



Better Buy: TransCanada Corp (TSX:TRP) vs. Enbridge Inc. (TSX:ENB)?

Description

Traditionally, pipelines have been a wonderful business that have helped make many Canadian investors wealthy.

This doesn't look like it's going to change. Many parts of Canada simply don't have any desire to have pipelines in their backyard. Any proposed expansions or new routes are met with fierce resistance. Even though these naysayers may only be a small minority, the media picks up on the story and it gains momentum.

This might be bad news for the Canadian economy as a whole, but it's good news for owners of existing pipelines. Their assets become all the more valuable.

Let's take a closer look at Canada's two largest pipeline stocks to determine if one is a clear winner over the other.

Asset base

Both **Enbridge** ([TSX:ENB](#))([NYSE:ENB](#)) and **TransCanada** ([TSX:TRP](#))([NYSE:TRP](#)) are diverse energy giants with a multitude of different assets.

Let's start with Enbridge, which is known as being a little more focused on oil pipelines versus natural gas. These pipelines generated approximately \$6.4 billion in EBITDA, according to the company's last annual report. The natural gas distribution business — which includes Ontario, Quebec, and certain parts of the U.S. — generated \$1.4 billion in EBITDA, and the power generation division earned a little less than \$400 million before interest, taxes, and depreciation.

TransCanada is much more focused on natural gas pipelines. In its most recent completed fiscal year, it did approximately \$7.3 billion in EBITDA. Approximately \$5 billion — or 68% — of those earnings came from natural gas pipelines. \$1.3 billion was generated from the company's oil pipeline business, while \$1 billion came from producing power.

In short, both of these companies have a large reliance on pipelines, but TransCanada is a smidgen more diversified.

However, I'm giving Enbridge the edge here. Oil pipelines are the bigger story today. People don't care so much about natural gas pipelines. Thus, Enbridge's asset base would be harder to reproduce today.

Valuation

Both these companies have huge depreciation charges, which means we can't value them on net earnings. This vastly understates their cash flow generation abilities.

Through the first three quarters of 2018 — full-year results aren't out yet — Enbridge generated \$3.40/share in distributable cash flow. If we annualize that figure, it gets us to \$4.60 per share, putting Enbridge shares today at just under 10 times that proxy for earnings.

TransCanada reports comparable distributable cash flow as a proxy of its total cash flow. Based on the first three quarters of 2018, the company should report approximately \$5.5 billion in distributable cash flow for the year, or approximately \$6.17 per share based on an average of 915 million shares outstanding. This puts TransCanada shares at approximately 8.5 times that metric.

In short, TransCanada is cheaper on a price-to-cash flow basis, but both stocks look like good values today.

Dividends

Upon first glance, the edge goes to Enbridge. Thanks to a recent 10% dividend hike, it has a forward yield of 6.2%. TransCanada's 5.1% yield is also pretty impressive, but Enbridge clearly wins the current yield battle.

Both companies have a demonstrated history of increasing the dividend over time, so one doesn't really have an edge over the other there.

A different story emerges when we look at the payout ratio versus cash flow. TransCanada looks like it'll earn \$6.17 per share in distributable cash flow in 2018. The current dividend is \$2.76 per share, giving it a payout ratio of just 45% of cash flow.

Enbridge's payout ratio is much higher. It looks poised to earn \$4.60 per share in distributable cash flow in 2018, while its current dividend is \$2.95/share. That gives it a payout ratio of 64%. This is much higher than TransCanada's payout ratio.

I have to give the edge in dividends to TransCanada. It offers a nice yield today with a much more conservative payout ratio.

The bottom line

It's likely both TransCanada and Enbridge will continue to be great investments over time. I personally

own both in my portfolio. But at this point, I'd give the slight edge to TransCanada. I like its more diverse operations and its focus on natural gas pipelines, and its dividend looks to be a little more secure.

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