



## TransCanada Corporation: Activists at the Gate

### Description

Sandell Asset Management, a significant shareholder of **TransCanada Corporation** ([TSX: TRP](#))([NYSE: TRP](#)) recently published a letter to the TransCanada board with certain proposals to increase shareholder value. This article explores the potential for success under these proposals.

### A three-pronged proposed strategy

The Sandell proposals contain three separate aspects – each which has been quantified to illustrate the potential value that can be added through these actions.

In the first instance Sandell suggests that TransCanada should sell all of its U.S.-based oil and gas assets to its master limited partnership (MLP), **TC Pipelines LP** (NYSE: TCP) at reasonable valuations and allow merger and acquisition activity and other growth opportunities to be explored in the MLP. This would create a top-tier MLP with scale, improved distribution growth prospects, and result in a higher valuation. TransCanada would remain the effective general partner and large shareholder in the MLP in order to benefit from the cash flow and valuation enhancement of the MLP.

Second, TransCanada should move the focus in its reporting from earnings per share to standard industry practice of EBITDA and adjusted funds from operations. Valued on either of these alternative bases, Sandell estimates that TransCanada trades at a considerable and unjustified discount to its nearest comparable entity, **Enbridge Inc.** ([TSX: ENB](#))([NYSE: ENB](#)).

Third, Sandell suggests that the power generation segment be separated from the pipeline business. This would allow the creation of a significant pure play North American power company and the appointment of a top class management team to drive business growth. This separation would also allow investors to value the more stable cash flows of the pipeline business separately from the more volatile energy business resulting in a higher overall valuation.

In combination, these three strategies would lift the TransCanada intrinsic value to \$75, a 30% premium to the current share price.

## Are the proposals realistic?

TransCanada has previously sold assets to its MLP and is on record indicating that further sales will take place to finance the large capital expenditure program. The Sandell proposal will therefore call for an accelerated execution of a plan that is already in place and could readily be implemented should the TransCanada board agree.

The reporting of profits to highlight the cash generation capabilities is unlikely to add much value as professional analysts already adjust their valuation metrics to incorporate cash generation parameters.

The separate listing of the power business could also add value as the higher level of volatility in the profits of this business clearly has the potential to detract from the value of the more stable pipeline business. This may be the most difficult aspect to convince the board to implement.

## What next?

Sandell has previously followed a similar approach to encourage the board of **Spectra Energy Corp** ([NYSE: SE](#)) to sell a major portion of its assets to its MLP. The share prices of both Spectra and its MLP improved considerably after the completion of the transactions.

Sandell indicated that it has already engaged with some of the largest TransCanada shareholders and have received a “validation of the merits” of the proposals. Most of the largest shareholders are institutional asset managers including RBC Wealth Management, RBC Global Asset Management, TD Asset Management, and Deutsche Asset and Wealth Management.

However, the TransCanada board released a statement labeling the Sandell analysis as “flawed” and emphasized its view that the current strategy is the correct one for shareholders. It is likely that the business strategy and the letter will be discussed at the upcoming investor day on November 19.

## The TransCanada dividend is attractive – now with additional upside

TransCanada has a sound dividend payment and track record with a current yield of 3.4%. Low to mid, single-digit dividend growth is expected over the next few years as cash is conserved to help finance the massive planned \$46 billion capital expenditure program.

Well-considered strategies to enhance shareholder value and increase the dividend growth are likely to be supported by shareholders and the Sandell proposals could create a bonus on top of the attractive yield.

## CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

## TICKERS GLOBAL

1. NYSE:ENB (Enbridge Inc.)
2. NYSE:TRP (Tc Energy)

3. TSX:ENB (Enbridge Inc.)
4. TSX:TRP (TC Energy Corporation)

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