Income Investors: Inter Pipeline (TSX:IPL) Could Be the Cheapest 7.6% Yielder on the TSX Index

Description

There's no doubt that the main attraction to **Inter Pipeline** (TSX:IPL) stock is its huge 7.6%-yielding dividend, which, while safe, leaves investors exposed to greater downside potential, as shares have continued to tread water since oil's implosion in 2014.

For those with stomachs that are strong enough to handle volatility, though, the midstream player offers a hard-to-match value proposition to income-oriented investors at these depths (shares down 33% from five-year highs). Not only does Inter Pipeline sports a dividend that's on the higher end of the spectrum, but it also has encouraging cash flow-generative projects in the pipeline (no pun intended) that could finance further dividend hikes down the road, even as the energy market continues to drag its feet.

Over the intermediate term, though, Inter Pipeline is in a financially tight situation, as it pursues ambitious growth projects to lift the stock from its funk sustainably.

The company has been looking at selling some of its European assets to help finance its $3.5 billion Heartland Petrochemical Complex, which is seen as a significant growth driver for the company moving forward. The massive facility is expected to average an annual EBITDA of up to $500 million and is expected to go online in the latter part of 2021.

If all goes well with the project, I wouldn't be surprised if IPL stock tested the $30 mark by then. But in the meantime, look for management to produce more financial wiggle room itself, as it balances Heartland and its sizeable dividend commitment without having to raise even more debt.

For now, the dividend looks safe. The FFO payout ratio is quite stretched (at nearly 90% as of the third quarter), however, leaving little room for operational hiccups.

Fellow Fool contributor Kay Ng previously noted that Inter Pipeline was one of three top yield hogs that would be to the liking of hungry income investors.

"About 83% of cash flows have long-term contracts, and that portion of the cash flow is therefore relatively stable." said Ng. "However, 66% of its natural gas liquids (NGLs) cash flow, which contributes about 14% of its consolidated cash flow, is commodity-based."

Like all midstream operators, Inter Pipeline faces a high degree of uncertainty, both with regulatory hurdles and commodity prices as well as volume risk. As such, I'd only advise patient deep-value investors load up on the name, because the volatility is pretty much guaranteed with the name.

There are certainly safer dividends with yields north of 7% out there, but for those who desire to lock in the chunky dividend alongside substantial capital gains over the next few years, Inter Pipeline is a top pick while the stock continues to remain out of favour on Bay Street.

With a relatively safe dividend and a catalyst in Heartland that's vastly discounted by analysts, Inter Pipeline certainly looks like one of those rare opportunities to pay a quarter to get a dollar.

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