



## Which Pipeline Should You Choose?

### Description

When hunting for investment opportunities in Canada's oil patch, many investors look past staid pipeline and infrastructure companies in the midstream and focus instead on the more glamorous oil explorers and producers. But with Canada's pipeline companies forming a crucial part of the energy infrastructure required to support the patch, they are a virtual gold mine for investors in this era of surging global energy demand.

Not only are they able to clip the ticket on each barrel of crude they transport, but growing energy demand from emerging economies and pipeline capacity constraints bode well for their future ability to generate revenue. With three major midstream companies operating in Canada, as well as a number of small players, the big question for investors is which one belongs in your portfolio.

### **This company delivers over half of Canada's crude to the U.S.**

Despite U.S. demand for Canadian crude expected to fall, midstream giant **Enbridge** ([TSX: ENB](#))([NYSE: ENB](#)) is well-positioned to continue growing.

Not only is the company responsible for shipping around 52% of the total Canadian crude exported to the U.S., but it's also the first to receive a license from U.S. regulators allowing it to re-export Canadian crude from there. This will give Enbridge access to European markets, which are desperately trying to reduce dependency on Russian energy imports in light of the crisis in Ukraine.

Enbridge is also pushing hard for approval of its Northern Gateway pipeline that will connect the patch to Canada's west coast, enabling access to crucial Pacific Rim energy markets. This will reduce dependence on the U.S., currently Canada's key export market, and provide access to what is expected to become the world's greatest consumer of energy: China. Already in 2013, China overtook the U.S. to become the world's largest net importer of crude, and demand is expected to soar as economic growth accelerates in the world's second-largest economy.

This bodes well for Enbridge's future revenue, cash flow, and bottom line.

Enbridge pays a tasty dividend yield of 2.7%; over the last 10 years, its dividend has grown by 13% per

year, rewarding income-hungry investors for their loyalty. With a dividend payout ratio of 60%, it's certainly sustainable and will continue to grow as Enbridge capitalizes on accessing new markets and on its dominant position in Canada's crude transportation industry.

### **This quiet achiever in the patch goes from strength to strength**

Unlike its competitors Enbridge and **TransCanada** ([TSX: TRP](#))([NYSE: TRP](#)), **Pembina Pipeline** (TSX: PBA)([NYSE: PBA](#)) has a lower profile. It maintains a quiet but strong presence in local communities, which has seen it deftly avoid much of the negative publicity associated with other midstream companies operating in the patch.

More importantly, it continues to perform strongly; Q1 2014 EBITDA, a measure of core profitability, jumped a solid 34% compared to the previous quarter and a massive 50% compared to the equivalent quarter in 2013. Cash flow also continues to grow, having shot up a healthy 32% quarter over quarter and 5% year over year for the first quarter of 2014.

This has seen Pembina continue to reward investors through the payment of a consistently growing monthly dividend, with the dividend being increased twice over the last year alone. This gives Pembina a very attractive dividend yield of 3.8%, but a payout ratio of 136% indicates the dividend may not be sustainable.

However, in light of the company's history of solid cash flow growth, this dividend does appear sustainable when this ratio is calculated using operational cash flow in place of net income, where it falls to 78%.

### **Ongoing controversy is clouding this midstream company's future**

TransCanada continues to attract media attention for all of the wrong reasons, particularly in regards to the ongoing battle to receive approval for the northern leg of its Keystone pipeline.

But despite the controversy and TransCanada's inability to generate income from the capital invested thus far, the company still continues to perform strongly. First quarter 2014 EBITDA shot up 5% quarter over quarter and a staggering 20% year over year.

TransCanada also pays a healthy dividend yield of 3.8% and has a payout ratio of 78%, highlighting the sustainability of the dividend.

### **Which one is best for your portfolio?**

All three companies have strengths and weaknesses. Enbridge pays the lowest yielding dividend, Pembina has a dividend payout ratio over 100% when calculated using net income, and TransCanada's Keystone pipeline remains mired in controversy.

When evaluating a number of key valuation ratios, it is TransCanada that appears the cheapest, with an EV of 14 times EBITDA compared to Enbridge's 23 times and Pembina's 17 times. However, it is Pembina that has the strongest balance sheet, with a conservative debt-to-equity ratio of 0.38, while TransCanada's is 1.28 and Enbridge's is a massive 1.53 times equity.

While all three offer an attractive opportunity for investors to bet on solid ongoing growth in the patch, it

is Pembina which stands out as the obvious choice for risk-averse investors. Not only does it pay a monthly dividend with a solid yield of almost 3.8%, but it also has the strongest balance sheet coupled with solid EBITDA growth.

However, for risk-tolerant investors who are willing to gamble on the eventual approval of the Keystone pipeline, TransCanada may offer better value given it is the most attractively priced.

## CATEGORY

1. Investing

## TICKERS GLOBAL

1. NYSE:ENB (Enbridge Inc.)
2. NYSE:PBA (Pembina Pipeline Corporation)
3. NYSE:TRP (Tc Energy)
4. TSX:ENB (Enbridge Inc.)
5. TSX:PPL (Pembina Pipeline Corporation)
6. TSX:TRP (TC Energy Corporation)

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