



TransCanada Corporation (TRP)

Updated September 13th, 2018 by Nick McCullum

Key Metrics

Current Price: \$42	5 Year CAGR Estimate: 7.7%	Volatility Percentile: 25.1%
Fair Value Price: \$40	5 Year Growth Estimate: 4.0%	Momentum Percentile: 9.5%
% Fair Value: 105%	5 Year Valuation Multiple Estimate: -1.3%	Valuation Percentile: 50.2%
Dividend Yield: 5.0%	5 Year Price Target: \$48	Total Return Percentile: 50.5%

Overview & Current Events

TransCanada Corporation operates Canada's largest natural gas pipeline system. The company owns more than 57,000 miles of natural gas pipelines and more than 3,000 miles of liquids pipelines. TransCanada Corporation operates through three segments: Natural Gas Pipelines, Oil Pipelines, and Energy. The Natural Gas Pipelines segment contributed more than 50% of consolidated revenue in the most recent fiscal year. TransCanada Corporation is headquartered in Calgary, Alberta, Canada, and its common shares are cross-listed on both the Toronto Stock Exchange and the New York Stock Exchange, where they trade with a market capitalization of US\$38 billion. In this report, all figures are reported in U.S. dollars and the company's NYSE-listed shares have been used for the purpose of valuation analysis.

In early August, TransCanada Corporation reported (8/2/18) financial results for the second quarter of fiscal 2018. In the quarter, the company saw revenues decline by 1.1% while adjusted earnings-per-share of \$0.86 increased by 13% over the same period a year ago. Through the first six months of the fiscal year, performance was even better as adjusted earnings-per-share rose by 17%. The company's strong bottom line performance was driven by robust contributions from its legacy assets as well as \$7 billion of new growth projects that entered into service over the last twelve months. In addition, the company benefitted from the positive impact of U.S. tax reform. Shares of TransCanada Corporation rose slightly following its earnings release before retracing their gains quickly in the weeks to come.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$2.07	\$2.01	\$1.77	\$2.12	\$1.84	\$2.28	\$2.12	-\$1.26	\$0.12	\$2.00	\$2.20	\$2.68
DPS	\$1.18	\$1.45	\$1.60	\$1.65	\$1.76	\$1.73	\$1.66	\$1.50	\$1.68	\$1.99	\$2.15	\$2.50
Shares	616.47	684.36	696.20	704.00	705.00	707.00	709.00	702.61	863.76	881.38	910.0	925.0

TransCanada's growth strategy has been to raise capital (in the form of either debt or equity) to fund growth projects. Over the last decade, this has failed to generate any meaningful growth for the company *on a per-share basis* as the additional net income generated by these projects has been offset by the increased number of shares outstanding. Still, we believe that the next several years will show an improvement for TransCanada Corporation as the company benefits from a continued rebound in the energy markets. We believe that TransCanada Corporation is likely to generate around \$2.20 of adjusted earnings-per-share in fiscal 2018, with 4% annualized growth occurring in the years to come. Applying a 4% growth rate to our 2018 earnings-per-share estimate of \$2.20 allows us to calculate a 2023 earnings-per-share figure of \$2.68. Given the company's high payout ratio, dividend growth is not likely to exceed earnings growth for the foreseeable future.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	17.2	14.1	20.1	19.4	23.9	20.2	22.5	N/A	N/A	24.2	19.2	18.0
Avg. Yld.	3.3%	5.1%	4.5%	4.0%	4.0%	3.8%	3.5%	3.8%	4.0%	4.1%	5.0%	5.1%

Excluding 2015 and 2016 when the company's earnings were depressed, TransCanada Corporation has traded at an average price-to-earnings ratio of 20.2 over the last decade. We believe that this historical valuation multiple is a bit

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

rich, and that the company's true fair value lies somewhere closer to 18 times earnings. TransCanada Corporation is trading at a price-to-earnings ratio of 19.2 today. If the company's valuation were to contract to a price-to-earnings ratio of 18 over the next 5 years, this would reduce investors' annualized returns by 1.3% per year during this time period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

