Pembina Pipeline Corp. (PBA)

Updated August 31st, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$25	**5 Year CAGR Estimate:**	4.0%	**Market Cap:**	$13.0 B
Fair Value Price:	$17	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	8/24/20
% Fair Value:	152%	**5 Year Valuation Multiple Estimate:**	-8.0%	**Dividend Payment Date:**	9/15/20
Dividend Yield:	7.4%	**5 Year Price Target**	$21	**Years Of Dividend Growth:**	4
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	5.0%

Overview & Current Events

Pembina Pipeline Corporation is based in Calgary, Canada. It has been serving the energy industry of North America with its transportation and midstream services for 65 years. It owns an integrated system of pipelines that transport various hydrocarbon liquids and natural gas products produced primarily in western Canada. The company also has gathering and processing facilities. Pembina has a market cap of $13 billion and operates in three segments; Pipelines, Facilities, and Marketing & New Ventures. In 2019, these segments generated 57%, 27% and 16% of the company's total gross profit, respectively. All the figures in this report are in US dollars.

In early August, Pembina reported (8/6/20) financial results for the second quarter of fiscal 2020. The low prices of oil and NGL, which were caused by the pandemic, caused lower producer activity and a decline in transported volumes. In addition, the marketing segment was hurt by lower margins. As a result, earnings plunged -62% over last year's quarter.

Pembina is facing a headwind from the pandemic, which has caused a severe downturn in the energy market. This downturn has caught Pembina off guard, with a material debt load. As a result, the company now intends to cut its capital expenses by 42% this year and defer some growth projects. Pembina is protected by its strong contracts, but the downturn will hurt this year's results, as it has reduced transported volumes and the margins in the marketing segment. Management expects adjusted annual EBITDA near the low end of its previous guidance of $3.25-$3.55 billion.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$1.11	$1.00	$0.87	$1.09	$0.92	$0.77	$0.73	$1.43	$1.76	$2.00	***$1.50***	***$1.91***
DPS	$1.51	$1.58	$1.60	$1.60	$1.50	$1.35	$1.38	$1.57	$1.73	$1.78	***$1.86***	***$1.86***
Shares[1]	167	168	259	308	328	348	389	432	509	518	***550***	***700***

During the last decade, although Pembina has more than tripled its share count, it has grown its earnings-per-share at a 6.8% average annual rate. This growth has not been uniform, as the company failed to grow its earnings-per-share from 2010 to 2016. Nevertheless, the company has a long backlog of additional growth projects. Thanks to these projects, management previously stated that it expected to grow adjusted cash flow per share by 8%-10% per year and raise the dividend by about 5% per year beyond this year. Due to the depressed oil prices that have resulted from the coronavirus, we expect earnings-per-share to fall from $2.00 to $1.50 and then grow by 5% per year beyond this year.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	24.3	32.9	41.7	36.5	48.3	37.4	36.4	23.1	19.2	18.2	***16.7***	***11.0***
Avg. Yld.	5.6%	4.8%	4.4%	4.0%	3.4%	4.7%	5.2%	4.8%	5.1%	4.9%	***7.4%***	***8.8%***

Pembina has traded at remarkably high price-to-earnings ratios through much of the last decade. In addition, due to its huge capital expenses on growth projects, the company has posted negative free cash flows in most years so we cannot

[1] In millions.

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use cash flows to evaluate the stock. The stock is now trading at a price-to-earnings ratio of 16.7, which is much higher than our assumed fair earnings multiple of 11.0. We have assumed such a low fair earnings multiple due to the appreciable debt load, which has weakened the position of Pembina in the ongoing coronavirus crisis. If the stock trades at our fair value estimate in five years, it will incur an -8.0% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	137%	158%	184%	147%	162%	176%	188%	110%	98.2%	89.1%	***124%***	***97.2%***

