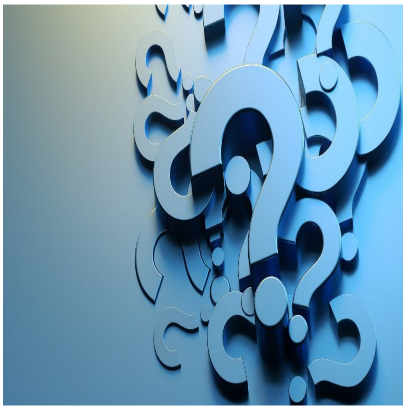

Is Inter Pipeline (TSX:IPL) a Great Buy After Its Dividend Cut?

Description

The stock market is an ongoing drama. Last year, **Inter Pipeline** (TSX:IPL) stock was offered a bid of $30 per share, which it rejected. Who would have thought the stock would trade at about $8 today?

Inter Pipeline's dividend yield was getting way up there at greater than 21%. In a none-too-surprising development, the company cut its dividend by 72% yesterday.

The new monthly dividend equates to an annualized payout of $0.48 per share at writing, resulting in a yield of 6.1% at the recent quotation of $7.84 per share.

Is the dividend safe now? Is Inter Pipeline stock a great buy after the dividend cut?

A closer look at Inter Pipeline stock's dividend cut

Before the dividend cut, Inter Pipeline had increased its dividend for 11 consecutive years. It froze its dividend in 2008. Otherwise, its previous dividend growth streak would have been even longer.

Inter Pipeline stock's dividend cut is a good reminder not to entirely trust a company's dividend history. Having a good dividend track record is only one indicator that a stock could potentially be a good dividend stock.

The energy infrastructure company already showed some warning signs in the past few years. Specifically, its three-year dividend growth rate slowed down dramatically to 2.9% compared to its 10-year dividend grate rate of 7.3%. Last year, it hiked its dividend by just 1.5%.

Moreover, the company's operating cash flow per share increased by only 1% in 2018.

The dividend cut made sense

Given that the stock has fallen so much — more than 60% — since February, it didn't make sense for the company to maintain its high yield that was within reach of 22% before the cut. That would be a waste of money given today's difficult operating environment for energy companies due to absurdly low oil prices.

Inter Pipeline is better off cutting the dividend, preserving capital, improving the balance sheet, and investing for future growth.

The dividend cut frees up about $525 million a year for the company. This capital can then be used to help finance the large Heartland Petrochemical Complex project without the need to dilute current shareholders.

The current yield of 6.1% is reasonable and sustainable. The payout ratio went from being 62% of operating cash flow to about 24%.

Investors don't need to be too disappointed. Management intends to increase the dividend in the future as business conditions permit.

Cost reduction

In an effort to lower costs, starting in April, the salary of the president and CEO and other executives, respectively, will be reduced by 20% and 10%. As well, the board of directors' cash retainer will be reduced by 15%.

Risk reduction

Inter Pipeline is seeking a partnership in the Heartland project. After its latest moves, the company can self-fund the project without issuing more equity. However, if it can find a partner, it'll be able to reduce project concentration risk, as Heartland makes up about 95% of its secured capital program.

The Foolish bottom line

Inter Pipeline has a decent balance sheet and is awarded an S&P credit rating of BBB+. After the dividend cut, its current yield is sustainable. If it can find a suitable partner for the Heartland project, it'll be able to free up more capital for other projects to reduce project concentration risk.

At normalized levels, the stock should trade closer to $20, which represents upside potential of about 155%, but it could take a few years for it to get there. Meanwhile, investors can enjoy a yield of 6.1%.

Although Inter Pipeline is an attractive investment today, there are safer dividend stocks investors can consider in the energy infrastructure space, including **Enbridge** and **TC Energy**.

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