



Inter Pipeline (IPPLF)

Updated August 14th, 2021 by Kay Ng

Key Metrics

Current Price:	\$16	5 Year CAGR Estimate:	9.8%	Market Cap:	\$8.6B
Fair Value Price:	\$18	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	08/23/21
% Fair Value:	91%	5 Year Valuation Multiple Estimate:	2.0%	Dividend Payment Date:	09/15/21
Dividend Yield:	2.4%	5 Year Price Target	\$22	Years Of Dividend Growth:	0
Dividend Risk Score:	D	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 Q2 2021 results on 08/05/21. Its financial results were decent. Total transportation volume rose 3%. It generated revenue of C\$703 million, up 30% versus Q2 2020. Adjusted EBITDA, a cash flow proxy, climbed 2% to C\$235 million. Funds from operations (FFO) rose 12% to CAD\$206 million and was also up ~12% to C\$0.48 on a per-share basis. For the first half of (H1) 2021, Inter Pipeline increased revenue by 22% to C\$1.4 billion versus H1 2020. Adjusted EBITDA climbed 4% to C\$513 million. FFOPS rose 13% to C\$1.04.

Inter Pipeline’s key growth project, Heartland Petrochemical Complex (“HPC”) project, is set to complete by the end of 2021 and start generating cash flow in early 2022. The company noted that currently, HPC has ~68% of production capacity that is held under high-quality, long-term take-or-pay contracts. The objective is to increase it to at least 70%.

Because of strong H1 results, we updated our 2021 FFOPS estimate to \$1.60. Notably, the stock climbed higher to about \$16-per-share thanks to the bidding war between Pembina Pipeline (PBA, TSX:PPL) and Brookfield Infrastructure Partners L.P.’s (BIP, TSX:BIP.UN). It looks like the bidding war could end by the end of this month with BIP as the victor.

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	\$1.60	\$2.04
DPS	\$0.95	\$1.06	\$1.11	\$1.16	\$1.11	\$1.17	\$1.27	\$1.26	\$1.29	\$0.59	\$0.38	\$0.76
Shares¹	264	275	307	326	336	368	380	404	419	429	430	475

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%.

The COVID-19 pandemic was a drag on its 2020 results. The future should be brighter for Inter Pipeline. Energy demand has improved as COVID-19 vaccine programs roll out, as we see a rebound in FFOPS in H1 2021. 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. If it were not to be acquired, Inter Pipeline would at least partially restore its cut dividend down the road.

¹ Shares in millions.

Disclosure: Kay Ng owns shares of Brookfield Infrastructure.



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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%	2.4%	3.4%

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 slightly undervalued.

Safety, Quality, Competitive Advantage, & Recession Resiliency

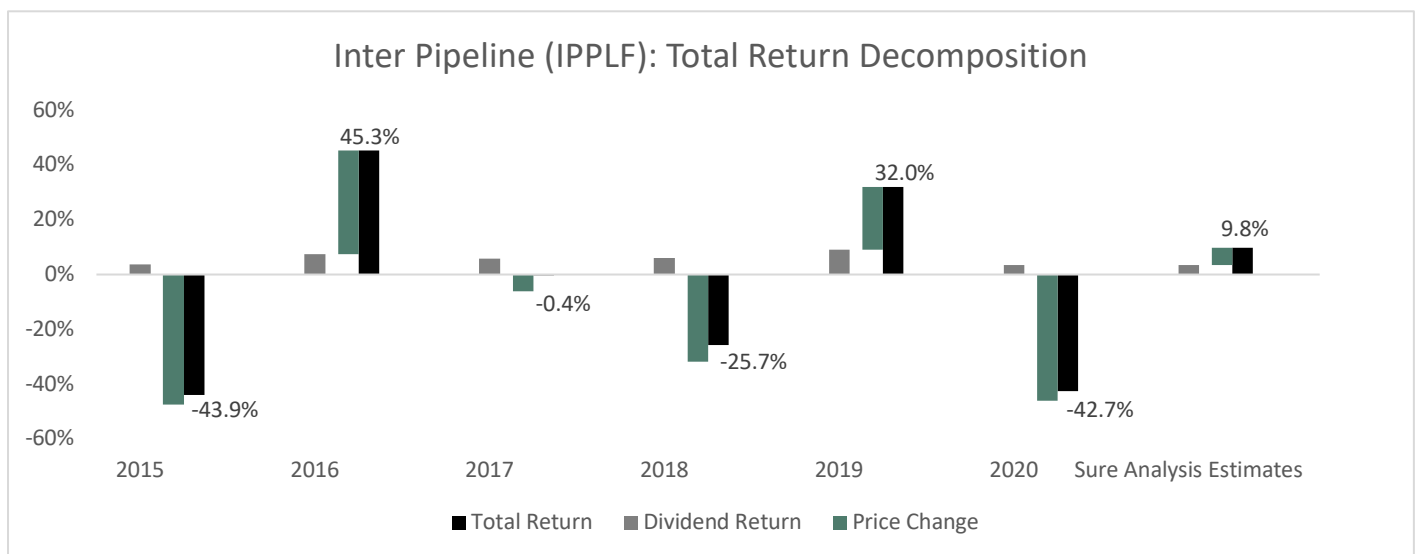
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	63%	65%	72%	75%	64%	64%	62%	60%	81%	43%	24%	37%

