# *Management's Discussion and Analysis*

**For the three months ended March 31, 2011**

# *Forward-Looking Information*

The following Management's Discussion and Analysis (MD&A) highlights significant business results and statistics for Inter Pipeline Fund's (Inter Pipeline) three month period ended March 31, 2011 to provide Inter Pipeline's unitholders and potential investors with information about Inter Pipeline and its subsidiaries, including management's assessment of Inter Pipeline's and its subsidiaries' future plans and operations. This information may not be appropriate for other purposes. This MD&A contains certain forward-looking statements or information (collectively referred to as "forward-looking statements") within the meaning of applicable securities legislation. Forward-looking statements often contain terms such as "may", "will", "should", "anticipate", "expect", "continue", "estimate", "believe", "project", "forecast", "plan", "intend", "target" and similar words suggesting future outcomes or statements regarding an outlook. Any statements herein that are not statements of historical fact may be deemed to be forward-looking statements. Forward-looking statements in this MD&A include, but are not limited to statements regarding: 1) Inter Pipeline's beliefs that it is well positioned to maintain its current level of cash distributions to its unitholders through 2011 and beyond; 2) the maintenance of Inter Pipeline's cash distribution level combined with the tax treatment of distributions to its unitholders effective in 2011 should result in a favourable after-tax treatment for Inter Pipeline's taxable unitholders; 3) Inter Pipeline being well positioned to operate and grow in the future; 4) cash flow projections; 5) timing for completion of various projects, including the Polaris diluent pipeline project for the Kearl oil sands mining project (Kearl project) and new pipeline connection to the Sunrise oil sands project (Sunrise project) and Cochrane liquid sweetening project; and, 6) capital forecasts.

Readers are cautioned not to place undue reliance on forward-looking statements, as such statements are not guarantees of future performance. Inter Pipeline in no manner represents that actual results, levels of activity and achievements will be the same in whole or in part as those set out in the forward-looking statements herein. Such information, although considered reasonable by Pipeline Management Inc., the general partner of Inter Pipeline (General Partner) at the time of preparation, may later prove to be incorrect and actual results may differ materially from those anticipated in the forward-looking statements. By their nature, forward-looking statements involve a variety of assumptions and are subject to various known and unknown risks, uncertainties and other factors, which are beyond Inter Pipeline's control, including, but not limited to: risks and assumptions associated with operations, such as Inter Pipeline's ability to successfully implement its strategic initiatives and achieve expected benefits; assumptions concerning operational reliability; the availability and price of labour and construction materials; the status, credit risk and continued existence of customers having contracts with Inter Pipeline and its subsidiaries; availability of energy commodities; volatility of and assumptions regarding prices of energy commodities; competitive factors, pricing pressures and supply and demand in the natural gas and oil transportation, ethane transportation and natural gas liquids (NGL) extraction and storage industries; assumptions based upon Inter Pipeline's current guidance; fluctuations in currency and interest rates; inflation; the ability to access sufficient capital from internal and external sources; risks inherent in Inter Pipeline's Canadian and foreign operations; risks of war, hostilities, civil insurrection and instability affecting countries in which Inter Pipeline and its subsidiaries operate; severe weather conditions; terrorist threats; risks associated with technology; Inter Pipeline's ability to generate sufficient cash flow from operations to meet its current and future obligations; Inter Pipeline's ability to access external sources of debt and equity capital; general economic and business conditions; potential delays and cost overruns on construction projects, including, but not limited to the Corridor project and other projects noted above; Inter Pipeline's ability to make capital investments and amount of capital investments; changes in laws and regulations, including environmental, regulatory and taxation laws, and the interpretation of such changes to laws and regulations; the risks associated with existing and potential future lawsuits and regulatory actions against Inter Pipeline and its subsidiaries; increases in maintenance, operating or financing costs; availability of adequate levels of insurance; political and economic conditions in the countries in which Inter Pipeline and its subsidiaries operate; difficulty in obtaining necessary regulatory approvals and maintenance of support of such approvals; and such other risks and uncertainties described from time to time in Inter Pipeline's reports and filings with the Canadian securities authorities. The impact of any one assumption, risk, uncertainty or other factor on a particular forward-looking statement is not determinable with certainty, as these are interdependent and Inter Pipeline's future course of action depends on management's assessment of all information available at the relevant time.

**Readers are cautioned that the foregoing list of important factors is not exhaustive. See also the section entitled RISK FACTORS included in Inter Pipeline's MD&A for the year ended December 31, 2010. The forward-looking statements contained in this MD&A are made as of the date of this document, and, except to the extent expressly required by applicable securities laws and regulations, Inter Pipeline assumes no obligation to update or revise forward-looking statements made herein or otherwise, whether as a result of new information, future events, or otherwise. The forward-looking statements contained in this document and all subsequent forward-looking statements, whether written or oral, attributable to Inter Pipeline or persons acting on Inter Pipeline's behalf are expressly qualified in their entirety by these cautionary statements.**

# *Management's Discussion and Analysis*

## For the three month period ended March 31, 2011

The MD&A provides a detailed explanation of Inter Pipeline's operating results for the three month period ended March 31, 2011 as compared to the three month period ended March 31, 2010. The MD&A should be read in conjunction with the March 31, 2011 unaudited condensed interim consolidated financial statements (interim financial statements), the unaudited interim consolidated financial statements and MD&A of Inter Pipeline for the quarterly periods ended March 31, June 30 and September 30, 2010, the audited consolidated financial statements for the year ended December 31, 2010, the **Annual Information Form** and other information filed by Inter Pipeline at www.sedar.com.

