Is Inter Pipeline Ltd's (TSX:IPL) 8.3% Yield Safe?

Description

For dividend investors, a yield can be appealing because it means your dividend income will be higher for owning a particular stock. But if the yield becomes too big or unaffordable for the company, there's always the possibility that the payouts could be cut or even eliminated entirely.

There's no crystal ball or guarantee of if and when a dividend will be cut. There are many stocks that have yields of more than 5% that investors may have expected to be reduced by now and yet they remain intact.

Many factors can impact those decisions, including the company's leadership, the importance it places on paying a dividend, its outlook for the future, and, of course, whether it can afford to or not.

Let's look at **Inter Pipeline** (TSX:IPL) and see how well it performs on that last factor — affordability. There are a couple ways that I normally analyze the health of a company's dividend: in terms of profit as well as by looking at its cash flow.

Payout ratio as a percentage of profit

To do an analysis based on profitability, what we need to do is look at per-share earnings and dividends paid per share. Over the past 12 months, Inter Pipeline has generated earnings per share of $1.54. And with monthly dividend payments of $0.1425, the company is paying out $1.71 in dividends for each share, on annual basis.

At 111%, that's a very high payout ratio and could be a cause for concern for investors. It suggests the company is not making enough to cover dividend payments.

However, with profits being dragged down by non-cash items, it can sometimes paint a worse picture than what's actually the case. Let's switch gears and look at cash flow to see if things are any better there.

Payout ratio as a percentage of free cash flow

When looking at cash flows, it's important to look at free cash rather than just cash from operations. Investors aren't going to expect a company to forgo needed and recurring capital expenditures for the sake of paying a dividend, nor would they want to.

And so looking at free cash gives us an accurate picture of what a company has left over to save for later (perhaps for a big purchase or acquisition) or to pay out to shareholders.

Overall, Inter Pipeline has done a good job of generating free cash flow in recent quarters and has posted a positive figure in each of the past five periods.

During the trailing 12 months, Inter Pipeline's free cash has totaled $401 million and is above the $323 million that it paid out in cash dividends during that time.

However, at a payout ratio of over 80%, that's still a bit high. It may be an improvement from the profit percentage, but it's still a little worrisome.

Bottom line

Given the state of uncertainty in the industry, and with other companies cutting back on dividends, I wouldn't be surprised for Inter Pipeline to follow suit at some point.

If you're looking to invest in this stock, I wouldn't suggest relying on the dividend. It's a nice bonus, but it shouldn't be the main reason you invest.

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