Is Inter Pipeline Ltd’s (TSX:IPL) 9% Yield in Danger?

Description

Inter Pipeline (TSX:IPL) has been a favourite of dividend lovers for nearly a decade. The company operates energy infrastructure such as pipelines, which purportedly offer stability in an otherwise uncertain market. Management supports their claims of stability by pointing to their clean balance sheet, investment grade credit rating, consistent dividend, and conservative growth plans for boosting its payout over the long term.

Yet Inter Pipelines stock performance has been weak of late, with shares recently hitting a one-year low, pushing the dividend yield up near 9%. Is this your opportunity to buy into a stable 9% dividend with growth? Or is the market signaling trouble that the company’s management team would rather you ignore?

Inter Pipeline is less stable than management claims

Sure, earning money from a company that owns and operates energy infrastructure is typically more stable than one that produces the energy itself. For example, producers are mostly forced to sell at commoditized prices and are at the whims of a volatile pricing market. Plus, it’s costly and difficult to transport and process the production, meaning they also need to pay someone else to do this for them. Options are fairly limited; pipelines and crude by rail are usually the only viable options — not a great position to be in.

Limited energy infrastructure has wreaked havoc on the energy market in Canada. In October of 2018, Canadian oil prices fell as low as $20 per barrel, while U.S. prices remained above $50 per barrel. The reason: limited energy infrastructure. Pipelines and railroads were running out of capacity, forcing producers to bid irrationally to move their production. They simply had no other option.

If you’re thinking this is great for Inter Pipeline, think again. Money-losing customers are hardly a path to long-term profits. In 2018, around 94% of Inter Pipeline’s earning came from Canada. Half of those earnings came from the company’s pipeline business, which is heavily exposed to oil sands production.

Oil sands production has always been risky. Environmental and political groups have frequently applied heavy pressure, as these facilities can devastate thousands of acres of pristine habitat. Apart from that, the breakeven prices are higher than nearly every other region in the world. Often, oil sands facilities need $30-40 per barrel wholesale prices to turn a profit. Cheaper options in the U.S., for comparison, can break even at $10 per barrel. So, while oil sands production is rising, many projects could be cancelled if energy prices weaken. That would dry up important revenue sources for Inter Pipeline, possibly for good.

International regulations could also render huge swaths of the company's customer base economically unviable. This would be a death blow to Inter Pipeline's dividend. For example, over the next two years, new marine regulations will impact the sulfur content used in shipping fuel. Sulfur levels will need to fall to 0.5% from 3.5%. According to the Canadian Energy Research Institute, around 20% of oil sands projects will be shut down. While Inter Pipeline's management team has avoided the subject, the current dividend will likely be cut unless global regulations change quickly.

If you're an income investor looking for a stable payout, Inter Pipeline's 9% dividend is too good to be true.

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