Financial information presented in this MD&A is based on information in Inter Pipeline's interim financial statements for March 31, 2011. The Canadian Accounting Standards Board (AcSB) requires all Canadian publicly accountable enterprises to adopt International Financial Reporting Standards (IFRS) for interim and annual reporting periods for fiscal years beginning on or after January 1, 2011. Consequently, Inter Pipeline is presenting its first financial results under the principles of IFRS, with fiscal 2010 results restated for comparative purposes beginning in the current quarter of 2011. The Canadian Institute of Chartered Accountants (CICA) incorporated IFRS in the CICA Handbook so it is now considered part of Generally Accepted Accounting Principles (GAAP). See the **INTERNATIONAL FINANCIAL REPORTING STANDARDS** section for further information on the transition to IFRS.

This MD&A reports certain non-GAAP financial measures that are used by management to evaluate the performance of Inter Pipeline and its business segments. Since certain non-GAAP financial measures may not have a standardized meaning, securities regulations require that non-GAAP financial measures are clearly defined, qualified and reconciled with their nearest GAAP measure. See the **NON-GAAP FINANCIAL MEASURES** section for further information on the definition, calculation and reconciliation of non-GAAP financial measures. All amounts are in Canadian dollars unless specified otherwise.

Management determines whether information presented in this MD&A is material based on whether it believes a reasonable investor's decision to buy, sell or hold securities in Inter Pipeline would likely be influenced or changed if the information was omitted or misstated.

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# INTERNATIONAL FINANCIAL REPORTING STANDARDS

Inter Pipeline's interim financial statements for March 31, 2011 have been prepared in accordance with International Accounting Standard (IAS) 34 – *Interim Financial Reporting* (IAS 34) and International Financial Reporting Standard 1 – *First-time Adoption of IFRS* (IFRS 1). The accounting policies used are consistent with IFRS as issued by the International Accounting Standards Board (IASB) and interpretations of the International Financial Reporting Interpretations Committee (IFRIC) that Inter Pipeline expects to adopt in its first annual IFRS financial statements for the year ended December 31, 2011. The interim financial statements do not contain all disclosures required by IFRS for annual financial statements, and accordingly, should be read in conjunction with Inter Pipeline's consolidated financial statements and the notes thereto for the year ended December 31, 2010. Subject to certain transition elections disclosed in note 21 *Transition to IFRS* (Note 21) of the March 31, 2011 interim financial statements, Inter Pipeline has consistently applied the same accounting policies in its opening IFRS balance sheet at January 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 21 discloses the impact of the transition to IFRS on Inter Pipeline's reported balance sheets, statements of net income, comprehensive income and cash flows, including the nature and effect of significant changes in accounting policies from those used in Inter Pipeline's consolidated financial statements for the year ended December 31, 2010. In this MD&A the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS. Comparative figures for 2010 in the financial statements previously reported under Canadian GAAP have been restated to give effect to these changes.

The policies applied to the March 31, 2011 interim financial statements are based on IFRS issued and outstanding as of May 5, 2011 (the date that Inter Pipeline's interim financial statements are approved) with effective dates for periods ending on December 31, 2011. Any subsequent changes to IFRS, that are given effect in Inter Pipeline's annual consolidated financial statements for the year ending December 31, 2011 could result in restatement of the interim financial statements, including the transition adjustments recognized on transition to IFRS.

The transition to IFRS had an immaterial impact on Inter Pipeline's key financial performance indicator, funds from operations*. Restatement of 2010 consolidated financial statements to IFRS resulted in a decrease in funds from operations* of $1.3 million or 0.4% for the year ended December 31, 2010, and a $0.2 million or 0.2% increase for the three months ended March 31, 2010.

For further discussion on Inter Pipeline's transition to IFRS, see the **Changes in Accounting Policies** section and also refer to Note 21 of the March 31, 2011 interim financial statements.

* Please refer to the **NON-GAAP FINANCIAL MEASURES** section

## FIRST QUARTER HIGHLIGHTS

- Funds from operations* increased in the quarter to a record $100.3 million, up $14.7 million or 17% over first quarter of 2010 results despite becoming a taxable entity in 2011
- Low quarterly payout ratio before sustaining capital* of 61.8%
- Cash distributions to unitholders totalled $62 million or $0.24 per unit
- Generated quarterly net income of $64.5 million, up $3.2 million or 5% over first quarter 2010 results
- Set a new record for quarterly throughput volumes on Inter Pipeline's oil sands and conventional oil pipeline systems, averaging 948,400 barrels per day (b/d)
- Oil sands transportation volumes averaged 777,600 b/d, an increase of 143,500 b/d or 23% over first quarter 2010 levels
- Began receiving revenue from the recently completed $1.85 billion expansion of the Corridor pipeline system
- Successfully completed a $325 million Canadian public debt offering of senior unsecured medium-term notes
- Conservative quarter end recourse debt to capitalization* ratio of only 42%

* Please refer to the **NON-GAAP FINANCIAL MEASURES** section

## PERFORMANCE OVERVIEW

| (millions, except per unit and % amounts) | Three months ended March 31 2011 | Three months ended March 31 2010 (restated) |
|---|---|---|
| Revenues | | |
| Oil sands transportation | $ 72.8 | $ 34.9 |
| NGL extraction | 159.9 | 173.0 |
| Conventional oil pipelines | 43.7 | 37.6 |
| Bulk liquid storage | 26.6 | 26.0 |
| | 303.0 | 271.5 |
| Funds from operations[1] | | |
| Oil sands transportation | $ 43.1 | $ 18.6 |
| NGL extraction | 53.0 | 47.6 |
| Conventional oil pipelines | 32.6 | 28.3 |
| Bulk liquid storage | 10.5 | 10.2 |
| Corporate costs | (38.9) | (19.1) |
| | $ 100.3 | $ 85.6 |
| Per unit[1] | $ 0.39 | $ 0.33 |
| Net income | $ 64.5 | $ 61.3 |
| Per unit – basic and diluted | $ 0.25 | $ 0.24 |
| Cash distributions[2] | $ 62.0 | $ 57.6 |
| Per unit[2] | $ 0.240 | $ 0.225 |
| Units outstanding (basic) | | |
| Weighted average | 258.3 | 255.8 |
| End of period | 258.5 | 256.3 |
| Capital expenditures | | |
| Growth [1] | $ 40.8 | $ 31.2 |
| Sustaining[1] | 2.8 | 2.5 |
| | $ 43.6 | $ 33.7 |
| Payout ratio before sustaining capital[1] | 61.8% | 67.3% |
| Payout ratio after sustaining capital[1] | 63.6% | 69.3% |