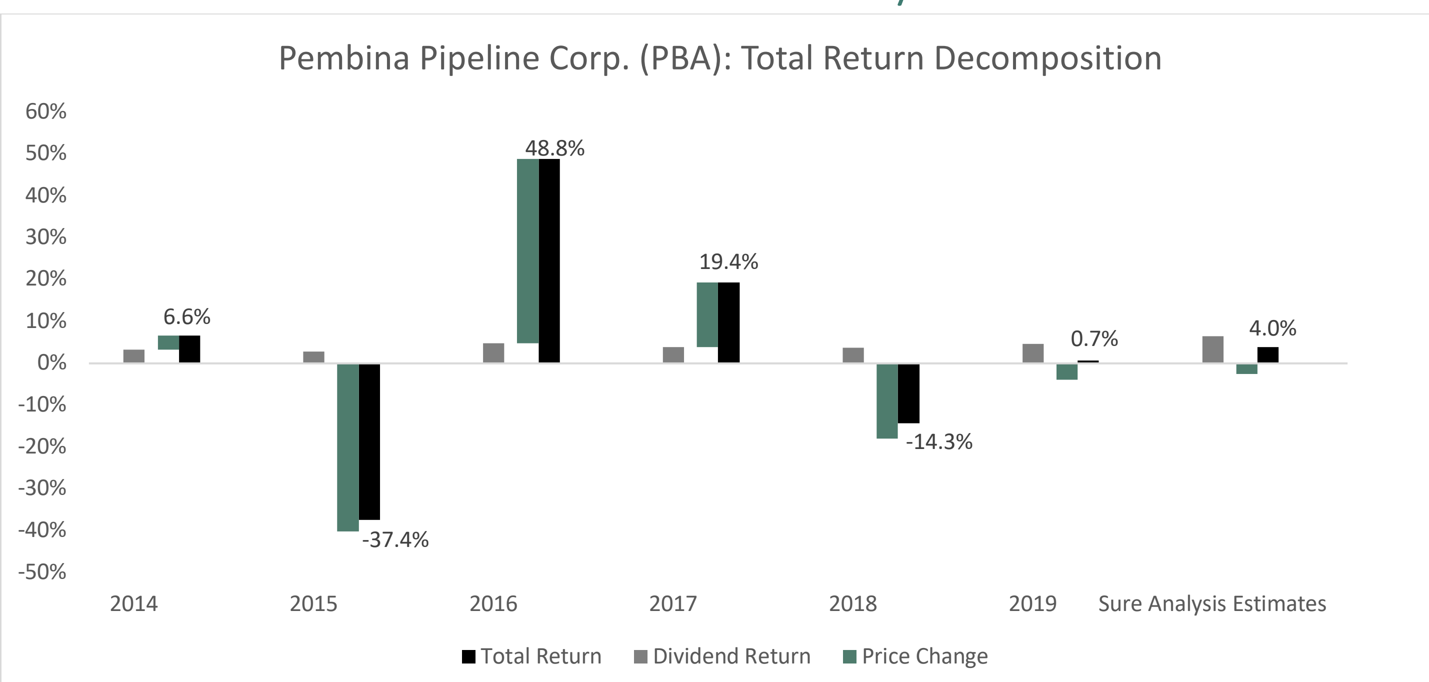
The competitive advantage of Pembina lies in its large scale and its integrated assets in some of the most prolific resource plays in North America. Pembina has steadily increased the fee-based portion of its EBITDA, from 77% in 2015 to 87% in 2019. It has pursued this strategy in order to secure a reliable and growing dividend, which is the top priority of management. Pembina has raised its dividend (in CAD) for 8 consecutive years and pays dividends on a monthly basis, which is enticing for income-oriented investors. In addition, it has a stronger balance sheet than most midstream companies, with its credit rating standing at a BBB level. However, the company has been caught in the ongoing downturn with a significant debt load, with its current liabilities of $1.2.billion (due in the next 12 months) exceeding its current assets of $0.61 billion.

If the ongoing crisis lasts longer than expected, investors should be aware that the dividend may come under pressure due to the elevated payout ratio and the significant debt load of the company.

Final Thoughts & Recommendation

Pembina has reported record earnings for two years in a row, but it has been caught with a high debt load in the ongoing downturn of the energy market, which has been caused by the pandemic. As a result, the stock may offer just a 4.0% average annual return over the next five years. If the pandemic subsides soon, the stock could offer outsized returns. However, due to our concern over the leverage of the company, we rate shares as a hold.

Total Return Breakdown by Year



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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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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	1,195	1,695	3,428	4,861	5,497	3,632	3,221	4,167	5,672	5,447
Gross Profit	271	348	507	764	772	652	809	1,103	1,462	1,539
Gross Margin	22.7%	20.5%	14.8%	15.7%	14.0%	18.0%	25.1%	26.5%	25.8%	28.3%
SG&A Exp.	46	63	97	128	141	123	147	182	215	223
D&A Exp.	61	71	180	166	205	206	221	295	322	385
Operating Profit	223	285	410	635	614	510	663	899	1,225	1,305
Operating Margin	18.7%	16.8%	12.0%	13.1%	11.2%	14.0%	20.6%	21.6%	21.6%	24.0%
Net Profit	170	168	225	341	347	318	352	681	986	1,124
Net Margin	14.3%	9.9%	6.6%	7.0%	6.3%	8.8%	10.9%	16.4%	17.4%	20.6%
Free Cash Flow	69	(194)	(224)	(189)	(554)	(791)	(504)	(252)	795	668
Income Tax	(8)	39	75	139	151	156	143	110	358	27

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	2,856	3,271	8,327	8,586	9,701	9,297	11,138	20,331	19,577	25,380
Cash & Equivalents	125	---	27	48	46	20	26	255	115	99
Accounts Receivable	105	143	326	394	364	331	119	141	367	440
Inventories	26	21	109	149	118	86	134	134	145	96
Goodwill & Int. Ass.	245	239	2,637	2,408	2,447	2,034	2,102	3,749	3,237	4,922
Total Liabilities	1,806	2,329	4,030	3,729	4,243	3,948	4,985	9,324	9,001	12,542
Accounts Payable	99	139	303	337	382	269	352	370	381	549
Long-Term Debt	1,309	1,593	2,568	2,137	2,465	2,395	3,079	6,009	5,534	7,772
Shareholder's Equity	1,050	942	4,292	4,485	4,700	4,557	5,034	9,031	8,752	10,529
D/E Ratio	1.25	1.69	0.60	0.44	0.45	0.45	0.50	0.55	0.53	0.61

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	6.4%	5.5%	3.9%	4.0%	3.8%	3.3%	3.4%	4.3%	4.9%	5.0%
Return on Equity	16.1%	16.8%	8.6%	7.8%	7.6%	6.9%	7.3%	9.7%	11.1%	11.7%
ROIC	7.4%	6.8%	4.8%	4.9%	4.7%	4.1%	4.1%	5.2%	6.0%	6.1%
Shares Out.	167	168	259	308	328	348	389	432	509	518
Revenue/Share	7.13	10.08	13.21	15.78	16.76	10.44	8.28	9.65	11.14	10.60
FCF/Share	0.41	-1.15	-0.86	-0.61	-1.69	-2.27	-1.30	-0.58	1.56	1.30

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