



3 Reasons to Buy TransCanada Corporation

Description

The price of oil has declined sharply over the past few weeks – depending on the specific contract, declines of 15-22% from the recent peaks have been registered. The impact on oil exploration and production firms has been significant with even the best integrated Canadian operations such as **Suncor Energy Inc** ([TSX:SU](#))([NYSE:SU](#)) and **Imperial Oil Limited** ([TSX:IMO](#))(NYSE:IMO) falling substantially.

The share prices of oil and gas pipeline companies, which for the most part have limited direct exposure to the oil price, have fallen in sympathy. The share price of **TransCanada Corporation** ([TSX: TRP](#))([NYSE: TRP](#)), for example, has now declined by 13% from the recent peak. For reasons explained below, this may have created a good opportunity to acquire shares in the company.

1. TransCanada owns an extremely valuable asset base

TransCanada owns critical energy infrastructure assets in Canada, the U.S., and Mexico. This includes one of the largest natural gas transmission networks in North America measuring 68,500 km, which transports around 20% of North America's daily natural gas requirements. The company also owns 3,500 km of liquid pipelines that transport almost 25% of Canada's crude oil exports to the U.S. as well as 19 power plants with 10,800 MW of power generating capacity.

TransCanada also plans to expand the pipeline capacity over the next few years through a \$38 billion capital expenditure program. The program will be focussed on the expansion of the oil/liquids pipeline business with capacity expansion mostly backed by long-term contracts or regulated cost-of-service business models. The company expects to almost double EBITDA by 2020 from the 2013 level of \$4.9 billion.

The business operations of TransCanada, which are mostly subject to regulatory overview, and certainly subject to intense scrutiny from environmentalists, have strong barriers to entry to possible competitors.

2. The company profitability is not directly affected by a lower oil price

The main income generator for TransCanada is the pipeline business that represents about 70% of its 2013 EBITDA. This is expected to grow to about 80% by 2018 as the new capacity additions come on stream over the next few years. The company does not extract or own the gas or oil transported through its pipelines and accordingly does not have any oil or gas price exposure in this part of the business. Obviously, an extended period of low oil and gas prices may impact the customer base utilising the pipeline facilities but this is not foreseen in the short to medium term.

The considerably smaller energy business through the power generation facilities in the Western Power operations in Alberta and the U.S. Power operations in New England and New York, are exposed to commodity price volatility. Earnings from these businesses are generally correlated to the prevailing power supply and demand conditions and the price of natural gas. Extended periods of low gas prices will exert downward pressure on power prices and therefore profits from these facilities.

3. The dividend is secure and should increase over time

Despite the \$38 billion capital expenditure program planned over the next few years, the dividend should be secure and is expected to grow by 5% per year over the next few years (compared to 7% per year since 2000). The capital expenditure program is expected to be financed from operating cash flows, credit facilities, sales of assets to the U.S master limited partnership and preferred shares.

The free cash flow generated by the company (operating cash flow minus maintenance capital expenditures) adequately covers the dividend payments and is expected to do so for the foreseeable future.

Long-term investors should be well rewarded

The TransCanada share price spiked a few weeks ago on rumours that activist shareholders have bought shares in the company but the declining oil price and the general decline in the overall market, have brought the TransCanada share price back to more attractive levels.

With a dividend yield on the current price of 3.7% plus growth of around 5% per year over the next few years, high single-digit returns should be achievable.

CATEGORY

1. Energy Stocks
2. Investing

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1. NYSE:TRP (Tc Energy)
2. TSX:IMO (Imperial Oil Limited)
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