



Could Enbridge Inc. Shares Be Worth 30% More Than They Are Now?

Description

One key principle of value investing is the idea that the price you pay determines your rate of return. That is to say, the less you can pay for a business of a particular value, the higher the return you can get. If this is true, **Enbridge Inc.'s** ([TSX:ENB](#))([NYSE:ENB](#)) return prospects just increased substantially after the recent pullback.

Enbridge shares have plummeted 23% since mid-April along with the broader market, but this decline represents little to no fundamental change to Enbridge's underlying earnings potential. The reason is because most of Enbridge's earnings come from regulated assets with long-term cost-of-service contracts that guarantee Enbridge a rate of return higher than its cost of capital. This protects Enbridge from risk due to falling oil volumes, and the fee-based nature of most of its business (whereby the company is paid a fee per barrel transported) ensures Enbridge has very little commodity price exposure.

The bottom line is, the recent plunge in oil prices does not warrant a 23% drop in Enbridge shares. More importantly, recent developments mean that Enbridge has even more value to create than to simply recover its losses.

1. Enbridge has secure, high growth visible beyond 2018

The value of a business is a largely a result of the growth prospects in its earnings, but also the predictability of those earnings, and how visible they are going forward. After all, a business with a high projected growth rate that is very uncertain (or visible for only a couple years ahead) is much higher risk than one with more certain growth.

Currently, Enbridge not only has very high projected growth, but this growth is very certain and visible past 2018. Enbridge is projecting a 10-12% compound annual growth rate (CAGR) through to 2018, and an 18% growth in cash flow over the same period. The certainty of this growth comes from the fact that it's due to the commercially and politically secured projects Enbridge has coming online over the next several years.

The company has a \$44 billion capital program, of which, \$34 billion is commercially secured, and this \$34 billion in projects is all set to be in service by 2018 (with over \$11 billion already completed). These projects are largely governed by long-term contracts where Enbridge has little commodity price or downside risk for reduced volumes, and can therefore predict its earnings well.

After 2018, Enbridge also has visibility into its earnings. This is thanks to the “tilted return profile” of \$21.4 billion of Enbridge’s \$34 billion in capital projects. These are projects that do not produce a flat rate of return over time, but rather, increase over time, and Enbridge can therefore expect the return of these projects to continue to grow past their in-service date and beyond 2018. The reason for this is because many of the shippers have production that will be increasing over time rather than coming 100% online immediately.

As production ramps up for these projects, so will the volumes and therefore the return for Enbridge. In addition, tolls often start smaller then increase, which also boosts the return profile.

2. Enbridge is currently undervalued

Enbridge’s high and secure earnings growth combined with the fact that its dividend is expected to grow by a historically high 14-16% annual CAGR with an increased payout ratio means Enbridge should trade at a higher multiple than it currently is. Currently, Enbridge is trading at a 2016 price-to-earnings ratio of 20. Enbridge typically trades between 15 and 26 times earnings, and judging by the fact Enbridge currently has unprecedented earnings growth and unprecedented dividend growth and payout, a 26 times earnings multiple or higher is justified.

Not to mention, Enbridge currently trades below its major U.S peers **Kinder Morgan** and **Spectra Energy** on a cash flow basis, despite better dividend and earnings growth. Assuming Enbridge traded at its historic high of 26 times earnings, it would be worth \$64.50 per share—nearly 30% above current prices.

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Author

amancini

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