DSR PREMIUM NEWSLETTER

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This is your site and your exclusive newsletter. Please, feel free to share any ideas, opinions, comments, or suggestions with us via email at dividendustries@gmail.com.

APRIL 27th, 2023

Dear DSR member,

It is with great pleasure that we present our weekly premium newsletter which is an important component of your subscription to Dividend Stocks Rock.

You may benefit from viewing our video explaining the differences between the Buy List, our ratings, and our portfolio models. You can retrieve this information in the Videos section of the website.

Referral

Feel free to share our ideas with your friends or associates who may benefit from this information. **We would personally consider any referrals you make on our behalf to be the ultimate compliment for our efforts.**

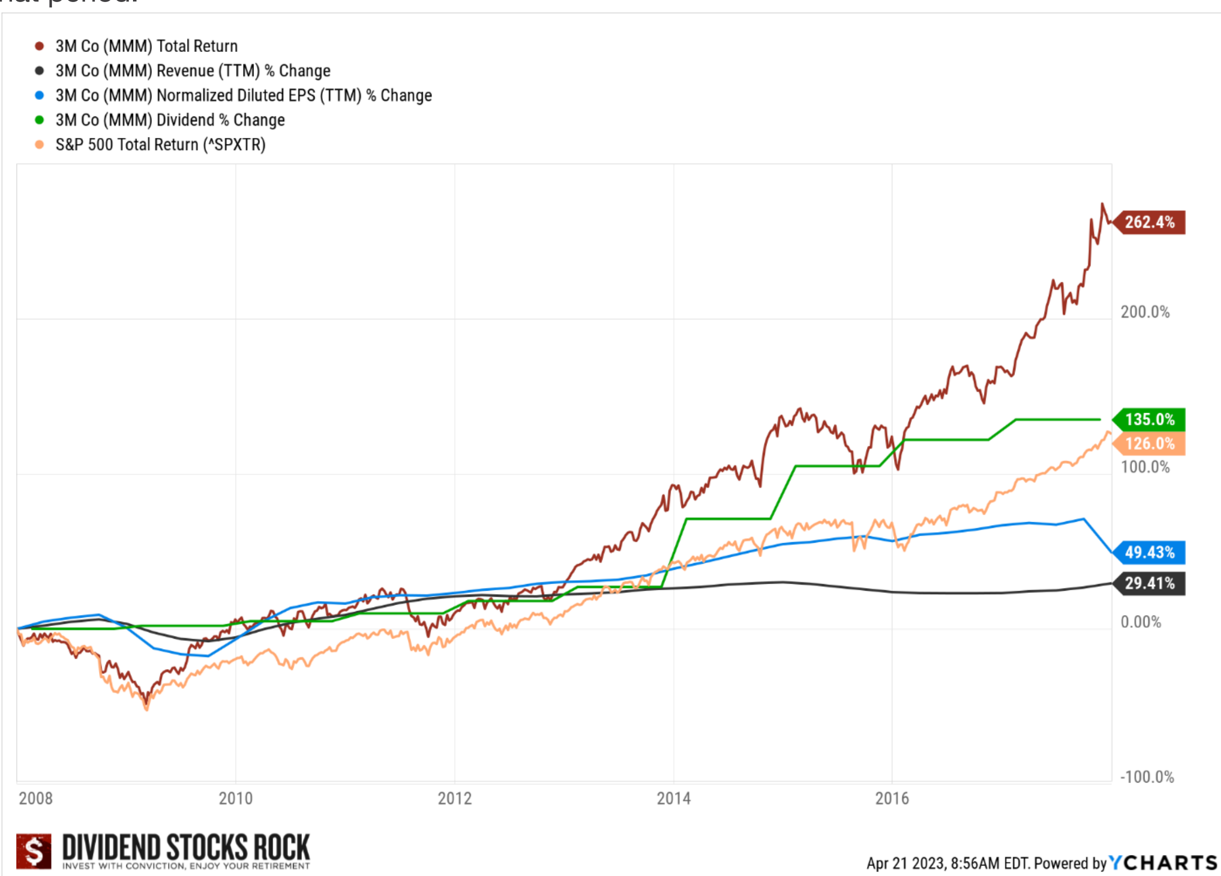
WHY I SOLD ENBRIDGE & TC ENERGY – A FULL REVIEW

For those of you who have been DSR members for a while, I probably have sounded like a broken record when I say, ***"Review your portfolios quarterly"***. I've discussed the importance of reviewing, taking mental notes, tweaking, and, on occasion, making a major shake-up in my portfolios.

The reason for following such a process is simple: **the world changes all the time.** Funny enough, I try to explain to my kids (they are 11, 15, and 17) that 20 years ago, I had a cd player and a flip phone. As the world changes, the economy evolves, and companies adapt.

> *"What was true 5 years ago could be a pile of baloney today."*

For investors, **it means that what was true about an economic context, or a company 5 years ago could be a pile of baloney today.** 3M Co. (MMM) was a darling in 2018. Between January 1st 2008 (before the financial crisis) and January 1st 2018, that stock generated a total return (capital appreciation + dividend) of +262.40% vs. the S&P 500 at +126%. The 3M stock presented a decent dividend triangle (considering its size) with revenue up 30%, EPS up 49%, and dividends up 135% during that period.



Would I have been able to convince you to sell MMM in 2018 after such a performance? Unfortunately, stats between January 1st, 2018, and 2023 aren't that great.

- Total return: -39.63%
- Revenue: +8.12%
- EPS: -15.31%
- Dividends: 9.56%

Selling in 2018 was the right move. That's easy to say when we look back and play Monday morning quarterback. In early 2023, we sold our shares of MMM in our DSR portfolio models. They were there before 2018 and we were able to sell at a small profit.

> *"Mike, why did you sell such a cash flow machine?"*

During that portfolio update, I also announced I sold shares of TC Energy (TRP.TO) and Enbridge (ENB.TO) across our portfolios. I had Enbridge in my personal portfolio as well. **I sold all my shares in Enbridge.** That triggered several emails from DSR members. Keep in mind that Enbridge and TC Energy are the 2nd and 8th most held stocks at DSR, respectively. Telling my members, I disliked two of their favorite securities isn't an easy thing and it requires a lot of conviction. While I explained my point of view when we updated the DSR portfolio models, I thought of sharing a larger piece of research with you.

This research on ENB and TRP isn't built to provide you with a buy or sell recommendation. I want to show you how I analyze specific items and the questions I ask myself as I dig further into a company's financial statement.