IPPLF has not been resilient in the pandemic caused recession, as its performance has been significantly 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-. If Inter Pipeline were to stay as a standalone company, 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.

Final Thoughts & Recommendation

Inter Pipeline is trading at a slight discount. If it stays an independent company, we estimate total returns of 9.8%, coming from a current yield of 2.4%, FFO growth of 5.0%, and multiple expansion of 2.0%. At writing, IPL trades at C\$19.95 per share, which is close to BIP's latest offer of C\$20.00. The bid is unlikely to go higher. Therefore, the best course of action is probably to sell and reinvest into another dividend stock 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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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	1165	1206	1323	1410	1313	1378	1744	2001	1910	1792
Gross Profit	783	843	898	914	973	980	1155	1269	1081	1018
Gross Margin	67.2%	69.9%	67.8%	64.8%	74.1%	71.1%	66.2%	63.4%	56.6%	56.8%
SG&A Exp.	66	78	83	78	60	101	100	106	131	140
D&A Exp.	101	125	123	129	148	173	197	211	269	269
Operating Profit	427	463	138	500	623	588	685	749	520	450
Operating Margin	36.7%	38.4%	10.4%	35.5%	47.4%	42.7%	39.2%	37.5%	27.2%	25.1%
Net Profit	251	307	-56	303	335	340	406	457	406	268
Net Margin	21.5%	25.5%	-4.3%	21.5%	25.5%	24.6%	23.3%	22.9%	21.3%	15.0%
Free Cash Flow	312	1	-1437	-602	328	468	501	103	-567	-324
Income Tax	81	89	84	104	147	114	143	166	-16	84

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	4755	5712	7192	7449	6507	7529	8240	8415	9915	10247
Cash & Equivalents	50	65	44	53	29	16	21	34	25	31
Accounts Receivable	107	148	231	135	132	168	195	178	247	258
Inventories	---	---	---	---	---	10	10	7	11	11
Goodwill & Int. Ass.	503	623	580	514	429	508	524	496	446	339
Total Liabilities	3280	3950	4953	4973	4232	5165	5485	5504	6784	6941
Accounts Payable	159	295	544	336	159	206	266	343	488	364
Long-Term Debt	2603	3128	3703	3938	3483	4307	4322	4155	5081	5329
Shareholder's Equity	1391	1668	1972	2195	2033	2364	2755	2911	3131	3306
D/E Ratio	1.87	1.88	1.88	1.79	1.71	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	5.3%	5.9%	-0.9%	4.1%	4.8%	4.8%	5.2%	5.5%	4.4%	2.7%
Return on Equity	18.4%	20.1%	-3.1%	14.6%	15.8%	15.4%	15.9%	16.1%	13.4%	8.3%
ROIC	7.3%	6.9%	-1.0%	4.9%	5.5%	5.5%	5.9%	6.5%	5.3%	3.2%
Shares Out.	264	275	307	326	336	368	380	404	419	429
Revenue/Share	4.47	4.46	4.63	4.30	3.92	4.00	4.66	5.14	4.62	4.19
FCF/Share	1.20	0.00	-5.03	-1.84	0.98	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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