# FIIG | Factsheet

# TransCanada PipeLines

17 February 2022

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**Sector:** Infrastructure
**Sub-sector:** Midstream
**Country:** Canada
**Ownership:** Public

## Issuer Outline

TransCanada PipeLines Ltd and TransCanada Trust are wholly-owned subsidiaries of TC Energy Corp (TC Energy, Group). TC Energy is one of the largest diversified energy companies in North America, with three key core segments:

- Natural gas pipelines, with a network spanning over 90,000 km which supplies more than 25% of natural gas across Canada, US and Mexico;
- Liquid pipelines, consisting of a 4,900 km network that connects the Western Canadian production areas with key demand markets and refineries;
- Energy, with TC Energy partially or wholly owning seven power generation facilities with a combined generation capacity of 4,200 megawatts (74% nuclear, 26% gas fired)

In 2021, TC Energy generated EBITDA of CAD9.3bn, with 29% contributed by Canadian gas pipelines, 41% by US gas pipelines, 16% by liquid pipelines, 7% by power generating assets and 7% from Mexican gas pipelines. TC Energy is listed on the New York and Toronto stock exchanges, with market capitalisation of CAD65bn as at 17 February 2022.

## Key Financials (CADbn)

| LTM (31 Dec) | 2021 |
|---|---|
| Revenue | 14.285 |
| EBITDA | 9.326 |
| Net Interest Expense | 2.160 |
| Total Assets | 104.218 |
| Cash | 0.673 |
| Debt | 52.766 |
| Net Debt/EBITDA | 5.7x |
| EBITDA/Net Interest Expense | 4.3x |

*Source: FIIG Securities, S&P Capital*

## Summary Bond Details

| ISIN | Issue Amount | Ranking | Coupon | Coupon Frequency | First Call | Maturity Date |
|---|---|---|---|---|---|---|
| US89356BAA61 | USD750m | Subordinated | 5.625%[1] | Semi-Annual[3] | 20 May 2025 | 20 May 2075 |
| US89356BAE83 | USD1.1bn | Subordinated | 5.50%[2] | Semi-Annual[3] | 15 Sept 2029 | 15 Sept 2079 |
| US89352HAC34 | USD1bn | Subordinated | Libor+2.21% | Quarterly | Anytime | 15 May 2067 |

*Note 1: Coupon reset at 3mLIBOR+3.528% from May 2025 and 3mLIBOR+4.278% from May 2045*
*Note 2: Coupon reset at 3mLIBOR+4.154% from Sept 2029 and 3mLIBOR+4.904% from Sept 2049*
*Note 3: Quarterly from the reset date*

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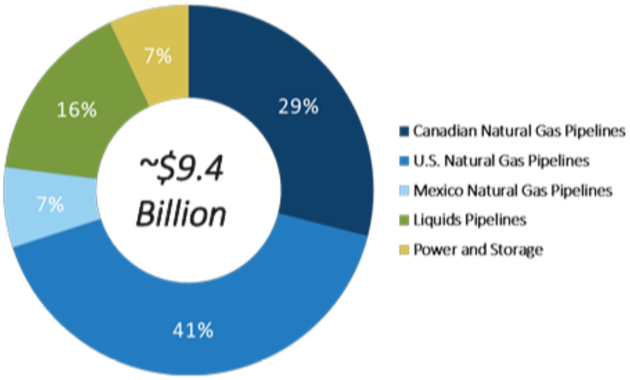
### Strengths

- Competitive position: TC Energy is one of the largest natural gas pipeline owners and operators in the North American market, transporting about 25% of demand. It is also a major liquid pipeline owner, handing about 20% of all Canadian crude exports. While its power generation segment contributes significantly less to the Group's earnings, its 4,200MW of capacity makes it one of the largest private sector operators in the country.
- Predictable cash flows: A significant portion of TC Energy's revenue comes from revenue streams that are either subject to a regulatory framework or generated from long-term offtake agreements with strong counterparties. Earnings from its Canadian gas pipelines are supported by regulation which provides earnings stability going forward, including by allowing the Group to charge a tariff that is sufficient to earn an appropriate return on capital invested. While not identical to the Australian regulatory model, it shares some similarities which supports S&P's view that TC Energy's business risk profile is as strong as those of Australian regulated businesses, such as Ausnet or Transgrid. The Group's electricity generation segment is also supported by long-term contracts; in particular, the Bruce Power generation units in Alberta, which represent about 75% of TC Energy's total capacity, has offtake contracts until 2064 with IESO, the independent electricity system operator and a Crown corporation managing the electricity system in Ontario, Canada's most populous province and the home of Canada's capital city.

