Why am I Bullish on Pipeline Stocks?

Description

The oil and natural gas pipeline stocks are like dividend pipelines for passive investors. These infrastructure companies build long pipelines and contract with utilities to transmit oil and natural gas through them. Initially, it takes time to build pipelines, but it brings a lifetime of convenience and cash flow. These cash flows pay off the project in some years, and the future toll money is pure profits after deducting maintenance expenses. But this convenience is now coming under fire for environmental reasons.

The environmental impact of building pipelines

This year, U.S. president Joe Biden rejected **TC Energy's** (TSX:TRP)(NYSE:TRP) Keystone XL Pipeline project for environmental reasons. A pipeline brings a lot of convenience in transmitting anything liquid or gaseous that can flow. But it also brings the risk of oil spills several times in its lifetime. Hence, the route must be correctly mapped.

An article from the Center for Biological Diversity shows that there were many waterways and wildlife areas on the route of the Keystone XL pipeline. the pipeline could have a significant impact on land, water, air, and wildlife. After over a decade of planning, revisions, and failed approval, TC Energy cancelled the project in June. This project shows that the new environmentally aware population is making it increasingly difficult to build pipelines.

How a slowdown in pipeline construction can impact pipeline stocks

Pipeline companies like TC Energy and **Enbridge** (TSX:ENB)(NYSE:ENB) earn cash by charging a toll for transmitting oil and natural gas. They increase their cash flow by building more pipelines and pay some portion of it to shareholders as dividends. This is how TC Energy and Enbridge increased their dividend compounded annual growth rate (CAGR) to 6.8% and 12.7%, respectively. They use the remaining cash to build new pipelines.

But now, pipeline construction is slowing, which could slow the dividend-growth rate. However, every dark cloud has a silver lining. The slowdown in pipeline construction will make existing infrastructure more valuable. Anything valuable becomes an attractive acquisition target. The pipeline companies could divert their capital from building new pipelines to acquiring existing pipelines.

Warren Buffett acted fast. He grabbed the opportunity last year (when the energy market dipped) to buy **Dominion Energy's** natural gas pipeline business. At present, **Pembina Pipeline** and **Brookfield Infrastructure Partners** are at loggerheads to acquire **Inter Pipeline**. This is just the beginning. The pipeline consolidation could intensify with time as combined companies bring significant cost synergies. They could merge their existing pipelines with newly acquire pipelines to get greater coverage.

The end of oil dominance

The pipeline operators face another risk of the shift to renewable energy. Accelerating innovation and adoption of renewables could gradually reduce oil consumption in some sectors. For instance, the increasing adoption of electric vehicles (EVs) could reduce gasoline consumption. Natural gas will play a role in this switch as it is in the middle of oil and renewable.

Enbridge and TC Energy will benefit the most as they have a large infrastructure of natural gas pipelines. With changing energy trends, they will convert their pipeline to transmit renewable energy.

Why am I bullish on pipeline stocks?

While pipelines continue to pay dividends, the new angle of consolidation could drive up pipeline stocks and bring capital appreciation. Any major acquisition, if successful, could give shareholders of the target company a premium price. And the acquirer could accelerate dividend growth from the merger synergies.

I would suggest building a portfolio of pipeline stocks by investing in big names like Enbridge, TC Energy, and Pembina.

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