



TC Energy Corporation (TRP)

Updated February 17th, 2020 by Aristofanis Papadatos

Key Metrics

| | | | | | |
|-----------------------------|------|--------------------------------------------|-------|----------------------------------|-----------|
| Current Price: | \$56 | 5 Year CAGR Estimate: | 6.5% | Market Cap: | \$52.8 B |
| Fair Value Price: | \$51 | 5 Year Growth Estimate: | 4.0% | Ex-Dividend Date: | 3/30/2020 |
| % Fair Value: | 109% | 5 Year Valuation Multiple Estimate: | -1.8% | Dividend Payment Date: | 4/30/2020 |
| Dividend Yield: | 4.5% | 5 Year Price Target | \$62 | Years Of Dividend Growth: | 5 |
| Dividend Risk Score: | D | Retirement Suitability Score: | D | Last Dividend Increase: | 8.0% |

Overview & Current Events

On May 3rd, 2019, TransCanada Corporation changed its name to TC Energy Corporation. TC Energy 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. TC Energy Corporation operates through three segments: Natural Gas Pipelines, Oil Pipelines, and Energy. The Natural Gas Pipelines segment generated 66% of consolidated revenue in the most recent fiscal year. TC Energy 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\$53 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, TC Energy Corporation reported (2/11/20) financial results for the fourth quarter of fiscal 2019. Despite the lower contributions that resulted from the \$3.4 billion of asset sales, which strengthened the balance sheet, the company grew its comparable annual earnings-per-share 7% thanks to the strong performance of its legacy assets and the contribution from \$8.7 billion of growth projects that were placed into service last year. Thanks to the strong demand for its assets, the company continued to enjoy almost historically high utilization rates.

Growth on a Per-Share Basis

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|---------------------------|--------|--------|--------|--------|--------|---------|--------|--------|--------|--------|---------------|----------------|
| EPS | \$1.77 | \$2.12 | \$1.84 | \$2.28 | \$2.12 | -\$1.26 | \$0.12 | \$2.38 | \$2.97 | \$3.18 | \$3.20 | \$3.89 |
| DPS | \$1.60 | \$1.65 | \$1.76 | \$1.73 | \$1.66 | \$1.50 | \$1.68 | \$1.99 | \$2.12 | \$2.31 | \$2.49 | \$3.18 |
| Shares¹ | 696.2 | 704.0 | 705.0 | 707.0 | 709.0 | 702.6 | 863.8 | 881.4 | 918.0 | 938.0 | 960.0 | 1,100.0 |

TC Energy'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 2017, 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 share count.

However, we believe that the next several years will show an improvement for TC Energy Corporation as the company benefits from a continued rebound in energy markets and a strong pipeline of growth projects. TC Energy has more than \$20 billion of growth projects underway. These projects are supported by regulated or long-term contracted business models. Management expects earnings and cash flows to continue to grow in the upcoming years. We expect 4% annualized growth over the next five years. Management raised the dividend 8% this year and reiterated its guidance for 8%-10% dividend growth in 2021 and 5%-7% dividend growth per year thereafter, though the high leverage is a concern.

Valuation Analysis

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Now | 2025 |
|------------------|------|------|------|------|------|------|------|------|------|------|-------------|-------------|
| Avg. P/E | 20.1 | 19.4 | 23.9 | 20.2 | 22.5 | --- | --- | 24.2 | 14.3 | 15.1 | 17.5 | 16.0 |
| Avg. Yld. | 4.5% | 4.0% | 4.0% | 3.8% | 3.5% | 3.8% | 4.0% | 4.1% | 5.0% | 4.8% | 4.5% | 5.1% |

¹ In millions.

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Excluding 2015 and 2016, when the company's earnings were depressed, TC Energy Corporation has traded at an average price-to-earnings ratio of 20.0 over the last decade. The stock is currently trading at a price-to-earnings ratio of 17.5, which is higher than our assumed fair price-to-earnings ratio of 16.0. If the stock reverts to our fair value estimate over the next five years, it will incur a -1.8% annualized drag due to the contraction of its valuation level.

