



TransCanada Corporation (TRP)

Updated February 20th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	\$43	5 Year CAGR Estimate:	13.0%	Volatility Percentile:	19.7%
Fair Value Price:	\$51	5 Year Growth Estimate:	4.0%	Momentum Percentile:	48.1%
% Fair Value:	84%	5 Year Valuation Multiple Estimate:	3.6%	Growth Percentile:	22.2%
Dividend Yield:	5.4%	5 Year Price Target	\$62	Valuation Percentile:	79.2%
Dividend Risk Score:	F	Retirement Suitability Score:	C	Total Return Percentile:	75.9%

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 generated 59% 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\$40 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 mid-February, TransCanada Corporation reported (2/14/19) financial results for the fourth quarter of fiscal 2018. In the quarter, the company grew its comparable earnings-per-share by 26% and exceeded the analysts' estimates by 7% thanks to the strong performance of its legacy assets, a reduced tax rate and contribution from \$4 billion of growth projects that were placed into service. In the year, the company grew its comparable earnings-per-share by 25% and thus achieved record earnings-per-share. TransCanada has \$36 billion of growth projects underway, with about \$9 billion of projects near the commission phase. Management thus expects the earnings and the cash flows to continue to grow in the upcoming years.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$2.01	\$1.77	\$2.12	\$1.84	\$2.28	\$2.12	-\$1.26	\$0.12	\$2.38	\$2.97	\$3.20	\$3.89
DPS	\$1.45	\$1.60	\$1.65	\$1.76	\$1.73	\$1.66	\$1.50	\$1.68	\$1.99	\$2.12	\$2.31	\$2.70
Shares	684.36	696.20	704.00	705.00	707.00	709.00	702.61	863.76	881.38	918.0	950.0	1100.0

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, until last year, this strategy failed to generate meaningful growth for the company *on a per-share basis*, as the additional net income generated by these projects was offset by the increased number of shares outstanding.

However, 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 and a strong pipeline of growth projects, as mentioned above. We 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 is a concern.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	14.1	20.1	19.4	23.9	20.2	22.5	N/A	N/A	24.2	14.3	13.4	16.0
Avg. Yld.	5.1%	4.5%	4.0%	4.0%	3.8%	3.5%	3.8%	4.0%	4.1%	5.0%	5.4%	4.4%

Excluding 2015 and 2016, when the company's earnings were depressed, TransCanada Corporation has traded at an average price-to-earnings ratio of 19.8 over the last decade. The stock is currently trading at a price-to-earnings ratio of

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13.4, which is lower than our assumed fair price-to-earnings ratio of 16.0. If the stock approaches our fair value estimate over the next five years, it will enjoy a 3.6% annualized gain thanks to the expansion of its valuation level.

Safety, Quality, Competitive Advantage, & Recession Resiliency

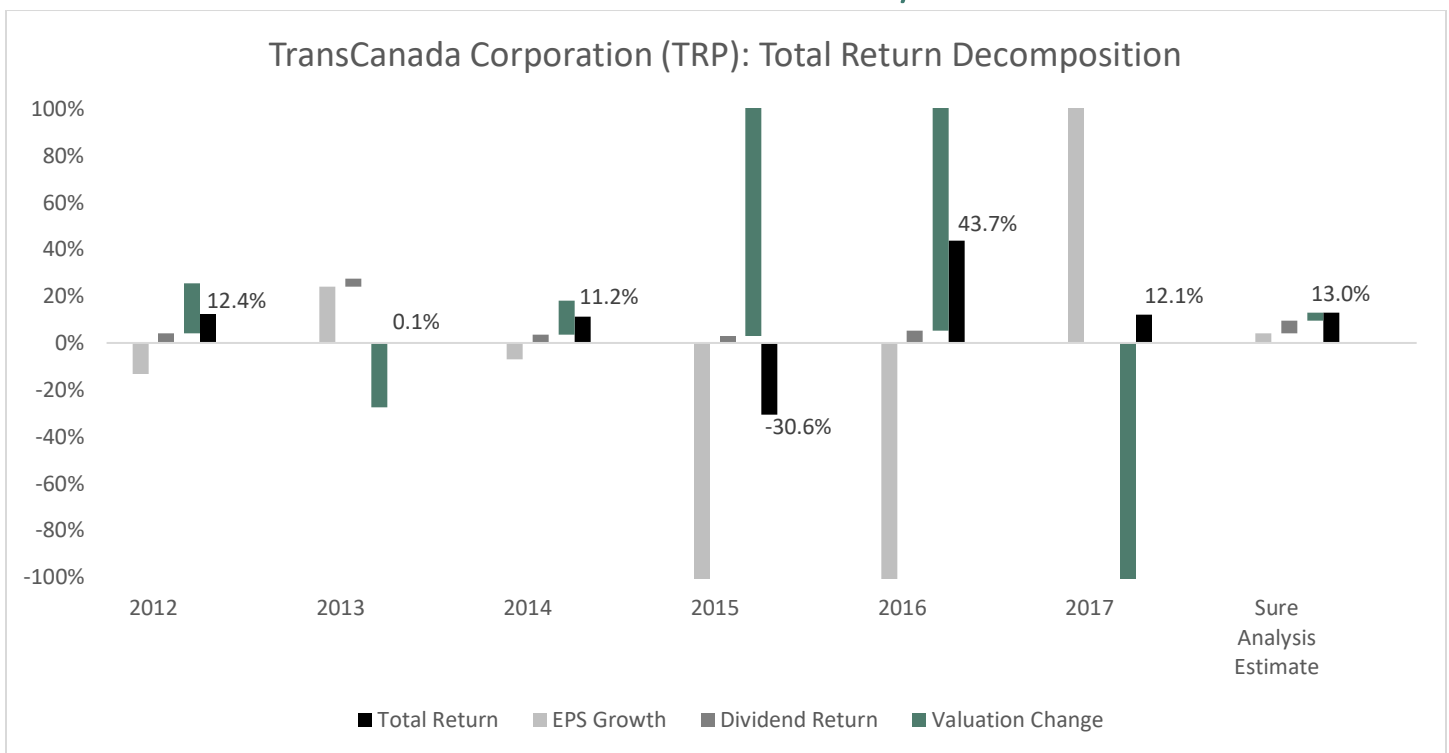
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	72.1%	90.4%	77.8%	95.7%	75.9%	78.3%	-119%	N/A	83.6%	71.4%	72.2%	69.4%

