Enbridge 6.9% Dividend Yield Transported by Strong Expansion

Price $38.28 | **Dividend Holding** | **August 10, 2024**

- 6.9% Dividend Yield
- Strong acquisition and expansion profile, focusing on building out utility and Gulf Coast capacity.
- Secular tailwinds in liquids from 500 Mbbl/d in expansion in the WCSB.
- Strong LNG and WCSB export demand driving expansionary footing.
- Expects continued capital deployment of $4-7 billion per year over the medium-term.

Note: 1 CAD = $0.75 USD.

Investment Thesis

Enbridge (ENB) is a combined liquids and natural gas midstream company, that also provides some utility service to end customers. ENB's revenue profile is somewhere between a typical midstream player and a utility. This provides a revenue floor during low-price periods, though the tradeoff is often a cap on return on equity.

ENB is undergoing a repositioning, expanding both its utilities segment with $14 billion in acquisitions, and its Gulf Coast operations with more than $10.2 billion in capital spend encompassing both tuck-in acquisition and organic expansion.

With its existing footprint, we expect ENB to earn north of $2.9 billion in free cash flow, which more than covers its 6.9% dividend yield and its expansion plans. We believe that the aggressive expansion in high-margin assets on the Gulf Coast coupled with more stable utilities expansion provides an excellent value proposition to income-focused investors.

Estimated Fair Value

EFV (Estimated Fair Value) = EFY25 EPS (Earnings Per Share) times P/E (Price/EPS)

EFV = E25 EPS X P/E = $2.35 X 21.0 = $49.35

	E2024	E2025	E2026
Price-to-Sales	2.9	2.9	2.7
Price-to-Earnings	18.0	16.7	15.7

Pipelines

Enbridge operates the largest system of liquids pipelines in North America. Across 18,000 miles ENB moves around 3.1 MMbbl/d (millions of barrels of oil per day) across its arteries. The general flow from WCSB in the liquids segment is heavy oil is moved to Chicago, where it is either routed for refining and export in Houston into light oil or routed for refining in the Midwest before being shipped as light oil for export in Montreal.

ENB has connections to 75% of North American refineries, and accounts for 25% of exports to terminals. According to ENB's estimates, it holds the "prime" connections to 30% of North American supply (cheapest and shortest route to refineries).

Overall, the liquids segment represents 72% of revenue, with an EBITDA margin of 30%.

U.S. and Canadian Mainline

The Mainline system has 8,600 miles of pipe accounts for 65% of Canadian oil exports, and 40% of imports. The line between Sarnia and Montreal represents 25% of North American oil exports. Combined, these lines move 3.1 MMbbl/d in oil.

The Mainline system tolling agreement includes escalators for US CPI, and the tolling agreement has been written to provide a collar of 11% - 14.5% ROE (return on equity at 50% equity stake). Around 70% of volumes are tolled on this agreement, with 27% being take-or-pay, and 3% being spot.

Secularly, we believe that the western section will continue to have higher (>95%) utilization as WCSB ramps up production efforts by more than 500 Mbbl/d, which you can read more about in our Suncor report here. ENB projects 99% utilization in the western section by 2026.

Other Liquids

Other liquids includes more than 8,000 miles of pipelines connecting 2.7 MMbbl/ to both the WCSB to the United States refinery network (PADD), or connecting oil fields to Cushing, OK terminal and both the Henry Hub and Corpus Christi liquids terminals.

ENB’s expansionary efforts are focused on the Gulf Coast. In 2021, Enbridge purchased the Ingleside Energy Center for $3 billion. The IEC is the #1 crude exporting terminal in the United States by volume, with around 900 Mbbl/d in the quarter ending March 2024.

