TransAlta Renewables Inc. (TRSWF)

Updated August 8th, 2023 by Quinn Mohammed

Key Metrics

Current Price:	$10.0	**5 Year CAGR Estimate:**	9.9%	**Market Cap:**	$2.7 B
Fair Value Price:	$11.3	**5 Year Growth Estimate:**	2.0%	**Ex-Dividend Date:**	09/14/23
% Fair Value:	89%	**5 Year Valuation Multiple Estimate:**	2.4%	**Dividend Payment Date:**	09/29/23
Dividend Yield:	7.0%	**5 Year Price Target**	$12	**Years Of Dividend Growth:**	0
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Rating:**	Hold

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.

On July 10th, 2023, TranAlta Renewables announced it entered into an agreement with TransAlta Corporation (TAC) where TAC will acquire all of TransAlta Renewables' shares. Shareholders of RNW will receive 1.0337 common shares of TAC or C$13.00 in cash, which represented an 18.3% premium of the closing price of RNW on the TSX on July 10th, 2023. The transaction is expected to close in October 2023, and is subject to shareholder approval.

TransAlta Renewables reported second quarter 2023 results on August 3rd, 2023. The company generated 22% less renewable energy production compared to the year-ago quarter. During Q2, TransAlta Renewables generated 956 GWh compared to 1,231 GWh in Q2 2022. Revenue came in lower by 29% over the prior year, to C$99 million.

Adjusted EBITDA decreased by 21% year-over-year and free cash flow decreased by 1% to C$86 million compared to C$87 million. Cash available for distribution (CAFD) per share was flat at C$0.18.

The extended facility outage at the Kent Hills 1 and 2 wind facilities continue to 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 required a full foundation replacement, which are now completed. At this point, turbines are being reassembled, commissioned, and returned to service, which 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	***$0.98***	***$1.08***
DPS	$0.28	$0.66	$0.59	$0.66	$0.72	$0.69	$0.72	$0.70	$0.69	$0.72	***$0.70***	***$0.74***
Shares[1]	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

[1] In millions

TransAlta Renewables Inc. (TRSWF)

Updated August 8th, 2023 by Quinn Mohammed

Kent Hills 1 and 2 coming back online in the second half of 2023. Additionally, TransAlta Renewables recently announced a 10-year contract extension at Kent Hills with New Brunswick Power Corporation.

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. 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	***10.2***	***11.5***
Avg. Yld.	3.7%	7.1%	7.3%	5.6%	7.5%	8.0%	5.4%	5.7%	4.6%	5.7%	***7.0%***	***5.9%***

The stock's valuation ran up in 2020 and 2021 along with other renewable power stocks. TransAlta Renewables' average multiple was 10.9 from 2013 to 2022. We peg fair value 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%	***71%***	***68%***

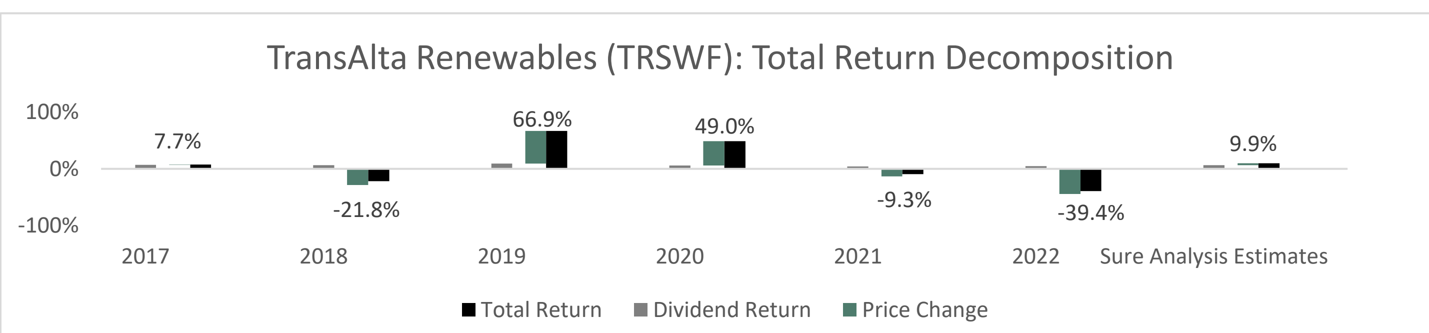
Because dividends are paid from cash flow, we decided to calculate the payout ratio using this metric. The company's dividend should continue to be sustained by free cash flow, resulting in a reasonable payout ratio, but we don't expect it to increase meaningfully.

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. Share price has increased on the news of the merger with TransAlta Corporation, and they are indeed trading 3.5% higher than the acquisition price. This indicates that some shareholders believe a better offer could be realized, but TAC already owns a meaningful portion of TransAlta Renewables, which somewhat reduces the likelihood of an improved offer. Barring the merger, annualized total return potential of 9.9% for the stock has us downgrading it from buy to hold.

Total Return Breakdown by Year



[Click here to rate and review this research report. Your feedback is important to us.]

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.

TransAlta Renewables Inc. (TRSWF)

Updated August 8th, 2023 by Quinn Mohammed

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.