Donald Trump Owns Shares of TransCanada Corporation: Here's Why You Should Too

Description

While Donald Trump may not be known as an equity investor, he has generated admirable returns on his stock portfolio. Trump reported $27 million of profits on sales in 2014 in a portfolio currently estimated to be between $30 and $80 million. Trump's investing success did not come from owning complex hedge funds, but rather through buying and holding high-quality, usually dividend-paying, blue-chip names. It should be no surprise then that one of Trump's larger holdings is **TransCanada Corporation** (TSX:TRP)(NYSE:TRP).

TransCanada is unique in that it offers a very stable power generation utility business combined with a stable but rapidly growing infrastructure business. This combined approach has produced a dividend that has increased every year since 2000 at a growth rate of 7% annually, with a total shareholder return of 15% annually since 2000.

Here are a few reasons why now is the best time in recent memory to take Donald Trump's lead and buy TransCanada.

TransCanada has huge growth ahead, and a very stable business model

TransCanada is involved in three separate businesses—energy, natural gas pipelines, and liquids pipelines. Currently, natural gas pipelines generate about 55% of earnings, while liquids and energy generate around 23% of earnings each. These three businesses all have in common the fact that they are largely based on long-term contracts, with the pipeline businesses consisting of mainly rate-regulated assets. Having assets that are rate-regulated provides tremendous stability, as a well as a competitive edge.

Working in conjunction with government regulators and shippers, rate-regulation allows TransCanada to lock in a return that covers operating costs, while recovering the initial cost of investment in theasset and providing a rate of return that is in excess of the cost of capital. This largely insulates TransCanada's pipelines from any commodity price risk and volume risk, and also enables TransCanada to lock out competition to an extent.

While the regulated nature of the assets does provide a cap on returns, agreements often allow some upside incentive earnings by increasing revenues and reducing costs above base revenues. For example, TransCanada's recent tolling agreement on its Canadian Mainline allows it to earn a 10.1 % return on equity, and in Q2 2015 TransCanada generated $24 million in incentive earnings.

While this stability drives a steady and growing dividend and provides safety to investors, TransCanada also has a huge $46 billion capital growth program that is expected to increase earnings by an 8% annual growth rate through to 2017, and a 16% annual growth rate beyond 2017 should the company receive approval for its major projects. As a result, TransCanada has pledged to grow its dividend by 8-10% annually through to 2017, above the historical rate of 7% (which plenty of room to go up).

TransCanada is currently trading at a very reasonable valuation

There's little doubt that the stability and diversification of TransCanada's business model played a role in originally attracting Trump to TransCanada. While it is uncertain what price Trump originally purchased TransCanada at, one thing is clear: shares are trading at a huge bargain today.

TransCanada is currently trading at a 2016 forward price-to-earnings (P/E) ratio of 16. This means that TransCanada is trading at 16 times its estimated 2016 earnings. On average, TransCanada trades between 14 times, and 20 times it's forward earnings, which means that currently TransCanada is trading near the bottom of its range.

Is this justified? Almost certainly not.

Enbridge Inc. (TSX:ENB)(NYSE:ENB)is currently trading at a 2016 forward P/E of 21. While Enbridge does have a slightly higher growth rate (10-12% instead of TransCanada's 8%), TransCanada's growth rate will be much higher than Enbridge's if its major projects get approved. The end result is that TransCanada should trade only slightly less than Enbridge in a worst-case scenario, which means now is a good time to buy.

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