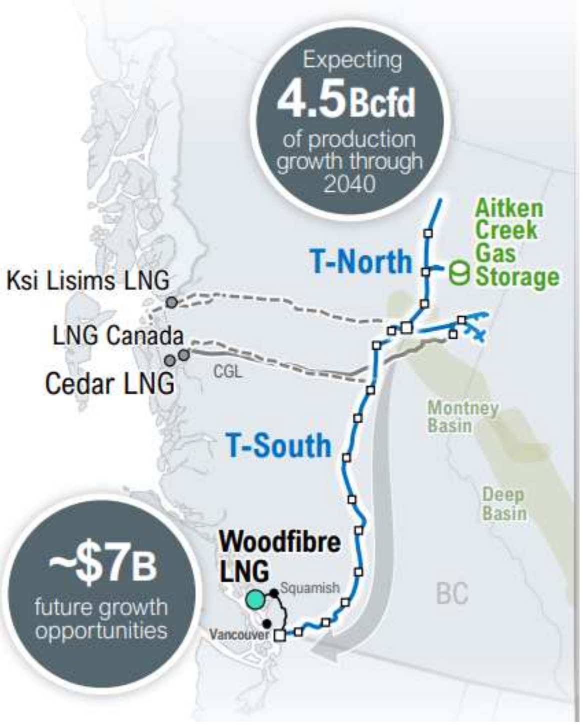
Importantly, it is one of only 3 terminals in the US that can handle VLCCs (very large crude carrier). Enbridge also owns 1 of the other 2, the Seaway Texas Complex.

The largest of the transmission expansions is the light oil super system, connecting the Permian and Eagle Ford to the EIC terminal at Corpus Christi. ENB is building the supersystem by acquiring existing pipelines, including 68.5% in Gray Oak, and 30% of Cactus II. Together, these have a capacity of ~1.5 MMbbl/d in capacity – or about 49% of daily production volume from the combined Permian and Eagle Ford basins. ENB expects to continue expanding the Gray Oak pipeline in 2025, with an additional 120 Mbbl/d of capacity.

Historically, ENB has sought to become the operator of majority-owned assets like Gray Oak. While management has not stated that this is the case in the near future, in our view, it is likely that the Gulf Coast strategy includes the full acquisition of, or at least the operation of, the Gray Oak line.

