



Why Did Warren Buffett Buy Kinder Morgan Inc. Instead of TransCanada Corporation?

Description

Warren Buffett's latest investment may have taken a few people by surprise: he bought **Kinder Morgan Inc.** ([NYSE:KMI](#)), the largest energy infrastructure company in North America.

Kinder Morgan is best known for its pipeline network, which includes the largest natural gas network in North America, and the company also transports 2.1 million barrels of petroleum products per day. For that reason, its stock price has largely followed the price of oil. Of course, that was a big negative in 2015, a year in which Kinder Morgan's stock declined by nearly 65%.

Yet there are some important distinctions between Kinder Morgan and the energy producers. First of all, the company's distributable cash flow (DCF) has remained very steady. It actually increased slightly in 2015 and is expected to remain flat this year. The company also has some very attractive growth projects, more than 90% of which are fee-based with attractive counter-parties.

To put it bluntly, Kinder Morgan is a lot more stable than an energy producer. And the company's steady business model is right up Mr. Buffett's alley. That being the case, there's another company that he could have considered as well: **TransCanada Corporation** ([TSX:TRP](#))([NYSE:TRP](#)).

The case for TransCanada

TransCanada has a lot of the same benefits as Kinder Morgan. The company operates a vast pipeline network and generates revenue primarily from fees. Exposure to commodity prices is minimal. And cash flow tends to be very stable.

TransCanada also has a key advantage over Kinder Morgan: its credit status. The company has an A-credit rating from S&P and a Baa1 rating from Moody's, while over at Kinder Morgan, those ratings are BBB- and Baa3, respectively, just one notch above junk status. Kinder Morgan even had to slash its dividend late last year to preserve its investment grade rating.

Why is Mr. Buffett buying Kinder Morgan instead?

There are a few possible explanations for why Mr. Buffett spurned TransCanada. One obvious reason is that Kinder Morgan is a bigger company, which makes it easier for Mr. Buffett to assume a large position. For someone with his financial resources, this certainly plays a factor. Of note, his stake in the company was worth nearly US\$400 million as of the end of last year.

Another likely reason is that Kinder Morgan is cheap. The company traded at about seven times DCF as of the end of last year, while its peer group all traded for more than nine times DCF. This discount is at least partly due to the company's minuscule dividend, but as long as the company reinvests its cash flow wisely, then this shouldn't discourage any investors.

In fact, both Kinder Morgan and TransCanada make for very compelling investments right now. One of them seems to be cheaper, while the other one is a legitimate dividend champion.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:KMI (Kinder Morgan Inc.)
2. NYSE:TRP (Tc Energy)
3. TSX:TRP (TC Energy Corporation)

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