3 Share Price Growth Catalysts for TransCanada Corporation After Keystone XL

Description

After **TransCanada Corporation** (TSX:TRP)(NYSE:TRP) was denied a Presidential Permit for Keystone XL, shares predictably plunged 8%. The result is that TransCanada is currently trading at a very low forward price-to-earnings ratio of 15.5. Not only is this well below TransCanada's peers, but it also on the low end of its 10-year range.

Does this mean TransCanada shares are a bargain? Perhaps, but one thing is certain—the company's long-term growth prospects have been reduced without the $8 billion project, and this means less potential upside for TransCanada.

In the short term, however, TransCanada has some room to move upwards and close the huge valuation gap between it and its peers. To do this, TransCanada will need some catalysts to boost the share price. Fortunately, there are a few catalysts that could happen in the near future.

1. TransCanada could boost its dividend-growth rate

Currently TransCanada expects to grow its dividend at 8-10% annually through to 2017, driven by the $12 billion in small- to medium-sized growth projects that are expected to be in service before that date.

It is important to note, however, that both TransCanada's expected dividend-growth rate as well as its payout ratio are below some of its peers. **Enbridge Inc.** (TSX:ENB)(NYSE:ENB), for example, is growing its dividend by a 14-16% CAGR from 2015 to 2019 (much of that growth will be coming from hikes earlier this year).

TransCanada has only given dividend-growth guidance till 2017, and in the 2013-2017 period, it will be growing its dividend by an 8-10% CAGR. An increase in dividend growth to 10-12% could be a catalyst that helps propel the share price higher.

This boost in the growth rate would likely be driven partially by an increase in the payout ratio. TransCanada currently only pays out about 44% of its cash flow to shareholders. This works out to a dividend-coverage ratio of 2.25 (which means the dividend is covered 2.25 times by cash flow). This is compared to two for Enbridge and one for many American pipelines.

For pipeline companies the higher the payout ratio, the higher the valuation, and by boosting its payout ratio and dividend-growth rate, TransCanada could see a boost to shares.

2. TransCanada could drop down more assets

Recently, pipelines have been creating value by "dropping down" or selling assets into master limited partnerships (MLPs) or other subsidiaries. Enbridge, for example, recently completed a $30 billion drop down to its Enbridge Income Fund Holdings vehicle.

These transactions allow the parent pipeline company to receive more value for the assets, since the subsidiaries buying the assets often place more value on the stable cash flows and dividends of particular assets than the parent company does. This is especially true for MLPs, since they pay no taxes at the corporate level, which makes the cash flows more valuable.

At the same time, these subsidiaries can help fund the parent company's growth program at a low cost either by providing cash in exchange for the assets or by providing shares in the subsidiary and then issuing equity to fund the parent company's growth projects, so the parent company does not have to.

TransCanada does have a drop-down strategy in place—it plans to sell all of its U.S. natural gas pipelines to its U.S. MLP, TC Pipelines. TransCanada has about $5 billion left to drop down, which can be used to help fund TransCanada's huge growth program.

This drop-down program, however, is fairly small scale compared with what TransCanada's competitors have been doing. If TransCanada expanded the scope of its drop-down strategy (which could include, for example, dropping down the U.S. portion of the existing Keystone system), TransCanada shares could see a boost.

3. TransCanada could receive other project approvals

Keystone XL is only one of many projects for TransCanada. For example, the $5 billion Prince Rupert Gas Transmission project has received all required permits, and the facility it serves (the Pacific Northwest LNG facility) is simply waiting on a confirmation from the Government of Canada. A positive confirmation could help TransCanada shares.

The same goes for any positive news from the ongoing assessment of the $12 billion Energy East pipeline from the National Energy Board.

CATEGORY

1. Investing

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2. NYSE:TRP (Tc Energy)
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Date
2025/08/25
Date Created
2015/11/13
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