



# TransCanada Corporation (TRP)

Updated November 16<sup>th</sup>, 2018 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b>	\$40	<b>5 Year CAGR Estimate:</b>	9.4%	<b>Volatility Percentile:</b>	24.0%
<b>Fair Value Price:</b>	\$40	<b>5 Year Growth Estimate:</b>	4.0%	<b>Momentum Percentile:</b>	15.4%
<b>% Fair Value:</b>	100%	<b>5 Year Valuation Multiple Estimate:</b>	0.0%	<b>Growth Percentile:</b>	20.5%
<b>Dividend Yield:</b>	5.4%	<b>5 Year Price Target</b>	\$49	<b>Valuation Percentile:</b>	52.5%
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	D	<b>Total Return Percentile:</b>	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\$36 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 November, TransCanada Corporation reported (11/1/18) financial results for the third quarter of fiscal 2018. In the quarter, the company grew its comparable earnings-per-share by 43% and exceeded the analysts' estimates by 25% thanks to the strong performance of its legacy assets, a reduced tax rate and contribution from \$7 billion of growth projects that came online over the last 12 months. Thanks to strong momentum in Natural Gas Pipelines and Liquids Pipelines, management expects the earnings and cash flows to continue to grow. Moreover, thanks to approximately \$10 billion of new projects coming online early next year, the company will be able to fund its hefty \$36 billion investment program more readily from next year, though it will still need to resort to capital markets.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$2.07	\$2.01	\$1.77	\$2.12	\$1.84	\$2.28	\$2.12	-\$1.26	\$0.12	\$2.00	<b>\$2.50</b>	<b>\$3.04</b>
<b>DPS</b>	\$1.18	\$1.45	\$1.60	\$1.65	\$1.76	\$1.73	\$1.66	\$1.50	\$1.68	\$1.99	<b>\$2.15</b>	<b>\$2.70</b>
<b>Shares</b>	616.47	684.36	696.20	704.00	705.00	707.00	709.00	702.61	863.76	881.38	<b>915.0</b>	<b>980.0</b>

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 energy markets. Thanks to the impressive performance in the third quarter, we have revised our earnings-per-share estimate for this year from \$2.20 to \$2.50. We also expect 4% annualized growth over the next five years. Management recently reiterated its guidance for 8%-10% annual dividend growth over the next three years, though the high leverage and the high payout ratio make us somewhat cautious.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	17.2	14.1	20.1	19.4	23.9	20.2	22.5	N/A	N/A	24.2	<b>16.0</b>	<b>16.0</b>
<b>Avg. Yld.</b>	3.3%	5.1%	4.5%	4.0%	4.0%	3.8%	3.5%	3.8%	4.0%	4.1%	<b>5.4%</b>	<b>5.5%</b>

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. The stock is trading at a price-to-earnings ratio of 16.0

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today. Given its poor growth record, its high leverage and its poor free cash flows, we believe that the current price-to-earnings ratio is fair for this stock. As a result, we do not expect the valuation of the stock to play an important role in its average annual return over the next five years.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

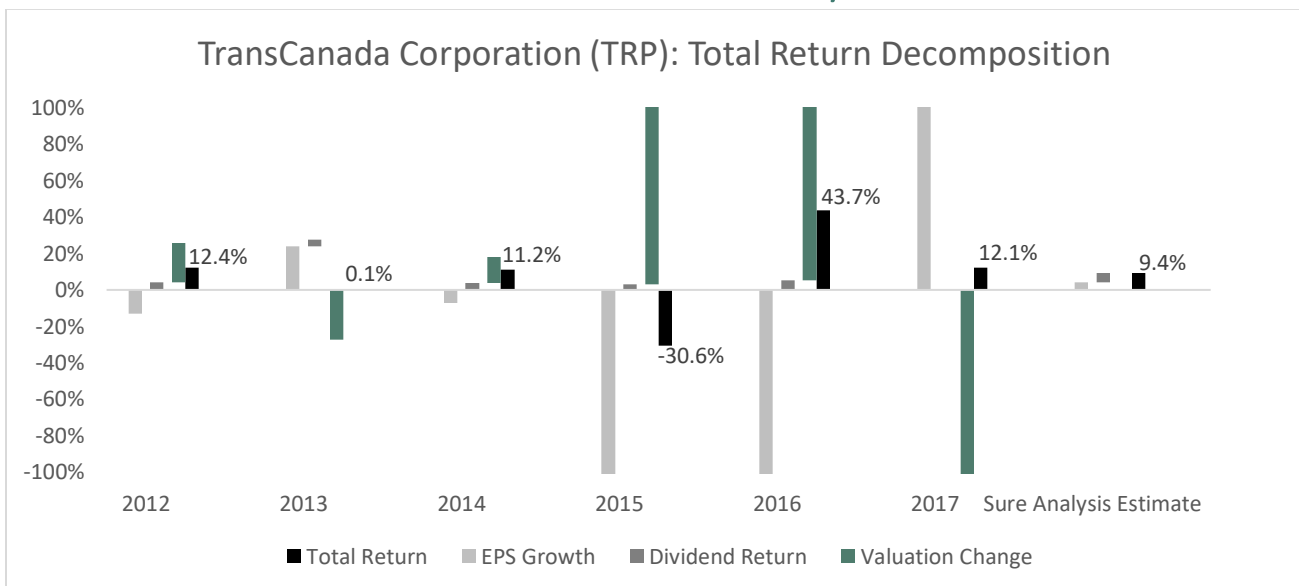
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	12.1%	10.5%	5.1%	6.9%	6.2%	6.4%	6.8%	6.8%	5.3%	5.8%	6.0%	7.5%
Debt/A	64.2%	61.4%	61.6%	61.4%	62.1%	62.6%	64.7%	71.8%	69.2%	68.8%	70.0%	65.0%
Int. Cov	3.3	3.2	4.0	3.6	3.3	3.7	3.2	0.2	1.4	2.8	2.5	3.5
Std. Dev.	25.2%	25.9%	19.6%	15.5%	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%	86.0%	88.8%

