0%	-0.1%	0.4%	10.5%	7.7%			3.7%
ROIC	2.6%	2.8%	8.6%	-0.1%	0.3%	7.2%	5.4%			2.6%
Shares Out.	---	---	114.7	114.7	164.5	223	235	257	275	275
Revenue/Share	1.92	2.14	2.04	1.43	1.16	1.95	1.80	1.69	1.92	2.14
FCF/Share	-0.43	1.00	1.18	1.09	1.20	1.07	1.25	1.14	(0.43)	1.00

Note: All figures in millions of Canadian dollars unless indicated otherwise.

Disclaimer

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