Is Enbridge Inc.'s (TSX:ENB) 6.7% Yield Safe?

Description

Enbridge Inc. (TSX:ENB)(NYSE:ENB) has seen its share price decline more than 20% in the past year, and that's moved its yield up. The dividend stock is one of the best on the TSX, as Enbridge has a great track record for growing its payouts over the years. However, with the yield sitting at 6.7%, investors might be worried that it is getting too high and that it may be unsustainable.

Is the dividend in trouble?

While many investors assume that because a yield is higher than 5% it may not be sustainable, that's not necessarily true. After all, if Enbridge shot up to $50, then its dividend yield would shrink to 5.4%, which would appear much more acceptable to dividend investors. The danger with looking at dividend yield is that it can change quickly, since there is an inverse relationship that exists between price and the yield percentage.

The factors that investors should consider when assessing a dividend's health include the company's fundamentals, the industry it operates in, and payout ratio.

When it comes to oil and gas stocks, the industry has been struggling, even as oil prices have been rising. Enbridge's stock has been going in an opposite direction, as negativity surrounding pipelines has kept investors bearish on the industry in Canada, and the cancellation of pipeline projects certainly doesn't help.

Over the long term, the industry continues to recover, and if commodity prices can remain stable, then stocks like Enbridge should start to see some more favourable price movement. However, it may not be until we see a change in government that we see the outlook in Canada become much more positive.

As for its fundamentals, Enbridge has been able to post a strong profit in each of its last five quarters, averaging a reliable 6% margin during that time. It's also a positive sign that the company is continuing to grow, with revenues up over 14% in its most recent quarter.

Payout ratios

When assessing a dividend, investors normally consider payout ratios to determine whether payments can be expected to continue. In the trailing 12 months, Enbridge's per-share earnings have totaled just $1.37, as the company had a couple of quarters with low earnings recently. Current quarterly payments of $0.671 equate to an annual dividend of $2.684 per share, which is well in excess of the company's earnings.

However, there are limitations with using earnings to assess payouts, as non-cash items can easily skew the results, as can one-time expenses. Cash flow can often give you a better predictor of the dividend's health, as that's what truly coming into the business. In its most recent quarter, Enbridge accumulated $1.3 billion in free cash, of which 65% was paid out in the form of dividends.

However, in previous periods free cash has been negative, as Enbridge has been spending a lot on investing activities to help grow its business.

Bottom line

Although the high yield may scare off investors at first glance, Enbridge has a bright future, and once conditions in the industry become more conducive to growth, the stock will take off, and the yield could quickly shrink.

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