Is Pembina Pipeline’s (TSX:PPL) 8.9% Dividend Yield Too Good to Ignore?

Description

The significant disruption from the pandemic, demand-supply imbalance, and uncertain outlook have taken a toll on oil prices and weighed heavily on the energy infrastructure companies. For instance, shares of **Pembina Pipeline** (TSX:PPL)(NYSE:PBA) are down about 38% year to date. Moreover, its stock has declined over 17% in one month.

However, the massive erosion in its stock price value has driven its yields higher. Currently, Pembina Pipeline offers a very high dividend yield of 8.9%, which should grab the attention of every income investor.

While Pembina Pipeline’s high yield looks highly attractive, lower oil prices and an uncertain outlook aren’t a very conducive operating environment for this energy infrastructure company. In the most recent quarter, Pembina Pipeline reported a 30% decline in its top line. Meanwhile, its earnings declined by 62%. The company blamed weaker energy demand, reduced crude activities, lower frac spreads, and compressed margins for the decline.

Prolonged weakness in energy demand could weigh on the Pembina Pipeline’s business and, in turn, its payouts. Pembina has said that it does not intend to announce any additional dividend increase for the rest of 2020.

However, investors should note that Pembina Pipeline, through acquisitions and reinvestments, has transformed its business, which is supported by long-term, fee-based contracts.

The majority of Pembina’s crude oil, NGL, and condensate products transported are contracted under long-term firm contracts. A firm contract has a minimum volume or revenue commitment (take-or-pay). Moreover, under its cost-of-service contractual arrangements, shippers are obligated to pay their share of operating costs and rate base whether they use Pembina’s all of the fixed capacity or not.

Is Pembina’s 8.9% yield safe?

As discussed above, Pembina Pipeline’s underlying business is backed by fee-based, long-term contracts that support its payouts. Moreover, investors should note that majority of these contracts have take-or-pay or cost-of-service arrangements, which means that these contracts do not have volume or price risk.

Further, the company has diversified across commodities, including natural gas, NGL, crude, and condensate, which acts as a hedge. Over the years, the company has increased the fee-based contribution to its adjusted EBITDA from 77% in 2015 to about 90-95% in 2020. Also, it has lowered the target payout ratio from 135% of its fee-based cash flows in 2015 to about 70-75% in 2020, which is encouraging.

Pembina Pipeline's highly contracted business and strong fee-based distributable cash flows indicate that its payouts are safe.

In the most recent quarter, Pembina Pipeline said that it "expects its cash flow from operating activities, the majority of which is derived from fee-based contracts, will be more than sufficient to meet its short-term and long-term operating obligations, capital investment requirements and to fund its dividends."

Bottom line

Investors should note that Pembina Pipeline's stock could remain volatile in 2020, reflecting an uncertain energy outlook. However, if you can sit tight amid volatility and hold the shares of this energy infrastructure company for medium to long term, you could gain significantly from Pembina's stellar dividend yield and recovery in its stock price.

CATEGORY

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