I hope to help you in your investing process by sharing my thoughts and reflections on two loved dividend growth stocks. The full review will include many key points:

- Why are they loved?
  - Total return, dividends, or both?
- Are their dividends safe?
  - Understanding their business models
  - Finding and understanding the right numbers
- Why sell Enbridge and TC Energy?
  - The burden of debt
  - ESG issues
- Why hold them?
  - Growth perspective
  - Cash flow generation

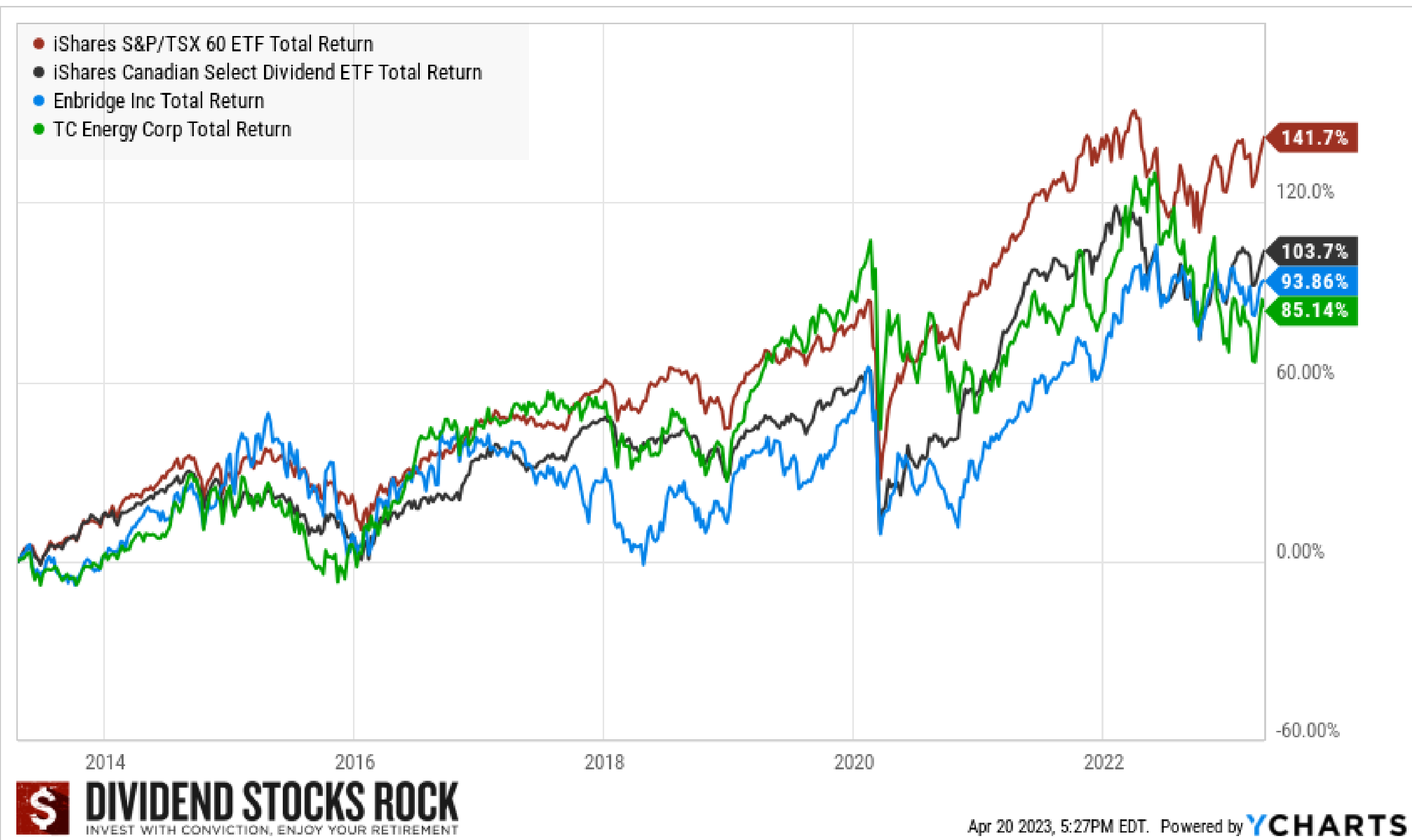
I hope you will enjoy this rational discussion of two widely held pipeline stocks.

WHY ARE THEY LOVED?

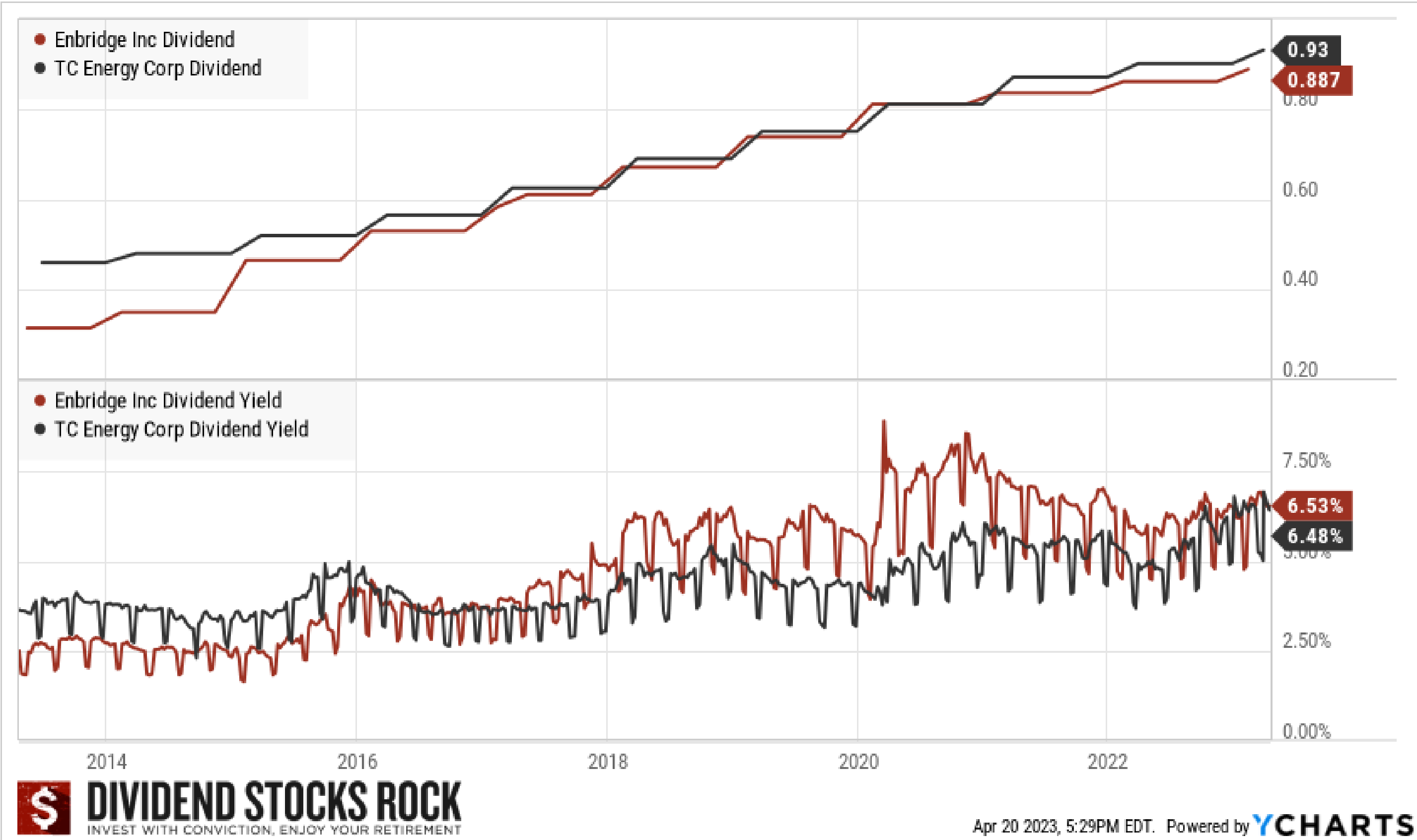
This newsletter is not about destroying or praising these companies. I'll have a bear case, but I'll also discuss the bull case at the end of this report. Both cases include good arguments, and we can all agree that Enbridge and TC Energy are incredibly popular among dividend investors.

