



TransAlta Renewables Inc. (TRSWF)

Updated March 9th, 2022 by Quinn Mohammed

Key Metrics

Current Price:	\$15	5 Year CAGR Estimate:	5.2%	Market Cap:	\$3.8 B
Fair Value Price:	\$13	5 Year Growth Estimate:	3.0%	Ex-Dividend Date:	03/14/22
% Fair Value:	113%	5 Year Valuation Multiple Estimate:	-2.4%	Dividend Payment Date:	03/31/22
Dividend Yield:	5.0%	5 Year Price Target	\$15	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 50 facilities powered by wind, natural gas, hydro, or solar. It generates the majority of cash flow from its natural gas and wind assets.

TransAlta Renewables reported fourth quarter and FY 2021 results on February 24th. The company generated slightly less renewable energy production than last year, at 4,332 GWh compared to 4,471 GWh in 2020. Still, revenues came in higher by 8% over the prior year, to \$470 million CAD.

Year-over-year, adjusted EBITDA was unchanged and free cash flow ("FCF") dropped 5% to \$357 million CAD compared to \$377 million. Cash available for distribution ("CAF") per share, as a result, also decreased 10% to \$1.03 CAD.

The company suffered a tower collapse at the Kent Hills 2 wind site, and upon further investigation, determined that all 50 turbine foundations at the Kent Hills 1 and 2 wind sites require a full foundation replacement. This rehabilitation will take until the end of 2023 to be fully complete. The replacement is expected to cost between \$75 million and \$100 million.

Leadership provided a fiscal 2022 outlook. The company anticipates generating 9% year-over-year growth in adjusted EBITDA, to about \$505 million. Free cash flow should come in at about \$365 million, and cash available for distribution at roughly \$265 million.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
FCFPS	\$0.94	\$0.86	\$0.92	\$0.95	\$1.05	\$1.00	\$1.11	\$1.13	\$0.99	\$1.05	\$0.99	\$1.15
DPS	\$0.17	\$0.28	\$0.66	\$0.59	\$0.66	\$0.72	\$0.69	\$0.72	\$0.70	\$0.69	\$0.73	\$0.77
Shares ¹	114.7	114.7	164.5	223.0	235.0	257.0	275.0	275.0	266.0	267.0	267.0	301.0

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 over C\$3.5 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 2012 to 2021, its free cash flow per share increased by just 1.2% per year in US\$. Looking ahead, we think that growth will face a headwind from the Kent Hills 1 and 2 wind facilities outage, as the costs of replacement and foregone

¹ In millions

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revenue will impact TransAlta. For now, we estimate a 3% growth rate for the FCFPS through 2027. 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 2027.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
P/AFFO	---	8.8	10.1	8.5	11.3	9.6	7.8	11.9	12.4	15.3	14.7	13.0
Avg. Yld.	---	3.7%	7.1%	7.3%	5.6%	7.5%	8.0%	5.4%	5.7%	4.6%	5.0%	5.1%

The stock's valuation ran up in 2020 and 2021 along with other renewable power stocks. The stock's average multiple was 10.6 from 2013 to 2021. 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 13.0 times AFFO, making shares overvalued at present.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	18%	33%	72%	62%	63%	72%	62%	64%	71%	66%	74%	67%

