Is Enbridge's (TSX:ENB) Dividend Safe?

Description

I tend to shy away from high-yielding stocks. Often times, a high yield is not sustainable and can be a red flag for investors. At times, it can also be a sign that the company's stock price has weakened. This is particularly true when a company's yield is far above its historical averages.

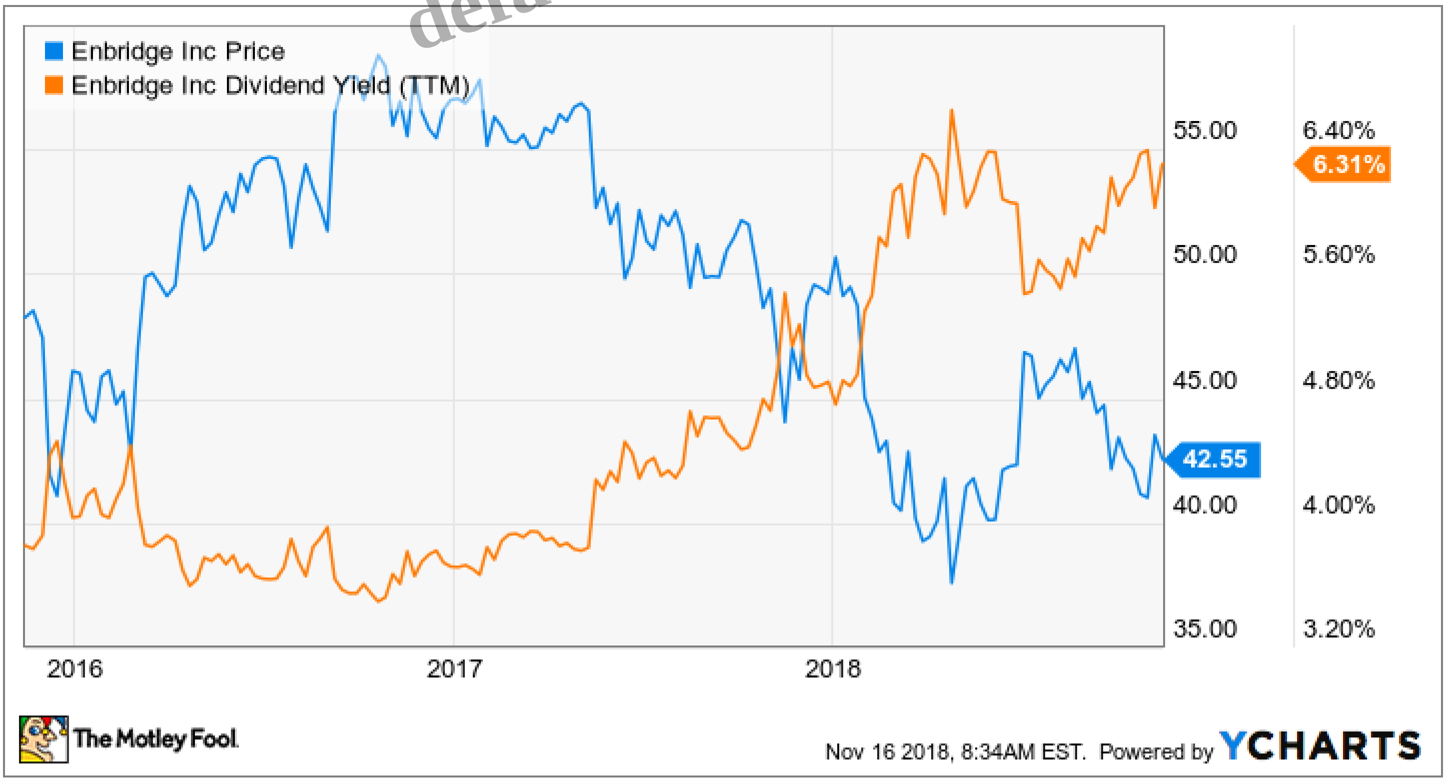
Are the company's fundamentals deteriorating? Is the dividend sustainable? Is the yield in line with industry and historical averages? These are great questions to ask before jumping into a juicy yield. This brings me to **Enbridge** (TSX:ENB)(NYSE:ENB).

Is Enbridge's dividend safe? Let's take a look.

Poor stock performance

As of writing, Enbridge is yielding above 6%! Rarely do high-quality companies offer investors such a high starting yield.

Ever since the company's purchase of Spectra Energy in 2016, its share price has been in a downward spiral, which is why the yield has jumped. The graph below provides a nice visual on what happened:



As you can see, Enbridge's yield has almost doubled. It's therefore not surprising that investors have called the safety of the dividend into question.

Why did its share price tank? The market largely did not favour the Spectra Energy deal. Bears felt that the company overpaid and took on too much debt.

Fundamentals

We are now two years removed since Enbridge first announced its intention to buy Spectra. Over this period, the company has been laser-focused on reducing its debt. It has been doing so through the sale of non-core assets and debt-restructuring.

Has it had success? Absolutely. Enbridge had targeted a debt to earnings before interest, taxes, depreciation and amortization (EBITDA) of 5.0 by the end of the year. Although that's still high, the ratio is down significantly from its high of around 8.

Through the first nine months of the year, Enbridge is on target to exceed its target. As of end of the third quarter, the company's debt/EBIDTA ratio stood at 4.7. It is also on pace for record earnings, EBITDA and discounted cash flow.

So far so good.

Dividend safety

At first glance, the company's dividend does not appear well covered. The company's payout ratio is above 100% as it has negative 12-month earnings. However, earnings contain many one-time items that have no bearing on the company's ability to pay the dividend.

A better metric is the company's dividend as a percentage of cash flows. Through the first nine months of the year, the company paid out $2.013 per share in dividends and generated $3.40 in discounted cash flows. At a payout ratio of 59%, the dividend is well covered.

The company is also undergoing a restructure by purchasing its sponsored vehicles and bringing them all under the Enbridge banner. The simplified structure is expected to lead to a stronger balance sheet and more retention of cash flows. As such, the dividend coverage will further improve once the deals close.

It's for this reason the company has guided to 10% dividend growth through 2020.

Foolish takeaway

Enbridge has had its share of bumps in the road, but management has delivered on expected targets. The company has a multitude of growth projects in the pipeline, which will drive EBTIDA, revenue and earnings expansion. The company is also posting significant discounted cash flows and its simplified structure will only improve its dividend coverage ratio. Enbridge's dividend is safe.

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