| (millions, except per unit and % amounts) | As at March 31 2011 | As at December 31 2010 (restated) |
|---|---|---|
| Total assets | $ 4,720.4 | $ 4,715.6 |
| Total debt[3] | $ 2,762.4 | $ 2,801.2 |
| Total partners' equity | $ 1,339.8 | $ 1,328.0 |
| Enterprise value [1] | $ 7,178.1 | $ 6,651.2 |
| Total debt to total capitalization[1] | 67.3% | 67.8% |
| Total recourse debt to capitalization[1] | 42.0% | 41.0% |

(1) Please refer to the **NON-GAAP FINANCIAL MEASURES** section of this MD&A.
(2) Cash distributions are calculated based on the number of units outstanding at each record date.
(3) Total debt reported in the March 31, 2011 interim financial statements includes long-term debt of $2,754.7 million inclusive of discounts and debt transaction costs of $7.7 million.

## THREE MONTHS ENDED MARCH 31, 2011

Inter Pipeline's first quarter 2011 financial results were at record high levels as each business segment generated increased operating results over the same period in 2010. Funds from operations* of $100.3 million in the quarter were up $14.7 million or 17.2% over the first quarter of 2010. The strong cash flow resulted in an attractive payout ratio before sustaining capital* of 61.8%. Funds from operations* in the oil sands transportation business increased to a new quarterly record as a result of substantial completion of the Corridor pipeline expansion project and its revenue commencement as of January 1, 2011. Operating results in the oil sands transportation business also increased as a result of higher volumes on the Cold Lake pipeline system. Higher frac-spreads compared to the same period in 2010 were the primary driver for an increase in operating results from the NGL extraction business resulting in a new quarterly record. Funds from operations* in the conventional oil pipelines business also increased, largely due to higher tariff revenue and increased throughput volumes. Lastly, the bulk liquid storage business recorded higher operating results, in spite of an unfavourable move in foreign exchange rates. These increases in funds from operations* were partially offset by higher corporate costs. These higher costs were largely related to current income taxes, which are being accrued for the first time in 2011, and lower levels of capitalized interest associated with the Corridor expansion being placed into commercial service.

In the first quarter, net income increased $3.2 million or 5.2% from $61.3 million in 2010 to $64.5 million in 2011. Net income was favourably impacted by increased operating results as discussed above and a decrease in deferred income taxes compared to the first quarter of 2010. These increases were partially offset by an unrealized loss in the mark-to-market value of derivative financial instruments, compared to an unrealized gain in the first quarter of 2010.

During the first quarter of 2011, total cash distributed to unitholders increased $4.4 million or 7.6% from $57.6 million in 2010 to $62.0 million in 2011. The increase is primarily due to increased monthly cash distributions of $0.005 per unit effective December of 2010.

Inter Pipeline's consolidated debt decreased $38.8 million to $2,762.4 million at March 31, 2011 from $2,801.2 million at December 31, 2010, during which time approximately $43.6 million was spent on capital projects.

## OUTLOOK

Inter Pipeline's business strategy is to acquire and develop long-life, high-quality energy infrastructure assets that generate sustainable and predictable long-term cash flow. Inter Pipeline's existing asset base is presently generating record cash flow, resulting in a continuing low payout ratio while also absorbing new income tax obligations arising in 2011 under SIFT legislation. Despite the change to taxable status, Inter Pipeline is well positioned to sustain current levels of cash distributions to unitholders through 2011 and beyond. Inter Pipeline's decision to increase cash distributions by 6.7% in December 2010, within months of becoming taxable, is a positive indication of its strong financial position and positive outlook. In 2011, Inter Pipeline's $220 million capital expenditure program will continue to advance projects that support long-term strategic growth initiatives and generate stable cash flows far into the future. Investment activity will be primarily oil sands related, centred on development of the Polaris diluent transportation system and preliminary engineering of a potential multi-year expansion of the Cold Lake pipeline system.

The Corridor pipeline expansion project is now fully commissioned and operational, at a total cost of $1.85 billion. The expansion has increased bitumen blend capacity on the Corridor system from 300,000 b/d to 465,000 b/d. This added capacity will facilitate transportation of increased oil sands production from the Athabasca Oil Sands Project (AOSP), including the recent Jackpine mine development. The AOSP is owned by Shell, Chevron and Marathon. The Corridor expansion is governed by a cost-of-service contract that will generate stable long-term cash flows. In 2011, the final step in the project, the commissioning of a 43 kilometre products line from the Scotford upgrader to the Edmonton market hub, was successfully

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* Please refer to the **NON-GAAP FINANCIAL MEASURES** section

completed. As per the contract terms, Inter Pipeline began receiving incremental revenue from the expansion on January 1, 2011.