I asked myself if that love was justified. I then looked at the past 10 years of history. The specific reason why I've picked 10 years was to see how both pipelines performed during a nearly perfect environment for them:

1. Growing economy supporting constant demand for oil & gas.
2. Low-interest rate benefitting capital-intensive business models such as pipelines.
3. Banks with accommodating credit underwriting processes (mostly a result of point #1 and #2).
4. Strong labor market offering qualified workers.
5. Smaller ESG (Environmental, Social, and Governance) issues and concerns.



As you can see, the TSX 60 (XIU.T) and an ETF with a dividend growth focus did better than the two pipelines. To be fair, the returns are quite similar and the TSX 60 benefited from the oil & gas exploration companies after 2020. In the end, most shareholders hold ENB and TRP for their dividend payout not for their total return.



Both pipelines' dividend profiles are quite impressive. In 2023, Enbridge will celebrate 28 years of consecutive dividend increases while TC Energy is not far behind with 23 years. On top of paying a generous yield, they are part of the top 15 Canadian stocks with the longest dividend growth streaks. As I said, "quite impressive".

> *"Will what happened in the past 20 years continue to be true in the next*

While both operate in the energy sector, the nature of their business makes them look a lot more like utility businesses. Pipelines are constructed and maintained to supply a specific demand. We need oil & gas and pipelines are a key element in transporting those precious liquids from their point of extraction all the way through their transformation and distribution points. Since we don't build pipelines for fun (they are heavily regulated), barriers to entry are considerable. Finally, pipelines enjoy long-term contracts with their customers that are usually protected by inflation (escalator clauses) and include a "take of pay" clause. In other words, no matter what happens, customers must pay a minimal fee to reserve their place in the pipelines even if they don't use it. There are no doubts that pipelines are currently essential elements of the infrastructure for our economy. ENB and TRP are the largest and most established pipelines in Canada. They are truly cash-flow generators, and this is why so many investors hold them. Will what happened over the past 20 years continue to be true over the next decades? Since many shareholders are in for the dividend, let's tackle the elephant in the room.

IS THE DIVIDEND SAFE?

ENB and TRP have a similar trajectory when it comes to paying dividends. They were quite generous a few years ago, but we now feel the party has calmed down. ENB increased its dividend by 10% yearly for a few years before slowing down to 3%/year starting in 2021. TRP was more in the 7-8% dividend increase range until it cooled off the market with a lower target rate. On their website, they target a 3% to 5% increase, but the latest two increases are closer to 3% (3.4% and 3.3%).

When you see companies slowing down their dividend growth rate, but their average yield goes up, it tells you the stock price is declining. This is what we have observed since the end of 2020. That red flag would probably push you to look at their payout ratio. Here they are:

Enbridge: Payout ratio of 271%, cash payout ratio of 115%.

TC Energy: Payout ratio of 560%, cash payout ratio of 697%.

Stop the presses! Those payout ratios are ridiculous, and the dividends will no doubt be cut!

Not so fast. If companies continue to hike their distribution, there must be an explanation, right?

Understanding the business

When you see numbers that don't make sense, don't be so quick to discard a stock. Start digging and asking questions instead. When I see crazy payout ratios like this, I automatically look at the financial statements to understand how the company is making money and if it can continue to pay its shareholders. I see the dividend like any other debt: the company must be able to afford the dividend payment. As opposed to debt, however, the dividend is easier to cut if you run into bad times. Shareholders will be upset, but the business will continue to run.

As mentioned earlier, pipelines are capital-intensive businesses. It means they require large sums of money to invest in the construction and maintenance of those pipelines. You can expect them to cover all angles and make sure the liquids they transport will not end up in a lake (even if it sometimes happens).

The payout ratio is based on earnings. Earnings are calculated based on GAAP (generally accepted accounting principles). Those principles include “non-cash items”. The non-cash items are numbers that will affect the earnings calculation, but that have no impact on the company's bank account. Think about how your house value would affect your net worth, but not how much you have in your bank account to pay your mortgage at the end of the month.

To illustrate the impact of those non-cash items, I've highlighted a few of them in Enbridge's 2022 Q4 financial statements.