TransCanada has been investing heavily in growth projects in the last decade and will continue to do so in the years ahead. Consequently, it has posted negative free cash flows in 8 out of the last 10 years and has a leveraged balance sheet, with low interest coverage and a net debt that is about *20 times its earnings*. The company is thus exposed to unforeseen headwinds, such as a downturn in the energy market or a recession. In addition, as it often issues new shares, it dilutes its shareholders at a high rate whenever its stock plunges due to a headwind. On the other hand, despite its high payout ratio, the stock is not likely to cut its dividend anytime soon thanks to the strong momentum in its business and the increasing contribution of new projects in its cash flows.

## Final Thoughts & Recommendation

TransCanada Corporation offers a 5.4% dividend and is thus likely to offer a 9.4% average annual return over the next five years. For yield-hungry investors looking for exposure to the energy sector, the company is ahold. However, due to its high leverage, its negative free cash flows and its tendency to dilute shareholders, investors should not view this as a buy-and-hold forever stock. Instead, if they buy the stock, they should take profits at some point. Moreover, there are other opportunities within the energy sector, such as Exxon Mobil and Total, which have better return prospects at current prices and a much less risky profile.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Revenue</b>	8117	7202	6643	7928	8009	8543	9226	8895	9475	10377
<b>Gross Profit</b>	3865	4374	2371	3198	3007	3225	3410	3172	3455	3940
<b>Gross Margin</b>	47.6%	60.7%	35.7%	40.3%	37.5%	37.8%	37.0%	35.7%	36.5%	38.0%
<b>D&amp;A Exp.</b>	1174	1212	1125	1343	1375	1442	1459	1383	1464	1586
<b>Operating Profit</b>	2989	2430	1875	2783	2573	2793	3105	2998	3352	3892
<b>Operating Margin</b>	36.8%	33.7%	28.2%	35.1%	32.1%	32.7%	33.7%	33.7%	35.4%	37.5%
<b>Net Profit</b>	1356	1215	1239	1599	1354	1734	1667	-898	176	2436
<b>Net Margin</b>	16.7%	16.9%	18.7%	20.2%	16.9%	20.3%	18.1%	-10.1%	1.9%	23.5%
<b>Free Cash Flow</b>	21	-2137	-1454	1186	973	-1047	-101	-35	-176	-1774
<b>Income Tax</b>	567	341	375	582	466	593	753	27	266	-69

## Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Total Assets</b>	31989	41607	46582	46369	48648	50619	50415	46406	65307	68470
<b>Cash &amp; Equivalents</b>	1062	946	764	641	554	871	421	613	754	866
<b>Acc. Receivable</b>	1039	917	1271	1072	1057	1054	1131	999	1539	2006
<b>Inventories</b>	397	485	425	243	225	236	252	233	273	301
<b>Goodwill &amp; Int.</b>	4097	4134	5595	3881	3854	3775	3709	3626	10353	10405
<b>Total Liabilities</b>	20552	25537	28700	28484	30216	31708	32624	33324	45161	47086
<b>Accounts Payable</b>	1713	2083	2243	682	928	813	1399	1085	1812	2264
<b>Long-Term Debt</b>	16350	19315	21862	21097	22297	24202	24451	25282	33269	34601
<b>Total Equity</b>	10468	14444	15501	15251	15769	15695	14485	10045	15039	16747
<b>D/E Ratio</b>	1.56	1.29	1.31	1.28	1.31	1.39	1.49	2.13	1.85	1.74

## Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Return on Assets</b>	4.3%	3.3%	2.8%	3.4%	2.9%	3.5%	3.3%	-1.9%	0.3%	3.6%
<b>Return on Equity</b>	13.4%	9.8%	8.3%	10.4%	8.7%	11.0%	11.0%	-7.3%	1.4%	15.3%
<b>ROIC</b>	5.0%	3.8%	3.3%	4.1%	3.4%	4.1%	3.9%	-2.2%	0.4%	4.5%
<b>Shares Out.</b>	616.47	684.36	696.20	704.00	705.00	707.00	709.00	702.61	863.76	881.38
<b>Revenue/Share</b>	14.20	11.03	9.60	11.28	11.34	12.07	12.99	12.55	12.47	11.87
<b>FCF/Share</b>	0.04	-3.27	-2.10	1.69	1.38	-1.48	-0.14	-0.05	-0.23	-2.03

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

## Disclaimer

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