The Polaris diluent transportation system is a key focus of investment activity in 2011. Initially supported by two major commercial agreements, the Polaris system is currently the only independent diluent transportation system to the Athabasca oil sands region. The first transportation contract, a 25-year, 60,000 b/d cost-of-service agreement to transport diluent for the Kearl oil sands project under development by Imperial Oil Limited and ExxonMobil Canada, was signed in 2009 and is expected to commence service in late 2012. The second major long-term contract is for diluent transportation to the Sunrise oil sands project, under development by Husky Oil Operations Limited and BP Canada Energy Company. Starting in late 2013 Inter Pipeline will provide 30,000 b/d of committed diluent capacity to the Sunrise project under a 20-year cost-of-service contract. Construction on both projects is expected to advance significantly in 2011, on schedule to meet planned in-service dates. The Polaris transportation contracts are structured such that they do not have any commodity price or throughput risk.

Together, the Kearl and Sunrise diluent transportation agreements have contracted 90,000 b/d of throughput capacity on the Polaris system or roughly 75% of its current minimum planned capacity, and will generate approximately $67 million in incremental EBITDA* annually when fully in service. Inter Pipeline is pursuing additional diluent transportation opportunities to utilize the Polaris system for other third party opportunities in addition to future expansions of the Kearl and Sunrise projects. Capacity on the Polaris system can be expanded significantly beyond 120,000 b/d through the addition of pump capacity followed by the construction of parallel segments of pipeline.

In 2011, preliminary engineering and development work began on a potential multi-year expansion of the Cold Lake pipeline system. Additional capacity on the Cold Lake main line is expected to be required to meet forecast volume growth from existing shippers and prospective third parties. Potential expansion projects would be undertaken in numerous phases comprised of new pipeline loops, pipeline laterals, additional pump stations and associated facilities. Inter Pipeline recently expanded a segment of the Cold Lake system that provides service to the Foster Creek oil sands project, jointly owned by Cenovus and ConocoPhillips. The $40 million expansion, completed on schedule, was placed into service and began generating revenue for Inter Pipeline in December 2010. This strategic infrastructure development is consistent with Inter Pipeline's plans to extend the Cold Lake system further north and add infrastructure to meet future production growth and transportation requirements.

Inter Pipeline's NGL extraction business segment again posted very strong results in the first quarter, due to frac-spread prices that remained very high relative to historical averages. While strong commodity prices directly benefit overall financial performance through higher frac-spreads, Inter Pipeline is shielded from the impact of weaker commodity prices as exposure is limited primarily to one revenue stream, the sale of propane-plus extracted at the Cochrane NGL extraction facility. As the oil sands-related organic growth projects discussed earlier enter into service, Inter Pipeline's exposure to commodity price fluctuations should become a smaller proportion of Inter Pipeline's consolidated financial results.

Inter Pipeline's balance sheet remains in a very strong position, supported by positive financial results and moderate debt levels. Inter Pipeline's total recourse debt to capitalization ratio was relatively low at 42.0% at March 31, 2011. Inter Pipeline continues to maintain significant available capacity on existing credit facilities, and was therefore well prepared to fund the $460 million equity contribution obligation associated with the Corridor expansion project in early January 2011. Also in the first quarter, Inter Pipeline further strengthened its balance sheet by successfully completing a $325 million public debt offering. The 10-year unsecured medium-term notes (MTN Series 1) were issued at an attractive coupon rate of 4.967%. Net proceeds were used to reduce indebtedness on Inter Pipeline's revolving credit facility. The offering was met with very strong demand and represents a new source of capital to support Inter Pipeline's future growth opportunities.

On January 1, 2011, publicly traded flow-through entities such as income trusts and limited partnerships became taxable. The change to a taxable status led many organizations in this sector to change their business structure and lower cash distribution levels to pay these new tax burdens. In contrast, Inter Pipeline's long-term business strategy led to a successful transition to the new taxation environment

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* Please refer to the **NON-GAAP FINANCIAL MEASURES** section

without making major changes to its business structure, or making any reductions to its cash distribution level. In fact, effective with the January 2011 distribution payment, Inter Pipeline raised annualized distributions by six cents per unit. Strong fundamentals in all four of our business segments support Inter Pipeline's position that it can maintain current distribution levels into the foreseeable future, in spite of new income tax obligations.

In 2009, Inter Pipeline's board of directors engaged in a formal process to consider alternative business structures. After considering the impacts of all relevant variables such as the level of income taxes to be paid, corporate conversion costs, counterparty consent issues and sustainability of distributions, Inter Pipeline's governance committee and other independent directors concluded that no material tangible benefit to Inter Pipeline's unitholders would arise from changing the existing business structure. As a result, Inter Pipeline's board of directors determined that Inter Pipeline will remain structured as a publicly traded limited partnership into the foreseeable future. The board of directors will continue to monitor future events which could affect this decision.

The change to a taxable entity will also lead to a more favourable tax treatment of Inter Pipeline's cash distributions in the hands of a taxable investor in two ways. First, for distributions with a record date after January 1, 2011, the taxable portion of distributions, excluding a minor portion relating to foreign source income, will be eligible for the dividend tax credit resulting in a lower effective tax rate for taxable investors. For example, using 2010 tax rates, a Canadian resident in the highest marginal tax bracket will have their effective tax rate on the eligible dividend portion of distributions reduced by approximately 16% to 24% depending on their province of residence. Previously, the entire taxable portion of Inter Pipeline's cash distributions was classified as either business or interest income for tax purposes and not eligible for the dividend tax credit. Second, a portion of distributions is expected to be treated as a return of capital. The return of capital will not be taxable to the unitholder and will reduce the adjusted cost base of investors' units, thereby effectively deferring payment of associated taxes until disposition of the units.

Inter Pipeline's stable and diversified business continues to support strong investment grade credit ratings. In late 2010, Standard & Poor's (S&P) increased Inter Pipeline's investment grade credit rating to BBB+ with a stable outlook, up from BBB. Earlier in 2010, DBRS upgraded Inter Pipeline's investment grade credit rating to BBB (high) with a stable trend, up from BBB. Inter Pipeline (Corridor) Inc. (Corridor) has been assigned investment grade credit ratings of A3 (stable outlook), A- (positive outlook), and A from Moody's Investor Services (Moody's), S&P and DBRS, respectively. The MTN Series 1 notes were issued investment grade credit ratings of BBB+ and BBB (high) by S&P and DBRS, respectively.

