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ENBRIDGE INC (ENB)

Enbridge owns extensive midstream assets that transport hydrocarbons across the U.S. and Canada. Its pipeline network consists of the Canadian Mainline system, regional oil sands pipelines, and natural gas pipelines. The company also owns and operates a regulated natural gas utility and Canada's largest natural gas distribution company. Finally, the firm has a small renewables portfolio primarily focused on onshore and offshore wind projects.

3 YR Weekly Chart (Feb 11, 2022)

ENB - 4Q 2022 Earnings Report

Enbridge's fourth-quarter results and reaffirmed 2022 guidance align with **MORNINGSTAR ANALYSIS**.

We expect to maintain our fair value estimate and narrow moat rating. Management's 2022 EBITDA guidance is CAD 15 billion-15.6 billion, a range that includes our CAD 15.5 billion forecast. The main drivers are higher Mainline volumes, the addition of Line 3, and the recently completed acquisition of Ingleside Energy. The dividend increased 3% to CAD 0.86 per share. The three-year capital allocation plan of CAD 5 billion-6 billion is unchanged, with CAD 3 billion-4 billion toward the core business while the remainder could be used for M&A, buybacks, or other opportunistic projects. Notably, Enbridge has been boosting its cost of capital for projects to factor in regulatory and permitting risks, credit and capital cost risks, changes in climate policy, and carbon prices. It also said that a resolution on the resubmittal for the Mainline contracting structure would probably be resolved in mid- to late 2023, in line with prior commentary. Distributable cash flow guidance of 5%-7% annually for 2021-24 was also reiterated.

New projects have primarily revolved around exports and low-carbon initiatives, which we think is positive. Enbridge recently announced 2 million barrels of storage expansion in late-stage development at Ingleside, designed to better capture oil export opportunities, and incremental projects designed to meet Texas liquefied natural gas and Western Canadian LNG needs as well. From a low-carbon perspective, we're most intrigued by the Alberta carbon capture project as a test case for future projects. Factors mentioned by management as useful for the effort included a combination of stakeholders, such as emitters, midstream, government, and First Nation participation. However, there also needs to be local expertise and infrastructure in place to replicate similar hubs in other cities such as Houston or Corpus Christi.

Business Strategy & Outlook

Enbridge stands out among North American midstream operators with a focus on oil pipelines and a utility-like earnings profile. The firm's most important asset, its Mainline system, controls over 70% of Canada's takeaway capacity and is linked to highly complex U.S. refineries that value heavy oil, meaning demand remains secure in the near to medium term despite the increase in U.S. light oil production.

Enbridge's size and high profile invites challenges for new projects, which we expect to become a permanent feature. The multi-year effort to bring Line 3 into service due to opposition from indigenous tribes has essentially concluded with the line entering service in late 2021. At the same time, Line 5 is entering what is likely to be a protracted series of legal challenges with the state of Michigan regarding regulatory oversight. A third effort to shift Mainline contracting to long-term decade-plus contracts from an uncontracted monthly nomination system has been undertaken to lock in customers as competing projects were proposed. The Canadian Energy Regulator, or CER, rejected Enbridge's new contracting proposal in late 2021. In response, Enbridge plans to pursue either a new incentive contract structure or a cost of service contracting structure. Enbridge will submit a cost-of-service application to the CER while these discussions take place and expects a decision in 2023.

With major future pipeline projects unlikely for years at this stage on the scale of Line 3 at least, Enbridge's 5% to 7% growth profile is supported by the rest of its businesses, namely gas transmission, a significant utility based in Ontario, and a small renewables segment. Combined, Enbridge plans to invest CAD 3 billion to CAD 4 billion annually across its portfolio, with an incremental up to CAD 2 billion available for buybacks and debt reduction as well as new organic development. The utility and renewables businesses offer opportunities in renewable natural gas, hydrogen, carbon capture, and wind, placing Enbridge among the leaders in midstream in terms of being able to address long-term demand and ESG-related concerns for oil and gas.