Year ended December 31,	2022	2021	2020
(millions of Canadian dollars)			
Operating activities			
Earnings	**2,938**	6,314	3,416
Adjustments to reconcile earnings to net cash provided by operating activities:			
Depreciation and amortization	**4,317**	3,852	3,712
Deferred income tax expense *(Note 25)*	**957**	1,091	447
Unrealized derivative fair value (gain)/loss, net *(Note 24)*	**1,280**	(173)	(756)
Income from equity investments *(Note 13)*	**(2,056)**	(1,711)	(1,136)
Distributions from equity investments	**1,827**	1,630	1,392
Impairment of long-lived assets	**541**	—	—
Impairment of equity investments *(Note 13)*	**—**	111	2,351
Impairment of goodwill *(Note 16)*	**2,465**	—	—
Gain on joint venture merger transaction *(Note 13)*	**(1,076)**	—	—
(Gain)/loss on dispositions	**12**	(319)	(6)
Other	**37**	(73)	268
Changes in operating assets and liabilities *(Note 29)*	**(12)**	(1,466)	93
Net cash provided by operating activities	**11,230**	9,256	9,781

Source: ENB 2022 Q4 Financial MDA page 9

As you can see, we start with earnings at nearly $3B, but we end with more than $11B in net cash provided by operating activities. Items such as depreciation, amortization and impairments will impact earnings, but will have no impact on the company's ability to pay dividends.

Some investors will then look at the cash payout ratio. It offers a closer look at the company's bank account and ability to pay the dividend. Unfortunately, the amount of capital expenditures (money used to fund projects and other investments) is deducted from the cash flow. Therefore, we look at the cash generated by the business, we take out the cash invested in new projects, and we then can see what is remaining to pay dividends.

Many capital-intensive businesses will do a different calculation: they will look at the profitability of their future investments and will raise debt to fund them. In other words, they will borrow money at 6% if they believe that investment will generate a return of 12% per year in the future.

On the following page, you can identify more than $4.6B that went into capital expenditure in Enbridge's statement (you find this information in the cash flow statement). Under "financial activities", you will also see the total dividend payment (roughly $7B for 2022) while the company issued $7.5B in new debt. After a quick look, one may think Enbridge is financing its dividend by securing more debt.

This is half true, and half false. It is true that ENB can't afford its capital expenditure + pay a dividend with its current balance sheet. It must raise debt to finance its activities and ensure enough liquidity to be distributed to shareholders.

However, the company does that because it believes in the future return that will be generated by the capital expenditure. If those investments were simply to maintain the business and not generate additional revenue, they would have a serious problem.

Investing activities			
Capital expenditures	**(4,647)**	(7,818)	(5,405)
Long-term investments and restricted long-term investments	**(1,041)**	(640)	(487)
Distributions from equity investments in excess of cumulative earnings	**763**	533	705
Additions to intangible assets	**(174)**	(275)	(215)
Acquisitions	**(828)**	(3,785)	(24)
Proceeds from joint venture merger transaction *(Note 13)*	**522**	—	—
Proceeds from dispositions	**—**	1,263	265
Affiliate loans, net	**135**	65	(16)
Net cash used in investing activities	**(5,270)**	(10,657)	(5,177)
Financing activities			
Net change in short-term borrowings	**481**	394	223
Net change in commercial paper and credit facility draws	**(1,333)**	2,960	1,542
Debenture and term note issues, net of issue costs	**7,547**	8,032	5,230
Debenture and term note repayments	**(4,198)**	(2,264)	(4,463)
Sale of noncontrolling interest in subsidiary *(Note 8)*	**1,092**	—	—
Contributions from noncontrolling interests	**13**	15	23
Distributions to noncontrolling interests	**(259)**	(271)	(300)
Common shares issued	**3**	5	5
Common shares repurchased	**(151)**	—	—
Preference share dividends	**(338)**	(367)	(380)
Common share dividends	**(6,968)**	(6,766)	(6,560)
Redemption of preference shares	**(1,003)**	—	—
Redemption of preferred shares held by subsidiary	**—**	(415)	—
Other	**(314)**	(87)	(90)
Net cash provided by/(used in) financing activities	**(5,428)**	1,236	(4,770)

Source: ENB 2022 Q4 Financial MDA

To determine if ENB and TRP can afford to pay their dividends going forward, we must look at the distributable cash per share. On the next page, you will see how Enbridge adjusts its EBIDTA and does more calculations to arrive at the distributable cash per share.

You can see that this includes non-standard (read NON-GAAP) calculations. If you don't feel comfortable with such math, then you get the indication that Enbridge or TC energy may not be a good fit for your portfolio. It's crucial to understand the nature of the business of the companies you choose for your portfolio.

The distributable cash flow (DCF) for 2022 is $10,983M (That's close to the net cash provided by operating activities we saw on the previous page of this newsletter). The DCF per share (which would be seen as the equivalent of the earnings per share (EPS)) is $5.42 for the year.

Considering Enbridge paid $3.44 in dividends, that leads to a DCF payout ratio of 63.47%. Therefore, it's fair to say that ENB can afford to make the dividend payment based on the cash generated by its activities. However, that is also assuming the company can continue to either borrow money to finance new projects or eventually slowdown its capital expenditures to start paying back that debt.

2022 Financial Results

	Q4		YTD	
($ Millions, except per share amounts)	**2022**	2021	**2022**	2021
Liquids Pipelines	2,327	2,108	8,908	7,731
Gas Transmission & Midstream	1,117	922	4,417	3,850
Gas Distribution & Storage	467	450	1,856	1,853
Renewable Power Generation	122	140	522	496
Energy Services	(62)	(83)	(364)	(360)
Eliminations and Other	(60)	150	192	431
Adjusted EBITDA[1]	**3,911**	**3,687**	**15,531**	**14,001**
Cash distributions in excess of equity earnings	254	65	407	313
Maintenance capital	(354)	(274)	(820)	(686)
Financing costs	(969)	(840)	(3,580)	(3,091)
Current income tax	(204)	(142)	(595)	(352)
Distributions to Noncontrolling Interests	(75)	(64)	(259)	(271)
Other	100	55	299	127
Distributable Cash Flow[1]	**2,663**	**2,487**	**10,983**	**10,041**
DCF per share[1]	**1.31**	**1.23**	**5.42**	**4.96**
Adjusted earnings per share[1]	**0.63**	**0.68**	**2.81**	**2.74**

Source: Q4 2022 ENB presentation

For TC Energy, we get into the same carousel of adjustments. If you look at the net income per share for 2022 you get $0.64 (vs. a dividend payment of $3.60). You don't need to be a math genius to see that it doesn't add up. Remember, the payout ratio for TC Energy at the time of the writing of this newsletter was 560%!

However, if you look at the table on the next page, you will see that TRP provides what they call their "comparable EPS". It states its non-standard calculation (non-GAAP) but provides a better picture of the company's real ability to pay its dividend. The Comparable EPS is $4.30 for the year (up by 1% vs 2021).

Considering a $3.60 dividend, the payout ratio is 83.72%. Interestingly, while many may think ENB's debt is too high and its dividend is at greater risk, it looks like TC Energy shows the "weaker" dividend profile for 2023.

