



Why Did Inter Pipeline (TSX:IPL) Stock Sink by 70%?

Description

Inter Pipeline Ltd (TSX:IPL) was once on top of the world. Shares tripled in price from 2008 to 2016. And while shares were stagnant over the next four years, investors weren't too concerned considering the stock delivered a reliable 8% dividend.

Then [the worst](#) happened. In February, shares were priced at \$22. Today, they're below \$8. What happened?

Compare these pipelines

Many investors compare Inter Pipeline stock to another pipeline owner, **Enbridge Inc** ([TSX:ENB](#))([NYSE:ENB](#))

Enbridge is the largest pipeline operator in North America. It has a market cap of \$75 billion. Over the years, the company has shown a consistent ability to sidestep market turmoil. Shares sailed through the 2008 financial crisis nearly unscathed. In 2014, when oil prices plunged by 50%, Enbridge stock actually *increased* in price.

The reasons for this performance are simple. First, pipelines typically charge customers on volumes, not pricing. Even if oil prices gyrate, profits remain steady. Second, pipelines are often the *only* option for a company to ship its fossil fuel output, which leads to pricing power for pipelines.

Third, Enbridge's network spans coast to coast, allowing it to reach nearly any market or refinery and enabling the company to charge an even greater premium.

Since the year began, Enbridge stock has uncharacteristically lost 30% of its value. Inter Pipeline, however, has shed *two-thirds* of its value. What's going on?

Time to buy Inter Pipeline?

Due to pricing power and relatively lower maintenance costs, pipelines produce a lot of excess cash flow, further supporting market-leading dividends. After the pullback, Enbridge stock yields 8.8%. Inter Pipeline, meanwhile, has a shocking 24% dividend.

Is it time to buy Inter Pipeline? Not so fast. When you dig deeper, Inter Pipeline doesn't have the advantages that Enbridge possesses.

The most glaring difference is that, despite its name, Inter Pipeline does much more than operate pipelines. Around 20% of cash flow comes from natural gas processing. Another 10% comes from bulk liquid storage.

These businesses are much more exposed to swings in commodity pricing. The ongoing price war between Saudi Arabia and Russia, which has seen cheap oil overload the market, could persist through the end of the year, hindering profitability in these segments.

The second difference is the client base. With its scale, Enbridge serves a wide range of customers that own projects in multiple countries, all with different extraction techniques and price break-evens. A diversified portfolio is an advantage when energy markets are tanking.

Inter Pipeline, meanwhile, derives more than 50% of its cash flow from oil sands projects. That's a problem.

Oil sands projects have always been at a cost disadvantage, as oil sands output needs additional refining, adding costs. While U.S. shale projects have break-evens of around US\$25 per barrel, Canadian oil sands output typically has a break-even of around US\$35 per barrel, sometimes even higher.

With oil prices approaching US\$20 per barrel, it's clear that high-cost projects won't survive for long. As these projects exit the market, Inter Pipeline could lose up to half of its business. That's a deathblow in a business with high fixed costs.

The current 24% dividend from Inter Pipeline is a mirage. Expect it to be cut as early as April, especially considering that the company needs to preserve cash to get its Heartland Petrochemical Complex online.

The stock price, meanwhile, could rebound in 2020, but that will only happen if the oil price war ends quickly — a situation that's completely out of the company's hands.

There are plenty of cheap stocks that can easily survive the current crisis and thrive when the downturn ends, but Inter Pipeline isn't one of them.

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