Economic Moat

Ref: https://www.morningstar.com/InvGlossary/economic_moat.aspx

We award Enbridge a narrow moat rating. Our narrow moat is based on an efficient scale moat source. While we remain very confident in demand for Canadian oil (approximately 1.8% growth CAGR through 2030) and gas (9% CAGR over the same time frame) in the near to medium term, we are far more uncertain around long-term demand in the latter stages of our forecast due to the high carbon emissions intensity associated with the full cycle of oil sands production, which is a primary source for Enbridge's assets. Oil sands carbon intensity is among the highest among all the basins we cover, and it is disproportionately exposed to threats if countries and governments continue to seek ways to reduce greenhouse gas emissions. We expect material stakeholder challenges from legal, regulatory (Enbridge already pays carbon taxes, for instance), and community perspectives for any new major Enbridge project, and likely new oil sands projects from producers, challenging the investment case for new pipes and boosting costs for existing assets. Beyond stakeholder issues, we believe refineries that run a heavy crude slate that requires Canadian heavy are increasingly looking to renewable diesel (produced from food waste), raising significant questions around the sustainability of long-term demand. Finally, while the nascent hydrogen and other renewable opportunities offer ways for

Enbridge to manage the energy transition, we believe at best, they could become narrow-moat businesses, further reducing our confidence in an overall wide moat rating.

Looking at each of Enbridge's businesses, we assess the liquids pipelines business as narrow (more than 50% of EBITDA), which are large pipeline projects largely protected by long-term contracts in a region that is consistently short of pipeline capacity. We continue to believe the former Spectra assets (which was a wide moat when it was acquired), now part of Enbridge's demand-driven gas transmissions business, remains wide given the quality and irreplaceable nature of the assets. The remainder of the earnings profile is mostly an Ontario-based utility, which we'd consider a narrow-moat business, and a very small (about 4% of EBITDA) no-moat renewables portfolio.

Midstream companies process, transport, and store natural gas, natural gas liquids, crude oil, and refined products. Hydrocarbons are produced and consumed in different places and in different forms from how they come out of the ground. Midstream firms transport and process hydrocarbons. Once a transport route is established, there's usually little need to build a competing route. Doing so would drive returns for both routes below the cost of capital. Thus, pipelines are generally moaty because they efficiently serve markets of limited size.

New pipelines are typically constructed to allow shippers or producers to take advantage of large price differentials (basis differentials) between two market hubs because supply and demand is out of balance in both markets. Pipeline operators will enter into long-term contracts with shippers to recover the project's construction and development costs, in exchange for a reasonable tariff that allows a shipper to capture a profitable differential, and capacity will be added until it is no longer profitable to do so.

Pipelines are approved by regulators only when there is an economic need, and pipeline development takes about three years, according to the U.S. Energy Information Administration. Regulatory oversight is provided by the Federal Energy Regulatory Commission, National Energy Board, and at the state, provincial, and local levels for cross-border Canadian pipelines. New pipelines under consideration must contend with onerous environmental and other permitting issues. Further, project economics are locked in through long-term contracts with producers before breaking ground on the project. If contracts cannot be secured, the pipeline will not be built.

A network of pipelines serving multiple end markets and supplied by multiple regions is typically more valuable than a scattered collection of assets. A pipeline network allows the midstream firm to optimize the flow of hydrocarbons across the system and capture geographic differentials, use storage facilities to capture price differentials over time, and direct more hydrocarbons through its system via storage and gathering and processing assets, ensuring security of flows and higher fees. Finally, it is typically cheaper for an incumbent pipeline to add capacity via compression, pumps, or a parallel line than it would be for a competitor to build a competing line.

The major consideration for assessing evidence of a moat for a midstream firm is asset quality, where we consider the firm's competitive strengths and assets within the efficient scale regional markets they serve. Asset quality is evaluated based on the location of the individual assets, the type of asset (for example, pipeline versus gathering and processing), the cost-competitiveness of the basins the assets serve, capital intensity, and the overall quality of the network. Basin cost-competitiveness is important as pipelines are likely to remain relevant longer if connected to a low-cost hydrocarbon supply. Further, some of the highest-quality midstream firms have a dense network of assets that connect to key refineries, basins, and market hubs and are a reliable transportation provider for shippers. This connectivity encourages shippers to use the pipelines but also protects the midstream entity. The asset integration prevents another third party from extracting rents by owning an asset that is part of the route to the most profitable market.

