



TransAlta Renewables Inc. (TRSWF)

Updated March 26th, 2021 by Kay Ng

Key Metrics

Current Price:	\$16	5 Year CAGR Estimate:	-1.9%	Market Cap:	\$4.2B
Fair Value Price:	\$10	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	04/14/21
% Fair Value:	161%	5 Year Valuation Multiple Estimate:	-9.1%	Dividend Payment Date:	04/30/21
Dividend Yield:	4.3%	5 Year Price Target	\$11	Years Of Dividend Growth:	0
Dividend Risk Score:	C	Retirement Suitability Score:	B	Last Dividend Increase:	N/A

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 (TAC, TSX:TA), which remains a major shareholder in the alternative power generation company. Unless otherwise noted, US\$ is used in this research report.

The company has maintained or increased its dividend in C\$ every year since 2014. Its portfolio consists of about 44 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 Q4 and full-year 2020 results on 03/03/2021. Year over year, comparable EBITDA rose by 5%, adjusted funds from operations (“FFO”) were up by 3% to C\$304 million, adjusted FFOPS climbed by 2% to C\$1.33, and cash available for distribution rose 3% to C\$1.14 per share. (When converted to US\$, the 2020 AFFOPS was US\$0.99.) The main drivers of higher comparable EBITDA were full-year contributions from two U.S. wind farms, improved performance for the Canadian Wind and Hydro segments, and a stronger Australian dollar that improved results for the Australian Gas segment.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
AFFOPS	---	\$0.94	\$0.86	\$0.92	\$0.95	\$1.05	\$1.00	\$1.11	\$1.13	\$0.99	\$1.01	\$1.12
DPS	---	\$0.17	\$0.28	\$0.66	\$0.59	\$0.66	\$0.72	\$0.69	\$0.72	\$0.70	\$0.70	\$0.74
Shares¹	---	114.7	114.7	164.5	223	235	257	275	275	267	272	301

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 ~12-year weighted average contract life. The company has made ~C\$3 billion of acquisitions since 2013 but the rising share count has prevented its cash flow per share from rising much, especially when the foreign exchange volatility between US\$ and C\$ is accounted for. From 2013 to 2020, its adjusted funds from operations per share increased by 2% per year in US\$. Looking ahead, we think that growth will face a slight headwind from the COVID-19 pandemic, but not enough to threaten the dividend or the long-term growth outlook. For now, we estimate a 2% growth rate for the AFFOPS through 2026. The company has maintained the same monthly dividend (in C\$) since late 2017 and management seems more interested to reinvest back into the dividend versus growing the dividend every year. However, a dividend increase every few years is a possibility. For now, our estimate uses a 1% dividend growth rate through 2026.

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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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
P/AFFO	---	---	8.8	10.1	8.5	11.3	9.6	7.8	11.9	12.4	16.1	10.0
Avg. Yld.	---	---	3.7%	7.1%	7.3%	5.6%	7.5%	8.0%	5.4%	5.7%	4.3%	6.6%

The stock's valuation ran up in 2020 along with other renewable power stocks. We believe that to be an outlier. Taking that out, the stock's average multiple was 9.7 from 2013 to 2020. 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 setting a fair value estimate at 10 times AFFO, making shares overvalued at present.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	18%	33%	72%	62%	63%	72%	62%	64%	71%	69%	66%

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 and a reasonable payout ratio, but don't expect it to increase meaningfully.

