Is Inter Pipeline Ltd.'s (TSX:IPL) 8% Dividend Yield Safe?

Description

Stocks that pay higher dividend yield than the market average are generally considered risky. Investors avoid these names due to the risk of their payouts being slashed down the road. But sometimes a company can be punished just by association and has its stock undervalued.

Calgary-based **Inter Pipeline** (TSX:IPL) is one such undervalued dividend stock, but it's attractive for long-term income investors.

What is hurting IPL stock?

It's hard to find anything wrong with the business model of IPL. It runs diversified operations in the energy infrastructure space. This Canadian company owns 4,800 miles of pipeline, transporting over 1.4 million barrels of crude per day. It operates 16 strategically located petroleum and petrochemical storage terminals in Europe. IPL's NGL business is one of the largest in Canada.

With these diversified operations, IPL is also expanding fast. In Canada, IPL is in the middle of building a $3.5 billion petrochemical complex near Edmonton to convert propane into polypropylene plastic. In late October, IPL announced a $354 million deal to buy European storage terminals from Texas-based **NuStar Energy**.

With this impressive portfolio, however, what's hurting IPL is Canada's pipeline congestion that is forcing the nation's largest producers to cut their development plans. The pipeline capacity shortage is so acute that it has forced Alberta to control the oil supply so that Canadian crude prices could recover from their slump.

Investors are worried that IPL's high leverage may not be sustainable at some point and may force the company to cut its dividend payout. IPL has $6 in debt for every dollar generated in earnings before interest, taxes, depreciation, and amortization.

Another important thing for dividend investors to watch out for is the company's ability to generate enough funds through operations to support its payouts. Last year, that payout ratio was 60%, as the company generated $2.80 per share in funds from operations and distributed $1.68 per share in dividends.

Bottom line

After analyzing these numbers, it seems to me that IPL's dividend is safe, and it's unlikely that it will need to cut its payouts to preserve cash. The company is in a growth mode, and it's well-entrenched in North America's energy supply chain. IPL's $1.71-a-share annual payout and its about 8% dividend yield is a great deal for income-seeking investors.

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