We consider Enbridge's assets to be very high quality. The crown jewel of its portfolio is the Canadian Mainline crude pipeline system, but Enbridge also operates other top-tier assets, such as regional oil sands pipelines, U.S. and Canadian natural gas pipelines, and regulated utilities.

The Mainline is Canada's largest pipeline. With a shipping capacity of approximately 2.85 mmbbl/d, the pipeline transports primarily heavy oil from Canada's oil sands to refineries across North America, including Canada's east coast; the U.S. Midwest; Cushing, Oklahoma; and the U.S. Gulf Coast. Refinery capacity connected to the Mainline approximates 3.5 mmbbl/d. Furthermore, the Mainline offers more access to the U.S. Midwest, where producers can maximize netbacks, compared with competing pipelines along with lower tolls to the U.S. Gulf Coast.

Canada's oil sands supply is separated from most of its refining markets by large distances and relies on pipeline transportation. Pipeline takeaway capacity from the country approximates 4 mmbl/d, with approximately 71% of the takeaway capacity residing on the Mainline system. Increasing environmental and government regulations, as well as political opposition, have made new pipeline projects increasingly difficult to sanction in recent years. Accordingly, the Canadian crude industry would crumble without the Mainline system. Enbridge also operates the Express-Platte pipeline. While the pipeline is Canada's smallest crude pipeline, it's one of the few outlets for Canadian crude producers.

The company's regional oil sands pipeline network is also top-tier. The network connects to 11 producing oil sands projects. The company's major regional pipelines provide transportation from all three of the oil sands locations, but are primarily focused on the largest region, Athabasca. The system moves nearly 1.2 mmbbl/d of oil sands production, or over 40% of Alberta's total oil sands production.

Enbridge's Canadian natural gas pipelines are in position to benefit from growing production in the Western Canadian Sedimentary Basin, highlighted by the Alliance Pipeline. The Alliance pipeline is the only rich gas export pipeline from the Western Canada Select Basin but can also export dry gas. Shipments originate from the Horn River, Montney, Duvernay, and Bakken formations and are transported to the U.S. Midwest. Canadian natural gas production is expected to increase at a 9% compound annual growth rate over the next decade, accompanied by growth in natural gas liquids.

Spectra Energy's gas transmission assets diversify Enbridge's asset base with high-quality natural gas pipelines. Enbridge's U.S. natural gas network is exceptionally well positioned to serve most of the Eastern U.S., including cities such as New York, Boston, and Philadelphia. Enbridge's ability to connect and balance supply and demand with its pipelines and storage assets means customers are eager to pay for the opportunity to access the network. These assets are also primarily demand-driven and serve end users like utilities, which keeps utilization high and removes the risk of a basin becoming less cost competitive and stranding the pipeline asset.

Contract quality is primarily assessed by term, with long-term contracts (10-plus years) being preferred with take-or-pay provisions. Contract quality does not directly support the efficient scale moat source, but it more directly speaks to the sustainability of future excess returns. Entities that are primarily oriented around pipelines are the strongest positioned as they obtain the longest terms. Long-term contracts for pipelines tend to be made up mostly of capacity reservation fees and a more modest transportation fee. Shippers are obligated to use the pipeline but not required to do so; however, they must pay the reservation charges in any scenario, ensuring rents for the pipelines. The smaller transportation fees are only paid based on actual volumes shipped. Less well-positioned firms typically contain a large component of gathering and processing, storage, fractionation, or other business areas, where it is harder to argue that advantages will persist for two decades or more, and contract terms tend to be only a few years, reflecting the reduced barriers to entry compared with pipelines.