($ millions except where indicated)	2022	2021	2020	2019	2018
Net income attributable to common shares	641	1,815	4,457	3,976	3,539
Net income per common share (Basic - dollars)	0.64	1.87	4.74	4.28	3.92
Segmented earnings	3,632	4,059	6,773	6,585	5,764
Net cash provided by operations	6,375	6,890	7,058	7,082	6,555
Comparable earnings (1)	4,279	4,142	3,939	3,851	3,480
Comparable earnings per common share (1) (dollars)	4.30	4.26	4.19	4.14	3.86
Comparable EBITDA (1)	9,901	9,368	9,342	9,366	8,563
Comparable funds generated from operations (1)	7,353	7,406	7,385	7,117	6,522
Capital spending (2)	8,961	7,134	8,900	8,784	10,929

(1) Comparable earnings, comparable earnings per common share, comparable EBITDA and comparable funds generated from operations are non-GAAP measures. These measures do not have any standardized meaning under U.S. GAAP and therefore are unlikely to be comparable to similar measures presented by other companies.

Source: TC Energy Investor Fact Sheet

Conclusion: the dividend is safe but…

Now that you understand how pipelines can afford to pay dividends with triple-digit payout ratios, you can track those results quarterly and ensure the dividend is safe. Both pipelines can afford to pay their dividends, but it doesn't mean everything is perfect and rosy in pipeline land. **The dividend safety score should be revised quarterly with great attention.** There is a bear case for both ENB and TRP.

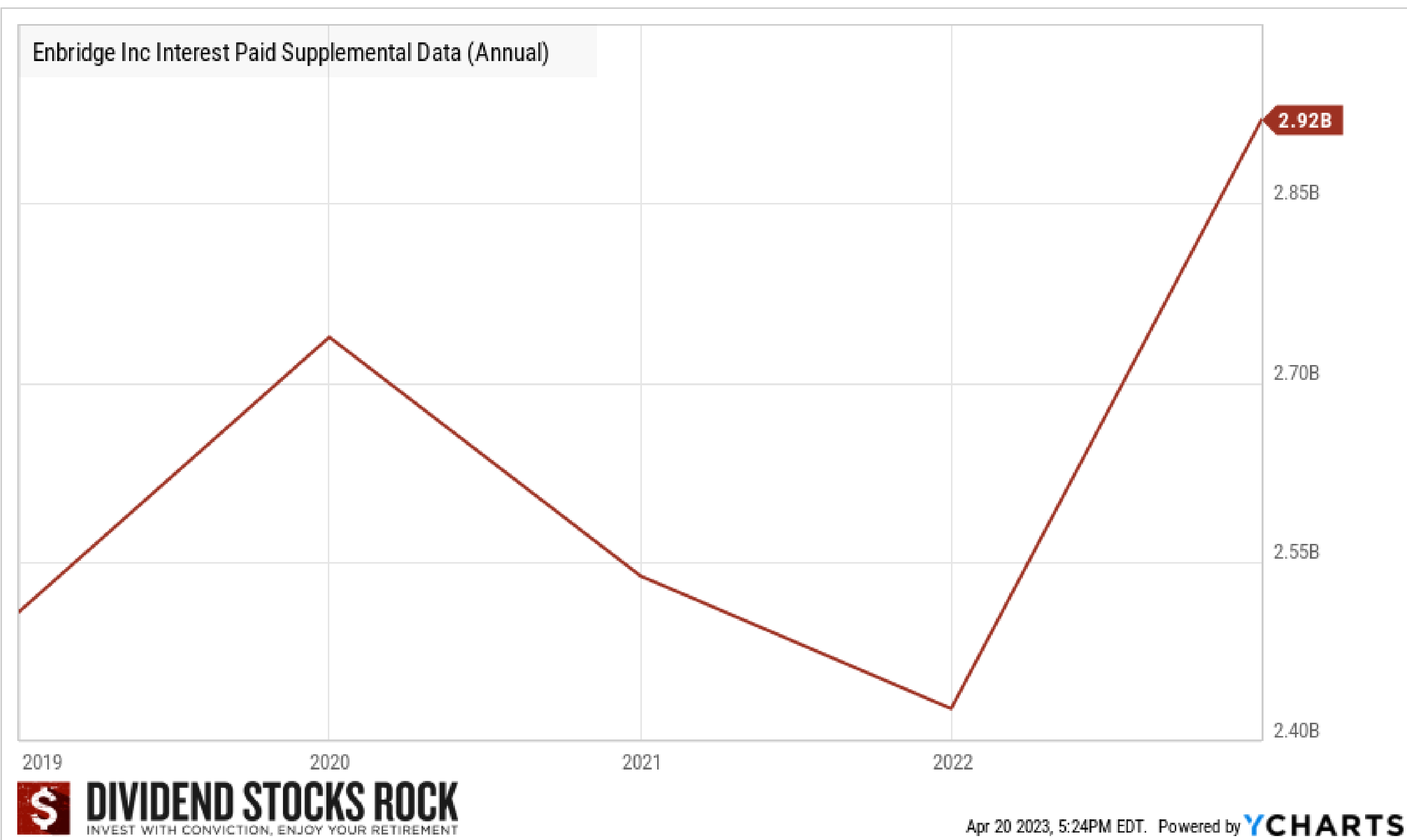
WHY SELL ENBRIDGE & TC ENERGY

I want to restate what I mentioned in my introduction: I'm not telling you to sell your shares of ENB or TRP. I'm simply offering my point of view on two dividend growers. The reason why I sold my shares of ENB is simple: I see many clouds gathering and I see little in the way of growth rays of sunlight shining through those clouds.

In other words: besides enjoying a generous dividend, I don't see how ENB will make me richer over the coming years. Since my strategy is focused on total returns by selecting dividend growers, Enbridge does not meet my investing strategy. It will only provide dividends, and it will eventually become a burden. I just wrote that the company could afford the promise made to shareholders, but it doesn't mean it will always be that way.

Interest rate

There are no surprises here: interest rates are higher today. But the real question is ***"what is the impact of higher interest rates on pipelines like Enbridge and TC Energy?".*** We'll talk about the debt situation later, but let's first tackle the interest paid by those companies.



