Is TransCanada Corporation About to Be Gutted and Divided?

Description

Is "Divided we stand" the new motto for **TransCanada Corporation** (TSX: TRP)(NYSE: TRP)? It very well could be if a group of activist U.S. hedge funds have their way.

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Word came out at the end the end of last week that Daniel Loeb's Third Point LLC among others have been weighing the possibilities of making a move on TransCanada. Normally, activist investors emerge when a company is doing poorly or in need of a shake-up, but TransCanada is in neither of these positions. Rather, it is Canada's second-largest pipeline company and the No. 1 mover of natural gas. It has been experiencing great growth in the past years and on first glance seems an unlikely candidate for this type of investor intervention.

So what changed? What has brought these activist investors out of the woodworks and placed a target on TransCanada?

The report

It seems that everything started back in June when an analyst from Citigroup hypothesized that TransCanada could divide the company into two entities — one for its pipelines business, which includes the proposed Keystone XL and Energy East projects. — and another for TransCanada's power-generation portfolio, which includes the Bruce nuclear facility in Ontario. This strategy would add approximately $26.00 per share worth of value to the company.

So it is understandable why these hedge funds would jump at the opportunity to see this type of value increase. But while this would be great for the hedge funds, where would this leave the company itself and its other investors?

The response

TransCanada appears to not be surprised about these rumours as it was preparing for this eventuality since the report came out back in June. In a press release, it stated that it remains convinced that its current structure is the best course for the company. Citing that a unified book helps it underpin itself as it works through its $38 billion capital program. A breakup would severely hinder its cashflow capabilities and throw a wrench in its capital expenditure plans.

As a type of retort to the break up plans TransCanada emphasized to investors that a great source of its funding is coming through its master limited partnership **TC PipeLines, LP** (NYSE: TCP), which will have the remainder of TransCanada's U.S. natural gas pipeline assets vended into, a move that will gross TransCanada US$500 million.

The result

Perhaps the old adage "If it ain't broke, don't fix it" comes into play here. Over the past 14 years, investors have seen a 16% annualized return on their investments and are receiving a 3.8% yielding dividend. Any unnecessary shakeups could bring about a short-term boom to the stock but cripple it in the long term, especially if the Keystone XL pipeline remains in "development hell" for the foreseeable future.

This news pushed up the stock by 6.3%, the highest single day increase it has seen in six years. Although it closed at $61.38, it is now well beyond the average price target of $57.10, making it quite overvalued and will undoubtedly bring about a sharp drop in price once the excitement dies down.

CATEGORY

1. Investing

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2. TSX:TRP (TC Energy Corporation)

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