**Figure: 1 – EBITDA contribution by asset (FY21)**




- Diversified capital structure: Although TC Energy, like its midstream energy peers, has a significant debt load (CAD52.8bn as at 31 December 2021), the debt load has significant diversity and is very long dated compared to Australian peers, with an average debt term of 18 years. Its largest exposure (in terms of debt maturing in a single year) will occur in 2027 when CAD3.0bn (or 5.7% of total debt) will become due for repayment. Over the next 10 years, an average of 4.0% of total debt is due in any given calendar year. This very well spread out debt maturity profile ensures that TC Energy's ongoing refinancing task is manageable and any temporary spike in debt costs would have a relatively small impact of the Group's total interest expense. We also note that TC Energy has CAD12.6bn of subordinated notes and preferred securities, which allows for interest to be deferred if required. In the unlikely event TC Energy was to come under material stress, this would allow the Group to reduce its interest expense.
- Long and stable financial performance: Over the past 20 years, TC Energy has exhibited very strong financial performance, generating a net profit in all but one year (in 2015, as a result of a major asset write-down). Over this period, the Group has distributed over CAD25bn of dividends, equivalent to an average of about CAD1,300m annually (and CAD2.3bn annually on average over the last five years). While the Group has invested over CAD96bn since 2002, this has been supported by strong operating cash flows (CAD78.7bn over the period). The Group's adjusted debt to EBITDA ratio (as per S&P's methodology that recognises the equity characteristics of the subordinated debt) is relatively high at 4.9x (FY20 data) compared to industrial peers, however, it is in line with Australian regulated utility companies given the predictability of cash flows can support higher debt volumes, all else being equal.

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## Risks

- Exposure to US energy markets: 41% of TC Energy's earnings are generating from its US gas pipeline segment. This market is characterised by a high level of competition and more cash flow volatility. These downsides are mitigated by the size of TC Energy's network in the US (about 52,000km) which allows the Group to transport about 25% of the total US natural gas demand. Further, the US pipeline network is focused on the Appalachian basin, one of the largest producing areas, as well as connection toward the Gulf of Mexico which serves five existing LNG export facilities (and an expected three additional currently being planned).
- Capital intensity: Like many midstream peers (and similar to Australian regulated utilities), TC Energy is a highly capital intensive business, with significant ongoing capital expenditure. Since 2000, the Group has invested about CAD100bn in its three core segments, which resulted in adjusted earnings growing from about CAD2.5bn to CAD9.4bn (on a comparable basis) but increasing its debt from CAD11.75bn to CAD52.8bn as at 31 December 2021. TC Energy's current capital program stands at CAD24bn, expected to be delivered over the next three years. While this capital program will further increase debt levels, these are supported by strong contractual commitments, on average longer than 20 years with limited volumetric risk. When possible, the Group also seeks equity partners to share the funding requirements and also raise non-recourse project finance to limit the risk for the rest of the Group.
- ESG Risks: TC Energy is exposed to a number of environmental, social and governance (ESG) risks given it operates in the oil & gas sector. This was particularly evident with the Keystone XL pipeline project which was eventually cancelled by the Biden administration and led the company to record a CAD2.1bn impairment charge in FY21. In light of the growing ESG focus and the fact that the core business will remain closely linked to hydrocarbons, the company is pursuing investment in renewable energies such as battery storage and a growing portion of its energy needs (linked to the pipeline operations) from solar and wind.

