



Inter Pipeline (IPPLF)

Updated March 3rd, 2021 by Kay Ng

Key Metrics

Current Price:	\$14	5 Year CAGR Estimate:	9.9%	Market Cap:	\$6B
Fair Value Price:	\$16	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	02/22/21
% Fair Value:	91%	5 Year Valuation Multiple Estimate:	2.0%	Dividend Payment Date:	03/15/21
Dividend Yield:	2.6%	5 Year Price Target	\$20	Years Of Dividend Growth:	0
Dividend Risk Score:	C	Retirement Suitability Score:	D	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 Q4 and full-year 2020 results on 02/18/21. During the quarter, Inter Pipeline generated revenue of C\$624 million, down 3% versus Q4 2019. Funds from operations (FFO) fell 6% to C\$204 million and was down about 8% to C\$0.48 on a per-share basis.

In 2020, revenue fell 5% to C\$2.4 billion against 2019. FFO fell 9% to C\$792 million and declined about 13% to C\$1.85 on a per-share basis due to a greater share count. Pipeline volumes fell marginally due to lower Conventional Oil Pipeline volume (from lower energy prices and reduced marketing activities) partly offset by an Oil Sands Transportation volume growth of 2%. Natural Gas Liquids (NGLs) Processing volumes climbed 3%, but it translated to 20% lower FFO year over year (due to depressed frac-spread pricing). Bulk Liquid Storage utilization climbed to 98% compared to 87% a year ago. All told, FFO growth in the Oil Sands Transportation and Bulk Liquid Storage wasn’t enough to offset higher operating costs and FFO declines in the NGL Processing and Conventional Oil Pipelines. Inter Pipeline gave an update on the Heartland Petrochemical Complex (“HPC”) project, its key project, which is expected to be fully complete by the end of 2021 and start generating cash flow in early 2022. We gave an initial 2021 FFOPS estimate of \$1.41. Notably, the stock appreciated to our multi-year price target (of \$14 per share) from our previous report, thanks to Brookfield Infrastructure Partners L.P.’s (BIP, TSX:BIP.UN) intention to acquire the company, whose shares it began accumulating since March 2020 during which there was a market crash.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
FFOPS	\$1.50	\$1.62	\$1.55	\$1.55	\$1.73	\$1.84	\$2.06	\$2.10	\$1.60	\$1.38	\$1.41	\$1.80
DPS	\$0.95	\$1.06	\$1.11	\$1.16	\$1.11	\$1.17	\$1.27	\$1.26	\$1.29	\$0.59	\$0.36	\$0.72
Shares¹	264	275	307	326	336	368	380	404	419	429	438	483

Inter Pipeline uses a combination of debt and equity offerings to fund its growth. From 2011 to 2020, 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 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. Shares in millions.

Disclosure: Kay Ng owns shares of Brookfield Infrastructure.



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Lower energy prices were already a drag on FFO in 2019. Combined with the COVID-19 pandemic, lower energy demand further weighed 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. The suspension of Inter Pipeline's dividend reinvestment program should prevent the share count from going higher. Inter Pipeline will at least partially restore its cut dividend down the road.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
P/FFO	11.0	13.1	14.9	17.5	12.6	10.5	10.5	8.5	9.9	8.5	10.0	11.0
Avg. Yld.	5.8%	5.0%	4.8%	4.3%	5.1%	6.1%	5.9%	7.1%	8.2%	5.0%	2.6%	3.7%

IPPLF has traded at a wide valuation range since 2011 with the average P/FFO being 11.7. We don't expect any material growth in cash flow until HPC comes online in 2022. As the key project has gotten much closer to completion after three years of construction, we set a higher fair long-term P/FFO than before – at 11.0. The stock is fairly value.

Safety, Quality, Competitive Advantage, & Recession Resiliency

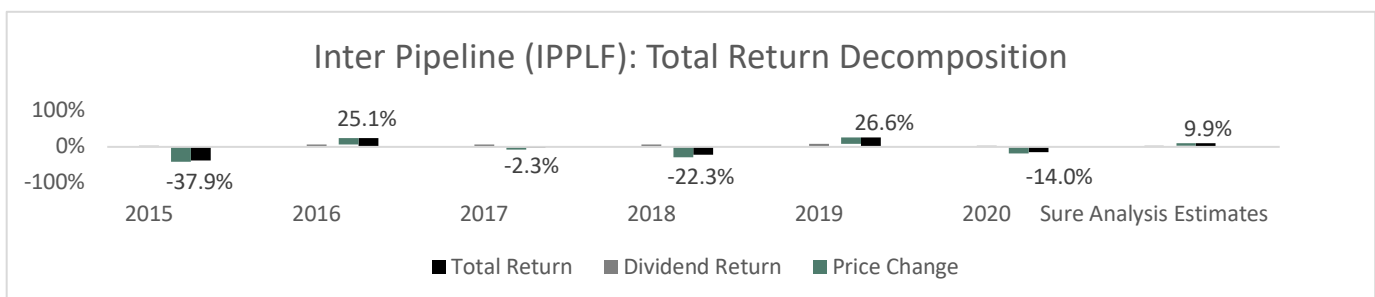
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	63%	65%	72%	75%	64%	64%	62%	60%	81%	43%	26%	40%

IPPLF 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 2020, 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. The good news is Inter Pipeline has no need for debt re-financing before HPC is expected to be in service, by which time it will generate much more cash flow. 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 trading at a fair valuation. If it stays an independent company, we estimate total returns of 9.9%, coming from a current yield of 2.6%, FFO growth of 5.0%, and multiple expansion of 2.0%. At writing, IPL trades at C\$17.84 per share, which is higher than BIP's offer price of C\$16.50 that can be raised to \$17-\$18.25. For each IPL share, investors could also opt to get 0.206 BIPC shares. However, BIPC trades at a ~30% premium to BIP, which provides the same cash distribution. Therefore, the best course of action is probably to hold or sell and reinvest into another dividend stock (such as BIP) that provides good income as the near-term value of Inter Pipeline shares have been reached.

Total Return Breakdown by Year



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1. Shares in millions.

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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue						1378	1744	2001	1910	1792
Gross Profit						980	1155	1269	1081	1018
Gross Margin						71.1%	66.2%	63.4%	56.6%	56.8%
SG&A Exp.						101	100	106	131	140
D&A Exp.						173	197	211	269	269
Operating Profit						588	685	749	520	450
Operating Margin						42.7%	39.2%	37.5%	27.2%	25.1%
Net Profit						340	406	457	406	268
Net Margin						24.6%	23.3%	22.9%	21.3%	15.0%
Free Cash Flow						468	501	103	-567	-324
Income Tax						114	143	166	-16	84

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets						7529	8240	8415	9915	10247
Cash & Equivalents						16	21	34	25	31
Accounts Receivable						168	195	178	247	258
Inventories						10	10	7	11	11
Goodwill & Int. Ass.						508	524	496	446	339
Total Liabilities						5165	5485	5504	6784	6941
Accounts Payable						206	266	343	488	364
Long-Term Debt						4307	4322	4155	5081	5329
Shareholder's Equity						2364	2755	2911	3131	3306
D/E Ratio						1.82	1.57	1.43	1.62	1.61

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets						4.8%	5.2%	5.5%	4.4%	2.7%
Return on Equity						15.4%	15.9%	16.1%	13.4%	8.3%
ROIC						5.5%	5.9%	6.5%	5.3%	3.2%
Shares Out.						368	380	404	419	429
Revenue/Share						4.00	4.66	5.14	4.62	4.19
FCF/Share						1.36	1.34	0.27	-1.37	-0.76

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

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