In 2011, Inter Pipeline has successfully transitioned from Canadian GAAP to IFRS. Overall, adoption of IFRS has not been a significant event for Inter Pipeline and its financial results. As a result of the new standards, assets and liabilities have changed by an insignificant amount, while key operating metrics such as debt to capital ratios and funds from operations* are minimally impacted.

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* Please refer to the **NON-GAAP FINANCIAL MEASURES** section

## RESULTS OF OPERATIONS

### OIL SANDS TRANSPORTATION BUSINESS SEGMENT

| | Three Months Ended March 31 | | |
|---|---|---|---|
| *Volumes (000s b/d)* | 2011 | 2010 | *% change* |
| Cold Lake (100% basis) | 508.2 | 447.6 | *13.5* |
| Corridor | 269.4 | 186.5 | *44.5* |
| | 777.6 | 634.1 | *22.6* |

| *(millions)* | | *(restated)* | |
|---|---|---|---|
| Revenue[1] | $ 72.8 | $ 34.9 | *108.6* |
| Operating expenses[1] | $ 19.8 | $ 13.3 | *48.9* |
| Funds from operations[1][2] | $ 43.1 | $ 18.6 | *131.7* |
| Capital expenditures[1] | | | |
| Growth[2] | $ 36.0 | $ 25.6 | |
| Sustaining[2] | 0.1 | - | |
| | $ 36.1 | $ 25.6 | |

(1) Cold Lake pipeline system's revenue, operating expenses, funds from operations and capital expenditures are recorded on the basis of Inter Pipeline's 85% ownership interest.
(2) Please refer to the **NON-GAAP FINANCIAL MEASURES** section of this MD&A.

#### Volumes

During the first quarter of 2011, average volumes in the oil sands transportation business increased 143,500 b/d or approximately 22.6% to 777,600 b/d compared to the same period in 2010.

The Cold Lake pipeline system is a bitumen blend and diluent pipeline system that transports diluted bitumen from the Cold Lake oil sands area of Alberta to delivery points in the Hardisty and Edmonton areas. In the first quarter of 2011, average volume transported on the Cold Lake pipeline system was 508,200 b/d, an increase of 60,600 b/d or 13.5% over the same period in 2010. The increase in volumes transported is primarily the result of increased production from all three of the Cold Lake founding shippers. Inter Pipeline expects to see continued incremental volume growth on the system that is broadly consistent with the shippers' long-term published forecasts.

The Corridor pipeline system transports diluted bitumen produced from the Muskeg River and Jackpine Mines near Fort McMurray, Alberta to the Scotford upgrader located northeast of Edmonton, Alberta, as well as feedstock and upgraded products between the Scotford upgrader and certain pipeline terminals in Edmonton, Alberta. Average volumes increased 82,900 b/d on the Corridor pipeline system to 269,400 b/d, an increase of 44.5% in the first quarter of 2011 compared to the same period in 2010. Volume increases in the first quarter of 2011 were primarily due to volumes from AOSP's Jackpine Mine which began production in the fourth quarter of 2010. Volumes were also lower in the first quarter of 2010 due to commissioning activities related to the Corridor pipeline expansion project.

#### Revenue

In the first quarter of 2011, revenue in the oil sands transportation business increased approximately $37.9 million or 109% as compared to the same period in 2010.

Revenue from Cold Lake increased $8.9 million, or 48% in the first quarter of 2011 compared to the same period in 2010. The increase in revenue was primarily due to increased volumes transported and higher power and operating cost recoveries.

The Cold Lake Transportation Services Agreement (Cold Lake TSA) provides for a structured return on capital invested including a defined capital fee that is applied to volumes transported through the pipelines and facilities that comprise the Cold Lake pipeline system, and a recovery of substantially all operating costs. The founding shippers' annual minimum ship-or-pay commitment under the terms of the Cold Lake TSA is $27.8 million to the end of December 2011 based on Inter Pipeline's 85% ownership

interest ($32.7 million – 100% basis). Inter Pipeline receives incremental revenue based on the capital fee for volumes shipped over and above the defined ship-or-pay amounts. In addition to the Cold Lake TSA, there are further agreements between Cold Lake LP and the founding and third party shippers that result in additional returns on capital invested and recovery of associated operating costs.

In the first quarter of 2011, Corridor's revenue increased $29.0 million, or 178% compared to the same period in 2010. The increase in revenue is primarily attributable to the substantial completion of the Corridor pipeline expansion project and its revenue commencement on January 1, 2011. Revenue was also favourably impacted in the current quarter by increased operating cost recoveries as compared to the same period in 2010.

The Corridor Firm Service Agreement (Corridor FSA) utilizes a rate base cost-of-service approach to establish a revenue requirement which provides for recovery of debt financing costs, all operating costs, rate base depreciation and taxes, in addition to providing a return on equity. As a result of this cost-of-service approach, Corridor's funds from operations* are not impacted by throughput volumes or commodity price fluctuations. The main drivers of any potential variation in Corridor's funds from operations* are changes to long-term Government of Canada bond rates, upon which the annual return on equity is determined, and changes to the Corridor rate base. With the substantial completion of the Corridor pipeline expansion project, the Corridor rate base increased effective January 1, 2011; therefore revenue and funds from operations* also increased.

### Operating Expenses

Operating expenses in the oil sands transportation business segment have a limited impact on Inter Pipeline's cash flow as substantially all expenditures are recovered from the shippers on both the Cold Lake and Corridor pipeline systems. In the first quarter of 2011, operating expenses in the oil sands transportation business increased $6.5 million compared to the same period in 2010.

