3 Reasons TransCanada Corporation Bought Columbia Pipeline Group Inc.

Description

On Thursday, **TransCanada Corporation** (TSX:TRP)(NYSE:TRP) announced a blockbuster US$13 billion deal to acquire **Columbia Pipeline Group Inc.** (NYSE:CPGX). We'll look at three reasons why TransCanada made such a bold move.

1. Access to the northeast

TransCanada may be best known for its rejected Keystone XL application, but the company's pipeline network primarily transports natural gas from western Canada. This has become quite a challenging business in recent years, primarily because of growing production from the Marcellus and Utica shale basins has been displacing Canadian gas. In fact, TransCanada's Mainline system has been running at only half capacity, and the outlook only looks worse.

To put some numbers on this story, natural gas production from the Marcellus and Utica has grown from less than two billion cubic feet per day (bcfd) in 2007 to 19 bcfd per day today, and analysts are expecting growth to 30 bcfd by 2020.

Meanwhile, Columbia Pipeline operates an extensive pipeline system in the U.S. northeast. So by making this acquisition, TransCanada gets access to a market that it had previously been losing out to. It's a classic case of "if you can't beat 'em, join 'em."

2. Higher earnings

TransCanada is paying well over 30 times earnings for Columbia Pipeline, which is not exactly a bargain price. Yet TransCanada still expects the deal to be accretive starting next year, partly due to $250 million of expected cost savings.

Better yet, 92% of TransCanada's profit will now come from regulated and long-term contracted assets, which should make for very strong cash flow. It may also allow the company to grow the dividend by more than its 8% annual target.

3. An opportunity to grow

Columbia Pipeline has numerous growth projects in its pipeline (no pun intended), and it has an profit-growth target of 20% per year to 2020.

This bodes very well for TransCanada, a company that has fewer growth opportunities after Keystone was rejected. Put another way, TransCanada is simply taking the capital that would have been used to fund Keystone and using it to buy Columbia Pipeline instead.

With all that said, TransCanada's stock has declined on the news, so shareholders still need to be won over. And there are good reasons to be skeptical. If TransCanada did indeed make this acquisition out of weakness (i.e., because it was getting displaced by the Marcellus and Utica), then there is reason to believe the company overpaid. We'll just have to see how this turns out.

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