

TransAlta Corporation

Small steps forward after a year of transformational deals

Maintain Rating: NEUTRAL | PO: 14.00 CAD | Price: 9.96 CAD

Transfer coverage of TransAlta Corporation

We transfer coverage of TransAlta Corporation (TA CN, TAC US) to Julien Dumoulin-Smith from Dariusz Lozny following a reallocation of resources. We maintain our Neutral rating given uncertain future growth prospects given a backwardated Alberta forward curve and challenging renewable development economics, which offset an optically attractive valuation in our view.

Renewable development remains core strategy

TA continues to make incremental progress in moving forward its Canadian, Australian, and US-based pipeline of development-stage renewables and infrastructure projects. Management continues to flag the long-term target of deploying \$3.5B in capital over the 2024-2028 period to develop 1.75 GW of assets with a target average EBITDA yield of 10%. Note that projects expected to reach final investment decision (FID) toward the back end of this period would also count toward the targets. Since rolling out these goals at the company's 2023 investor day, mgmt. has hedged somewhat on total deployment targets, stressing capital discipline would guide investment decisions in favor of stretching to hit MW deployment milestones.

Brookfield conversion messaging becoming more explicit

Infrastructure fund Brookfield continues to hold conversion rights allowing it to buy in to TA's Hydro fleet at a price of 13x EBITDA using a running 36-month trailing average, with the proportion of the assets acquired scaled by the purchase price. Since signing the deal in 2019 TA has acknowledged that it sees a conversion as likely without specifying expected timing – in recent updates commentary has become more explicit, with mgmt. estimating that based on the current 36-month window the conversion would be below 30%. All in a net positive that should help to crystallize the value of these assets which have been consistently proven to capture above-market pricing premiums given their dispatchable nature and minimal variable costs.

Capital allocation: one more deal, buyback renewed

TA shares underperformed following the 2023 investor day as mgmt. did not announce a formal buyback target, opting to double down on organic growth led by renewable development. The late-Dec announcement of an automatic repurchase plan for up to 14m shares through May 2024 was an incremental positive as it allows the company to sidestep blackout periods. Mgmt had previously indicated C\$12 as an attractive entry point for its own purchases of TA shares, making the current valuation rather attractive. Recent acquisitions including buy-in of its yieldco have reduced liquidity, however. Still pending is the acquisition of Heartland gas generation assets in Alberta which needs to pass federal competition review before proceeding. With less balance sheet flexibility, we still like potential buybacks as an incremental source of capital allocation.

26 January 2024

Equity

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Stock Data

Price (TOR / NYS)	9.96 CAD / 7.40 USD
Price Objective	14.00 CAD / 11.00 USD
Date Established	9-Aug-2023 / 9-Aug-2023
Investment Opinion	B-2-7 / B-2-7
52-Week Range	9.77 CAD - 13.97 CAD
Market Value (mn)	2,623 CAD
Free Float	85.7%
Average Daily Value	10.79 USD
Shares Outstanding (mn)	263.4 / 263.4
BofA Ticker / Exchange	YTA / TOR
BofA Ticker / Exchange	TAC / NYS
Bloomberg / Reuters	TA CN / TA TO
ROE (2023E)	22.0%
Net Dbt to Eqty (Dec-2022A)	126.6%

ESGMeter™

High

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Timestamp: 26 January 2024 05:45AM EST

Price objective basis & risk

TransAlta Corporation (YTA / TAC)

Our C\$14 PO (TAC US\$11) is based on a combination of DCF and multiples analysis. We value segments with a finite asset life (Gas, Energy Transition) and ongoing sustaining Off Coal Agreement, Sustaining Capex, and DevCo using discounted cash flow valuation. Our DCF assumes a 3.9% risk-free rate, 5.7% equity risk premium to account for exposure to carbon-emitting resources, and adjusted beta of 0.52 to reach a cost of equity of 6.8%.

We value the Hydro segment at 13x 2025 EBITDA. This is in-line with the multiple agreed as part of Brookfield's 2019 investment.

We value the Energy Mkt segment at a multiple of 6x 2025 EBITDA given potential for earnings volatility and exposure to market fluctuations.

We value the renewables segment at 10X 2025 EBITDA, in line with peer comps.

We apply a 9x EBITDA multiple to parent drag, using an average of segment multiples.