We can see how ENB's interest bill has increased of late. Now, let's look at the debt operations in 2022:

LONG-TERM DEBT ISSUANCES

During the year ended December 31, 2022, we completed the following long-term debt issuances totaling US$3.2 billion and $3.4 billion:

Company	Issue Date			Principal Amount
(millions of Canadian dollars unless otherwise stated)				
Enbridge Inc.				
	January 2022	5.00%	fixed-to-fixed subordinated notes due January 2082[1]	$750
	February 2022	Floating rate senior notes due February 2024[2]		US$600
	February 2022	2.15%	senior notes due February 2024	US$400
	February 2022	2.50%	senior notes due February 2025	US$500
	September 2022	7.38%	fixed-to-fixed subordinated notes due January 2083[3]	US$500
	September 2022	7.63%	fixed-to-fixed subordinated notes due January 2083[4]	US$600
	November 2022	5.70%	medium-term notes due November 2027	$600
	November 2022	6.10%	sustainability-linked medium-term notes due November 2032[5]	$900
	November 2022	6.51%	medium-term notes due November 2052	$500
Enbridge Gas Inc.				
	August 2022	4.15%	medium-term notes due August 2032	$325
	August 2022	4.55%	medium-term notes due August 2052	$325
Texas Eastern Transmission LP				
	December 2022	6.20%	senior notes due December 2032	US$600

Source: ENB 2022 Q4 Financial MDA

ENB issued various debt types with different terms and interest rates. As you can see, debt issued in September and November came with steep interest rates (5.70% to 7.63%). At the same time, some debt came to maturity and was repaid:

LONG-TERM DEBT REPAYMENTS

During the year ended December 31, 2022, we completed the following long-term debt repayments totaling $1.5 billion and US$2.0 billion, respectively:

Company	Repayment Date			Principal Amount
(millions of Canadian dollars, unless otherwise stated)				
Enbridge Inc.				
	February 2022	Floating rate notes[1]		US$750
	February 2022	4.85%	medium-term notes	$200
	July 2022	2.90%	senior notes	US$700
	December 2022	3.19%	medium-term notes	$350
	December 2022	3.19%	medium-term notes	$450
Enbridge Gas Inc.				
	April 2022	4.85%	medium-term notes	$125
Enbridge Pipelines (Southern Lights) L.L.C.				
	June and December 2022	3.98%	senior notes	US$72
Enbridge Pipelines Inc.				
	November 2022	2.93%	medium-term notes	$150
Enbridge Southern Lights LP				
	June and December 2022	4.01%	senior notes	$18
Texas Eastern Transmission, LP				
	October 2022	2.80%	senior notes	US$500
Westcoast Energy Inc.				
	December 2022	3.12%	medium-term notes	$250

Source: ENB 2022 Q4 Financial MDA

What bugs me is that they repaid debt at 2%, 3%, 4% while they issued debt at 5%, 6%, 7%. Let's see the end results of the debt situation:

Long-term debt	**72,939**	67,961

We see a long-term debt increase of 7.32% ($72.9B / $67.9B) and a total debt increase of 10% (page 10 of the same document). But we see an interest expense increase of 19.74% (from $2.66B to $3.18B). Again, you don't need an accounting degree and 5 more hours to dive into the company's financial statements to guess how the debt situation will become even more burdensome in 2023 and possibly for a few more years.

INTEREST EXPENSE

Year ended December 31,	2022	2021	2020
(millions of Canadian dollars)			
Debentures and term notes	**2,910**	2,806	2,873
Commercial paper and credit facility draws	**388**	114	163
Amortization of fair value adjustment	**(45)**	(50)	(54)
Capitalized interest	**(74)**	(215)	(192)
	3,179	2,655	2,790

I've done the same exercise digging into TRP's financial statement.

Long-term debt issued

The following table outlines significant long-term debt issuances in 2022.

Company	Issue date	Type	Maturity date	Amount	Interest rate
(millions of Canadian $, unless otherwise noted)					
TRANSCANADA PIPELINES LIMITED					
	May 2022	Medium Term Notes	May 2032	800	5.33%
	May 2022	Medium Term Notes	May 2026	400	4.35%
	May 2022	Medium Term Notes	May 2052	300	5.92%
ANR PIPELINE COMPANY					
	May 2022	Senior Unsecured Notes	May 2032	US 300	3.43%
	May 2022	Senior Unsecured Notes	May 2034	US 200	3.58%
	May 2022	Senior Unsecured Notes	May 2037	US 200	3.73%
	May 2022	Senior Unsecured Notes	May 2029	US 100	3.26%

Long-term debt retired

The following table outlines significant long-term debt retired in 2022.

Company	Retirement date	Type	Amount	Interest rate
(millions of Canadian $, unless otherwise noted)				
TRANSCANADA PIPELINES LIMITED				
	August 2022	Senior Unsecured Notes	US 1,000	2.50%

Source: TRP 2022 annual report

No surprise again as TC energy issued debt at 3%, 4%, and 5% and then paid debt off at 2.5%. Please note that TRP got "lucky" and issued debt in May of 2022, before the interest rate hikes that happened later in 2022. It's fair to think the interest rate situation will be similar in 2023 for TRP.

Interest expense

year ended December 31 (millions of $)	2022	2021	2020
Interest on long-term debt and junior subordinated notes			
Canadian dollar-denominated	**(776)**	(712)	(685)
U.S. dollar-denominated	**(1,267)**	(1,259)	(1,302)
Foreign exchange impact	**(383)**	(320)	(446)
	(2,426)	(2,291)	(2,433)
Other interest and amortization expense	**(189)**	(85)	(89)
Capitalized interest	**27**	22	294
Interest expense included in comparable earnings	**(2,588)**	(2,354)	(2,228)
Specific item:			
Keystone XL preservation and other	**—**	(6)	—
Interest expense	**(2,588)**	(2,360)	(2,228)

Source: TRP 2022 annual report

We can also see how interest payments increased by 10% (from $2.36B to $2.59B). TC energy debt structure (long-term debt + junior subordinated debt) went from $47.5B to $52B (+9.4%). The interest payments have increased at the same pace as the company's debt. This is a little surprising, but it's likely due to the timing of the debt issuance. Management discusses how the higher cost of debt affected earnings in 2022:

> increased Interest expense primarily due to higher interest rates on increased levels of short-term borrowings, long-term debt and junior subordinated note issuances, net of maturities, as well as the foreign exchange impact of a stronger U.S. dollar in 2022

We now know interest payments will continue to increase for the next few years. The FED and the Central Bank of Canada will continue their fight against inflation and have clearly stated they do not expect interest rates to decrease during 2023. The economic environment can change rapidly but thinking that interest rates will go back to 2018-2019 levels is like believing in unicorns. Therefore, each year that goes by will increase the interest payments (and we don't even talk about debt repayment here!).

All this interest payment talk leads to a larger issue, the debt situation.

