TransCanada Corporation Rises 20%: What Should You Do With it?

Description

The good thing about investing is that you don't have to catch the bottom to book solid gains. I bought some shares of **TransCanada Corporation** (TSX:TRP)(NYSE:TRP) at the $45 level and bought more when it fell to the $42 level, so my average cost basis is about $44 per share. Comparatively, the company's 52-week low is $40.60 per share, more than 8% lower than my cost basis.

At about $54 per share, TransCanada is about 22% higher from my average cost basis. What should I do with my gains?

My position

Being a value-dividend investor, I'm naturally focused on TransCanada's dividend; specifically, I want to know if it can continue to increase and if its shares are overpriced.

Thanks to TransCanada's most recent dividend hike of almost 8.7% that occurred at the start of the year, my yield on cost is almost 5.1%. However, investing is a forward-looking activity. Right now the shares yield almost 4.2%.

As I mentioned before, my shares have appreciated 22%, which is an excellent result for the duration of nine months.

TransCanada's strength

Since 2000, TransCanada has delivered average annual returns of 13%. This is what happens when you invest in an A-grade, quality company that shares profits with its shareholders via a strong, growing dividend.

From 2000 to now, its dividend has grown at a compound annual growth rate of 7%. More recently, from 2010 to 2015, its dividend grew on average 5% per year.

With $24 billion of near-term projects and over $45 billion of long-term projects, TransCanada expects to grow its dividend at a higher rate of 8-10% per year. If this materializes, TransCanada should trade at a higher multiple than it did in the past.

TransCanada's dividend is covered by earnings (payout ratio of 88%), distributable cash flow per share (payout ratio of below 50%), and funds generated from operations (below 30%).

Most importantly, TransCanada employs a low-risk business model. More than 90% of its earnings (before interest, tax, depreciation and amortization) come from regulated assets or long-term contracts.

Valuation

For strong dividend growers, the dividend yield is one source that indicates whether the company is priced at a good valuation or not.

Since 2000, TransCanada's dividend yield has only risen above 4.7% three times. It occurred in 2009 due to the market plummet during the financial crisis and in late 2015 when energy-related stocks plummeted because of low oil prices.

TransCanada's high yield and low yield range since 2000 has been roughly between the yields of 3.5% and 4.9%, where a strong support in the middle is approximately a yield of 4%.

So, the company is within a fair-value range and is not particularly expensive or cheap.

Conclusion

There are three things I could do: buy, hold, or sell. Technically, TransCanada is overbought, so it's likely that it'll either trade sideways or even dip in the near term.

Since I bought at a historically high yield of over 5% and there's a margin of safety for my original capital as the shares have risen over 20%, I'm likely to continue holding the quality shares for a growing dividend.

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