Does This High-Yield Energy Stock Belong in Your TFSA?

Description

Volatile stock markets, tumbling oil prices, rising interest rates … it's all enough to make long-time **Inter Pipeline** (TSX:IPL) shareholders pack it in for good.

Despite IPL stock being down 18% year to date (including dividends) through October 18, the company's four operating segments make it a player in Canada's energy infrastructure.

Its exposure to volume and price risk is limited

Furthermore, it will continue to benefit from existing constraints in Western Canada's transportation of oil, whether produced from the oil sands or conventionally. With 62% of its 2018 EBITDA generated transporting oil, 68% of which has little or no volume or commodity price exposure risk, the company has less exposure to the current energy situation than people might realize.

Sure, the collapse of oil prices in recent weeks has investors spooked — the U.S. benchmark for a barrel of oil hit below US$46 December 18, 40% lower than its price in early October — 55% of its EBITDA is based on cost-of-service contracts that have between 20 years and 40 years left on them.

Through the first nine months of 2018, ended September 30, Inter Pipeline's Oil Sands Transportation segment had 100% cost-of-service contracts with no volume or price risks. On the conventional side of its transportation business, cost-of-service contracts accounted for 20% of its EBITDA with fee-based contracts responsible for another 54% of that segment's EBITDA.

The only segment significantly exposed to volume and price risks is the company's natural gas liquids (NGL) processing business, where 85% of its $311 million in EBITDA is from commodity-based contracts.

Overall, of its $938 million in EBITDA through the first nine months of 2018, 70% was generated by cost-of-service and fee-based contracts.

The dividend is very sustainable

Inter Pipeline has increased its annual dividend for 10 consecutive years at a compound annual growth rate of 7%, meaning it doubled the annual payment in a decade. Over that decade, only once in 2008, was IPL's dividend yield higher than the current 8.5%.

Yet, Inter Pipeline's financial condition is arguably better than it's ever been, with its net debt to total capitalization at 55%, well below the 65% maximum under its loan covenants. Furthermore, 85% of its total recourse debt is fixed-rate, protecting the company in a rising interest rate environment.

From 2012 to 2017, the company's funds from operations (FFO) have grown at a faster rate than its dividend increase, leaving more than enough to pay out the dividend.

The company believes that its fee-based and cost-of-service cash flow alone should meet the dividend payout requirements in the future with the commodity-based and product margin contracts providing some leeway for increasing it by more than 5-7% annually.

Should it be in your TFSA?

The one thing you don't want in any tax-free or tax-deferred account is a capital loss. That's because you can't use these accounts to offset capital gains.

If that's the case, Inter Pipeline is definitely not the stock for you if you're not prepared to buy and hold it in years where it's retreated like in 2018.

However, if you want to own a business that's successful in spite of the oil and gas industry's problems, IPL is it.

In November, I'd highlighted the three reasons I like Inter Pipeline's 7.5% yield. A month later, its yield is 100 basis points higher at 8.5%, and I like it even more.

It's an income investor's dream stock.

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