While the Mainline is a common carrier pipeline and doesn't have any firm commitment at the moment, it has historically been very highly utilized, typically 90%-plus, including periods of apportionment. If accepted in 2023, one possible contracting structure will essentially shift the pipeline to 90% take-or-pay contracts and 10% spot market shipments, which we'd expect to be fully utilized. The other will be a cost of service structure. The Mainline represents the best option for producers to access multiple markets and to move production. In addition, eight of the 10 largest crude producers, which represent two thirds of Canada's crude production, are investment-grade counterparties and rely on the Mainline.

Other assets also retain long-term contracts. The Express-Platte contains 20-year contracts, while regional oil sands system has average durations that range from 20 to over 30 years. In U.S. natural gas, on average, the pipelines have a remaining contract duration that exceeds 10 years, with over 95% of the capacity contracted by investment-grade counterparties, providing for stable and secured cash flows.

Material ESG exposures create additional risk for midstream investors. In this industry, the most significant exposures are greenhouse gas emissions (from upstream extraction, midstream operations, and downstream consumption), and other emissions, effluents, pipeline spills, and opposition and protests. In addition to the reputational threat, these issues could force climate-conscious consumers away from fossil fuels in greater numbers, resulting in long-term demand erosion. Climate concerns could also trigger regulatory interventions, such as production limits, and removal of existing infrastructure.

Midstream emissions are relatively low in the lifecycle of oil and gas, and midstream firms have relatively lower risk than upstream and downstream firms from carbon taxes. Canadian firms already pay carbon taxes on their carbon emissions, most of which are generally passed to their shippers and other customers. Spills represent a major threat and have created great resistance from environmentalists, Indigenous groups, and other climate-conscious persons. Examples of the opposition are seen in President Biden's revocation of the Keystone XL presidential permit, legal battles over the Dakota Access Pipeline system, and Enbridge's own challenges with its Line 3 and 5 pipelines.

Enbridge has outlined two major ESG-related targets. It plans to be zero net carbon by 2050 on Scope 1 and 2 emissions, and it plans to reduce its carbon emissions intensity by 30% by 2030 from 2020 levels.

Fair Value & Profit Drivers

Our fair value estimate for Enbridge is $44 (CAD $53) per share after updating for third-quarter results. Our fair value estimate corresponds to 2022 enterprise value/EBITDA multiples of 11.6 times. Our cash flow forecasts incorporate the addition of the Line 3 replacement pipeline as well as the

Moda deal, and we assume Line 5 remains operational while Enbridge and Michigan engage in mediation. Our 2021 adjusted EBITDA forecast is CAD 14.2 billion, and we expect distributable cash flow to reach CAD 10 billion in the same period. We forecast a distributable cash coverage ratio of 1.52 times. Our 2022 estimates for EBITDA, distributable cash flow, and the distributable cash coverage ratio are CAD 15.5 billion, CAD 10.6 billion, and 1.52 times, respectively.

Risk & Uncertainty

Enbridge's biggest challenges are primarily regulatory, legal, and other stakeholder risks related to identifying and executing on projects within its growth portfolio. Challenges over Line 3, 5, and its small stake in the Dakota Access Pipeline offer clear examples of the potentially higher costs and lost earnings involved.

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Capital Allocation

Our capital allocation rating for Enbridge is Standard. In our view, the company maintains a sound balance sheet, with leverage in the target range of 4.5-5.0 times EBITDA. We expect the balance sheet to improve, as the company's growth portfolio is poised to generate incremental cash flow that will be directed toward paying down debt, increasing the dividend, investing in high-return projects, and possibly buy back shares if conditions warrant.

Over the past few years, management sold off over CAD 10 billion in generally lower-quality assets, including gathering and processing businesses in a shift that has improved the overall quality of the business. The focus has been on secured projects with utility-like return profiles and limited to no sensitivity to commodity prices. Broadly, we think the shift makes sense. However, the positive implications of this shift are offset by our concerns over regulatory and other stakeholder legal and environmental issues that will continue to beset any new major Enbridge pipeline project it chooses to undertake. This has undoubtedly increased the cost of capital for new pipeline efforts as Enbridge acknowledges. We also note that many asset sales involved substantial write-downs of goodwill or fair values, making the shift a more expensive proposition.

