The 7% Dividend Stock That People Love Right Now

Description

Enbridge (TSX:ENB)(NYSE:ENB) is a Canadian icon. It's a giant in the pipeline industry. With a recent slide in the share price, however, the dividend yield is now above 7%.

This could be your shot to buy a blue-chip stock with an incredible income stream. Knowing that the company has raised the payout every year since 1995 should give you comfort regarding its sustainability.

Should you jump in?

Know these facts right now

If you want to secure a 7% annual dividend yield, you need to move fast. Let's get straight to the facts.

Enbridge is North America's biggest pipeline company. It transports nearly 20% of the continent's crude oil, plus a big chunk of the natural gas. Historically, this has been a great business.

Pipelines are like toll roads: once constructed, the cash flow comes streaming in. Initial construction costs can reach several million dollars per kilometre.

With a pipeline network spanning multiple countries, just imagine how difficult it would be to replicate Enbridge's asset base. It would easily cost $50 billion or more, although regulatory constraints would likely make it impossible anyway.

The point is that Enbridge owns enviable assets that are nearly impossible to compete with and produce huge annual cash flows, which the company then uses to support the 7% dividend.

Here's the bad news

If Enbridge is such an amazing stock, why is it trading with a 7% dividend? Well, there's some bad news, but if you understand this news fully, you can take advantage.

As a pipeline owner, Enbridge relies directly on two things: fossil fuel production and fossil fuel demand. Companies must be producing oil and natural gas that needs transporting to end users that require these fuels to be transported to them. Enbridge is simply the middleman, collecting its payment to connect each party.

When COVID-19 sent oil prices below US$40 per barrel, many analysts worried that parts of Enbridge's customer base would go bankrupt, meaning an end to production. And with increasing regulatory and social challenges regarding climate change, the demand equation is under pressure too.

Enbridge is stuck between two difficult forces: potentially lower production and headwinds for long-term demand. These forces could imperil the dividend for the first time, hence the recent share selloff.

Should you buy this dividend stock?

As the spectre of COVID-19 slowly recedes, normal life is picking back up in many areas of the world. That means higher demand due to increased driving, flying, and everything else that consumes fossil fuels. Oil prices have already rebounded strongly, relieving one side of the pressure for Enbridge.

The other question is the demand cliff. While we'll be using fossil fuels for decades to come, there's no doubt that renewables will eat into that demand over time.

If that demand cliff is close — say, in the next five years — the dividend could be cut to preserve cash. But if that demand cliff is far off — say, a decade or more — there's simply not much to worry about. Your investment decision hinges on where you think that demand cliff resides.

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