



Inter Pipeline (IPPLF)

Updated December 13th, 2020 by Kay Ng

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|----------------------------------|----------|
| Current Price: | \$11 | 5 Year CAGR Estimate: | 13.3% | Market Cap: | \$4.5B |
| Fair Value Price: | \$14 | 5 Year Growth Estimate: | 4.0% | Ex-Dividend Date: | 12/21/20 |
| % Fair Value: | 73% | 5 Year Valuation Multiple Estimate: | 6.5% | Dividend Payment Date: | 01/15/21 |
| Dividend Yield: | 3.2% | 5 Year Price Target | \$18 | Years Of Dividend Growth: | 0 |
| Dividend Risk Score: | D | Retirement Suitability Score: | F | Last Dividend Increase: | N/A |

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: 59% Oil Sands Transportation, 16% Natural Gas Liquids (“NGL”) Processing, 12% Conventional Oil Pipelines, and 13% Bulk Liquid Storage.

Inter Pipeline reported its Q3 2020 results on 11/12/20. During the quarter, Inter Pipeline generated revenue of C\$633 million, up 7% versus Q3 2019. Funds from operations (FFO) fell 4% to C\$196 million and was down 6% to C\$0.46 on a per-share basis as the share count rose. Pipeline volumes fell 11% due to 10% lower Oil Sands Transportation and 13% lower Conventional Oil Pipeline volumes. Natural Gas Liquids (NGLs) Processing volumes climbed 4%, and Bulk Liquid Storage utilization rose to 99% compared to 92% a year ago. FFO growth from Oil Sands Transportation, NGL Processing, and Bulk Liquid Storage wasn’t enough to offset declines from Conventional Oil Pipelines due to lower commodity prices and higher corporate costs. Adjusted EBITDA fell 3% to C\$242 million. The payout ratio was 26% in Q3 and 48% year to date. Inter Pipeline continues to build the Heartland Petrochemical Complex (“HPC”) project for future growth. It also acquired the Milk River pipeline system and cash proceeds of \$35 million in exchange for its Empress II and V straddle plants. Further, Inter Pipeline sold most of its European storage assets for £420 million (~C\$720 million). After this transaction, IPPLF will still own and operate 8 terminals, with ~19 million barrels of total storage capacity, in Sweden and Denmark. The proceeds will reduce its debt, strengthen its balance sheet, and help finance its capital expenditure program, including the HPC. Due to the rebound in FFO in Q3, we’ve improved our 2020 estimate.

Growth on a Per-Share Basis

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| FFOPS | \$1.29 | \$1.50 | \$1.62 | \$1.55 | \$1.55 | \$1.73 | \$1.84 | \$2.06 | \$2.10 | \$1.60 | \$1.44 | \$1.75 |
| DPS | \$0.90 | \$0.95 | \$1.06 | \$1.11 | \$1.16 | \$1.11 | \$1.17 | \$1.27 | \$1.26 | \$1.29 | \$0.56 | \$0.50 |
| Shares¹ | 258 | 264 | 275 | 307 | 326 | 336 | 368 | 380 | 404 | 419 | 429 | 548 |

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%.

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 HPC to generate average EBITDA of C\$450-500 million per year when it comes into service by 2022. In December, the company announced a C\$1 billion capital expenditure

1. 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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program for 2021 -- ~86% will be invested in NGL Processing; 80% of the C\$1 billion will be invested in HPC. It's good to see that the sustaining capital is low at 7% of the 2021 capex program.

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 | 7.3 | 10.0 |
| Avg. Yld. | 7.0% | 5.8% | 5.0% | 4.8% | 4.3% | 5.1% | 6.1% | 5.9% | 7.1% | 8.2% | 3.2% | 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. Growth will largely come from the project. We therefore 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

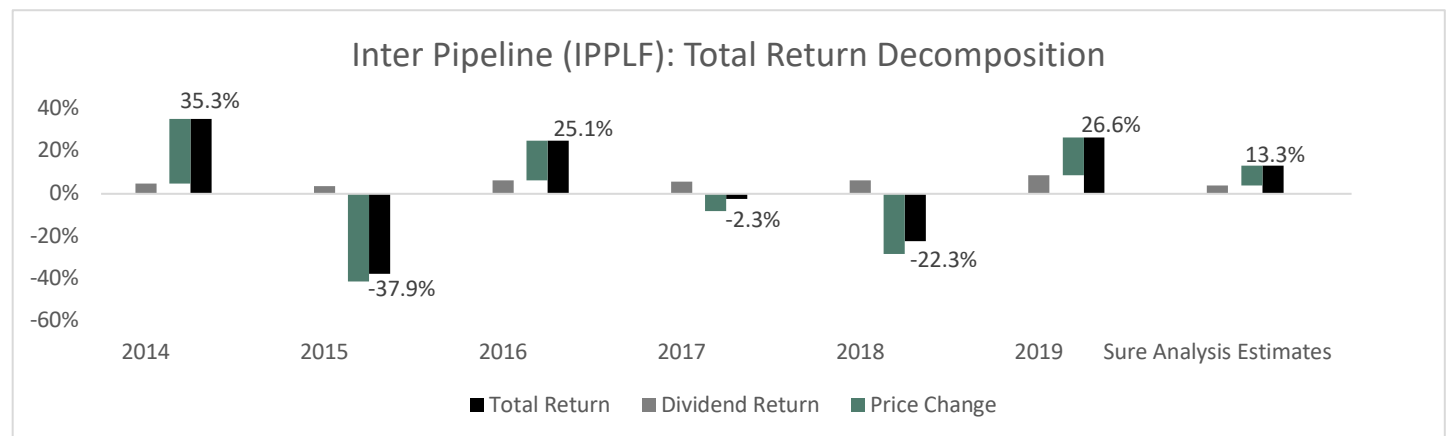
| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 70% | 63% | 65% | 72% | 75% | 64% | 64% | 62% | 60% | 81% | 39% | 29% |

The company has not been resilient in the pandemic caused recession, as its performance has been significant weighed down by lower energy prices. 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%. In July, it raised C\$700 million of senior unsecured medium-term notes that bears a fixed interest rate of 4.232% per year. 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. It's reducing its debt and helping fund HCP with the majority sale of its European gas storage business. 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 investment with a holding period of at least three years. Over the next five years, we estimate total returns of 13.3% in the stock, coming from a current yield of 3.2%, FFO growth of 4.0%, and multiple expansion of 6.5%.

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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