As a result, going forward, Enbridge likely faces a tougher path finding large organic pipeline projects that will move the needle on its already large asset base. We expect management will be able to find solid projects in its gas transmission, utility, and renewable portfolios, but this will be smaller singles and doubles versus the home runs of the past, which tends to reaffirm our Standard capital allocation rating. Still, we think with the Moda deal, Enbridge is effectively adding a high-quality asset that should provide solid earnings contributions for years, so we consider this a low-risk purchase that is a reasonable use of shareholder capital.

With the balance sheet on a positive path, and investments likely more restrained going forward, Enbridge has taken an appropriate stance on its prized dividend. The company has been prudent with dividend increases and has identified up to CAD 2 billion annually under its current capital spending program that can be allocated toward increased capital returns to shareholders, providing a very healthy margin of dividend support and safety.

Morningstar's Analysis

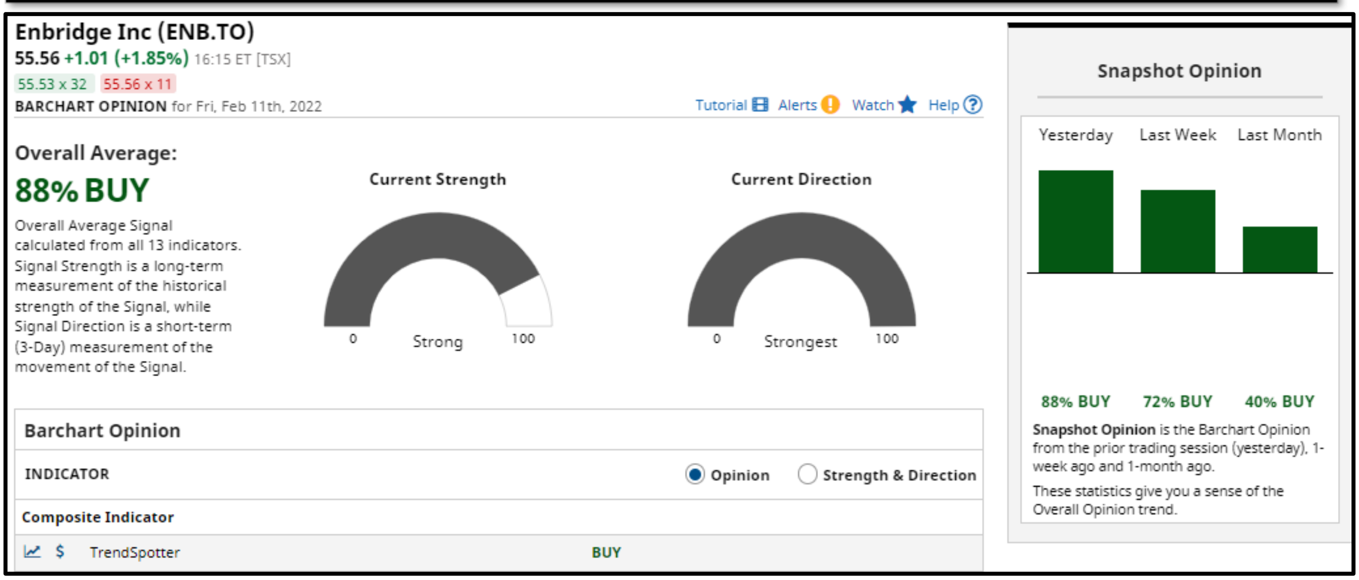
Bulls Say/Bears Say

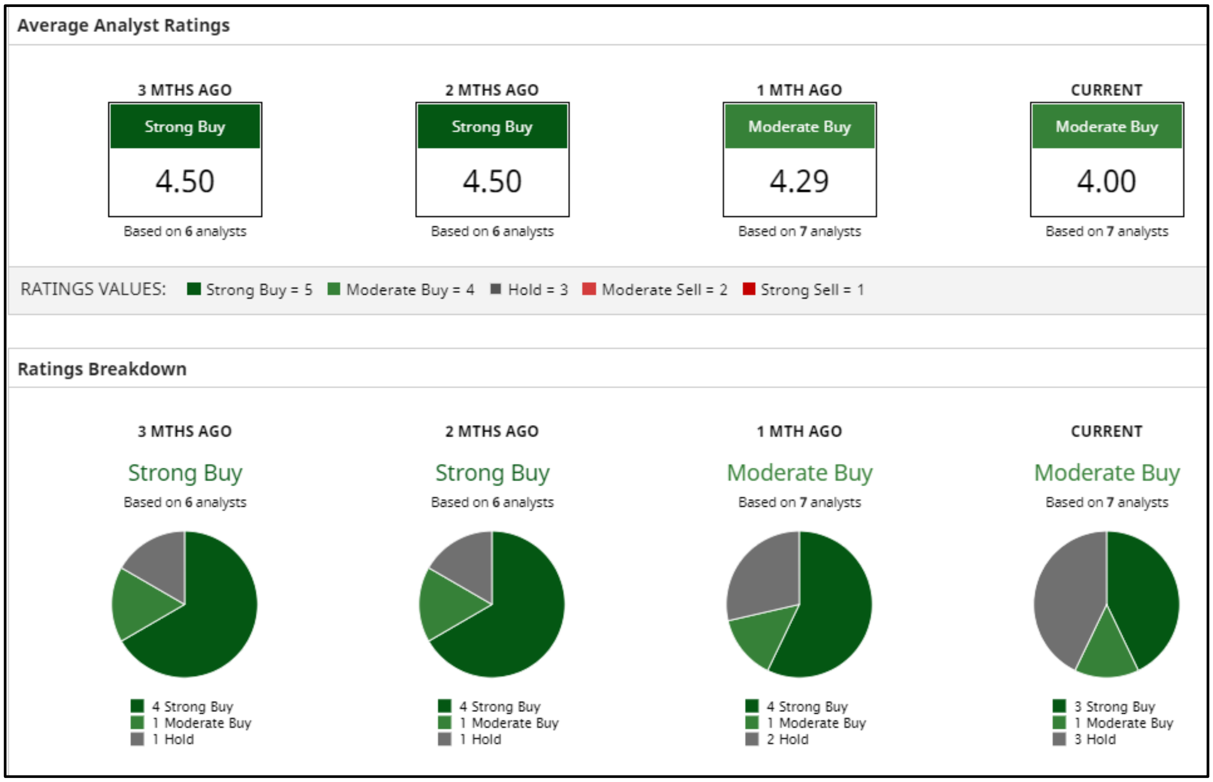
Bulls Say

- Enbridge is the liquids-focused version of gas-oriented Williams in terms of an attractive, highly regulated utility-like earnings profile.
- Enbridge offers a highly secure dividend that can increase 3% annually for the foreseeable future.
- The cancelation of Keystone XL puts Enbridge in a leading position to capture new organic pipeline expansions to serve the unmet need from producers.

Bears Say

- Due to its size and profile, Enbridge is a lightning rod for ESG-related legal and stakeholder challenges across its assets, including Line 3, 5, and it even has a small stake in the troubled Dakota Access Pipeline.
- Enbridge's pipelines carry substantial amounts of oil produced in the Canadian oil sands, one of the least environmentally friendly sources of production.
- Enbridge has yet to build a moaty renewables business, risking its capital investment here over the next few years.





Crude Oil vs. Energy Companies (Feb 11, 2022)

