Is TransCanada Corporation Really Worth $55 a Share?

Description

After hitting road blocks to organic growth in nearly every direction, **TransCanada Corporation** (TSX:TRP)(NYSE:TRP) has taken a different route this time by buying growth instead.

It's a route that analysts at **Citigroup Inc.** (NYSE:C) applauded because not only does it solve the company's growth problem, but it will make the company's overall earnings less cyclical because of the assets it plans to shed to pay for its acquisition. Add these changes up, and Citigroup's analysts believe the stock is now worth $55 a share, well above its current trading price.

A portfolio overhaul

TransCanada's $13 billion acquisition of U.S. pipeline company **Columbia Pipeline Group Inc.** (NYSE:CPGX) is a game changer for the company according to Citigroup because it will finally lead to the unloading of TransCanada's power assets. These are assets that Citigroup has advocated be split apart from TransCanada since 2014 in order for investors to have complete exposure to the company's pipeline assets.

The reason TransCanada is now planning to sell its power assets is because it offered to pay all cash for Colombia Pipeline Group as opposed to using stock to fund some or all of the deal. However, instead of borrowing vast sums of cash to pay for the deal, TransCanada chose to undertake a record $4.42 billion equity offering and sell its U.S. power assets and its Mexican pipeline joint venture.

According to Citigroup, TransCanada should be able to fetch $4 billion for the power assets and another $2 billion for its 49% stake in the Mexican natural gas pipelines, which should more than cover the cost of the deal once we include the assumption of debt.

A foundation for growth

In basically trading those two businesses for Columbia Pipeline Group, TransCanada will be shedding low growth cyclical assets for Columbia Pipeline Group's high-growth opportunities. That's because the company has US$7.3 billion in projects under construction that are expected to drive significant earnings growth between 2018 and 2020. In fact, Citigroup sees these projects boosting Columbia

Pipeline's EBITDA by 70%.

Given those projections, Citigroup sees TransCanada currently trading at a very attractive 15 times 2018 earnings, which is one of the lower multiples among large-cap pipeline and utility companies. It's this low-end multiple combined with the fact that TransCanada is expected to deliver robust 10% annual earnings and dividend growth through 2022 that's driving its $55 a share price target.

That upside to its current trading price also convinced Citigroup to upgrade TransCanada to a buy from its prior hold rating.

Investor takeaway

Citigroup loves TransCanada's decisions to buy the fast-growing Columbia Pipeline Group and jettison its cyclical U.S. power assets. That's because the deal provides a lot more certainty to long-term growth, which had been weighing the stock down. With that uncertainly and cyclicality removed, Citigroup sees a cheap stock that's a pretty compelling long-term buy in its book.

All that being said, TransCanada still has to not only close the Colombia Pipeline Group deal, but also sell both its power assets and its Mexican pipeline joint venture at or above the values that analysts have placed on those assets. Not to mention that the growth projects need to deliver as promised.

If TransCanada misses on one or more of these initiatives, then it is quite possible that Citigroup's estimates could prove to be too optimistic. It's a real risk given that TransCanada has had execution issues in the past, which is why it had to buy growth instead of build it. So, don't go banking on a quick profit, because that $55 upside is no sure bet.

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mdilallo