Why Now Is 2015's Best Opportunity to Buy Enbridge Inc.

Description

Since the beginning of May **Enbridge Inc.** (TSX:ENB)(NYSE:ENB) shareholders saw their shares decline by over 14%. This decline has largely mirrored the decline in the price of oil and was likely made worse by the fact that Enbridge's Line 9 reversal project was delayed slightly.

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While weak oil prices and a delayed Line 9 are certainly headwinds for Enbridge, they have little effect on the company's fundamental earnings power. While the share price has been dropping, Enbridge has been quietly moving towards the finalization of its $30.4 billion drop-down to **Enbridge Income Fund** (TSX:ENF)**,** which will allow Enbridge to fund its massive $44 billion capital program at a low cost, grow its dividend by 16% annually for the next three years, and grow its earnings by an expected 10-12% annually for the next five years.

Despite superior, visible earnings and dividend growth, Enbridge is still trading at a discount to its U.S. and Canadian peers. Combined, these factors make it an excellent time to buy Enbridge.

Enbridge's $30.4 billion drop-down transaction is driving growth

At the core of the thesis to buy Enbridge today is its massive drop-down transaction to Enbridge Income Fund. Currently, Enbridge has $44 billion in capital growth projects, $34 billion of which are commercially and politically secured and ready to be in service and generating earnings by 2017.

These projects will drive earnings-per-share growth, and the major challenge is being able to fund the projects affordably in a way that is accretive to earnings. The drop-down transaction helps to solve this issue. By "dropping down," or selling $30.4 billion worth of pipeline and renewable energy assets to its Enbridge Income Fund subsidiary, Enbridge is essentially transferring funding responsibility to the subsidiary.

Enbridge Income Fund is expected to issue between $600 and $800 million in equity annually to fund the growth program, which, in turn, means Enbridge does not have to. This means that Enbridge will receive earnings from the growth project without needing to issue a large amount of shares. The end result is Enbridge will see more earnings-per-share growth because more earnings are spread across fewer shares.

Why will Enbridge still receive earnings from assets it no longer owns? In exchange for the assets, Enbridge takes back equity in Enbridge Income Fund, which will allow Enbridge to maintain control and ownership over the assets (with an estimated 88% stake in Enbridge Income Fund). This, in turn, means Enbridge has a stake in earnings from the fund.

Enbridge receives a special fee known as an incentive distribution right, which provides Enbridge with a base fee of $7.5 million annually, plus a special 25% stake of Enbridge Income Fund's per share cash flow over $1.295. This gives Enbridge a claim on the income fund's growth.

The end result is that the drop-down secures funding for Enbridge's capital program (which, in turn, allows Enbridge to announce earnings growth of 10-12% annually with a high level of certainty), and also allows Enbridge to increase its dividend payout ratio and growth rate. This is due to the fact that Enbridge has smaller funding requirements.

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Strong secure earnings growth with smaller funding requirements means that Enbridge not only has higher dividend growth than its peers (with 15% annual growth expected compared with 8-10% for its peers), but also a more secure dividend. Currently, Enbridge is expected to have a dividend coverage of about two times (which means Enbridge has double the amount of cash flow that it spends on its dividend) compared with approximately one times for its peers.

Stronger growth also comes at a better price

The best part of buying Enbridge at current prices is that superior earnings growth as well as dividend coverage and growth comes at a better price. Currently, Enbridge is trading at about 23 times its 2016 earnings. This is a slight discount to its Canadian peers, which trade at about 24 times their 2016 earnings. Enbridge should, at the very least, trade in line with its peer group. A similar discount applies to Enbridge and its major U.S. peers **Kinder Morgan** and **Spectra Energy,** even though Enbridge offers better dividend growth and coverage.

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1. Energy Stocks
2. Investing

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