



TransAlta Renewables Inc. (TRSWF)

Updated May 25th, 2023 by Quinn Mohammed

Key Metrics

| | | | | | |
|-----------------------------|--------|--|-------|----------------------------------|----------|
| Current Price: | \$9.40 | 5 Year CAGR Estimate: | 10.8% | Market Cap: | \$2.5 B |
| Fair Value Price: | \$10.9 | 5 Year Growth Estimate: | 2.0% | Ex-Dividend Date: | 06/14/23 |
| % Fair Value: | 86% | 5 Year Valuation Multiple Estimate: | 3.2% | Dividend Payment Date: | 06/30/23 |
| Dividend Yield: | 7.4% | 5 Year Price Target | \$12 | Years Of Dividend Growth: | 0 |
| Dividend Risk Score: | C | Retirement Suitability Score: | A | Rating: | Buy |

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 first quarter 2023 results on May 5th, 2023. The company generated 6.9% less renewable energy production compared to the year-ago quarter. During Q1, TransAlta Renewables generated 1,219 GWh compared to 1,310 GWh in Q1 2022. Revenue came in lower by 17% over the prior year, to C\$119 million.

Adjusted EBITDA decreased by 8% year-over-year and free cash flow decreased by 14% to C\$93 million compared to C\$108 million. Cash available for distribution (CAFD) per share was down 21% to C\$0.71.

The extended facility outage at the Kent Hills 1 and 2 wind facilities weigh on results. The company suffered a tower collapse at the Kent Hills 2 wind site and 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 second half of 2023 to be fully complete. The replacement cost is estimated to be around \$120 million, 36% more than initially expected.

Growth on a Per-Share Basis

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| FCFPS | \$0.86 | \$0.92 | \$0.95 | \$1.05 | \$1.00 | \$1.11 | \$1.13 | \$0.99 | \$1.05 | \$0.96 | \$0.95 | \$1.05 |
| DPS | \$0.28 | \$0.66 | \$0.59 | \$0.66 | \$0.72 | \$0.69 | \$0.72 | \$0.70 | \$0.69 | \$0.72 | \$0.69 | \$0.73 |
| Shares¹ | 114.7 | 164.5 | 223.0 | 235.0 | 257.0 | 275.0 | 275.0 | 266.0 | 267.0 | 267.0 | 267.0 | 300.0 |

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 use the free cash flow per share metric in the table above.

TransAlta's portfolio is reinforced by long contracts as evidenced by its weighted average contract life exceeding 10 years. 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 2013 to 2022, its free cash flow per share increased by just 1.2% per year in US\$. Growth should resume with Kent Hills 1 and 2 coming back online in the second half of 2023, however the cost of replacement and foregone revenue have impacted TransAlta, which has seen its share price decrease 32% in the last one year period. On the bright side, TransAlta Renewables recently announced a 10-year contract extension at Kent Hills with New Brunswick Power Corporation.

¹ In millions

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For now, we estimate a 2% growth rate for FCFPS through 2028. The company has maintained the same monthly dividend (in C\$) since late 2017. However, a dividend increase every few years is a possibility. For now, our estimate uses a 1% dividend growth rate through 2028.

Valuation Analysis

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | Now | 2028 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| P/FCF | 8.8 | 10.1 | 8.5 | 11.3 | 9.6 | 7.8 | 11.9 | 12.4 | 15.3 | 13.2 | 9.8 | 11.5 |
| Avg. Yld. | 3.7% | 7.1% | 7.3% | 5.6% | 7.5% | 8.0% | 5.4% | 5.7% | 4.6% | 5.7% | 7.4% | 6.0% |

The stock's valuation ran up in 2020 and 2021 along with other renewable power stocks. The stock's average multiple was 10.9 from 2013 to 2022. We are setting a fair value estimate at 11.5 times FCF, meaning shares trade below our estimate of fair value now.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 33% | 72% | 62% | 63% | 72% | 62% | 64% | 71% | 66% | 75% | 73% | 69% |

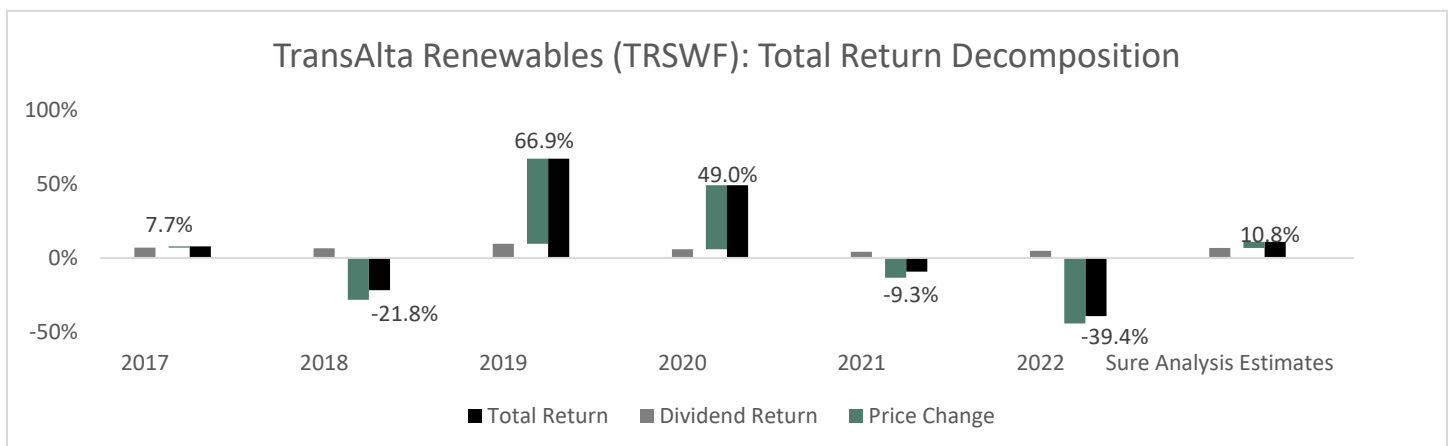
Because dividends are paid from cash flow, we decided to calculate the payout ratio using this metric. The company's dividend should continue to be sustained by free cash flow, resulting in a reasonable payout ratio, but we don't expect it to increase meaningfully.

