



TransAlta Renewables Inc. (TRSWF)

Updated May 17th, 2021 by Quinn Mohammed

Key Metrics

Current Price:	\$15	5 Year CAGR Estimate:	2.2%	Market Cap:	\$4.1B
Fair Value Price:	\$12	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	06/14/21
% Fair Value:	128%	5 Year Valuation Multiple Estimate:	-4.8%	Dividend Payment Date:	07/30/21
Dividend Yield:	5.0%	5 Year Price Target	\$13	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 45 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 first quarter results on May 12th. The company generated slightly less renewable energy production than last year, at 1,109 GWh compared to 1,173 GWh in the same prior year period. Despite this, revenues of USD \$104 million is a 15% increase in constant currency over 1Q2020.

Year-over-year, comparable EBITDA rose by 4% and adjusted funds from operations ("FFO") were in line with last year at around USD \$77 million. Adjusted FFO per share was identical to the same period last year, at \$0.29 per share. Cash available for distribution was also identical to the prior year period, at \$0.28 per share.

In the first quarter, the company completed previously announced acquisitions of a 303 megawatt asset portfolio from its parent company, TransAlta Corporation, which includes 274 MW of wind capacity.

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	\$1.14	\$1.26
DPS	---	\$0.17	\$0.28	\$0.66	\$0.59	\$0.66	\$0.72	\$0.69	\$0.72	\$0.70	\$0.76	\$0.80
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 a position in the security discussed in this research report.



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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	13.5	10.5
Avg. Yld.	---	---	3.7%	7.1%	7.3%	5.6%	7.5%	8.0%	5.4%	5.7%	5.0%	5.9%

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 10.5 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%	67%	63%

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.

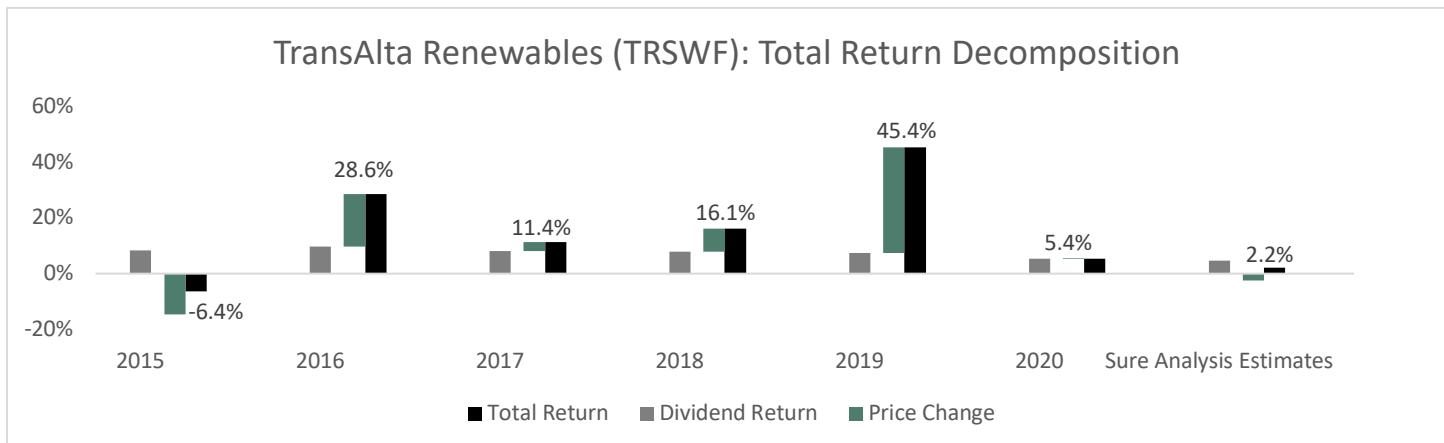
As the largest wind power generator in Canada, the company may have some competitive advantages, such as being an experienced developer and operator of wind facilities in Alberta. TransAlta Renewables hasn't been through a recession by itself. However, in the last recession, TransAlta stock fell about 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 likely that its multiple and share price will be dragged down severely in a recession.

TransAlta Renewables' debt-to-equity ratio is currently 63%, while its debt-to-asset ratio is 39%. 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 2.2% for the stock, coming from a current yield of 5.0%, a growth rate of 2%, and a valuation contraction of 4.8%. We rate the stock a sell at current prices as there is little growth ahead, and we believe the company to be trading 28% above fair value.

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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