Dividend Investors: The Case to Buy TransCanada Corporation

Description

The best part about dividends is that they're predictable. Nobody can tell you where the market is going next, but many companies raise their dividends on a regular schedule. Even better, a select few tell you *in advance* when they expect to increase their payouts.

Case in point: **TransCanada Corporation** (TSX:TRP)(NYSE:TRP).

In November, the Calgary-based utility and pipeline company announced plans to double its dividend growth rate from 8% to 10% annually through 2017. That's up from less than 5% previously.

What's the big deal?

Dividend hikes are a strong signal of confidence. Dashing investors' hopes would only damage management's credibly. That's why businesses don't typically make such promises unless they're confident they can deliver.

TransCanada's first-quarter results, which were released a few days after the dividend announcement, also reflected the company's strength. Led by big gains from the its liquids and natural gas pipeline businesses, TransCanada's revenues came in at $2.45 billion, up 11.2% from a year earlier.

Where is this growth coming from? To accommodate North America's energy boom, the company is investing more than $46 billion in new infrastructure projects through 2018. That includes thousands of miles of new pipelines as well as dozens of storage plants and processing facilities.

"Our three core businesses generated solid earnings and cash flow during the quarter," said Russ Girling, TransCanada's president and chief executive officer.

He continued, "Contributions from new assets like the Keystone Gulf Coast Extension and the Tamazunchale Extension in Mexico, along with strong results from Bruce Power, highlight the benefits of a diversified and growing portfolio of pipeline and power assets."

What's more, TransCanada is looking to transfer more properties to the company's master limited partnership (MLP), **TC PipeLines, LP** (NYSE:TCP). In all, management is looking to drop down approximately $215 million of assets in 2015, including a number of pipelines and processing facilities.

Financial engineering could unlock a tremendous amount of value for shareholders. Because these legal structures are taxed favourably, assets are worth substantially more inside an MLP than outside. Management estimates that they can sell these properties for about 10 times earnings before interest, taxes, depreciation, and amortization (EBITDA), much higher than they are being valued inside TransCanada.

All these efforts should generate big earnings (and by rough extension dividend) growth through the remainder of the decade.

Of course, no company is without problems. Environmental delays and oil spills are always a risk with these types of businesses. TransCanada's flagship Keystone XL pipeline also remains in regulatory limbo.

That said, the company's shares are trading at a reasonable 19 times forward earnings, the cheapest of its peer group. The stock's 3.7% yield is also above average. It looks as if these risks have already been priced in.

The one dividend stock for the next 10 years

Of course, you can't take TransCanada's dividend hikes to the bank just yet. Future distribution increases will depend on earnings and cash flow growth. Nothing is official until it has been approved by the board.

That said, management would not have raised investors' hopes unless they were confident they could deliver.

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