DIVIDEND

Enbridge Inc (TSX : ENB)					
Year	**Declaration Date**	**Ex-Dividend Date**	**Record Date**	**Payable Date**	**Dividend $ Amount**
2022	Dec 06, 2021	Feb 14, 2022	Feb 15, 2022	Mar 01, 2022	0.8600
2022 Total:					**0.8600**
2021	Nov 03, 2021	Nov 12, 2021	Nov 15, 2021	Dec 01, 2021	0.8350
2021	Jul 27, 2021	Aug 12, 2021	Aug 13, 2021	Sep 01, 2021	0.8350
2021	May 05, 2021	May 13, 2021	May 14, 2021	Jun 01, 2021	0.8350
2021	Dec 07, 2020	Feb 11, 2021	Feb 12, 2021	Mar 01, 2021	0.8350
2021 Total:					**3.3400**
2020	Nov 04, 2020	Nov 12, 2020	Nov 13, 2020	Dec 01, 2020	0.8100
2020	Jul 22, 2020	Aug 13, 2020	Aug 14, 2020	Sep 01, 2020	0.8100
2020	May 05, 2020	May 14, 2020	May 15, 2020	Jun 01, 2020	0.8100
2020	Dec 09, 2019	Feb 13, 2020	Feb 14, 2020	Mar 01, 2020	0.8100
2020 Total:					**3.2400**
2019	Nov 06, 2019	Nov 14, 2019	Nov 15, 2019	Dec 01, 2019	0.7380
2019	Aug 01, 2019	Aug 14, 2019	Aug 15, 2019	Sep 01, 2019	0.7380
2019	Apr 23, 2019	May 14, 2019	May 15, 2019	Jun 01, 2019	0.7380
2019	Dec 11, 2018	Feb 14, 2019	Feb 15, 2019	Mar 01, 2019	0.7380
2019 Total:					**2.9520**
2018	Nov 02, 2018	Nov 14, 2018	Nov 15, 2018	Dec 01, 2018	0.6710
2018	Aug 02, 2018	Aug 14, 2018	Aug 15, 2018	Sep 01, 2018	0.6710
2018	Apr 24, 2018	May 14, 2018	May 15, 2018	Jun 01, 2018	0.6710
2018	Nov 29, 2017	Feb 14, 2018	Feb 15, 2018	Mar 01, 2018	0.6710
2018 Total:					**2.6840**

ENBRIDGE

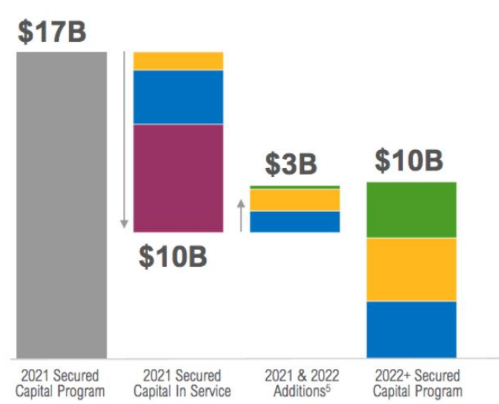
Secured Growth Outlook

	Project	Commercial Framework[1]	Expected ISD	Capital ($B)
Gas Transmission	Modernization Program	COS	2022-2025	2.2 USD
	Other Expansions	TOP	2022-2025	0.4 USD
Gas Distribution & Storage	Distribution System	COS	2022-2024	1.8 CAD
	Transmission/Storage Assets	COS	2022-2024	0.8 CAD
	New Connections/Expansions	COS	2022-2024	0.7 CAD
Renewable Power & New Energies	East-West Tie-Line	PPA	2022	0.2 CAD
	Solar Self-Powering	PPA	2022-2023	0.2 USD
	Saint-Nazaire Offshore[2]	PPA	Late 2022	0.9 CAD
	Fécamp Offshore[2]	PPA	2023	0.7 CAD
	Calvados Offshore[2]	PPA	2024	0.9 CAD
	Provence Grand Large	PPA	2023	0.1 CAD

Total 2022-2025 Secured Capital Program ~$10B[3]

