Is Bad News for TransCanada Good for Investors?

Description

Surging global energy demand makes investing in Canada's oil patch almost a sure bet. But investing in crude is a risky business, and there are many aspects of an oil producer's operations that can go wrong. The increasingly uncertain short-term outlook for crude prices because of geopolitical events and growing crude production will also affect oil producers' bottom lines.

A better option for risk-averse investors seeking exposure to growth opportunities in the patch is to invest in one of the companies providing critical infrastructure to oil producers.

These midstream companies help oil producers get their crude to the market, effectively allowing them to clip the ticket on every barrel of crude shipped inside and outside of Canada. The three largest midstream companies in the patch are **TransCanada** (TSX: TRP)(NYSE: TRP), **Enbridge** (TSX: ENB)(NYSE: ENB), and **Pembina Pipeline** (TSX: PPL)(NYSE: PBA).

Of the three, TransCanada is the most troubled, with approval for its Keystone pipeline mired in political controversy and subject to further regulatory scrutiny. So is TransCanada a worthwhile investment compared to its peers? Let's take a closer look.

Keystone pipeline troubles

Every moment the Keystone pipeline appears closer to approval, TransCanada receives further bad news. The northern leg of the pipeline is still waiting for approval after being scrutinized by the U.S. federal government for five years, and now U.S. safety regulators have placed additional conditions on its construction. These conditions were imposed after potentially dangerous flaws were found on the southern leg of pipeline.

The lengthy delay for approval on the northern leg is proving problematic not only for TransCanada but for the patch in general. Pipeline capacity and the ability to access key energy markets remains a big issue for the patch, underscoring the importance of the Keystone pipeline and its ability to generate revenue for TransCanada if approved.

The inability to gain approval for the project has seen TransCanada move to consider transporting crude by rail so that its customers are able to ship their crude to key refining markets. This will fill the gap in the short term, but it is a more costly transportation option for it and its customers. With all of the controversy and delays surrounding approval for the northern leg of the pipeline, it is unlikely TransCanada will receive any return on the capital it has invested in the project for some time.

Generating cash despite pipeline issues

Due to the troubles associated with the Keystone pipeline, TransCanada's share price has remained relatively flat, dropping 2% over the last year. This reflects the market's concern as to whether the pipeline will ever be completed.

The company's profitability also continues to suffer, with first-quarter earnings per share down almost 2% compared to the previous quarter and 8% compared to the equivalent quarter in 2013. But despite this, TransCanada's core profitability continues to grow, with first-quarter 2014 EBITDA up a healthy 3% quarter over quarter and 20% year over year to $1.4 billion.

While operating cash flow declined by 3% quarter over quarter, it jumped a massive 38% year over year to $979 million, illustrating that TransCanada remains a cash-generating machine despite its Keystone problems.

This sees TransCanada continuing to pay a healthy dividend with a yield of almost 4% compared to Enbridge's 2% and Pembina's 4%. It also has a payout ratio of 78%, indicating the dividend is sustainable, particularly with TransCanada continuing to grow operating cash flow.

Share price has great value compared to its peers

The company also appears attractively priced in comparison to its peers, with an enterprise value of 14 times EBITDA, which is lower than Enbridge's EV of 23 times EBITDA and Pembina's 17 times. Furthermore, its forward price-to-earnings ratio of 18 is lower than Enbridge's 21 and Pembina's 28, underscoring just how cheap it is compared to them.

Despite the problems and risks associated with the Keystone pipeline, TransCanada is an appealing play, considering its price in comparison to its peers and its tasty dividend yield. Now could be just the time for income-hungry investors seeking a growth opportunity in the patch to make a bet on TransCanada.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:ENB (Enbridge Inc.)
2. NYSE:PBA (Pembina Pipeline Corporation)
3. NYSE:TRP (Tc Energy)
4. TSX:ENB (Enbridge Inc.)
5. TSX:PPL (Pembina Pipeline Corporation)
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