2 Big Reasons Dividend Investors Should Avoid Pembina Pipeline Corp., and 1 Stock They Should Buy Instead

Description

If you're looking for reliable dividends, the pipeline companies are a great place to look. After all, they operate critical infrastructure, make recurring revenue from long-term contracts, and also benefit from increased energy production in western Canada.

And among the pipeline companies, none has been a hotter performer than **Pembina Pipeline Corp.** (TSX: PPL)(NYSE: PBA). Over the past five years, Pembina's stock has skyrocketed by over 220%, and shareholders have collected a nice dividend along the way.

But there are reasons to avoid the stock, and two are listed below. Then we highlight a pipeline company you should buy instead.

1. A high price to pay

It's no secret that Pembina shares have performed very well. In fact, last year the company had the top-performing shares of any Canadian company in the energy infrastructure industry. But that's left one big problem: an expensive stock price.

To illustrate, let's look at 2013. The company had cash flow from operations of just over $2 per share. This does not mean the company earned that kind of money. Remember, maintaining pipelines requires lots of capital expenditures, which is not included in the number above. So the real earnings power of the company was likely well below $2 per share.

Yet Pembina still trades at nearly $50 per share. So that means one of two things: Either the company has to devote all its cash flow to dividends, leaving little room for growth, or you'll have to accept a tiny dividend yield. Neither is appealing.

2. Dilution

As it turns out, Pembina has chosen option A with regards to its dividend, with an annualized payout of $1.74 per share (paid monthly).

This is more than the company can pay just from cash flow. So what does it choose to do? Well, if you own Pembina shares, you can opt in to the dividend reinvestment plan (Drip), which offers you the chance to receive your dividend in shares rather than cash. As a bonus, you get a 5% discount for doing so. Last year, Pembina paid only $220 million in cash dividends; without the Drip, it would have had to pay roughly $500 million.

This creates a problem: Pembina's share count keeps growing. The weighted share count increased by nearly 20% in 2013 alone. This makes dividend raises very difficult — from 2004 to 2013, the dividend grew by only 4.6% per year. If you're looking for some growing cash income, you should look elsewhere.

1 stock to buy instead: TransCanada

TransCanada Corp. (TSX: TRP)(NYSE: TRP) is Canada's second-largest pipeline company. And it seems to be a better option than Pembina.

For one, its shares are not as expensive, trading at only about 12 times last year's cash flow from operations. Secondly, the company pays a very affordable dividend. So there's no need to issue discounted shares — last year, TransCanada's share count increased by less than 1%. As a result, there's no disincentive to receiving cash income, and the company's dividend can grow a lot faster.

Absent from this conversation is **Enbridge Inc.**, Canada's largest pipeline operator. But the free report below is about Enbridge. So with that report, you should have all the information you need on this industry.

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Date
2025/07/23
Date Created
2014/09/23
Author

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