Smarter Buy: Pembina Pipeline Stock or Enbridge?

Description

Pembina Pipeline (TSX:PPL) and **Enbridge** (TSX:ENB) are two of Canada's best-known pipeline stocks. Pembina is a smaller pipeline company that is also involved in natural gas and propane marketing. Enbridge is a large pipeline company that does business all across North America. Both companies have dividend yields well above 5%. The two companies are similar but different enough that they are not equivalent.

In this article, I will explore which of the two stocks is best for an income-oriented investor.

The case for Pembina Pipeline

The case for investing in Pembina Pipeline over Enbridge rests on the fact that it's somewhat more sound financially than Enbridge is. Both ENB and PPL have sizable amounts of debt, but PPL has much less debt compared to assets. Enbridge has $82.23 billion in debt and $67.4 billion in equity (i.e., assets minus liabilities), giving it a 1.22 debt/equity ratio. Generally, debt/equity ratios below one are considered ideal, so Enbridge doesn't pass this test. Pembina has $11.29 billion in debt and $16 billion in equity, so it has the desired below-one debt/equity ratio.

Other balance sheet metrics favour PPL, too. For example, its debt load is significantly smaller on a pound-for-pound basis than Enbridge's is.

Another thing that Pembina Pipeline has going for it is the fact that its payout ratio (dividends divided by earnings) is not overly high. PPL's payout ratio is 76.5%, which means that it has plenty of money left over to invest in its business after it pays its dividend. ENB's is 86.5%, which is below 100% (better than it was in the past) but still higher than PPL's. On the whole, it looks like Pembina Pipeline is handling its finances better than Enbridge is.

The case for Enbridge

The case for Enbridge comes down to stability. Enbridge is a true titan in the pipeline world. It has the longest pipeline network in North America by distance, and it has deep relationships with buyers in the United States. It also supplies 75% of the natural gas consumed in Ontario. Basically, this is a big, entrenched, economically vital company.

The same isn't quite the case for PPL. It's a smaller company whose pipeline network only covers Western Canada and a few miles into the United States. Its marketing and storage businesses are also relatively small. It would take hundreds of billions of dollars to compete with Enbridge; realistically, nobody is going to be getting that kind of money. It would not take a ton of money to compete with Pembina Pipeline, so the company's competitive position is more vulnerable.

The verdict

Taking into account all relevant factors, it looks to me like Enbridge is a slightly better buy than Pembina Pipeline right now. The latter company has a somewhat better balance sheet, but its advantages basically end there. Enbridge has an economic moat, a durable competitive advantage that competitors can't match. Pembina does not have such a moat, so it's more vulnerable to competitive threats than Enbridge is. Over the long run, this factor might result in Enbridge overcoming its debt problems and beating Pembina's total return.

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