Safety, Quality, Competitive Advantage, & Recession Resiliency

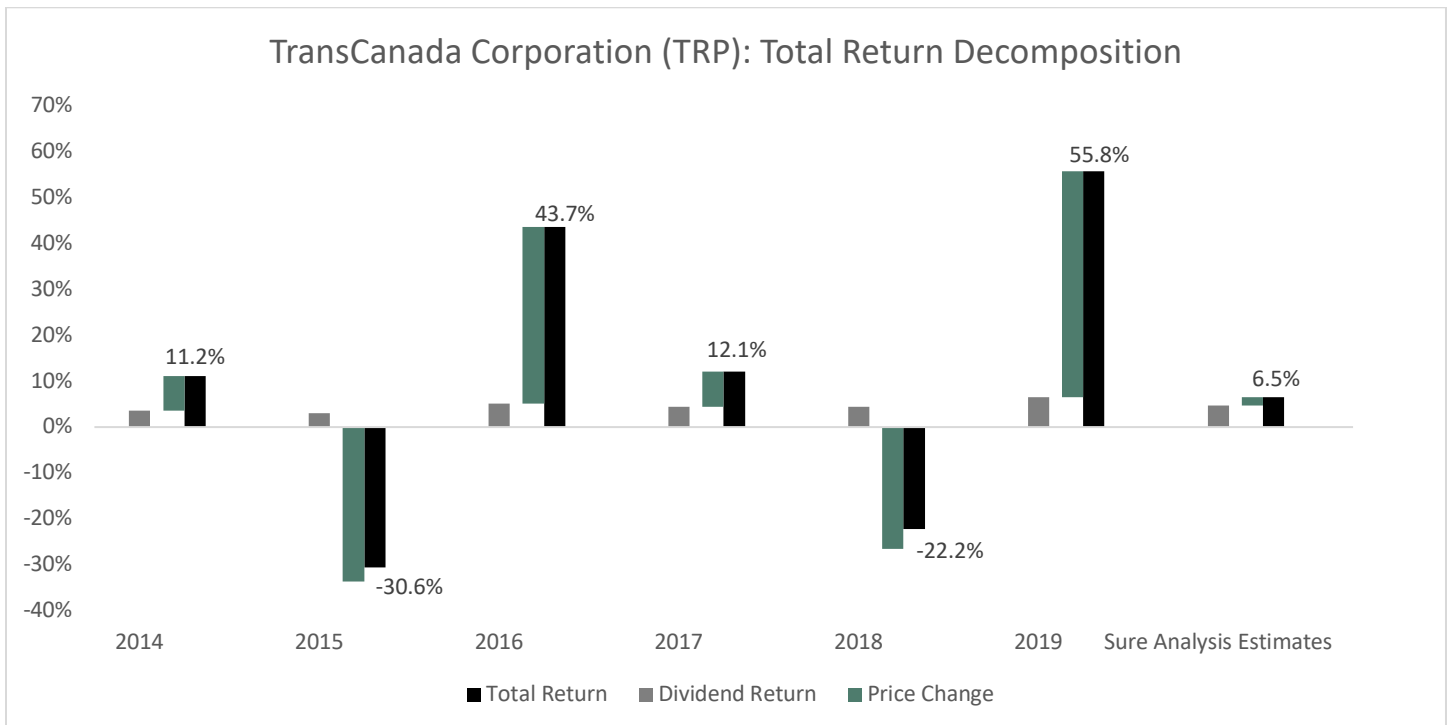
| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|--------|-------|-------|-------|-------|-------|------|------|-------|-------|-------|--------------|--------------|
| Payout | 90.4% | 77.8% | 95.7% | 75.9% | 78.3% | --- | --- | 83.6% | 71.4% | 72.5% | 77.9% | 81.7% |

TC Energy 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 9 out of the last 10 years and has a leveraged balance sheet, with interest coverage of only 2.5 and net debt that is about 15 *times its earnings*. The company is 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 declines. 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 to its cash flows.

