



Is Inter Pipeline Ltd.'s 7.6% Yield Safe?

Description

When talking about energy infrastructure companies, the first ones that come to mind would likely be **Enbridge Inc.** and **TransCanada Corporation**. Their valuations have come down because the energy outlook remains grim as oil prices continue to fall. Oil was just over US\$100 in 2014, and now it's at US\$37.

Now Enbridge yields 5.1% and TransCanada yields 4.7%. In 2014, no one thought these companies would hit these yields. If you're looking for a high yield in the energy infrastructure space, there's one other company to consider: **Inter Pipeline Ltd.** (TSX:IPL).

It yields 7.6%

After falling almost 43% from its 52-week high of \$36 to \$20.60 per share, Inter Pipeline now yields a whopping 7.6%. However, we all know that higher yields typically imply higher risk.

Is Inter Pipeline's 7.6% dividend at risk? With its share price falling like that, the first question a potential investor should ask is "Is its business at risk?"

Business and assets

Inter Pipeline has an enterprise value of \$12.7 billion and a market capitalization of just over \$7 billion. It has a wide range of energy infrastructure assets, including the following:

- over 2.2 million barrels per day of contracted capacity of oil sands transportation
- 3,800 km of oil pipeline network in western Canada
- natural gas liquids extractions (it processes 40% of natural gas exported from Alberta)
- 27 million barrels of bulk liquid storage capacity in Europe

To sum it up, Inter Pipeline transports and processes 1.9 million barrels of energy products every day.

Dividend growth and dividend safety

Inter Pipeline just increased its monthly dividend in November to 13 cents per share, which is 6.1% higher than it was a year ago. In fact, the company has increased the dividend for six consecutive years. On average, Inter Pipeline increased the dividend by 9.6% per year.

Usually, dividends of companies that have just increased the dividend should be safe. However, dividend history is just one part of the research necessary for dividend safety.

The company's annual payout is \$1.56 per share. In 2014 Inter Pipeline earned \$1.74 of funds from operations (FFO) per share. So, even using last year's FFO, the dividend was covered.

This year's FFO per share is estimated to be higher at \$2.23. So, the payout ratio is just below 70%.

Earnings stability

Safe dividends are supported by stable earnings.

Oil sands transportation makes up about 61% of EBITDA. Long-term stable cost-of-service contracts are typically 20 or more years, and over 95% of EBITDA coming from investment-grade entities help keep this portion of earnings safe.

About 30% of EBITDA is fee based, and roughly 8% of EBITDA is commodity based. Fee-based EBITDA has volume and operating cost exposure but no commodity price risk, while commodity-based EBITDA has volume and commodity price exposure.

It's good to see that Inter Pipeline has increased cost-of-service EBITDA from about 25% to 61% since 2010, while decreasing the other two types that are viewed as riskier.

In conclusion

Inter Pipeline is still financially strong with a solid balance sheet and an S&P credit rating of BBB+. Its dividend hike of 6.1% in November is a confidence booster, especially because that dividend is well covered by Inter Pipeline's FFO.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

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