Is TransCanada Corporation a Must-Buy for Income Investors?

Description

When I'm evaluating potential dividend stocks, I have two criteria: does the company have a predictable source of income to pay that dividend? Are there growth prospects to boost the dividend over coming years?

If you're like me, you like to get raises.

TransCanada Corporation (TSX:TRP)(NYSE:TRP) satisfies both of these requirements. Not only does it have a predictable source of income in long-term contracts, but thanks to a major acquisition in 2016, TransCanada has considerable growth prospects, allowing it to boost the dividend.

But first, let's look at the first half of the equation: earnings. Revenue in the second quarter was impressive, up 16.9% to $3.2 billion. Earnings increased by 80% to $659, or $0.76 per share compared to $0.52.

Earnings were up for two reasons. First, its portfolio of natural gas pipelines saw earnings improve from $41 million in 2016 to $120 million in 2017. And second, TransCanada acquired Columbia Pipeline, adding major U.S. natural gas pipelines to the portfolio. The combined entities earned $401 million, whereas TransCanada on its own generated only $188 million last year.

In my opinion, we'll find this acquisition as a major reason why TransCanada is an amazing income stock, and it's because of the geographic diversification. Due to an increase in natural gas generation in the United States, more business is being done there versus in Canada, which we can see in the earnings for the Canadian pipelines — they were down from $342 million to $305 million.

But the other reason is due to the massive book of near-term capital projects. All told, it has $24 billion it is looking to invest in projects that are low risk but provide considerable opportunity for revenue. And in the medium to long term, there is an additional $40 billion in projects. One of them, the Keystone XL pipeline, which was once considered dead, is now potentially on the table again.

Not only are earnings up, but the balance sheet looks incredible. Thanks to the sale of its U.S. northeast power assets, which fetched $4.1 billion, TransCanada was able to pay quite a bit of debt down — $7 billion during 2017. This has reduced the company's debt-to-equity ratio from 1.47 to 1.19.

As you can see, the business is doing very well, earnings are up, and its debt is being reduced. That's the recipe for a company that is going to pay a comfortable dividend and, if management's plans are true, will continue increasing it.

Between 2000 and 2016, the dividend was increased by a compound annual growth rate of 7%. Thanks to the acquisition, the company is able to boost the dividend even more with an expectation that it'll be 8-10% annually — closer to the higher end of that range.

TransCanada, due to its acquisition of Columbia, is diversified in both Canada and the United States. Thanks to 95% of its business being contractual, its earnings are strong and are expected to continue growing. Due to a massive book of development projects, earnings should accelerate over the coming years. And finally, it pays a 4% yield, which is good for $0.625 per quarter. If you ask me, owning this stock is a no brainer.

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