Why Enbridge Inc. Is a Smarter Dividend-Growth Play Than TransCanada Corporation

Description

The TSX celebrated an important birthday this month, marking the 73rd month of the current bull market—a full two years longer than average. While this is certainly cause for celebration, it also means that you should expect lower and more volatile returns going forward.

It is for this reason that there is no better time to invest in the Canadian pipeline space, with its regulated rates of return, stable cash flows, and constantly growing dividends. In fact, research has found that these are the exact kind of stocks that both perform well and with less volatility over the long term.

Enbridge Inc. (TSX:ENB)(NYSE:ENB) and **TransCanada Corporation** (TSX:TRP)(NYSE:TRP) are the two premier names in this sector, and if you're looking for strong double-digit dividend growth over the long term, there are very good reasons why Enbridge is your best bet.

Enbridge has stronger four-year predicted dividend growth

Starting with the basics, both companies have—to the delight of shareholders—begun to offer increasing long-term visibility in their earnings and dividend growth. Enbridge is predicting an impressive 10-12% compound annual growth rate (CAGR) in earnings between 2015 and 2018, and this earnings growth will be accompanied by a 14-16% CAGR in its dividend.

Enbridge is able to growth its dividend at a greater rate than earnings due to the fact that the company will also be increasing its payout ratio over the four-year term, from 73% at the end of 2014 to a target payout ratio of 85% by 2018. This CAGR could result in a doubling of Enbridge's dividend by 2018, as **Royal Bank of Canada** analysts are predicting a $2.83 per share dividend—double 2014's $1.40 dividend. Enbridge kicked off this growth with a 33% dividend hike at the end of 2014.

TransCanada, on the other hand, is offering a much more conservative growth profile. TransCanada is forecasting an 8% CAGR in earnings by 2017 and a corresponding 8-10% dividend CAGR. To TransCanada's credit, this represents a doubling of their prior dividend-growth rate of 4%. This hike likely occurred, amongst other things, due to pressure from shareholders to increase payout ratio and dividend growth to a level that is competitive with other pipelines and MLP's.

The result is that by 2016 TransCanada will only see its dividend grow by 16%, while Enbridge will see its dividend grow by 51% based on estimates. All this begs the question—what is the source of the difference between these two companies' dividend-growth trajectories? There are two reasons.

Enbridge has a stronger backlog of projects driving earnings

Ultimately, dividend growth will follow earnings growth, and Enbridge is set to offer stronger earnings growth thanks to its large backlog of commercially secured growth projects through to 2018. Currently, Enbridge has a $44 billion capital spending program, of which, $34 billion is secured. In 2014 $10 billion of this went into service and the remaining $24 billion in secured funding is estimated to be in service by the end of 2018.

In comparison, the majority of TransCanada's $46 billion growth program will be executed after 2017, with $12 billion in small and medium-term projects being implemented between now and 2017. This is one of the drivers behind TransCanada's lower four-year earnings CAGR. In addition, approximately $20 billion of TransCanada's post-2017 growth is dependent on the Keystone XL and Energy East pipelines, both of which are subject to governmental approval, delays, and cost overruns.

Enbridge has been better at using its sponsored vehicles to finance growth

Enbridge's strong financing is the reason why it is able to increase its dividend at such a fast pace compared with TransCanada. Enbridge announced a plan to drop down, or transfer, $17 billion of its Canadian assets to its **Enbridge Income Fund** sponsored vehicle.

This massive drop down will provide a significant source of low-cost funding for Enbridge's capital program, thereby leaving significant room for dividend growth.

TransCanada is pursuing a similar plan, but plans to drop down only $1 billion per year to its **TC Pipelines Ltd.** MLP, providing it with far less available financing, and therefore less dividend growth.

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