



2 Reasons to Avoid TransCanada Corporation, 1 Stock to Buy Instead

Description

TransCanada Corporation's ([TSX: TRP](#))([NYSE: TRP](#)) stock is trading at a lofty valuation after rumors over a potential break-up of the company triggered a buying frenzy that pushed shares to an all-time high.

Rumors that the company is a prime candidate to be broken apart have circled since a **Citigroup** research report suggested the company's share value could improve if the company's businesses were broken apart, but these rumours kicked it into high gear last week after reports suggested that activist hedge funds have recently been amassing a stake in the company, leading investors to think that a deal was imminent. In response to the latest share movement, TransCanada said it felt its current structure was the best way to ensure profits and maximize returns.

With TransCanada suggesting that it is not looking to sell part of its business right now, and with shares hovering near an all-time high, does it make sense to invest in the company? There are two reasons that separately suggest that now is not a good time to buy the stock, but when these two factors are combined the argument is even stronger.

1. Overvalued stock

TransCanada stock is trading around \$60 per share, just below its recent all-time high of \$61.23. A high stock value is not a deterrent if the company's fundamentals and metrics suggest that more upside is in store. In the case of TransCanada the company faces some fundamental business challenges while the metrics suggest that the company is overvalued. For example, the company's price-to-book ratio is currently sitting at t 2.50, well above its 10-year average of 1.96. The higher value suggests the stock is overvalued.

2. Keystone project finances

A fundamental challenge that TransCanada faces right now is the Keystone XL pipeline project. The delay to the Keystone project alone was not enough of a reason to turn sour on TransCanada's stock but the company's recent report that the budget for the project could be 85% higher than previously expected warrants some caution. If the project is approved and development ensues, TransCanada

says costs could balloon to up to US\$10 billion. The alternate option is that the project is never approved and is not developed. Either scenario has negative implications.

Defenders of TransCanada will say that the company has other projects and assets that will continue to support the company, and I agree with this, and have a long-term bullish expectation on the company, but given the recent budget adjustments on the Keystone project and the stock's relative strength, the company faces some major headwinds.

Two separate factors, powerful once combined

Given the latest developments surrounding the Keystone project and the high valuation of TransCanada's stock suggest that the company's stock may not have much positive momentum left, at least in the near term. If you are interested in investing in the Canadian energy industry, a strong alternate option is **Encana Corporation** (TSX: ECA)(NYSE: ECA).

In contrast to TransCanada, Encana Corporation's stock has recently been on the downtrend, and has some immediate upside potential. The first positive for the company is the fact that we are entering peak natural gas demand season, where prices rise and the company's high exposure to natural gas should provide it some upside support.

In addition, the company is in the midst of an aggressive and so-far successful transformation. Under the leadership of Doug Suttles, who became CEO in 2013, the company has dramatically improved its operating costs. In the first quarter 2014 the company swung to a profit, compared to the loss it reported in the year-over-year quarter. While the company stayed profitable in the second quarter, its earnings missed expectations even though operating costs declined as natural gas sales volumes and prices were lower. With peak natural gas demand season just upon is, this weakness could prove to be temporary and we will likely see an increase in prices soon that will be a positive for the company's stock.

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