TransCanada Corporation: Buy, Sell, or Hold?

Description

TransCanada Corporation (TSX:TRP)(NYSE:TRP) is down about 8% in the past month and investors are wondering if this is a good time to start a new position in the stock.

default watermark

Let's take a look at the current situation to see if this company deserves a spot in your portfolio.

Earnings profile

TransCanada reported 2014 net income of $1.7 billion or $2.46 per share. The numbers came in slightly better than 2013 and the company expects earnings to increase again this year.

Natural gas pipelines make up the bulk of TransCanada's operations. In Canada, the company expects to get a nice earnings boost from growth in its NGTL System as it connects new natural gas supplies in northeastern B.C. and western Alberta. The Canadian Mainline is projected to deliver lower revenues in 2015 due to a change in toll rates, but the new arrangement has also allowed the company to sign long-term agreements that should set the stage for better revenue stability and a new expansion on the eastern end of the system.

U.S. gas pipelines are predicted to deliver stronger results on the back of new multi-year contracts to transport gas out of the Utica/Marcellus shale plays.

The liquids pipelines are expected to deliver similar earnings to those of 2014, as no major assets are set to go online this year. The long-term outlook is quite different, as TransCanada has a number of projects in development that are scheduled to go into service over the next few years.

The company's energy portfolio should deliver flat to slightly lower earnings in 2015. Most of the electricity output is sold under long-term contracts, but lower prices in the spot market in Alberta could hurt results.

Capital projects

TransCanada's revenue growth depends on the company's ability to get new pipelines approved, built, and put into service in an efficient and cost-effective way.

In its Q4 2014 report, TransCanada said it expects $12 billion in small-to-medium-sized projects to go into service by the end of 2017, and another $34 billion in commercially secured larger projects to be operational by the end of 2020.

One project, the northern portion of Keystone XL, has been a major distraction for management, and I think the latest setback on the pipeline should send a note of caution to potential investors. The cost to build Keystone XL has ballooned to $8 billion, and investors have to ask themselves if it is wise for the company to continue throwing money and resources at the project.

TransCanada says its customers remain firmly committed to getting the pipeline built, but the rising expenses are squeezing the cost advantage of the project. At some point, shareholders should brace for the possibility that the project might get shelved.

To support the funding of the broader capital program, TransCanada is selling its U.S. natural gas pipelines to a newly created master limited partnership, TC Pipelines, L.P. The company believes it will be able to “drop down” as much as $1 billion per year in assets over several years.

Dividend growth

default watermark

TransCanada recently increased its dividend by 8% to $2.08 per share, which puts the yield at about 3.9%. As new pipelines go into service, investors should see the payout continue to increase. The company has had an annualized dividend growth rate of 5.2% over the past 10 years.

Should you buy?

TransCanada trades at about 22 times earnings and 2.3 times book. This is higher than the five-year average for the stock, so the shares are still a bit expensive, even after the recent sell-off. The company is a solid long-term income play, but I would rate it a hold right now, given the valuation and the uncertainty facing some of its larger projects.

CATEGORY

1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

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

Category

1. Energy Stocks
2. Investing

Tags

1. Editor's Choice

Date
2025/09/13
Date Created
2015/03/16
Author
aswalker

default watermark

default watermark