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 interest coverage of only 2.8 and a net debt that is about *18 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 13.0% average annual return over the next five years. For yield-hungry investors looking for exposure to the energy sector, the company is a hold. 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 good return prospects at current prices and a much less risky profile.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	7202	6643	7928	8009	8543	9226	8895	9475	10377	10556
Gross Profit	4374	2371	3198	3007	3225	3410	3172	3455	3940	4823
Gross Margin	60.7%	35.7%	40.3%	37.5%	37.8%	37.0%	35.7%	36.5%	38.0%	45.7%
D&A Exp.	1212	1125	1343	1375	1442	1459	1383	1464	1586	1813
Operating Profit	2430	1875	2783	2573	2793	3105	2998	3352	3892	4790
Operating Margin	33.7%	28.2%	35.1%	32.1%	32.7%	33.7%	33.7%	35.4%	37.5%	45.4%
Net Profit	1215	1239	1599	1354	1734	1667	-898	176	2436	2857
Net Margin	16.9%	18.7%	20.2%	16.9%	20.3%	18.1%	-10.1%	1.9%	23.5%	27.1%
Free Cash Flow	-2137	-1454	1186	973	-1047	-101	-35	-176	-1774	-2592
Income Tax	341	375	582	466	593	753	27	266	-69	333

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	41607	46582	46369	48648	50619	50415	46406	65307	68470	72627
Cash & Equivalents	946	764	641	554	871	421	613	754	866	327
Acc. Receivable	917	1271	1072	1057	1054	1131	999	1539	2006	1861
Inventories	485	425	243	225	236	252	233	273	301	316
Goodwill & Int.	4134	5595	3881	3854	3775	3709	3626	10353	10405	10409
Total Liabilities	25537	28700	28484	30216	31708	32624	33324	46036	47086	49872
Accounts Payable	2083	2243	682	928	813	1399	1085	1812	2264	2367
Long-Term Debt	19315	21862	21097	22297	24202	24451	25282	33269	34601	36887
Total Equity	14444	15501	15251	15769	15695	14485	10045	15039	16747	18618
D/E Ratio	1.29	1.31	1.28	1.31	1.39	1.49	2.13	1.85	1.74	1.71

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	3.3%	2.8%	3.4%	2.9%	3.5%	3.3%	-1.9%	0.3%	3.6%	4.0%
Return on Equity	9.8%	8.3%	10.4%	8.7%	11.0%	11.0%	-7.3%	1.4%	15.3%	16.2%
ROIC	3.8%	3.3%	4.1%	3.4%	4.1%	3.9%	-2.2%	0.4%	4.5%	4.9%
Shares Out.	684.36	696.20	704.00	705.00	707.00	709.00	702.61	863.76	881.38	918.0
Revenue/Share	11.03	9.60	11.28	11.34	12.07	12.99	12.55	12.47	11.87	11.69
FCF/Share	-3.27	-2.10	1.69	1.38	-1.48	-0.14	-0.05	-0.23	-2.03	-2.87

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

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