TransCanada Corporation Plans to Spend $46 Billion; Is the Dividend Safe?

Description

TransCanada Corporation (TSX: TRP)(NYSE: TRP) owns critical energy infrastructure assets in Canada, the U.S., and Mexico, including 68,500 km of natural gas transmission networks, 3,500 km of liquid pipelines, and 19 power plants with 10,800 MW of power generating capacity. As part of the third-quarter results, the company updated its capital spending plans for the next few years, now estimated at $46 billion.

Sound third-quarter financial results

TransCanada announced adjusted earnings per share of $0.63 for the third quarter, which was the same as the comparable quarter last year and in line with the market expectation. For the nine months completed in the current financial year, the profit per share was 2.4% higher than the previous year.

Revenues increased by 11% in the quarter and by 17% in the first nine months, as all three main divisions recorded higher billings. Operating and other expenses increased by 9%, resulting in income before interest and taxes rising by 16% for the quarter. The interest expense for the quarter jumped by 29% as a result of higher debt levels, the higher interest cost on U.S. dollar debt translated into Canadian dollars, and lower capitalised interest cost with the completion of the Gulf Coast extension of the Keystone Pipeline System.

Natural gas pipelines, the largest of the three main divisions, increased its earnings by 11% compared the same quarter last year and 13% so far this year. The profit of the U.S. pipeline component was boosted on translation by almost 10% as a result of the weaker Canadian dollar.

Liquids pipelines turned in a very strong performance, with earnings improving by 49% in the quarter and 38% so far this year. The Gulf Coast extension of the Keystone Pipeline System and the weaker Canadian dollar boosted profits for this division.

Despite generating higher revenue, the energy division reported slightly lower earnings as the Western Power division experienced a sharp decline in realised power prices, with spot prices in Alberta declining by 24% in the quarter compared to last year.

The cash flow of the business remains strong, with a very high 42% of revenues converting to operating cash flow. Free cash flow, or operating cash flow minus capital expenditures, amounted to $742 million for the first nine months of the year. The balance sheet is somewhat stretched, with net debt of $25 billion representing 55% of total capital.

Considerable capital expenditures planned but the dividend is safe – for now

Most of the $46 billion of capacity expansion projects planned by TransCanada over the next few years is backed by long-term contracts or cost-of-service business models. These expansion plans include the $12 billion Energy East Pipeline project and the $8 billion Keystone XL project. Financing will be derived from operating cash flows, credit facilities, sales of assets to the U.S. master limited partnership, and preferred shares. Supported by the new capacity additions, the company expects to almost double EBITDA by 2020 from the 2013 level of $4.9 billion.

TransCanada declared a dividend of $0.48 per share for the fourth quarter, which is 4% higher than the previous year. The company has grown the dividend on average by 7% per year over the past 14 years and built up a solid dividend payment track record since it cut the dividend in 2000.

Nevertheless, TransCanada will have its work cut out to finance the intended expansion plans, generate positive cash flow, and support growth in the dividend payments over the next few years.

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