Why TransCanada Corporation Shares Have Only 1 Way to Go in 2016

Description

Unless something dramatic happens before the end of the month, **TransCanada Corporation** (TSX:TRP)(NYSE:TRP) is set to have its worst year since 1999 with shares declining 24% year-to-date.

While sentiment around the stock has been negative due to declining commodity prices as well as the rejection of the $8 billion Keystone XL pipeline, over the past month TransCanada has been quietly announcing billions of dollars in new capital spending to drive growth, striking agreements towards the approval of its large-scale projects, and extending its dividend-growth outlook further into the future.

As a result, TransCanada's fundamentals look excellent, while its share price is in rough shape, setting TransCanada up to be an excellent value investment and for upside in 2016 as growing cash flow starts to bring investors back.

TransCanada has an excellent and secure growth outlook to 2020

At the core of TransCanada's strong fundamentals is something it recently re-affirmed at its recent investor day in November—that the company will be able to grow its earnings before income, taxes, depreciation, and amortization by 8% annually all the way through 2020.

In addition to this, TransCanada is also able to commit to growing its dividend by 8-10% annually through to 2020 as well, a growth target which is highly sustainable since TransCanada expects to have dividend coverage of 2.0 times its free cash flow, which means that TransCanada is essentially only using half of its available cash flow on its dividend.

This dividend and earnings-growth outlook is an improvement from 2014, where TransCanada was only able to project 8-10% dividend growth as well as the 8% earnings growth out to 2017 rather than 2020.

This growth will be driven by $13 billion in small- to medium-sized projects that are not only commercially secured, but also do not face the major regulatory hurdles that large projects such as Keystone XL or Energy East face. These projects should all be in service before 2018, and TransCanada expects to invest an additional $13 billion to extend the 8% earnings growth to 2020.

The best part of this earnings growth is that 8% is the very low end. TransCanada currently has a commercially secured $48 billion capital program, and the $13 billion that will drive growth until 2018 is only a small part of it. The additional $13 billion of incremental spending that will drive growth between 2018 and 2020 is not counted as part of the $48 billion program.

TransCanada currently has about $35 billion in large-scale projects, which includes the $14 billion Energy East, the $5 billion Prince Rupert Gas Transmission Pipeline, and the $4.8 billion Coastal Gaslink Pipeline.

Should these projects be approved, TransCanada is expecting an earnings-growth rate of 14% through to 2020.

TransCanada is announcing additional projects

While Keystone may be done for now, TransCanada has no shortage of new growth opportunities. Since the Keystone rejection, TransCanada has announced several major projects.

One project is $570 million that will be spent expanding TransCanada’s NGTL natural gas system, which is required due to new contracts TransCanada signed. In addition, TransCanada also announced it was selected to build and own the $500 million Tuxpan-Tula pipeline in Mexico.

This is only the start of TransCanada’s growth in Mexico. TransCanada already expects to invest $3 billion in Mexico by 2017, and Mexico currently planning six more projects (some as large as $4 billion) and plan to request proposals for these projects over the next few months. TransCanada has a good chance of winning approval to build many of these.

The company looks undervalued

Currently TransCanada is trading at only 16 times its projected 2016 earnings. Over the past 10 years, TransCanada has traded between 14 and 22 times its earnings, which means that TransCanada is currently near the bottom of its range.

Not only this, but TransCanada is also North America’s cheapest pipeline. TransCanada’s peers are trading at about 22 times earnings, which means TransCanada has room to move up potentially significantly if its major projects are approved and the company achieves the higher growth rate that these projects would produce.

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amancini