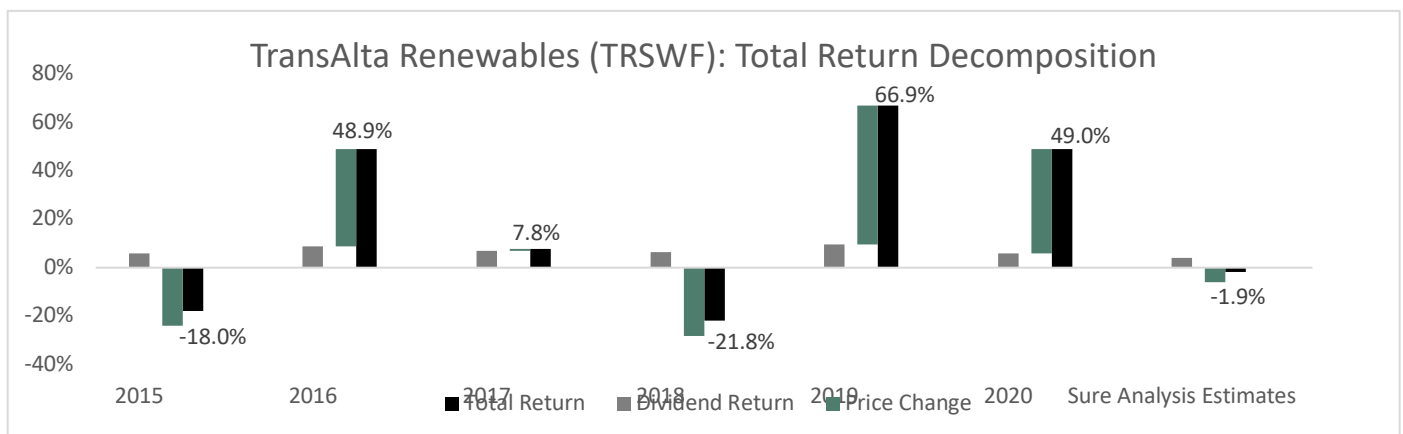
As the largest wind power generator in Canada, the company may have some competitive advantages, such as being an experienced developer and operator of wind facilities in Alberta. TransAlta Renewables hasn't been through a recession by itself. However, in the last recession, TransAlta stock fell about 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 60%, while its debt-to-asset ratio is 37%. So, the company's balance sheet is decent.

Final Thoughts & Recommendation

TransAlta Renewables is largely an income stock but has little growth based on its relatively short history trading on its own. Over the next five years, we estimate total annualized returns of -1.9% for the stock, coming from a current yield of 4.3%, a growth rate of 2%, and a valuation contraction of 9.1%. We rate the stock a sell at current prices as we estimate a negative total return.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	---	220	245	233	236	259	459	462	446	436
Gross Profit	---	207	232	220	223	236	362	364	363	359
Gross Margin	---	94.0%	94.4%	94.5%	94.5%	91.1%	78.9%	78.8%	81.4%	82.3%
D&A Exp.	---	74	77	74	75	79	115	122	136	135
Operating Profit	---	85	107	92	94	96	154	145	132	127
Operating Margin	---	38.5%	43.5%	39.4%	39.8%	37.1%	33.6%	31.4%	29.6%	29.1%
Net Profit	---	32	50	49	195	-2	9	236	179	92
Net Margin	---	14.6%	20.5%	20.8%	82.6%	-0.8%	2.0%	51.1%	40.1%	21.1%
Free Cash Flow	---	-49	115	135	180	267	252	322	300	239
Income Tax	---	14	20	14	31	21	38	35	8	25

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	---	2263	2014	1964	3336	3835	3628	3747	3702	3656
Cash & Equivalents	---	3	19	24	2	15	20	73	63	582
Accounts Receivable	---	42	37	36	62	87	111	115	90	134
Inventories	---	0	0	4	3	4	6	6	7	7
Goodwill & Int. Ass.	---	113	105	99	92	113	103	124	114	103
Total Liabilities	---	563	947	923	1310	1774	1431	1351	1389	1351
Accounts Payable	---	36	31	31	14	31	41	47	37	50
Long-Term Debt	---	373	685	658	797	1042	1043	932	939	866
Shareholder's Equity	---	1659	1028	1003	1989	2026	2161	2355	2268	2255
D/E Ratio	---	0.22	0.67	0.66	0.40	0.51	0.48	0.40	0.41	0.38

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	---	---	2.4%	2.4%	7.4%	-0.1%	0.2%	6.4%	4.8%	2.5%
Return on Equity	---	---	3.7%	4.8%	13.0%	-0.1%	0.4%	10.5%	7.7%	4.1%
ROIC	---	---	2.6%	2.8%	8.6%	-0.1%	0.3%	7.2%	5.4%	2.9%
Shares Out.	---	114.7	114.7	164.5	223	235	257	275	275	267
Revenue/Share	---	1.92	2.14	2.04	1.43	1.16	1.95	1.80	1.69	1.64
FCF/Share	---	-0.43	1.00	1.18	1.09	1.20	1.07	1.25	1.14	0.90

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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