Final Thoughts & Recommendation

TC Energy Corporation has rallied 60% since the end of 2018 and hence it has become less attractive. The stock could offer a 6.5% average annual return over the next five years thanks to its 4.5% dividend yield and 4.0% annual earnings-per-share growth. For yield-hungry investors looking for exposure to the energy sector, we believe the company is a hold. However, due to its high leverage, its negative free cash flows and its tendency to dilute shareholders, investors should take caution. 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 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|-------------------------|-------|-------|-------|-------|-------|--------|-------|-------|-------|------|
| Revenue | 6643 | 7928 | 8009 | 8543 | 9226 | 8895 | 9475 | 10377 | 10556 | |
| Gross Profit | 2371 | 3198 | 3007 | 3225 | 3410 | 3172 | 3455 | 3940 | 4823 | |
| Gross Margin | 35.7% | 40.3% | 37.5% | 37.8% | 37.0% | 35.7% | 36.5% | 38.0% | 45.7% | |
| D&A Exp. | 1125 | 1343 | 1375 | 1442 | 1459 | 1383 | 1464 | 1586 | 1813 | |
| Operating Profit | 1875 | 2783 | 2573 | 2793 | 3105 | 2998 | 3352 | 3892 | 4790 | |
| Operating Margin | 28.2% | 35.1% | 32.1% | 32.7% | 33.7% | 33.7% | 35.4% | 37.5% | 45.4% | |
| Net Profit | 1239 | 1599 | 1354 | 1734 | 1667 | -898 | 176 | 2436 | 2857 | |
| Net Margin | 18.7% | 20.2% | 16.9% | 20.3% | 18.1% | -10.1% | 1.9% | 23.5% | 27.1% | |
| Free Cash Flow | -1454 | 1186 | 973 | -1047 | -101 | -35 | -176 | -1774 | -2592 | |
| Income Tax | 375 | 582 | 466 | 593 | 753 | 27 | 266 | -69 | 333 | |

Balance Sheet Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|-------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|------|
| Total Assets | 46582 | 46369 | 48648 | 50619 | 50415 | 46406 | 65307 | 68470 | 72627 | |
| Cash & Equivalents | 764 | 641 | 554 | 871 | 421 | 613 | 754 | 866 | 327 | |
| Acc. Receivable | 1271 | 1072 | 1057 | 1054 | 1131 | 999 | 1539 | 2006 | 1861 | |
| Inventories | 425 | 243 | 225 | 236 | 252 | 233 | 273 | 301 | 316 | |
| Goodwill & Int. | 5595 | 3881 | 3854 | 3775 | 3709 | 3626 | 10353 | 10405 | 10409 | |
| Total Liabilities | 28700 | 28484 | 30216 | 31708 | 32624 | 33324 | 46036 | 47086 | 49872 | |
| Accounts Payable | 2243 | 682 | 928 | 813 | 1399 | 1085 | 1812 | 2264 | 2367 | |
| Long-Term Debt | 21862 | 21097 | 22297 | 24202 | 24451 | 25282 | 33269 | 34601 | 36887 | |
| Total Equity | 15501 | 15251 | 15769 | 15695 | 14485 | 10045 | 15039 | 16747 | 18618 | |
| D/E Ratio | 1.31 | 1.28 | 1.31 | 1.39 | 1.49 | 2.13 | 1.85 | 1.74 | 1.71 | |

Profitability & Per Share Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|-------|------|
| Return on Assets | 2.8% | 3.4% | 2.9% | 3.5% | 3.3% | -1.9% | 0.3% | 3.6% | 4.0% | |
| Return on Equity | 8.3% | 10.4% | 8.7% | 11.0% | 11.0% | -7.3% | 1.4% | 15.3% | 16.2% | |
| ROIC | 3.3% | 4.1% | 3.4% | 4.1% | 3.9% | -2.2% | 0.4% | 4.5% | 4.9% | |
| Shares Out. | 696.20 | 704.00 | 705.00 | 707.00 | 709.00 | 702.61 | 863.76 | 881.38 | 918.0 | |
| Revenue/Share | 9.60 | 11.28 | 11.34 | 12.07 | 12.99 | 12.55 | 12.47 | 11.87 | 11.69 | |
| FCF/Share | -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.

Disclaimer

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