Dividend Investors: How to Increase Your Yield From Enbridge Inc. by 72%

Description

Enbridge Inc. (TSX:ENB)(NYSE:ENB) is the solid foundation of many portfolios.

When you look at the company's fundamentals, it's pretty obvious why investors hold it in such high esteem. The company has North America's largest network of pipelines as well as other assets, including natural gas distribution services across eastern Canada and power generation assets in Ontario. Altogether, these businesses generate more than $37 billion in annual revenue and more than $3 billion in operating income.

The future is also looking pretty bright. In a presentation to analysts back in late 2014, the company outlined a plan that would see it boost earnings per share by approximately 14-16% annually through to 2018, while boosting its quarterly dividend by 33% for 2015. This would be accomplished by dropping down many assets to its subsidiary companies, which would then rid the parent of all the debt (and interest payments) associated with these assets. Since Enbridge owns much of the subsidiaries, dividends would then flow back to the parent.

While this was good for shareholders, bondholders weren't terribly excited about the news. Suddenly, bondholders found themselves in the position where much of Enbridge's debt would remain on the balance sheet, while assets would be transferred to separate subsidiaries. Naturally, this caused the price of the debt to decrease, especially the preferred shares.

This has created a buying opportunity for investors who are still bullish on Enbridge, but who also want some very attractive income to wait for the price of the preferred shares to right themselves. Let's take a closer look.

Supercharge your yield…by 72%

Currently, Enbridge's common shares yield 3.2%, with the expectation that the dividend will go up over time as earnings improve. We'll use that as our base number.

Meanwhile, the Series A preferred shares (TSX:ENB.PR.A) currently yield 5.5% on a steady dividend of $0.34375 per share. These are perpetual preferreds, which mean that they will pay the same dividend until the company redeems them. These shares have been trading since 1999, so I wouldn't be holding my breath for that to happen.

There's also the Series 13 preferred shares (TSX:ENB.PF.E), which also yield 5.5% as I write this. But these shares are much different than the other preferreds. Firstly, the Series A shares trade exactly at par, which is $25 per share. The Series E shares currently trade at less than $20, which is 20% under par.

Here's where the Series E shares get interesting. In 2020 these shares will experience a rate reset, which means they'll pay investors a new interest rate of whatever the five-year Government of Canada bond yields, plus 2.66%. Thus, these shares protect investors from interest rate hikes in the future.

Investors who buy either sets of these preferred shares are locking in a dividend yield of 72% higher than the common shares. Yes, the dividend of the common shares will likely increase over time, but for investors looking for income now, it's obvious which shares offer the better deal.

Let's compare the Enbridge preferred shares to its largest competitor, **TransCanada Corporation**. The latest preferred share offering from TransCanada is the Series 11 preferred, which has a current yield of just 3.8%.

To put that in comparison, the yield on TransCanada's preferred shares is so anemic that investors can do better buying the company's common shares, which yield 4.1% and offer the potential for both dividend and share price growth. And they don't get anywhere close to matching the yield offered by the Enbridge preferred shares.

There's little in the difference in operations of these two companies that should cause such a divergence on a fundamental level. It's caused by the bond market getting upset about Enbridge's drop-down strategy. That's very good news for investors who are looking for secure yield now from a company with one of the finest credit ratings in Canada.

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nelsonpsmith