In the first quarter of 2011, operating expenses increased $4.5 million on the Cold Lake pipeline system compared to the same period in 2010. Power costs increased $3.6 million primarily due to an increase in power prices, consumption and transportation costs. Other operating costs increased $0.9 million primarily due to higher maintenance costs which were partially offset by lower property taxes. In the first quarter, average Alberta power pool prices increased approximately 101% from $40.78/MWh in 2010 to $82.04/MWh in 2011.

Operating expenses incurred in the first quarter of 2011 on the Corridor pipeline system increased by $2.0 million compared to the same period in 2010. Property taxes, maintenance costs and other general operating costs increased by $2.8 million, largely due to the addition of the new 42-inch pipeline and associated facilities. Power costs decreased $0.8 million as a result of the 42-inch pipeline operating more efficiently and requiring less power to transport volumes, combined with the renegotiation of electrical service agreements to reflect this reduction in power requirements.

### Capital Expenditures

In the first quarter of 2011, approximately $7.5 million of growth capital* was expended on the Corridor pipeline expansion project for a total of $1,850.9 million spent to date. The Corridor pipeline expansion project is now fully commissioned with completion of commissioning activities on the 20-inch products pipeline in the first quarter of 2011. Corridor pipeline expansion project costs have been added to the rate base and began generating revenue on January 1, 2011. In the first quarter of 2011, in addition to the Corridor pipeline expansion project, growth capital expenditures* of $4.0 million were expended on overall system enhancements and maintenance at the Hangingstone River crossing on the Corridor pipeline system.

Detailed facility engineering, procurement and pipeline construction activity for Inter Pipeline's Polaris diluent pipeline system continues, with approximately $20.4 million of growth capital* spent during the first quarter of 2011 for a total of $35.8 million spent to date. Beginning in late 2012 and 2013, the Polaris system will provide diluent transportation services for the Kearl and Sunrise oil sands projects, respectively, utilizing the existing 12-inch diameter pipeline that has been idled from the Corridor

* Please refer to the **NON-GAAP FINANCIAL MEASURES** section

expansion project. The net book value of the Polaris pipeline will be deducted from Corridor's rate base, which is estimated to be in the latter half of 2012, prior to entering into diluent service for the Kearl project. Total cost to connect the Polaris pipeline to the Kearl and Sunrise projects and diluent receipt points in the Edmonton area is currently estimated to be approximately $150 million.

During the first quarter of 2011, approximately $3.3 million (85% share) was spent on the final stages of an expansion project on the Cold Lake pipeline system for a total of $34.3 million spent to date. The expansion increased transportation capacity for the Foster Creek oil sands project. Construction has been completed and the expansion was placed into service in December 2010. The expansion included installation of 27 kilometers of pipeline and related facilities on the Cold Lake system. The new pipeline parallels an existing Cold Lake pipeline north of the La Corey terminal and positions the Cold Lake system to meet near and longer term production targets from the Foster Creek project. Additional growth capital expenditures* of $0.8 million were expended on various other growth initiatives on the Cold Lake pipeline system in the first quarter of 2011.

## NGL Extraction Business Segment

| | | | | | | | | Three Months Ended March 31 |
|---|---|---|---|---|---|---|---|---|
| | 2011 | | | | 2010 | | | |
| | *mmcf/d* | *(000s b/d)* | | | *mmcf/d* | *(000s b/d)* | | |
| | Throughput | Ethane | Propane-plus | Total | Throughput | Ethane | Propane-plus | Total |
| Cochrane | 1,885 | 54.5 | 25.9 | 80.4 | 2,023 | 52.5 | 28.3 | 80.8 |
| Empress V (100% basis) | 1,051 | 24.6 | 11.4 | 36.0 | 1,042 | 20.1 | 12.0 | 32.1 |
| Empress II | 283 | 5.1 | 2.8 | 7.9 | 141 | 2.5 | 1.6 | 4.1 |
| | 3,219 | 84.2 | 40.1 | 124.3 | 3,206 | 75.1 | 41.9 | 117.0 |

| *(millions)* | 2011 | 2010 *(restated)* | *% change* |
|---|---|---|---|
| Revenue[1] | $ 159.9 | $ 173.0 | *(7.6)* |
| Shrinkage gas[1] | $ 78.0 | $ 99.4 | *(21.5)* |
| Operating expenses[1] | $ 28.7 | $ 26.0 | *10.4* |
| Funds from operations[1] [2] | $ 53.0 | $ 47.6 | *11.3* |
| Capital expenditures[1] | | | |
| Growth[2] | $ 1.2 | $ 0.5 | |
| Sustaining[2] | 1.0 | 0.5 | |
| | $ 2.2 | $ 1.0 | |

(1) Revenue, shrinkage gas, operating expenses, funds from operations and capital expenditures for the Empress V NGL extraction facility are recorded based on Inter Pipeline's 50% ownership.
(2) Please refer to the **NON-GAAP FINANCIAL MEASURES** section.

### Volumes

Inter Pipeline's NGL extraction plants processed an average of 3,219 million cubic feet per day (mmcf/d) of natural gas in the first quarter of 2011. Overall throughput volumes remained relatively consistent with the same period in 2010.

In the first quarter of 2011, throughput volumes decreased at the Cochrane facility by approximately 138 mmcf/d, primarily due to lower US west-coast demand for natural gas compared to the same period in 2010.

* Please refer to the **NON-GAAP FINANCIAL MEASURES** section

Throughput volumes at the Empress V and II facilities increased 9 mmcf/d and 142 mmcf/d, respectively in the first quarter of 2011, primarily due to higher volumes of natural gas exported from Alberta's eastern border as compared to the same period in 2010. Despite the consistency of throughput volumes at the Empress V facility, ethane recovery rates were approximately 4,100 barrels per mmcf/d higher as a result of ongoing ethane recovery improvement efforts. The increase in throughput volumes at the Empress II facility has not impacted operating results due to the cost-of-service commercial arrangements related to this facility.