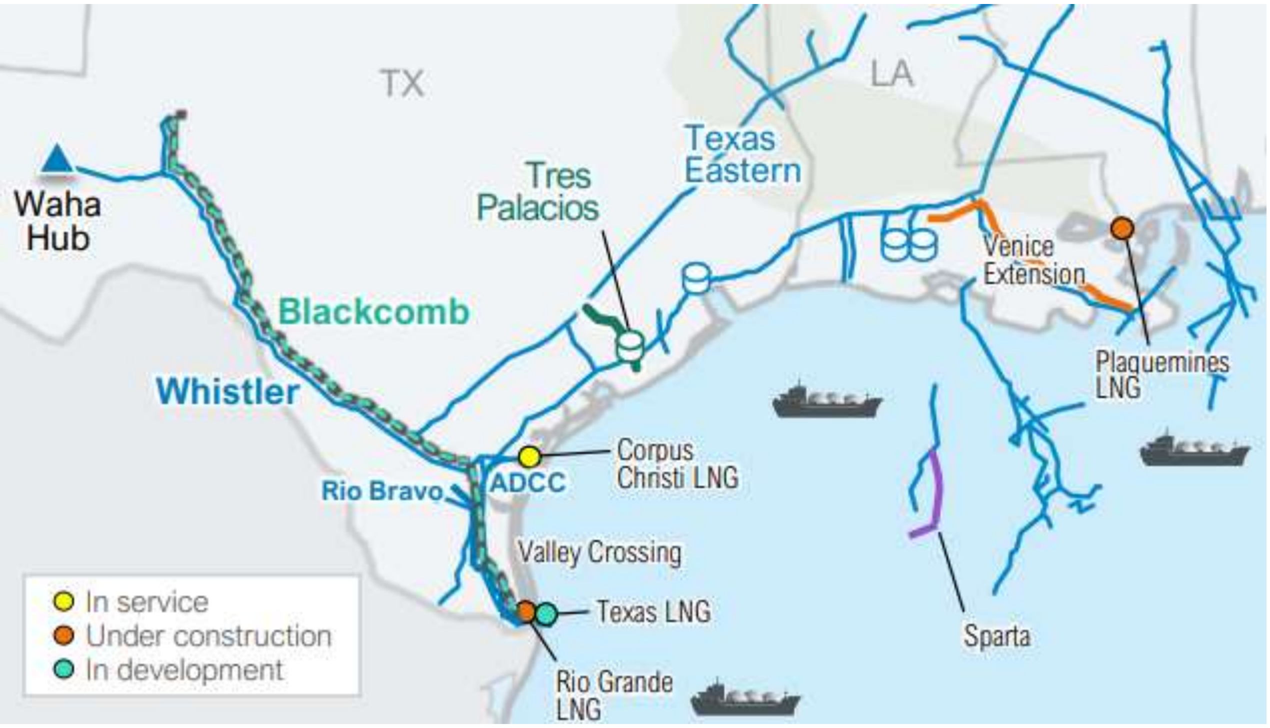
Gas Transmission and Storage

ENB's owned natural gas contains more than 48,000 miles of gathering pipe and 5,600 miles of transmission lines. This adds up to a capacity of 24.6 Bcf/d (billion cubic feet per day) of transmission capacity, or around 20% of US Natural gas demand. Additionally, ENB operates 274 Bcf of natural gas storage in the US – about 10% of the total US storage capacity. The transmission and storage business is 100% contracted for 2024, and the contracts have a weighted average term of 10 years.



The western Canada super system is a large-scale greenfield gas gathering and transport line moving gas from gas storage facilities in the WSCB, to the new Woodfibre LNG terminal. ENB has a 30% interest in the terminal with an expected in-service date of 2027 and more than 2.1 MTPA (millions of metric tons per year) of export capacity.

The western Canada super system is backed up by an additional $5.2 billion in approved expansions with cost-of-service regulated rates, and an expected increase of WCSB natural gas production of 4.5 Bcf/d through 2040.