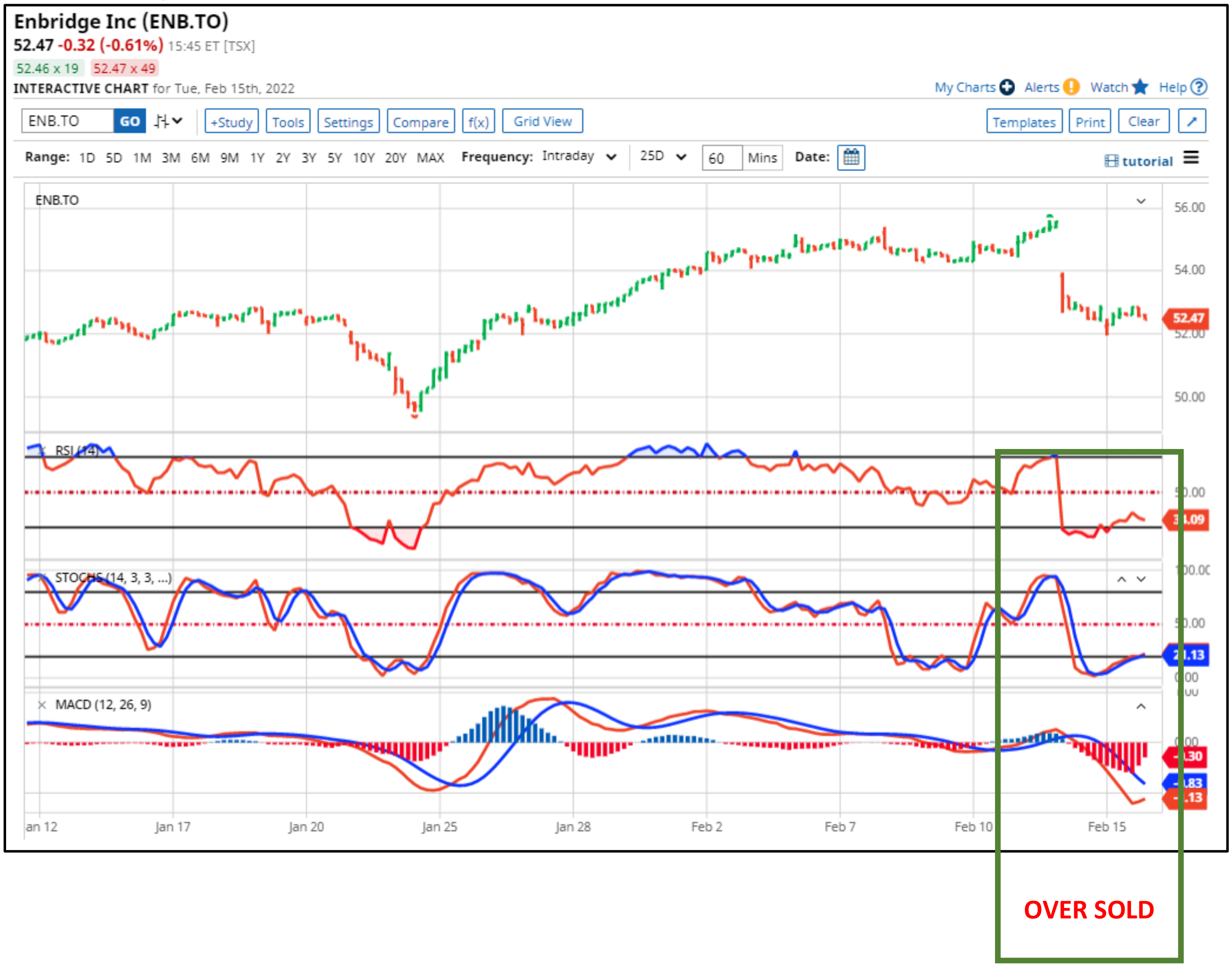
Capital Spent to Date ~$1B[4]

Executing on Secured Program



In conclusion, the company's results overall show the stability and reliability that we have come to expect from Enbridge. Although the company was not able to take full advantage of the surge in crude oil and natural gas prices that we have seen over the past year, it was still able to generate some growth. The company is also well-positioned to continue this growth trajectory over the coming few years in both its traditional and renewable businesses. The renewable business unfortunately is not particularly profitable despite the money that Enbridge is pouring into it but at least it is profitable, which is more than many companies will say. The strong cash flows also allowed the company to continue its track record of regular dividend increases, which any income-focused investor should be able to appreciate.

UPDATE: 25 Day 60M Feb 15, 2022



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