What's Dragging Down Enbridge Inc. Shares?

Description

Enbridge Inc. (TSX:ENB)(NYSE:ENB) is known for its strong dividend-paying history with +60 years of dividend payments and 21 consecutive years of dividend growth.

Yet, its dividend yield has been pushed up to nearly 5.2%, as its shares declined 4.8% on Thursday after releasing its third-quarter results. The stock is nearly 20% lower than it was a year ago.

What's dragging down the stock?

Higher interest rates

At the end of September, Enbridge had about $61.4 billion of long-term debt on its balance sheet. And the company needs to pay interest on the debt. In the first three quarters of the year, Enbridge booked interest expense of about $1.7 billion.

Enbridge has a policy to not have more than 25% of its total debt exposed to floating interest rates, which should limit the impact of rising interest rates. Nonetheless, interest rate hikes will make it costlier for the company.

Notably, Enbridge took on about $24.2 billion of debt in the first quarter. About 90% of it was for the acquisition of Spectra Energy. Enbridge also raised funds by issuing some shares. The dilution was a part of the reason why Enbridge had lower cash flow per share.

Lower cash flow per share

In the first three quarters, Enbridge generated higher available cash flow from operations (ACFFO) than the same period in 2016. However, it was 16.6% lower on a per-share basis. For Q3, it was 10.9% lower than the same period in 2016.

In the Q3 report, management reaffirmed the guidance range of $3.60-3.90 for its ACFFO per share this year. If Enbridge achieves that, it'd imply a payout ratio of about 62-68% of cash flow. So, the company's dividend should be intact.

What's the risk in the Line 3 replacement project?

Enbridge intends to put in service $12 billion of investment projects this year. About 85% are already online. Next year, there's about $7 billion of investments.

The biggest risk lies in the Line 3 replacement project, which is Enbridge's biggest investment in the three-year period ending in 2019. Line 3 is a ~$9 billion project (about 56% invested in Canada and 44% in the U.S.) The bigger a project is, the more complex it is, and the bigger chance for potential problems to occur.

The construction for Line 3 began in the summer in Canada and is underway for North Dakota and Wisconsin. Enbridge is still waiting for the green light from Minnesota.

Investor takeaway

No investment comes without risk. I liked Enbridge when it yielded 4.5%, and now that it yields 5.2%, I like it even more as a buy, as some of its risks have played out. That said, cautious investors should wait for some consolidation in the stock before buying.

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