Upside risks are higher merchant prices in Alberta and multiple expansion associated with a greater share of renewable generation in TA's asset mix.

Downside risks are new entrants to the Alberta power market driving prices lower, operating risks, fuel price exposure, and legislation adversely affecting the energy sector eg, carbon pricing.

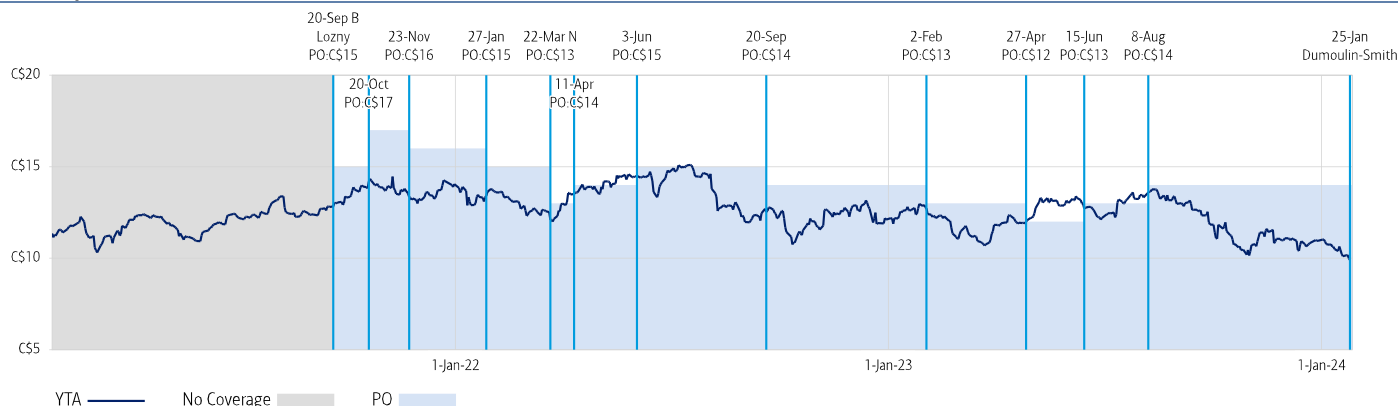
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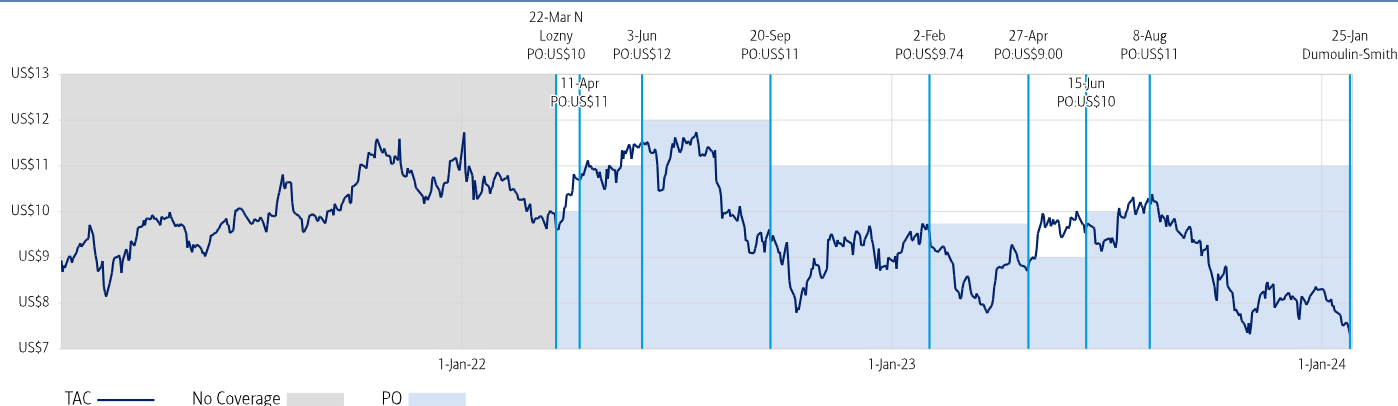
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TransAlta Corp. (YTA) Price Chart



TransAlta Corp (TAC) Price Chart



Equity Investment Rating Distribution: Utilities Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	72	46.45%	Buy	52	72.22%
Hold	45	29.03%	Hold	32	71.11%
Sell	38	24.52%	Sell	21	55.26%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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