A Dividend Stock With Over 7% Yield, but Is It Safe?

Description

For investors starving for high dividend yield, the biggest challenge is to find stocks that are not only safe, but that also offer good value.

If you only focus on high yields without doing a proper due diligence about the company's financial health, its ability to maintain its dividend payouts, and the general operating environment, then there's a good chance that you might lose your investment.

These days, Canada's energy infrastructure stocks are under pressure due to rising interest rates in Canada that diminish the investment appeal of utilities and pipeline operators, which borrow heavily to fund their operations. In this environment, however, some good stocks have fallen more than they deserve. **Inter Pipeline Ltd.** (TSX:IPL) stock is one of those beaten-down stocks. Let's take a deeper look.

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Business structure

Inter Pipeline is a Calgary-based energy infrastructure company operating four business segments in Western Canada and Europe. Its pipeline systems span over 7,800 kilometres in length and transport approximately 1.4 million barrels per day.

In Europe, Inter Pipeline operates 16 strategically located petroleum and petrochemical storage terminals with a combined storage capacity of approximately 27 million barrels. Its NGL business is one of the largest in Canada, processing an average of 2.8 bcf/d in 2017 with the capacity to produce over 240,000 b/d of NGL.

In the first-quarter earnings report released this month, it posted a record $143 million profit with a 3% increase in its funds from operations (FFO) led by a 20% jump in its FFO from its NGL processing operations.

The company also has a good pipeline of growth projects. The company is building a $3.5-billion Heartland Petrochemical Complex in an industrial area north of Edmonton.

The complex will convert propane into polypropylene, a plastic used in the manufacturing of products such as automobile parts, containers, and Canadian bank notes. For this project, Inter Pipeline will receive up to $200 million in royalty credits from the Province of Alberta in Canada.

In the first quarter, the company invested $125 million on this project, with a total 2018 capital plan of $700 million. Once the Heartland Complex is operational in late 2021, Inter Pipeline expects to earn $450-$500 million per year in long-term average annual EBITDA.

Share performance

Since the oil market downturn in 2014, the stock didn't move much. But as the oil prices began to recover and traded more than $70 a barrel, the outlook has brightened.

Trading at $23.95 at the time of writing, Inter Pipeline stock yielded 7.22% with a solid history of rewarding its investors. In November, the company hiked its payout by 3.7% to $1.68 per share annually, marking its 15 consecutive dividend increase.

Some analysts are skeptical about the company's short-term prospects as it undertakes the massive petrochemical project, which requires a great deal of cash burn and borrowing. Its stock is currently trading at 15.35 times its forward EPS, which is much lower than its five-year average multiple of 23.2.

Inter Pipeline is a good long-term bet for investors who can wait until the company is done with its major expansion. I don't think there is any threat to the company's dividend payout when oil prices are recovering and the company's other businesses continue to produce impressive cash flows.

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