The Debt situation

Each pipeline will do its best to convince you their balance sheet is robust. Enbridge will tell you that 80% of their EBIDTA is protected by contracts including inflation clauses. It will also tell you it enjoys a strong BBB+ credit rating (keep in mind Algonquin (AQN) has a BBB credit rating) and that 95% of their customers are investment grade. TC Energy will tell you that 85% of their debt is fixed and has an average term of 20 years. TRP is also showing a BBB+ credit rating.

While the debt to EBIDTA ratio is above 6 for both pipelines, they expect to reduce it to around 4.7 (ENB) and 4.75 (TRP) over the coming years. In the meantime, they seem heavily leveraged. Both management teams have revised their dividend growth policy accordingly (going down to 3%). This is a sign of prudent management, but it's also a sign that strong growth isn't expected soon. There are actually a few more headwinds coming their way…

Higher Carbon Tax

Regardless of if you believe in ESG investing or not, there is a real impact on your portfolio. Canadian carbon emissions taxes are expected to increase to $170 a ton by 2030 from $40 today. Enbridge is already on board to reduce its emissions, but this obviously requires capital to be invested.

Enbridge recently entered a $1 billion sustainability-linked credit facility and $1 billion bond, which links its ESG performance to borrowing costs. This has undoubtedly increased the cost of capital for new pipeline efforts as Enbridge acknowledges.

As for TRP, they face more headwinds as those taxes make hydrogen a viable alternative to gas-powered electricity generation by 2030 in Canada. We have seen several investment announcements by Air Products & Chemicals (APD)!) regarding hydrogen plants. Hydrogen costs are declining as investments increase, presenting an emerging threat.

TC Energy recently introduced targets to reduce its Scope 1 and 2 intensities by 30% no later than 2030 and reach net zero by 2050. Again, it will add up to additional capital expenditures.

Lack of growth vectors

On top of debt and taxes, another headwind is rising against pipelines: the difficulties around the construction of new pipelines.

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. They are reviewed and approved by regulators only when there is an economic need. With all the new regulations around carbon emissions, you can expect new constructions to take more time and cost more.

To illustrate such impacts, Enbridge recently wrote off $2.5B of goodwill against its gas transmission unit. The impairment was related to “higher interest rates and weaker projected long-term growth for the unit”.

TRP’s Coastal GasLink project is also expected to cost a lot more. The cost revision already went from $6.6B to $14.5B in 2022. In the most recent quarter, TRP had to take a $2.6B after-tax impairment charge for the quarter due to higher costs. That is without talking about Phase 2 that will be required to generate significant returns on this project. The increase in costs to build those pipelines are attributed to inflation and supply chain challenges, floods, terrain issues, and higher water disposal costs, among other items.

Finally, while ENB will face weaker growth, the Trans Mountain Pipeline expansion (also known as TMX) will be in operation in 2024-205. This new pipeline is expected to impact ENB’s Mainline volume by 5%-6%.

While both pipelines show a solid profile, I sold my shares mostly due to the lack of growth potential. They are facing many headwinds (interest rates, debt, carbon tax and higher costs) which make me want to look elsewhere to invest my hard-earned capital.

WHY HOLD ENBRIDGE & TC ENERGY

Now that I've been hitting the nail of my bear thesis for several pages, I will still leave you with a positive note. I wouldn't say there is a "bull case" for ENB and TRP, but I would agree there is a "hold case" for those beloved pipelines.

Strong business model

ENB and TRP are quite similar and quite different at the same time. Both business models show similar strengths.

About 75% of TC Energy's EBITDA is from natural gas pipelines across the U.S., Canada, and Mexico. It transports over 25% of the continent's daily gas needs.

Enbridge's Mainline system controls over 70% of Canada's oil resources and is linked to U.S. refineries. It transports 30% of North America's crude oil.

Pipelines are like railroads: they are not going anywhere, and they are essential.

Long-term contracts – long-term dividend growth policy

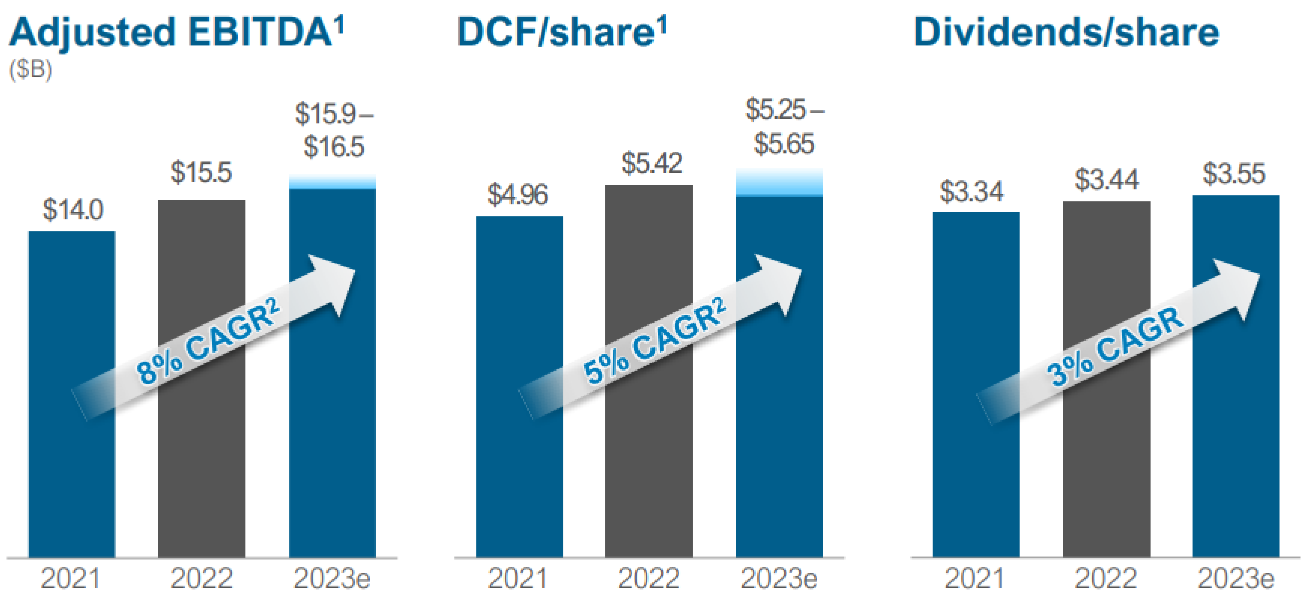
By its nature, pipelines enjoy robust contracts with their customers. As explained in my introduction, those contracts are usually shielded against inflation and includes a minimum fee (take or pay) to ensure the customer pays even if the pipeline is not used.