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 Renewables 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 generated some growth as well. Over the next five years, we estimate annualized total returns of 10.8% for the stock, coming from a current yield of 7.4%, a growth rate of 2.0%, and the potential for a valuation tailwind. We reiterate the stock as a buy at the current price due to the significant dividend yield.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 238 | 211 | 185 | 196 | 354 | 357 | 336 | 325 | 375 | 430 |
| Gross Profit | 225 | 200 | 175 | 178 | 279 | 281 | 274 | 268 | 270 | 277 |
| Gross Margin | 94.4% | 94.5% | 94.5% | 91.1% | 78.9% | 78.8% | 81.4% | 82.3% | 71.9% | 64.5% |
| D&A Exp. | 74 | 67 | 59 | 60 | 89 | 94 | 102 | 101 | 120 | 108 |
| Operating Profit | 104 | 83 | 74 | 72 | 119 | 112 | 99 | 95 | 69 | 94 |
| Operating Margin | 43.5% | 39.4% | 39.8% | 37.1% | 33.6% | 31.4% | 29.6% | 29.1% | 18.3% | 21.8% |
| Net Profit | 49 | 44 | 153 | -2 | 7 | 182 | 135 | 69 | 112 | 57 |
| Net Margin | 20.5% | 20.8% | 82.6% | -0.8% | 2.0% | 51.1% | 40.1% | 21.1% | 29.8% | 13.2% |
| Free Cash Flow | 112 | 122 | 141 | 202 | 194 | 248 | 226 | 178 | 203 | 107 |
| Income Tax | 19 | 12 | 24 | 16 | 29 | 27 | 6 | 19 | 9 | 13 |

Balance Sheet Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Assets | 1,891 | 1,692 | 2,404 | 28,44 | 2,885 | 2,751 | 2,834 | 2,867 | 2,940 | 2,379 |
| Cash & Equivalents | 18 | 20 | 1 | 11 | 16 | 54 | 48 | 456 | 191 | 66 |
| Accounts Receivable | 35 | 31 | 45 | 65 | 88 | 84 | 69 | 105 | 94 | 99 |
| Inventories | 0 | 4 | 2 | 3 | 5 | 4 | 5 | 5 | 6 | 7 |
| Goodwill & Int. Ass. | 99 | 85 | 66 | 84 | 82 | 91 | 87 | 81 | 72 | 60 |
| Total Liabilities | 889 | 795 | 944 | 1,316 | 1,138 | 992 | 1,063 | 1,059 | 1,275 | 1,049 |
| Accounts Payable | 29 | 27 | 10 | 23 | 33 | 35 | 28 | 40 | 64 | 94 |
| Long-Term Debt | 643 | 567 | 574 | 773 | 829 | 684 | 719 | 678 | 752 | 565 |
| Shareholder's Equity | 965 | 864 | 1,433 | 1,503 | 1,718 | 1,729 | 1,736 | 1,768 | 1,627 | 1,294 |
| LTD/E Ratio | 0.67 | 0.66 | 0.40 | 0.51 | 0.48 | 0.40 | 0.41 | 0.38 | 0.46 | 0.44 |

Profitability & Per Share Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 2.3% | 2.5% | 7.5% | -0.1% | 0.2% | 6.5% | 4.8% | 2.4% | 3.8% | 2.1% |
| Return on Equity | 3.7% | 4.8% | 13.3% | -0.1% | 0.4% | 10.6% | 7.8% | 3.9% | 6.6% | 3.9% |
| ROIC | 2.6% | 2.8% | 8.7% | -0.1% | 0.3% | 7.3% | 5.5% | 2.8% | 4.6% | 2.6% |
| Shares Out. | 114.7 | 164.5 | 223.0 | 235.0 | 257.0 | 275.0 | 275.0 | 266.0 | 267.0 | 267.0 |
| Revenue/Share | 2.08 | 1.84 | 1.12 | 0.88 | 1.51 | 1.39 | 1.27 | 1.22 | 1.40 | 1.61 |
| FCF/Share | 0.97 | 1.07 | 0.85 | 0.90 | 0.83 | 0.97 | 0.86 | 0.67 | 0.76 | 0.40 |

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

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