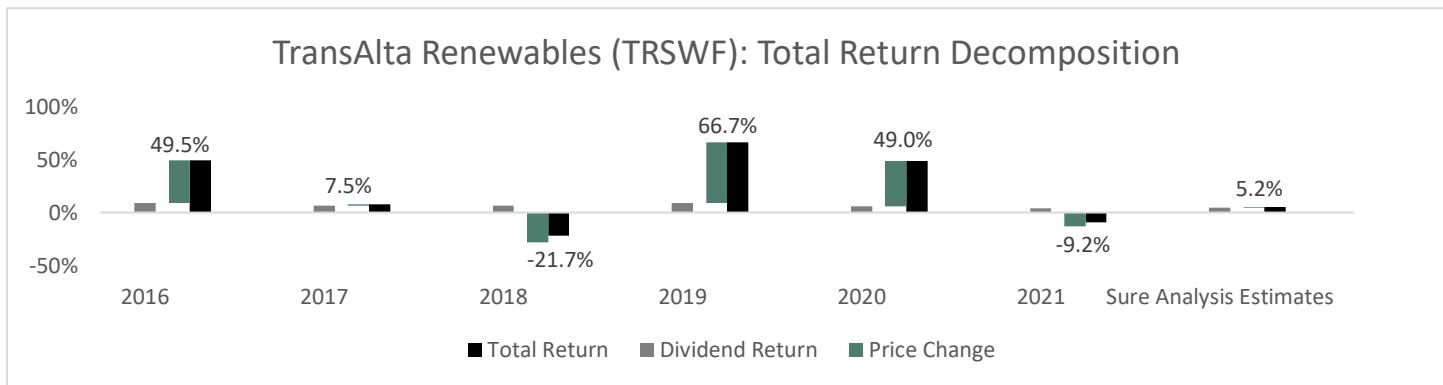
Because dividends are paid from cash flow, we decided to calculate the payout ratio from adjusted funds from operations. Its dividend should continue to be sustained by cash flow and a reasonable payout ratio, but don't expect it to increase meaningfully.

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.

Final Thoughts & Recommendation

TransAlta Renewables is largely an income stock but has little growth based on its history trading on its own. Over the next five years, we estimate total annualized returns of 5.2% for the stock, coming from a current yield of 5.0%, a growth rate of 3%, and the potential for a valuation contraction of -2.4%. We rate the stock a hold at current prices as there is moderate growth ahead, but we believe the company to be trading above fair value.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	220	238	211	185	196	354	357	336	325	375
Gross Profit	207	225	200	175	178	279	281	274	268	270
Gross Margin	94.0%	94.4%	94.5%	94.5%	91.1%	78.9%	78.8%	81.4%	82.3%	71.9%
D&A Exp.	74	74	67	59	60	89	94	102	101	120
Operating Profit	85	104	83	74	72	119	112	99	95	69
Operating Margin	38.5%	43.5%	39.4%	39.8%	37.1%	33.6%	31.4%	29.6%	29.1%	18.3%
Net Profit	32	49	44	153	-2	7	182	135	69	112
Net Margin	14.6%	20.5%	20.8%	82.6%	-0.8%	2.0%	51.1%	40.1%	21.1%	29.8%
Free Cash Flow	-49	112	122	141	202	194	248	226	178	203
Income Tax	14	19	12	24	16	29	27	6	19	9

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	2,274	1,891	1,692	2,404	28,44	2,885	2,751	2,834	2,867	2,940
Cash & Equivalents	3	18	20	1	11	16	54	48	456	191
Accounts Receivable	43	35	31	45	65	88	84	69	105	94
Inventories	0	0	4	2	3	5	4	5	5	6
Goodwill & Int. Ass.	114	99	85	66	84	82	91	87	81	72
Total Liabilities	566	889	795	944	1,316	1,138	992	1,063	1,059	1,275
Accounts Payable	37	29	27	10	23	33	35	28	40	64
Long-Term Debt	375	643	567	574	773	829	684	719	678	752
Shareholder's Equity	1,668	965	864	1,433	1,503	1,718	1,729	1,736	1,768	1,627
LTD/E Ratio	0.22	0.67	0.66	0.40	0.51	0.48	0.40	0.41	0.38	0.46

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	2.3%	2.5%	7.5%	-0.1%	0.2%	6.5%	4.8%	2.4%	3.8%	
Return on Equity	3.7%	4.8%	13.3%	-0.1%	0.4%	10.6%	7.8%	3.9%	6.6%	
ROIC	114.7	2.6%	2.8%	8.7%	-0.1%	0.3%	7.3%	5.5%	2.8%	4.6%
Shares Out.	114.7	114.7	164.5	223.0	235.0	257.0	275.0	275.0	266.0	267.0
Revenue/Share	-0.43	2.08	1.84	1.12	0.88	1.51	1.39	1.27	1.22	1.40
FCF/Share	114.7	0.97	1.07	0.85	0.90	0.83	0.97	0.86	0.67	0.76

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

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