The nature of those contracts helps ENB and TRP to project more accurately their cash flows. While inflation and higher interest rates will continue to impact future projects, existing ones are generating constant cash flow. This is how ENB expects to generate EBITDA (8%), DCF/share (5%) and dividend growth (3%) in 2023.

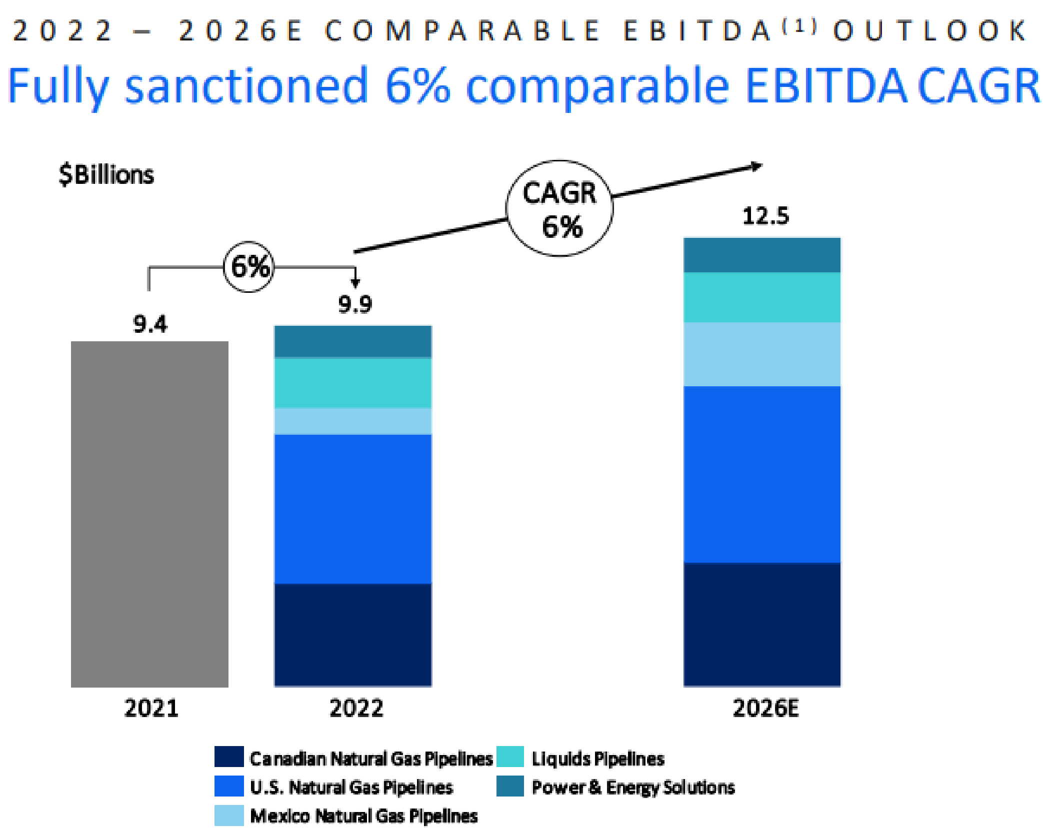
ENB has successfully increased its dividend for 28 consecutive years which is a record in the pipeline industry. The business model's resiliency has been tested over and over.

TRP projects a 6% EBIDTA growth through 2026 with a 3% to 5% dividend growth policy. The firm has maintained a consistent and prudent investment strategy for over two decades of investing 60% of its cash flow back into the business while paying out the remaining 40% to shareholders.

TRP has successfully increased its dividend for 23 consecutive years as of 2023 which is not that far behind ENB's record setting pace.



Source: Enbridge Q4 2022 Earnings Presentation



Source: TC Energy Q4 2022 presentation

Hold for stability and income.

While I continue to highlight that there is a big "if" around the dividend safety, I think it's fair to say both pipelines will continue to pay their dues for a while. The "hold thesis" is all about the stability of the cash flow generated by the existing projects.

CONCLUSION

I can't stress enough the importance of following pipelines with great attention quarterly. If you see more mentions of my bear case appearing in quarterly earnings (higher cost of debt, high debt ratio, impairments and charge offs due to delays and inflation, etc.), you'll know that the dividend safety is under pressure.

At this point, I can't qualify ENB or TRP as "screaming sell". Both companies will continue to provide an essential service and they will keep generating substantial cash flow. Their dividend is safe and both companies have proven they can navigate through challenging environment.

I expect the ENB and TRP stock prices to remain stable (e.g., small ups and downs, but limited capital appreciation) for a good while. Each quarter will bring more color, but I expect the main theme will remain higher interest rates, inflation, and limited growth for a while.

I hope this report will help you in your investment process and analysis of pipelines going forward. As usual, if you have any suggestions or questions regarding this analysis, I'm always only one email away!

Cheers,

Mike.

RATING CHANGES

This section communicates rating changes on the most popular stocks held at DSR. The changes mentioned below happened during this week upon our latest review.

NO RATING CHANGES

COMPANY	SYMBOL	PREVIOUS RATINGS (PRO/DIV)	NEW RATINGS (PRO/DIV)	COMMENT

OVERALL PORTFOLIO PERFORMANCE

Listed Returns are as of April 26th 2023:

Portfolios	Inception Date	Return	Benchmark	Added Value	Annualized Return	1 Y	YTD
CAD 25K	10/31/13	195.91%	115.49%	80.41%	12.00%	8.67%	11.00%
USD 25K	10/31/13	154.67%	156.72%	-2.05%	10.26%	-4.15%	0.64%
CAD 100K	10/31/13	126.38%	115.49%	10.89%	8.91%	3.94%	7.80%
USD 100K	10/31/13	187.72%	156.72%	31.00%	11.67%	0.07%	4.37%
USD 500K	05/31/14	102.27%	127.98%	-25.71%	8.23%	-0.29%	3.06%
CAD 500K	05/31/14	119.98%	89.54%	30.44%	9.25%	4.34%	5.98%
100% CAD	07/31/17	75.45%	48.41%	27.04%	10.45%	6.42%	9.84%
Retirement CAD	07/31/18	38.48%	37.41%	1.07%	7.11%	-6.45%	8.16%
Retirement USD	07/31/18	54.04%	54.99%	-0.95%	9.54%	-4.84%	0.85%

*Canadian portfolios added value is calculated based on 50% of VIG and 50% of XDV as half of portfolios are US stocks. Currency hasn't been taken into consideration.

Benchmarks are VIG and XDV.TO for all portfolios.