## Revenue

The NGL extraction business earns revenue from a combination of commodity based, fee-based and cost-of-service arrangements. Commodity based contracts provide for a sharing of profits from the sale of NGL products between the NGL extraction business and the purchaser. The profit share calculation consists of revenue from the sale of NGL products less costs to bring the NGL product to market, including extraction, shrinkage gas, fractionation and marketing costs. Commodity based contracts are exposed to frac-spread and volume risks. Fee-based contracts provide a fixed fee associated with each barrel of NGL produced and recovery of operating costs, including shrinkage gas costs. There is no commodity price exposure associated with this type of contract; however, fee-based contracts are exposed to volume fluctuations. Cost-of-service contracts provide a structured return on capital invested utilizing a rate base approach and a recovery of operating costs, including shrinkage gas. This form of contract provides the most stable cash flow of the three contract types, as there is minimal volume risk and no commodity price exposure.

In the first quarter of 2011, revenue decreased $13.1 million compared to the same period in 2010 primarily due to lower propane-plus volumes at the Cochrane facility, which was partially offset by higher propane-plus pricing. Revenue was also impacted by lower cost recoveries under the cost-of-service and fee-based contracts due to lower natural gas prices. Inter Pipeline recovers a significant portion of its shrinkage and fuel gas costs under these aforementioned contracts which is recognized as revenue.

## Frac-spread

| | Three Months Ended March 31 | | | |
|---|---|---|---|---|
| *(dollars)* | 2011 | | 2010 | |
| | *USD/USG (1)* | *CAD/USG (1)* | *USD/USG (1)* | *CAD/USG (1)* |
| Market frac-spread | $ 1.178 | $ 1.162 | $ 0.876 | $ 0.912 |
| Realized frac-spread | $ 0.991 | $ 0.977 | $ 0.816 | $ 0.849 |

(1) The differential between USD/USG and CAD/USG frac-spreads is due to fluctuations in exchange rates between US and Canadian dollars.

Market frac-spread is defined as the difference between the weighted average propane-plus price at Mont Belvieu, Texas and the monthly index price of AECO natural gas purchased for shrinkage calculated in US dollars per US gallon (USD/USG). This price is converted to Canadian dollars per US gallon (CAD/USG) based on the average monthly Bank of Canada CAD/USD noon rate. Realized frac-spread is defined in a similar manner and is calculated on a weighted average basis using market frac-spread for unhedged production and fixed-price frac-spread prices for the remaining hedged production. Propane-plus market price differentials, natural gas transportation and extraction premium costs have not been significant historically, and therefore are not included in the calculation of realized frac-spread. See the **RISK MANAGEMENT AND FINANCIAL INSTRUMENTS** section for further discussion of frac-spread hedges.

Realized frac-spreads in the first quarter of 2011 increased from $0.82 USD/USG in the first quarter of 2010 to $0.99 USD/USG. For the three month period ended March 31, 2011, market frac-spreads were above the 5-year and 15-year simple average market frac-spread of $0.70 USD/USG and $0.39 USD/USG, respectively, calculated at December 31, 2010.

## Shrinkage

Shrinkage gas represents natural gas bought by Inter Pipeline to replace the heat content of liquids extracted from natural gas processed at the Cochrane and Empress V facilities. The price for shrinkage gas is based on a combination of daily and monthly index AECO natural gas prices. In the first quarter of 2011,

shrinkage gas decreased $21.4 million due to lower AECO natural gas prices and lower throughput volumes compared to the same period in 2010. The weighted average monthly AECO price* decreased approximately 29.6% from $5.07 per gigajoule (GJ) in the first quarter of 2010 to $3.57/GJ during the first quarter of 2011.

### Operating Expenses

Operating expenses in the first quarter of 2011 were $2.7 million higher than in the same period in 2010, primarily due to increased power costs as a result of the increase in average Alberta pool prices of approximately 101% from $40.78 in 2010 to $82.04 in 2011.

### Capital Expenditures

In the first quarter of 2011, growth capital expenditures† were $0.6 million at the Cochrane facility, primarily relating to a liquid sweetening project, and $0.6 million at the Empress facilities relating to various projects.

## CONVENTIONAL OIL PIPELINES BUSINESS SEGMENT

| | Three Months Ended March 31 | | |
|---|---|---|---|
| *Volumes (000s b/d)* | 2011 | 2010 | *% change* |
| Bow River | 109.5 | 112.5 | *(2.7)* |
| Central/Mid-Saskatchewan | 61.3 | 53.7 | *14.2* |
| | 170.8 | 166.2 | *2.8* |

| *(millions)* | | *(restated)* | |
|---|---|---|---|
| Revenue | $ 43.7 | $ 37.6 | *16.2* |
| Operating expenses | $ 10.2 | $ 8.8 | *15.9* |
| Funds from operations[(1)] | $ 32.6 | $ 28.3 | *15.2* |
| Revenue per barrel[(2)] | $ 2.85 | $ 2.51 | *13.5* |
| Capital expenditures | | | |
| Growth[(1)] | $ 0.1 | $ 2.5 | |
| Sustaining[(1)] | 0.3 | 0.1 | |
| | $ 0.4 | $ 2.6 | |

(1) Please refer to the **NON-GAAP FINANCIAL MEASURES** section.
(2) Revenue per barrel represents total revenue of the conventional oil pipelines business segment divided by actual volumes.