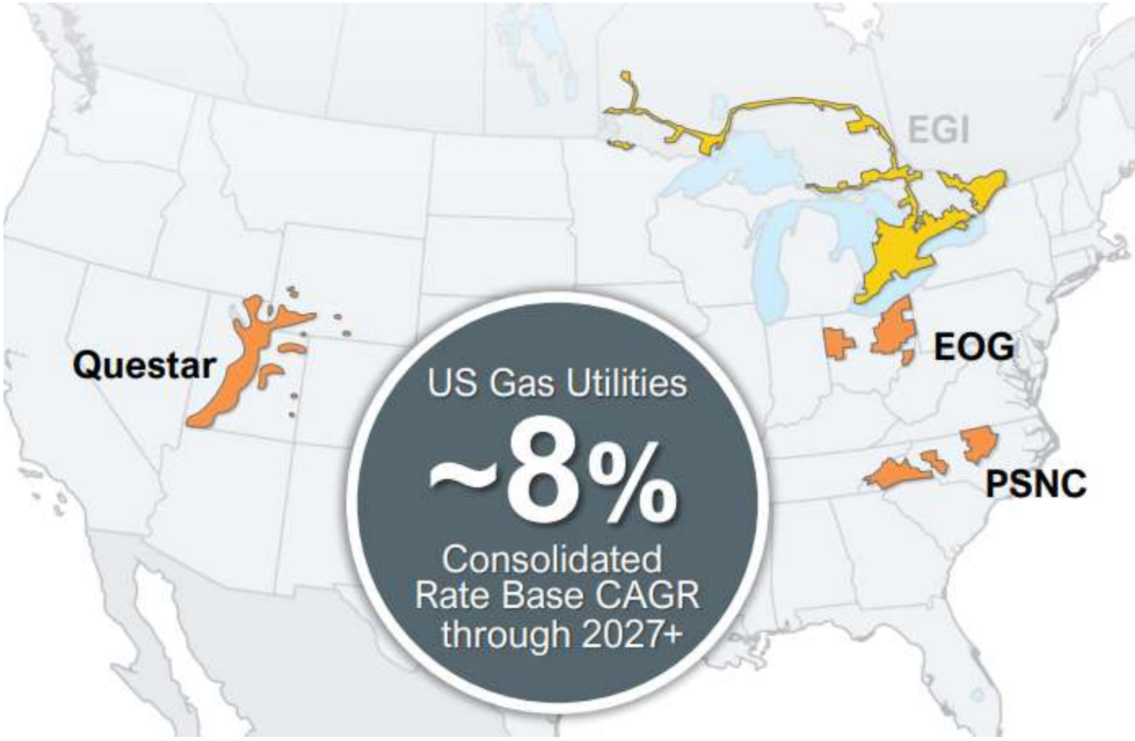


Continuing the Gulf Coast focus, ENB has joined the Whistler JV with 19% equity, moving gas from Waha Permian storage to several terminals and egress points near Corpus Christi. The Whistler JV moves 2.5 Bcf/d in natural gas. Additionally, Whistler has an embedded 6% rate increase through 2025, with an additional 3% in 2026. On top of the Whistler JV, ENB has $2.3 billion in assets under construction in the Gulf Coast LNG area.

The Natural Gas Transmission and Storage segment makes up 13.2% of revenues and has an EBITDA margin of 71.2%.

Regulated Business

ENB’s regulated business connects 9.3 Bcf/d of natural gas to more than 10 million customers (with 20 million connections), and 351 Bcf of utility storage, making it the largest integrated natural gas utility in North America. Starting in 2024 ENB expects to spend approximately $3 billion per year bolstering its utility business, with about 2/3 spent in the US and 1/3 spent in Canada.



Base rates in the US are a CAGR of 8% on average (2017-2026), with an authorized average ROE of 9.7% at an average of 46.6% equity. Rates will remain at this ROE until around 2026. Advantageously in the US, about 80% of capex in the US is rate-rider eligible, which means that ENB can pass on the cost of capex to customers.

Overall, ENB sees natural gas remaining a key utility over the long term, with low prices making natural gas cheaper than even electricity for heating. Despite some headwinds from unfavorable regulations on Ontario, the overall utilities business is expected to grow rates by 8% CAGR from 2025-2027, split evenly between US and Canadian operations. As of the quarter ending June 2024, gas utilities make up 12.2% of revenues, and have an EBITDA margin of 41%.

Outside of natural gas, the utilities segment operates 5.3GW of renewables serving 5.7 million people across both the US and Europe. Though this makes up a small portion of the business at around 1%.

Risk

Utility rates in Ontario are substantially lower, with only 4% CAGR (2017-2026), and unfavorable amortization terms for capex rate-riders. During 2023, the Ontario Energy Board determined that ENB was ineligible for a rate-rider for up-front servicing of new connected homes constructed, amounting to 43,000 homes in 2023. Instead, ENB had to amortize the cost over 40 years to customers, which is unreasonable considering the move toward electrification. ENB has the support of the Canadian Federal government for including the shorter-term rate-rider and is taking the Ontario Energy Board to court over their decision.

While ENB assumes no direct commodity risk, the weak natural gas market and weaker than expected oil market could put downward pressure on utilization if more firms choose to store and wait for higher prices. However, the liquids segment has not yet seen this downward pressure with a secular increase in WCSB production underway.

ENB has increased the debt level on the balance sheet with the $14 billion acquisition of 3 American utilities and heavy expansion plans on the US Gulf Coast and Canadian West Coast. This caused a downgrade from Moody's from Baa1 to Baa2, with the cited concern being decreased financial flexibility. Though we feel that the strategy's focus on several shorter-term acquisition projects is more favorable than larger long-term greenfield ones which have increasingly come under regulatory scrutiny.

Financials

With growing concerns about over-leveraging, ENB restated its capital priorities as keeping the balance sheet at 4.5-5.0x leverage (currently at 4.7x), return 60-70% of free cash to investors, and finally grow its footprint.

While unsecured debt was downgraded with more than $64 billion in net debt, only 5% of debt is exposed to floating rates, with ENB having an interest coverage ratio 2.3x and holding $2.6 billion in cash on hand as of the quarter ending June 2024. We feel that the current leverage is appropriate and in line with peers.

