This 5-Year Prediction for Enbridge (TSX:ENB) Might Surprise You

Description

You will rarely see anyone saying no to a dividend stock like **Enbridge** (TSX:ENB)(NYSE:ENB). It has become North America's largest pipeline operator. Many sing the glory stories of the perfect the toll-road model of Enbridge. It builds pipelines and collects money from utilities for letting them transmit oil and natural gas through the pipelines. But building pipelines is no longer easy, as there are environmental concerns. In this changing scenario, what do the next five years hold for Enbridge?

Enbridge and the shift to clean energy

The energy industry is not very dynamic. Any change or switch takes years because of high capital requirements. The change towards clean energy will delay Enbridge's upcoming projects. These delays will add to the project cost making new pipelines less feasible. But all this will happen gradually, giving Enbridge ample time to make its projects ecofriendly.

Over the past 40 years, Enbridge has diversified its pipelines beyond oil to natural gas. Natural gas is a bridge between carbon and low carbon energy. At present, natural gas meets 30% of Ontario's energy needs. To replace natural gas with electricity would require billions of dollars only to build a new transmission corridor.

Enbridge plans to use its existing pipeline infrastructure to transfer low-carbon energy. In a joint venture with Markham Power-to-Gas facility, Enbridge will blend 2% of renewable hydrogen into its existing natural gas network. It is also developing renewable natural gas (RNG) projects that transform landfill waste into carbon-neutral energy. Enbridge will transmit this energy through its existing local natural gas distribution networks across Canada.

Enbridge will bring around $3 billion of RNG and hydrogen blend projects online by 2023. It will also bring $2 billion of offshore wind projects online by 2023.

Enbridge's pipeline infrastructure becomes more valuable

As it becomes difficult to build new pipelines, the value of Enbridge's existing pipeline infrastructure is rising. At the same time, delays in new pipeline projects are increasing its project cost. For instance, its

Minnesota Line 3 replacement project cost increased by 13% and is now scheduled to come online by the end of 2021.

Enbridge pays dividend from the toll money it gets from the existing pipeline infrastructure. This shift to clean energy will not impact its cash flows, which means it can keep paying dividends. But how long can it keep increasing dividends, and at what rate? It grows the dividend in two ways:

- It builds new pipeline to generate a regular cash flow stream; and
- It increases its toll rate.

It has a 26-year average dividend-growth rate of 10%. But the pandemic reduced its 2021 dividend growth to 3%. The delay in new pipeline projects might impact its dividend-growth rate. At the same time, the limited number of pipelines will help Enbridge demand a higher toll rate for transmitting oil and natural gas. The magic number that balances a higher toll rate and capital investment in new projects will be Enbridge's dividend-growth rate.

Is Enbridge's debt a cause for concern?

Although Enbridge has a high leverage ratio of 4.6, it is in line with its target ratio of 4.5-5.0. The company balances out its debt with rising EBITDA, which makes debt manageable. It sets aside a portion of its cash flows for dividend and the remaining for capital expenditure and debt repayment. Hence, the rising debt is not a cause of concern for shareholders.

The major risk that Enbridge shareholders should be cautious of is a calamity, natural or man-made. If a calamity destroys any of its major pipelines, the company's cash flows would be significantly affected. Even the manageable debt would become a burden.

Foolish takeaway

No business is without risk. But what matters is the reward for taking the risk, and Enbridge pays a handsome reward of 6.89% dividend yield. The company will report its first-quarter earnings on May 7.

You could see some fluctuation in the stock price, but the next five years are pretty strong, as the company accelerates its investment in low carbon and clean energy. The company could benefit from environmental investing.

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