## Risks relevant to the Subordinated notes

- .Subordinated position of the notes: The notes are subordinated in all respects to TC Energy's senior debt. There is no restriction on the amount of securities, guarantees or other liabilities which the Group may issue or incur and which rank senior to or equally with the notes. This means that, in the unlikely event that TC Energy were to default, the recovery on the notes would likely be minimal.
- Fixed to floating coupon: The interest rate on the 2075 and 2079 notes will initially be fixed rate but the notes will then earn a floating rate coupon from their respective reset dates. Therefore, the interest rate from such reset dates could be less than the fixed rate for the initial period and will fluctuate based on movements in the risk-free rate.
- Interest can be deferred: Consistent with subordinated notes issued by corporates as a form of capital supporting their rating, the notes include an option for TC Energy to defer interest, noting that deferred interest would be cumulative and compounding (i.e. not foregone and investors will earn interest on the deferred portion of interest). We note that, in addition to a unilateral right to defer, interest may also be deferred if TransCanada Pipeline does not declare a dividend on its preferred shares. Since TransCanada Pipelines is wholly owned by TC Energy, the decision to declare a dividend would be entirely within the Group's control and therefore this feature, while unusual, does not appear to increase the risk of interest deferral. We further note that any deferral of interest (either as elected or because of no dividend being declared) would result in TC Energy not being able to declare a dividend on its common shares until such time all deferred interest payments have been made.
- Right to deferred interest attached to preferred shares: Under the terms of the 2075 and 2079 notes, when interest is deferred, TransCanada will issue preferred shares to noteholders which entitles the holder to receive ongoing cash flow that would mirror the noteholders' claim for the deferred interest. In the event a noteholder is determined to be an Ineligible Person (as defined in the notes terms and conditions), the preferred shares will be issued to the indenture trustee who will sell these preferred shares on market and distribute the proceeds to those noteholders who were deemed to be Ineligible. Proceeds received may be less that the interest that would have been received if not deferred.

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- Long dated security: The notes have long dated maturity dates and there is no certainty that TC Energy will seek to optionally redeem the notes at any time prior, even though the notes are callable much earlier than their maturity dates. As a consequence, holders wishing to recover their capital would need to sell their notes on market, at a price which may be lower than the face value of the notes. In addition, the margin paid on the 2067 notes is not subject to any step-up, meaning the Group has no financial incentive to redeem this particular series of notes prior to maturity, noting that the benefit to the rating (as further described below) will drop off in 2047, all else being equal. It should be further noted that TC Energy has stated its intention to only call the 2067 notes to the extent it has issued at least equal amount of similarly structured notes in the preceding 180 days. While this intention is not technically binding, a redemption without replacement would like cause a revaluation of the equity treatment by S&P of all of TC Energy's corporate hybrids, likely resulting in a rating downgrade.
- Rating risk: The notes have been issued in part to support TC Energy's corporate rating. This is because the terms of the notes (subordination, interest deferral, long maturity) results in the rating agencies treating 50% of the notes as equity for the purpose of their financial analysis. Further, based on S&P's current rating methodology, the notes would be treated as 100% debt from their first call date. This current rating construct means that TC Energy would have a significant incentive to redeem the notes at the first possible option. However, should rating agencies change their methodology and provide rating support for a longer period of time, this would remove this incentive to call and would likely result in a (potentially significant) drop in the price of the notes.

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## Financials

The financial summary below represents the consolidated operations of TC Energy Corp.

| FYE 31 December (CADm) | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|
| **Profit and Loss** | | | | | |
| Revenues | 13,449 | 13,679 | 13,255 | 12,999 | 14,285 |
| EBITDA | 6,592 | 8,052 | 8,250 | 8,394 | 9,326 |
| EBIT | 4,537 | 5,702 | 5,786 | 5,804 | 6,804 |
| Net Interest expense | (1,910) | (2,088) | (2,171) | (2,055) | (2,160) |
| Net Income | 3,157 | 3,517 | 4,433 | 4,913 | 2,046 |
| **Balance Sheet** | | | | | |
| Cash & equivalents | 1,089 | 446 | 1,343 | 1,530 | 673 |
| Total assets | 86,101 | 98,920 | 99,279 | 100,300 | 104,218 |
| Total debt | 43,516 | 50,256 | 50,467 | 50,212 | 52,766 |
| **Cash Flow** | | | | | |
| Cash flow from operations | 5,230 | 6,555 | 7,082 | 7,058 | 6,890 |
| Cash flow from investments | (3,699) | (10,019) | (6,872) | (6,052) | (7,712) |
| Free cash flow | (306) | (4,642) | (6,590) | (726) | (3,098) |
| **Credit Metrics** | | | | | |
| EBITDA Margin | 49.0% | 58.7% | 62.2% | 64.6% | 65.3% |
| Net debt/EBITDA | 6.4x | 6.3x | 6.0x | 5.9x | 5.7x |
| EBITDA/Net interest expense | 3.5x | 3.8x | 3.8x | 4.1x | 4.3x |
| Adjusted debt/EBITDA[1] | 5.3x | 5.4x | 4.9x | 4.6x | N/A |
| Adjusted FFO/Debt[1] | 13.8% | 13.5% | 13.9% | 14.9% | N/A |

*Note 1: Based on S&P methodology, including recognition of subordinated debt as 50% equity*
*N/A: Not available*
*Source: S&P Capital IQ*

## References

- TC Energy website

# TransCanada PipeLines

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