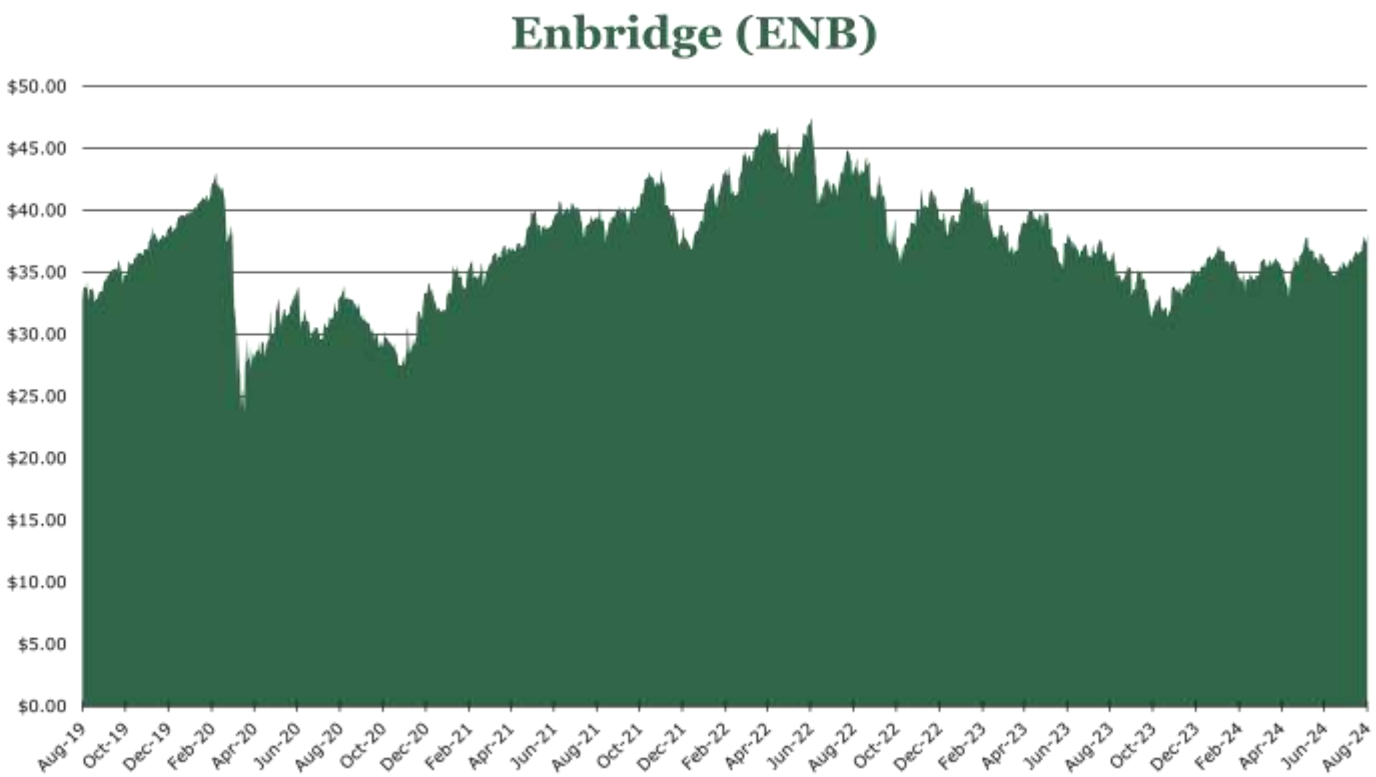
ENB posted around $1 billion in free cash for the quarter ending June 2024, with Free cash for 2023 being $2.9 billion. ENB is targeting 10-12% yearly shareholder returns through dividends and capital appreciation, currently with a dividend yield of 6.9%.

