My Top Energy Stock for 2019

Description

Midstream services provider **Enbridge Inc.** (TSX:ENB)(NYSE:ENB) holds the dubious honour of being the third most shorted stock on the TSX. The reasons for this are quite simple: short sellers believe that Enbridge is due to decline because of the confluence of weaker oil, higher interest rates, and a stronger U.S. dollar. Then you have the hazards associated with its massive mountain of debt that exceeds $59 billion plus the execution risks associated with its restructuring. According to short sellers, these factors will cause Enbridge's stock to collapse. The midstream giant is down by 16% over the last year, creating an opportunity for investors seeking exposure to crude and one of North America's top energy infrastructure stocks.

Wide economic moat

While there is plenty of negative sentiment surrounding Enbridge and considerable risks associated with the company, much of it does appear overbaked. What makes Enbridge stand out from many other oil companies is its almost unassailable economic moat. Significant advances in drilling technology and easy access to capital have substantially reduced the economic moat once associated with upstream oil producers. The impact this is having on oil stocks is being magnified by the sizable global supply glut and decreasing inelastic demand for crude as other forms of energy, including renewables, become available.

Nonetheless, for Enbridge the opposite has occurred. A combination of steep barriers to entry, including massive amounts of capital required to construct or acquire pipelines and storage infrastructure, as well as growing regulatory requirements along with the breadth and depth of Enbridge's continent-wide operations endow it with an impregnable moat. This protects its earnings from competition. Enbridge's pipeline infrastructure is responsible for shipping around 25% of all crude produced in North America. This combined with growing production and the fact that pipelines are the only cost effective and low risk means of shipping Canadian crude to U.S. refining markets means that demand will never deteriorate.

You only need to look at the critical nature of the $9 billion-dollar Line 3 Replacement Program to understand how important Enbridge's infrastructure is to the Canadian energy patch. That project will lead to a significant expansion of capacity on one of the most important pipelines for the oil sands, which is essentially the primary means of shipping bitumen and other forms of Canadian heavy oil to U.S. refineries.

Already, the considerable lack of pipeline exit capacity along with growing oil sands production saw the benchmark price for Canadian heavy oil Western Canadian Select (WCS) fall to a record low of just over US$12 a barrel in November 2018. This occurred because of local oil inventories in Western Canada reaching record levels that were weighing heavily on the price of WCS. After lobbying from **Cenovus Energy Inc.** and **Canadian Natural Resources Ltd.,** the government of Alberta elected to introduce mandatory production cuts of 325,000 barrels daily, which will remain in place until the Line 3 Program is completed. The program is expected to be completed and in service during the second half of 2019. It will drive a significant increase in throughput, which will give Enbridge's earnings a healthy lift and sustain both its planned growth initiatives as well as planned dividend hikes.

Enbridge has also made significant progress with deleveraging its balance sheet, completing $7.8 billion of non-core assets sales during 2018, which was well ahead of its target, and reducing debt to 4.7-times EBITDA by the end of the third quarter. The company expects debt to fall to around 4.5-times EBITDA, which along with growing earnings, will make its operations more sustainable. The roll up of its separately listed vehicles into a single corporate entity is also proceeding at steady clip. Once complete, that will simplify Enbridge's capital structure, improve its credit profile and further reduce costs, enhancing its appeal as an investment.

Why buy Enbridge?

The midstream giant's vast pipeline network, wide almost impenetrable economic moat, expanding portfolio of assets and growing earnings make it a very attractive stock to own. It not only offers growth, but also possesses defensive characteristics coupled with a regular dividend payment that has increased for the last 22 years. Enbridge hiked its dividend by 10% at the end of 2018, with that increase commencing in 2019. Combined with the decline in its market value, that now sees the midstream giant yielding a very juicy 7%, which means if investors buy now, they can lock in that yield while benefitting from Enbridge's plans to grow its dividend by 10% annually until 2020.

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Date
2025/08/25
Date Created
2019/01/02
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