Enbridge (TSX:ENB) Stock Alert: Time to Buy the 7% Dividend?

Description

Enbridge Inc (TSX:ENB)(NYSE:ENB) is one of the most valuable stocks in Canada. And rightfully so. It owns the largest network of pipelines on the continent and transports more than 20% of North America's crude oil production.

Yet big companies aren't immune from challenges. The recent oil price drop has dragged shares lower, a rare phenomenon. While the dividend is now above 7%, in some weeks it's soared above 8%.

It's not often that you can buy a world-class stock with a 7% dividend. Is now the time to buy Enbridge shares?

Here's the deal

Enbridge's pipelines make money by shipping fossil fuels like crude oil. For every barrel shipped, the company takes a cut.

This year has been a rollercoaster for oil prices. A rare combination of supply *and* demand challenges has forced pricing considerably lower. In January, oil was at US$60 per barrel. Today, it's closer to US$20 per barrel.

You're likely familiar with the demand side of the equation. Due to the coronavirus pandemic, oil consumption was fallen off a cliff. Airline traffic has plummeted by more than 80% and vehicle traffic has seen a similar decline. Even business activity and consumer purchasing are lower, resulting in less energy demand.

You'd think that falling demand would result in shrinking supply, a direct blow to Enbridge given that it gets paid based on volumes shipped. But it's actually the *opposite*. Industry-wide production has surged in 2020, with heavyweights like Saudi Arabia pumping more crude oil than ever.

It doesn't take a genius to realize the outcome of this double-whammy. Lower demand and surging supply can only mean one thing: falling prices.

But where does this leave Enbridge? It's actually complicated story. In the short term, higher supply should fill its pipelines to the brim. The long-term picture, however, is much darker.

Time to buy Enbridge?

Most oil producers can continue to pump oil at a loss for months. That's what is currently happening in Canada. The vast majority of the industry is below breakeven, but for many projects, it's difficult to fluctuate supply on a daily basis.

There's no question, however, that these businesses need to be profitable to continue operating. If Enbridge's customer base goes under, the company's profits will vanish.

How likely is this? The chances are higher than you'd expect. Most of Canada's oil production only turns a profit if oil is above US$30 per barrel. Some mega-projects requires prices above US$40 per barrel, although some analysts believe the true number is even higher than that.

With oil around US$25 per barrel, we're a long way away from a profitable Canadian oil industry. That's terrible news for Enbridge. Pipelines are a high fixed-cost business, meaning that most of the costs are realized regardless of the company's revenue. A small dip in sales could mean an even larger drop in profits.

If you're an oil bull, and believe prices will revert above US$40 before the end of 2020, it's certainly time to scoop up Enbridge's 7% dividend. But the payout is high for a reason.

If oil doesn't recover this year, we could see a *permanent* reduction in volumes. In this case, it's unlikely that the dividend will survive intact.

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