Kinder Morgan Inc. Just Cut its Dividend. Could Enbridge Inc. Be Next?

Description

The last week has been absolutely brutal for **Kinder Morgan Inc.** (NYSE:KMI) shareholders.

The company was very popular among retail investors, primarily because of its long history of dividend growth. In 2015 alone, the company raised its dividend three times, upping the quarterly payout from $0.45 per share to $0.51, a move that helped keep shares high. The stock remained at above $40 per share for the first six months of the year, even when other energy companies were imploding around it.

Alas, Kinder Morgan couldn't stay ahead of the energy storm. The market began to question the company's ambitious expansion plan, realizing that if North American energy production ultimately declines–which is the natural reaction of low prices–the industry isn't going have the capacity to fill the pipelines that Kinder Morgan plans to build. A potential wave of bankruptcies in the energy producers spells bad news for the contracts that ensure Kinder's current pipelines are filled. Remember, a contract is only as good as its counterparty.

Essentially, Kinder Morgan's problem is this: it doesn't generate enough cash flow to pay its dividend, pay the interest on its debt, and finance its growth. It counts on investors to lend it billions of fresh capital. The market is beginning to question its ability to get this financing.

On Tuesday the inevitable happened. Kinder Morgan announced a deep dividend cut, slicing the payout from $0.51 per quarter to $0.50 per year, a 75% cut.

Surprisingly, the stock popped on the news, trading nearly 9% higher on Wednesday morning. It appears that deep-value investors are happy to take the shares of disgruntled dividend-growth investors on the cheap. Still, Kinder Morgan is down nearly 58% over the last year. Wednesday's pop is little consolation to long-term holders.

Fortunately for most Canadian investors, exposure to Kinder Morgan is limited. But that doesn't mean we don't need to worry about similar problems on this side of the border. There's potential that **Enbridge Inc.** (TSX:ENB)(NYSE:ENB) could turn into a similar story.

Many similarities

There are a lot of parallels between Kinder Morgan and Enbridge. Both are currently in the middle of huge expansion programs. Both need capital to be able to afford to both expand and pay their dividends. Both have been singled out by ratings agencies as having too much debt. And both made promises of nice dividend hikes in the future, with Kinder Morgan officially breaking that promise with the dividend cut.

Kinder Morgan looks like it’s about to lose its investment grade debt status, which will make issuing debt much more expensive. Enbridge’s debt looks safer, but ratings agencies didn’t like the company’s plan to transfer assets to its drop-down company.

Ultimately, the proof is in the ratios. Debt-to-EBITDA is the most important ratio in industries with a lot of debt. Currently, Enbridge has a debt-to-EBITDA ratio of 10 times, while Kinder Morgan comes in at just 7.6 times. Both of these numbers include preferred shares as debt, which does skew things a bit. Remember, a company can choose not to pay preferred share dividends and not technically default its debt.

Of course, debt-to-EBITDA doesn’t tell the whole story. Enbridge is sitting on more than $1 billion in cash and generates more than $4 billion annually in operating cash flow. Its dividend is only 4.8% annually, which is a payout it can still afford.

The big issue is Enbridge’s aggressive expansion plans. The company is in the middle of a $38 billion program with $8 billion already in service. An additional $14.2 billion worth of projects are planned to enter service in 2017.

Some $25 billion of the $38 billion needed to complete the program has already been secured, putting $13 billion of growth projects at risk. But what happens if these pipelines come to market at the same time as North American energy production plummets?

Enbridge generates plenty of cash. But with a total debt load of $47 billion, including preferred shares, investors must be careful. I don’t think Enbridge’s situation is as dire as Kinder Morgan’s. Still, investors should probably be cautious, especially if crude doesn’t start recovering.

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