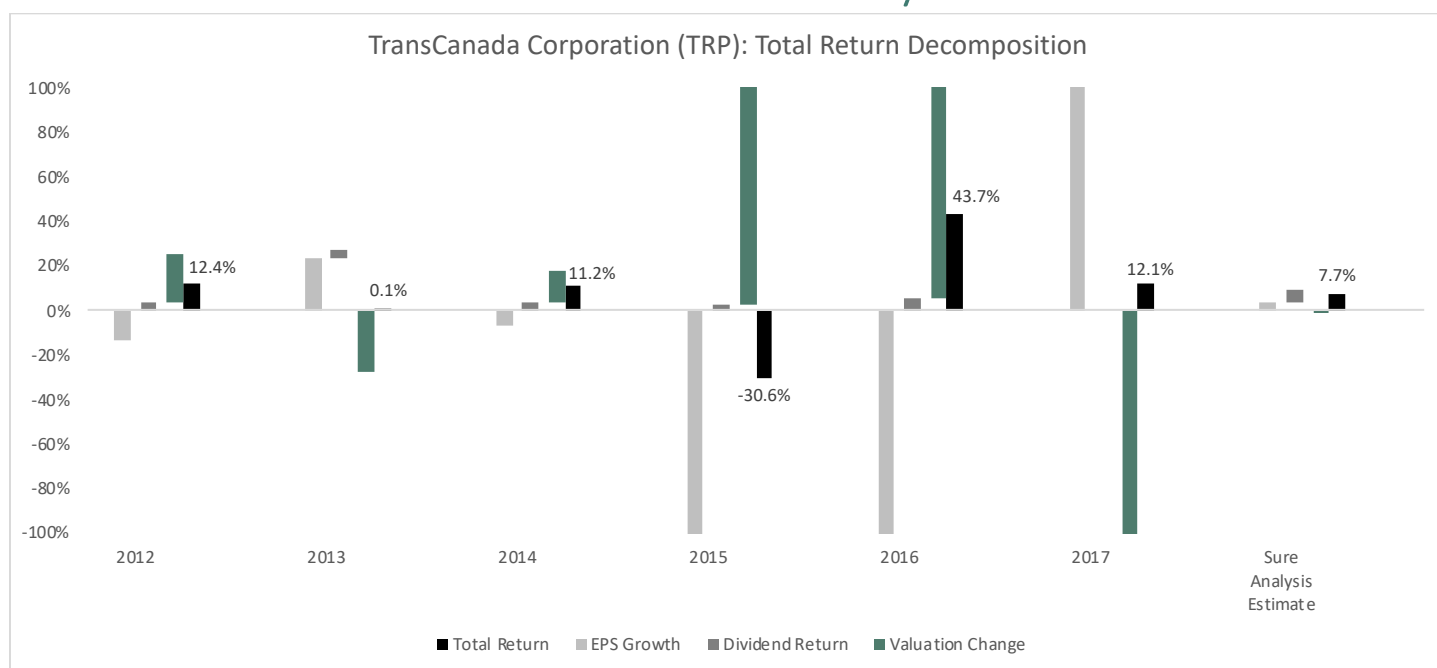
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	12.1%	10.5%	5.1%	6.9%	6.2%	6.4%	6.8%	6.8%	5.3%	5.8%	6.5%	7.5%
Debt/A	64.2%	61.4%	61.6%	61.4%	62.1%	62.6%	64.7%	71.8%	69.2%	68.8%	68.0%	65.0%
Int. Cov	3.3	3.2	4.0	3.6	3.3	3.7	3.2	0.2	1.4	2.8	3.5	3.5
Std. Dev.	25.2%	25.9%	19.6%	15.5%	12.8%	13.9%	18.8%	21.5%	19.0%	11.3%	16.0%	16.0%
Payout	57.0%	72.1%	90.4%	77.8%	95.7%	75.9%	78.3%	-119%	N/A	99.5%	97.7%	93.3%

TransCanada's quality metrics declined considerably with the volatility in the energy markets that began in 2014. With that said, the company's payout ratio is still below 100% (though barely) *using earnings*, while many of the company's peers pay out more than 100% of earnings as dividend payments to shareholders. This is possible due to the non-cash nature of many of their expenses (namely, depreciation). Separately, TransCanada's stock price volatility remained at comfortable levels even when oil prices fell precipitously. These factors combined with the company's high yield lead us to believe it is a suitable security for conservative, income-oriented investors.

Final Thoughts & Recommendation

Through a combination of dividend payments, earnings growth, and valuation contraction, TransCanada Corporation appears positioned to deliver mid-to-high single-digit total returns at current prices. For yield-hungry investors looking for exposure to the energy sector, the company may be a potential buy today. For other investors concerned primarily with total return, there are other opportunities within the energy sector (such as Exxon Mobil) that have better return prospects at current prices.

Total Return Breakdown by Year



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