



## TransCanada Corporation – Are Activists Getting Their Way?

### Description

Perhaps under pressure from Sandell Asset Management and other activist shareholders, **TransCanada Corporation** ([TSX: TRP](#))([NYSE: TRP](#)) has set clear targets for profit and dividend growth over the next few years, which it announced at its recent investor day. Let's take a look at the implications of these plans for investors.

#### EBITDA expected to grow to \$10 billion by 2020

TransCanada expects to grow earnings before interest, tax, depreciation, and amortisation (EBITDA) from \$4.8 billion in 2013 to around \$10 billion by 2020. The growth is expected to be slower initially, at 8% per year until 2017, with a number of smaller expansion projects including the Keystone Gulf Coast and Canadian Mainline expansions expected to come on line during this period. This will be followed by a faster growth phase, with EBITDA growing by 16% per year until 2020, when major projects including Keystone XL and Energy East are expected to start producing income.

Some of the projects still need to obtain regulatory approvals and are therefore not guaranteed to go ahead. However, it is notable that 95% of the additional capacity is expected to be fully commercially contracted or subject to cost of service contracts.

#### Finance levers to fund projects are in place

TransCanada management expects to finance the planned \$46 billion roster of projects and the cost of the dividend through cash flow generated by the existing operating businesses, commercial debt, project finance, equity finance, and sales of assets to its master limited partnership, **TC Pipelines, LP** (NYSE: TCP). The cost of the dividend in 2014 is expected to be \$1.4 billion and should grow to more than \$2 billion per year based on the dividend growth guidance.

On paper, the plans seem feasible, but it has to be noted that the TransCanada debt-to-capital ratio is already fairly high at 53%.

#### Dividend growth of 8%-10% per year until 2017

TransCanada says it intends to accelerate the dividend growth from 4% over the past few years to 8%-10% until 2017. The current dividend yield is 3.3%, and based on the mid-point of the growth projection, should yield 4.3% on the current price by 2017. Some capital growth is also possible.

Dividends are always at the discretion of the board of directors, who have to weigh, among other factors, the liquidity position of the company and its ability to meet commercial obligations before a dividend can be paid. There seems to be very little room for error, given the ambitious growth and financing plans.

### **Activist investors should be partly satisfied**

The letter written earlier this week by the activist shareholder Sandell Asset Management called for certain actions that would allow TransCanada to raise its dividend growth to at least 10% per year. These actions included an accelerated all-in sale of U.S. pipeline assets to the MLP in order to enhance the standing and rating of TC Pipelines. Company management does not seem to agree with this action and intends to continue with a piecemeal sale of assets over the next few years.

Sandell also suggested the separation of the power business, with the expectation that the value of the separated entities will deliver a higher overall valuation for shareholders. Again, this does not seem part of management's current thinking.

### **In conclusion**

The investor day delivered some good news for shareholders, and the share price reacted positively. However, Sandell estimated that the full implementation of its plans would increase the intrinsic value of TransCanada to \$75 per share. It is likely that the activists will continue to apply pressure.

### **CATEGORY**

1. Dividend Stocks
2. Energy Stocks
3. Investing

### **TICKERS GLOBAL**

1. NYSE:TRP (Tc Energy)
2. TSX:TRP (TC Energy Corporation)

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