

# Inter Pipeline (IPPLF)

Updated May 22<sup>nd</sup>, 2020 by Kay Ng

## Key Metrics

<b>Current Price:</b>	\$9	<b>5 Year CAGR Estimate:</b>	15.8%	<b>Market Cap:</b>	\$3.6B
<b>Fair Value Price:</b>	\$14	<b>5 Year Growth Estimate:</b>	3.0%	<b>Ex-Dividend Date:</b>	05/22/20
<b>% Fair Value:</b>	63%	<b>5 Year Valuation Multiple Estimate:</b>	9.7%	<b>Dividend Payment Date:</b>	06/15/20
<b>Dividend Yield:</b>	4.0%	<b>5 Year Price Target</b>	\$16	<b>Years Of Dividend Growth:</b>	0
<b>Dividend Risk Score:</b>	D	<b>Retirement Suitability Score:</b>	B	<b>Last Dividend Increase<sup>1</sup>:</b>	-72%

## Overview & Current Events

Inter Pipeline is based in Calgary, Alberta in Canada and has traded publicly since 1997. Its energy infrastructure assets transport, process, and store energy products largely in Western Canada and at a much smaller scale in Europe. Inter Pipeline has paid a cash distribution since 1997. It trades on the Toronto Stock Exchange with the ticker TSX:IPL. It also trades over-the-counter in the U.S. under the ticker IPPLF. All the figures in this report are in US\$ unless otherwise noted. Inter Pipeline operates in four segments. Its EBITDA diversification is roughly as follows: 55% Oil Sands Transportation, 20% Natural Gas Liquids Processing, 15% Conventional Oil Pipelines, and 10% Bulk Liquid Storage.

Inter Pipeline reported its Q1 2020 results on 5/07/20. During the quarter, Inter Pipeline generated revenue of C\$604 million, down 8% versus Q1 2019. Funds from operations (FFO) fell 2% to C\$207 million but was down 6% to C\$0.49 on a per-share basis as the share count rose. Pipeline volumes (including Oil Sands Transportation and Conventional Oil Pipelines) climbed 10% due to a 12% increase in Oil Sands Transportation volume. Natural Gas Liquids (NGLs) Processing volumes fell 3%, and Bulk Liquid Storage utilization rose to 95% compared to 78% a year ago. The drag on FFO was predominantly attributable to NGL processing FFO falling 36% year over year (YOY) due to lower commodity prices but was partially offset by growing FFO from bulk liquid storage. Adjusted EBITDA fell 1%. The payout ratio was 87% in Q1. However, at the end of the quarter, the company announced a dividend cut of 72% and reduced compensation of management and the board of directors, which allow it to better fund its capital program that largely consists of the Heartland Petrochemical Project (HPC). Simultaneously, Inter Pipeline suspended the sale of its European Bulk Liquid Storage operations, which is good as demand for energy storage is high right now. Inter Pipeline also revealed a 14% cost increase in the HPC project from the original estimate of C\$3.5 billion to C\$4 billion due to incremental commission and start-up costs, COVID-19 impacts, a revised design and construction of the polypropylene plant and propane dehydrogenation facility, and incremental interest during construction. It has also been seeking a partner to share the risk and reward of the HPC project. The company estimates 2020 adjusted EBITDA of C\$780 to \$810 million. Based on the midpoint, that'd be a 24% drop YOY. The EBITDA change isn't a direct translation to FFOPS change, though. So, for now, we estimate a 20% drop in FFOPS. The lower dividend per share is C\$0.48 (US\$0.34) on an annualized basis. Below, the 2020 DPS is US\$0.56 because Inter Pipeline announced the dividend cut beginning for the dividend payable in May.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>FFOPS</b>	\$1.29	\$1.50	\$1.62	\$1.55	\$1.55	\$1.73	\$1.84	\$2.06	\$2.10	\$1.60	<b>\$1.28</b>	<b>\$1.58</b>
<b>DPS</b>	\$0.90	\$0.95	\$1.06	\$1.11	\$1.16	\$1.11	\$1.17	\$1.27	\$1.26	\$1.29	<b>\$0.56</b>	<b>\$0.45</b>
<b>Shares<sup>1</sup></b>	258	264	275	307	326	336	368	380	404	419	<b>425</b>	<b>542</b>

Inter Pipeline uses a combination of debt and equity offerings to fund its growth. From 2010 to 2019, it increased its outstanding shares by 5.5% per year. The share count climbed 6.3% in 2018 due partly to the large investment in the HPC. The ever-higher share count is going to dampen FFOPS growth. Additionally, U.S. investors are also subject to foreign exchange risk from the fluctuations of the US\$ against the C\$. For example, from 2014 to 2019, in C\$, Inter Pipeline increased FFOPS by 3.8% per year, but translated to US\$, the rate was merely 0.6%.

1. Last Dividend Increase based in C\$. Shares in millions.

Disclosure: This analyst has no position in the security discussed in this research report and no plans to initiate one in the next 72 hours

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Lower energy prices were already a drag on FFO in 2019. Combined with the COVID-19 pandemic, lower energy demand will further weigh down FFO in 2020. The future should be brighter for Inter Pipeline. Energy demand will somewhat improve as COVID-19 subsides. Moreover, Inter Pipeline expects HCP to generate average EBITDA of C\$450-500 million per year when it comes into service by 2022.

## Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
P/FFO	9.9	11.0	13.1	14.9	17.5	12.6	10.5	10.5	8.5	9.9	6.7	10.0
Avg. Yld.	7.0%	5.8%	5.0%	4.8%	4.3%	5.1%	6.1%	5.9%	7.1%	8.2%	4.0%	2.9%

Inter Pipeline has traded at a wide valuation range since 2010 with the average P/FFO being about 11.8. We do not expect any material growth in cash flow through 2021 until the Heartland project comes online. Thereafter, we expect growth largely from the project, as such we think a fair 2025 P/FFO of about 10 makes sense to reflect a weaker outlook. The stock is undervalued for long-term investment.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

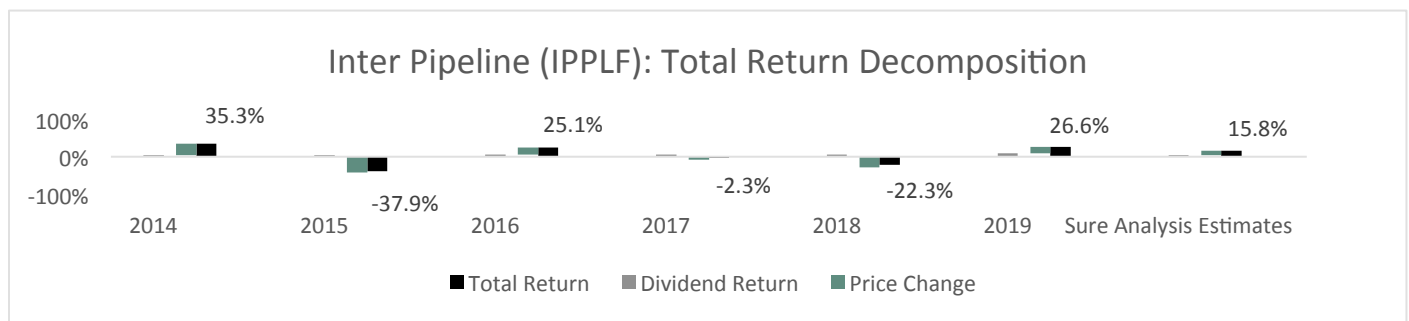
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	70%	63%	65%	72%	75%	64%	64%	62%	60%	81%	44%	29%

In the last recession and energy price collapse, Inter Pipeline's FFO stayed stable, which combined with a sustainable payout ratio, kept its dividend safe. The company has some advantages by having the core of its assets concentrated in Western Canada and keeping costs low that way. This allowed it to earn a high EBITDA margin of 48% in 2018; by Q1 2020, the EBITDA margin slipped to 42%. These weren't enough for Inter Pipeline to be resilient in this economic downturn, though. The company took on more debt to fund future growth, principally, the HCP. In 2019, it raised C\$1.45 billion of subordinate hybrid notes at 6.75%. Currently, the company maintains an investment-grade S&P credit rating of BBB-. We expect it to focus on completing HCP and reducing its debt levels before considering another big project. From 2010 to 2019, Inter Pipeline's payout ratio averaged 68%. Over the next few years, the company is going to be prudent on its dividend recovery, as much will depend on the stabilization of its FFO and the progress of HCP.

## Final Thoughts & Recommendation

Inter Pipeline is neither the highest-quality energy infrastructure company nor does it offer an attractive dividend at the moment. That said, it has price appreciation potential for longer-term investments with a holding period of at least three years. Over the next five years, we estimate total returns of 15.8% in the stock, coming from a current yield of 4.0%, FFO growth of 3.0%, and multiple expansion of 9.7%.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	967	1165	1206	1323	1410	1313	1378	1744	2001	1910
Gross Profit	414	783	843	898	914	973	980	1155	1269	1081
Gross Margin	42.9%	67.2%	69.9%	67.8%	64.8%	74.1%	71.1%	66.2%	63.4%	56.6%
SG&A Exp.	52	66	78	83	78	60	101	100	106	131
D&A Exp.	85	101	125	123	129	148	173	197	211	269
Operating Profit	278	428	464	140	503	625	591	688	753	524
Operating Margin	28.7%	36.7%	38.5%	10.6%	35.7%	47.6%	42.9%	39.5%	37.7%	27.5%
Net Profit	229	251	307	-56	303	335	340	406	457	406
Net Margin	23.7%	21.5%	25.5%	-4.3%	21.5%	25.5%	24.6%	23.3%	22.9%	21.3%
Free Cash Flow	14	312	1	-1437	-602	328	468	501	103	-567
Income Tax	6	81	89	84	104	147	114	143	166	-16

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	4715	4755	5712	7192	7449	6507	7529	8240	8415	9915
Cash & Equivalents	23	50	65	44	53	29	16	21	34	25
Accounts Receivable	129	107	148	231	135	132	168	195	178	247
Inventories						0	10	10	7	11
Goodwill & Int. Ass.	515	503	623	580	514	429	508	524	496	446
Total Liabilities	3387	3280	3950	4953	4973	4232	5165	5485	5504	6784
Accounts Payable	178	159	295	544	336	159	206	266	343	488
Long-Term Debt	2795	2603	3128	3703	3938	3483	4307	4322	4155	5081
Shareholder's Equity	1328	1391	1668	1972	2195	2033	2364	2755	2911	3131
D/E Ratio		1.87	1.88	1.88	1.79	1.71	1.82	1.57	1.43	1.62

## Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	5.1%	5.3%	5.9%	-0.9%	4.1%	4.8%	4.8%	5.2%	5.5%	4.4%
Return on Equity	17.7%	18.4%	20.1%	-3.1%	14.6%	15.8%	15.4%	15.9%	16.1%	13.4%
ROIC	8.7%	7.3%	6.9%	-1.0%	4.9%	5.5%	5.5%	5.9%	6.5%	5.3%
Shares Out.	258	264	275	307	326	336	368	380	404	419
Revenue/Share	3.76	4.47	4.46	4.63	4.30	3.92	4.00	4.66	5.14	4.62
FCF/Share	0.05	1.20	0.00	-5.03	-1.84	0.98	1.36	1.34	0.27	-1.37

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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