Better Buy: TransCanada Corporation vs. Inter Pipeline Ltd.

Description

There are a few simple reasons why investors love the pipeline sector.

One of the most important is the sustainability of earnings. Canada's largest pipelines have been moving away from commodity-based pricing, preferring to get paid a set amount based on volume. This leads to more stable earnings. As the prices of oil and natural gas declined, investors bearish on the commodities themselves flocked to the relative safety of pipeline stocks.

As **Enbridge Inc.** can attest, getting permission to build giant pipeline projects in Canada is easier said than done. The Federal Government makes a company spend millions of dollars and jump through hundreds of hoops before giving it the go-ahead to start construction. This long and labourious process ensures no pipeline start-ups can just show up and start taking market share.

Finally, there's the attractive dividends each pipeline spins off, which tends to be accompanied with impressive dividend growth. Dividend-growth investors have stuffed their portfolios with pipeline stocks for that very reason.

But which pipeline stock is the best? Let's take a closer look at two of Canada's largest: **TransCanada Corporation** (TSX:TRP)(NYSE:TRP) and **Inter Pipeline Ltd.** (TSX:IPL).

The businesses

While both of these companies are in the energy transport business, there are important differences between the two.

Let's start with Inter Pipeline. The company's main assets are three pipelines that transport bitumen from Alberta's oil sands to refineries close to Edmonton. It also has conventional oil pipelines, and it just acquired some natural gas pipelines. Approximately 90% of Inter's infrastructure is in Alberta, which is well known to be the friendliest province towards energy producers.

TransCanada is a much larger company with assets stretched across North America. It owns more than 90,000 km of natural gas pipelines, 4,300 km of liquids pipelines, and nearly 11,000 MW of powergeneration capacity. It has a market capitalization of nearly $55 billion versus Inter's much more modest $10.4 billion.

Growth potential

Inter has two major growth avenues. The first comes from its three oil sands pipelines, which were intentionally built with the future in mind. Today, those three pipelines transport about 2.3 million barrels of oil per day. They have capacity to handle 4.6 million barrels per day. As the oil sands expand, Inter will pick up more volume.

It also has the potential to acquire assets from cash-strapped energy producers looking to shore up their balance sheets.

TransCanada, meanwhile, has plenty of growth projects planned. It plans to spend $26 billion between now and 2020 on a dozen different projects around North America. And remember, it recently got approval from the United States to go ahead on its controversial Keystone XL extension.

Valuations

In 2016, TransCanada posted $6.6 billion in earnings before interest, taxes, depreciation, and amortization (EBITDA). It has a current enterprise value (EV) of $102.7 billion. This gives shares a current EV-to-EBITDA ratio of 15.6.

Inter had an EV of $16.7 billion as of December 31. It generated $1 billion in EBITDA in 2016, giving it an EV-to-EBITDA ratio of 16.7.

TransCanada is a little cheaper than Inter, but not by much.

Dividends

Both companies have been dividend-growth studs over the last decade.

Let's start with Inter. In 2007, it paid $0.84 per share each year in dividends. Nine dividend increases later, shares are estimated to pay $1.62 each in 2017. That's good enough for a 6.8% growth rate. The company has a payout ratio of approximately 60% of funds from operations, making the 5.8% yield safe.

TransCanada paid investors a dividend of $1.36 per share in 2007. These days, the payout is $2.50. That's good enough for a 7% growth rate. In 2016, the company delivered comparable distributable cash flow of $4.83 per share, giving it a payout ratio of 52%. Shares today yield 4%.

While TransCanada's dividend does look to be a little safer and may offer better growth over the next five years, Inter's yield is much higher today.

The bottom line

Both of these energy infrastructure powerhouses would look great in your portfolio. There's no clear winner between the two.

If I could only invest in one today, it would probably be Inter Pipeline because of its better dividend, smaller size, and Alberta-centric focus.

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Date
2025/07/06
Date Created
2017/04/07
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