From 2023 to 2026, ENB expects an EBITDA CAGR of 7-9%, with a mixture of tuck-in acquisitions, organic expansion, and cost savings. This translates to an EPS CAGR of 4-6%. We feel that these are reasonable midpoints, with 80% of EBITDA having inflation protection with CPI-indexed rates, and the short-term acquisition goals. ENB expects to have $6-7 billion in annual investment capacity on a go-forward basis (FCF less dividends, plus additional debt capacity provided by 5% EBITDA growth). We feel this number may be high if rates stay high, but FCF less dividends does still provide $4-5 billion in deployable capital per year which should be more than enough to maintain the growth-footing.

ENB's solid 6.9% yield, expansionary footing and 60-70% free cash payout provide a solid investment case to income-focused investors. We believe that the dividend will continue to be supported by free cash generating projects and acquisitions.

Peer Comparisons

	Enbridge (ENB)	TC Energy (TRP)	Kinder Morgan (KMI)	Williams Companies (WMB)
Price-to-Earnings	18.02	13.85	16.61	22.28
Price-to-Sales (TTM)	2.52	3.47	2.91	4.94
EV-to-EBITDA (FWD)	11.74	11.91	9.65	11.23
Net Income Margin	13.54%	20.16%	15.93%	28.40%
Dividend Yield	7.07%	6.56%	5.73%	4.61%


Enbridge (ENB)
$50.00
$45.00
$40.00
$35.00
$30.00
$25.00
$20.00
$15.00
$10.00
$5.00
$0.00
Aug-19
Oct-19
Dec-19
Feb-20
Apr-20
Jun-20
Aug-20
Oct-20
Dec-20
Feb-21
Apr-21
Jun-21
Aug-21
Oct-21
Dec-21
Feb-22
Apr-22
Jun-22
Aug-22
Oct-22
Dec-22
Feb-23
Apr-23
Jun-23
Aug-23
Oct-23
Dec-23
Feb-24
Apr-24
Jun-24
Aug-24

Disclaimer and Related Information

This article or video features Benjamin C. Halliburton, CFA or an investment idea(s) that Mr. Halliburton or Tradition Investment Management, LLC (Tradition) may invest in. Mr. Halliburton is the founder and owner of Tradition Investment Management, LLC, a registered investment adviser. Tradition is doing business as (DBA) Building Benjamins in the publishing, email, and website space. All material on the website should be considered paid advertising by Tradition. This article is a financial publication and is provided for educational purposes only. It is not an investment recommendation nor investment advice. It does not take into account your personal circumstances and whether this investment is appropriate for you, your objectives, or your risk tolerance. Under no circumstance is Building Benjamins or Tradition Investment Management LLC responsible for any actions that you may take after reading this educational information. Nothing from Building Benjamins should be considered personal investment advice. Building Benjamins and Tradition Investment Management LLC, the website, emails, interviews, social media pages, and other materials are published by Building Benjamins and do not necessarily match the opinions of the individuals or companies published or quoted herein. Investing, particularly stock or ETF investing, is risky and may result in losses and sometimes loss of your entire investment. Stock investing has company-specific operational risks like demand, competition, legal and regulatory, and broader financial market risks like liquidity, Economic cycle, and government policy. You may lose money in any stock investment or other investments and are solely responsible for those decisions.

Mr. Halliburton, Tradition Investment Management LLC, and/or the authors on this site may or may not have positions in the securities discussed in this educational report. Neither the author(s) nor Tradition Investment Management, LLC will knowingly trade ahead of any customer buy or sell resulting from this information. The information herein is shared as an educational endeavor. Mr. Halliburton, Tradition Investment Management LLC, and/or the authors on this site may transact in the security discussed at a later date, prior to, or without notification in this format. This is not investment advice but only a discussion of select investments for educational purposes. Building Benjamins is an investment website, blog, or newsletter, and the information contained cannot be reproduced, copied, or redistributed without the prior written authorization of Building Benjamins or Tradition Investment Management LLC. US copyright laws apply. We rely on information from sources we believe reliable, including the companies themselves, but cannot guarantee the accuracy of the information we provide. You rely on this information at your own risk and are responsible for the verification of the data.