### Volumes

In the first quarter of 2011, conventional oil pipeline volumes increased approximately 4,600 b/d compared to the same period in 2010. Volumes on the Central Alberta and Mid-Saskatchewan pipelines increased approximately 6,900 b/d and 700 b/d, respectively, for the first quarter of 2011 as compared to the first quarter of 2010. Central Alberta volumes were higher as trucked-in volumes increased due to wider heavy crude oil differentials resulting in favourable blending economics for shippers. New horizontal well drilling in the Viking light oil play resulted in positive volume growth on the Mid-Saskatchewan pipeline. Volumes on the Bow River pipeline system decreased approximately 3,000 b/d primarily due to natural volume declines.

### Revenue

Conventional oil pipeline revenue increased $6.1 million in the first quarter of 2011 compared to the same period in 2010. The increase in revenue was primarily due to mainline toll increases averaging 6% in both January 2011 and July 2010, and additional volumes on the Central Alberta and Mid-Saskatchewan pipelines as noted above.

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* Weighted average price calculated from one-month spot prices at AECO as reported in the *Canadian Gas Price Reporter*.

† Please refer to the **NON-GAAP FINANCIAL MEASURES** section

### Operating Expenses

In the first quarter, operating expenses were $1.4 million higher compared to the same period in 2010. The increase is primarily due to higher general maintenance, right-of-way and power pool costs, as well as the timing of integrity costs. These increases were partially offset by lower property taxes and a reallocation of certain employee groups to the corporate group.

### Capital Expenditures

Growth capital expenditures* in the first quarter of 2011 were $0.1 million relating to various small projects.

## BULK LIQUID STORAGE BUSINESS SEGMENT

| | Three Months Ended March 31 | | |
|---|---|---|---|
| | 2011 | 2010 | *% change* |
| Utilization | 98.7% | 95.4% | *3.5* |

| *(millions)* | | *(restated)* | |
|---|---|---|---|
| Revenue | $ 26.6 | $ 26.0 | *2.3* |
| Operating expenses | $ 13.3 | $ 13.5 | *(1.5)* |
| Funds from operations(1) | $ 10.5 | $ 10.2 | *2.9* |
| Capital expenditures | | | |
| Growth(1) | $ 3.5 | $ 2.6 | |
| Sustaining(1) | 0.7 | 0.6 | |
| | $ 4.2 | $ 3.2 | |

(1) Please refer to the **NON-GAAP FINANCIAL MEASURES** section.

### Utilization

Inter Pipeline, through its wholly owned subsidiary Simon Storage Limited (Simon Storage), owns eight deep-water bulk liquid storage terminals primarily servicing the petrochemical, petroleum and biofuel industries in the UK, Germany and Ireland. Despite the European economic environment being somewhat uncertain, demand for bulk liquid storage has held strong with tank utilization increasing to an average of 98.7% in the first quarter of 2011, compared to 95.4% in the same period of 2010. Demand for storage fluctuates historically due to market conditions within industry sectors and Simon Storage manages these fluctuations through customer and product diversification.

### Revenue

The business activities of Simon Storage consist primarily of bulk liquid storage and handling services that are underpinned by a range of long-term and short-term fee-based contracts. Simon Storage also offers a range of ancillary services to its customers through its engineering and facilities management divisions.

Revenue increased approximately $0.6 million in the first quarter of 2011 compared to the same period in 2010. Storage and handling revenue increased approximately $1.9 million as a result of higher utilization, increases in storage rates and additional handling and heating services. These increases were partially offset by a $0.9 million decrease in foreign currency translation adjustments and a $0.4 million decrease in ancillary business revenue, compared to the first quarter of 2010. The average Pound Sterling/CAD exchange rate declined from 1.63 in the first quarter of 2010 to 1.58 in the first quarter of 2011.

### Operating Expenses

In the first quarter of 2011, operating expenses decreased approximately $0.2 million compared to the same period in 2010. The decrease is primarily due to foreign currency translation adjustments and decreased ancillary business activity of $0.5 million and $0.3 million, respectively. These decreases were

* Please refer to the **NON-GAAP FINANCIAL MEASURES** section

partially offset by an increase in variable operating expenses of approximately $0.6 million in the core storage and handling business as a result of increased throughputs at key terminals.

### Capital Expenditures

Growth capital expenditures* of $3.5 million were incurred in the first quarter of 2011, mainly relating to a number of tank replacements, tank life extensions and tank modification projects at Immingham and other terminals.

## OTHER EXPENSES

| (millions) | Three Months Ended March 31 2011 | Three Months Ended March 31 2010 (restated) |
|---|---|---|
| Depreciation and amortization | $ 24.4 | $ 24.8 |
| Gain on disposal of assets | (0.1) | - |
| Financing charges | 18.9 | 9.6 |
| General and administrative | 12.6 | 11.0 |
| Unrealized change in fair value of derivative financial instruments | 10.3 | (7.1) |
| Fees to General Partner | 2.8 | 2.0 |
| Provision for income taxes | 19.5 | 8.9 |

### Depreciation and Amortization

Depreciation and amortization of tangible and intangible assets for the first quarter of 2011 was lower than the same period in 2010. Effective July 1, 2010, Inter Pipeline amended its useful life estimates for calculating depreciation on the Corridor, Cold Lake and Bow River pipeline systems. The estimated remaining service lives of these assets have been revised to 80 years to better reflect the number of years over which these pipeline systems will be in operation. This decrease was partially offset by increased depreciation for assets now in service related to 2010 capital expenditure programs.

### Financing Charges

| (millions) | Three Months Ended March 31 2011 | Three Months Ended March 31 2010 (restated) |
|---|---|---|
| Interest on credit facilities | $ 7.7 | $ 4.8 |
| Interest on loan payable to General Partner | 5.8 | 5.8 |
| Interest on Corridor debentures | 2.5 | 1.6 |
| Interest on senior unsecured medium-term notes | 2.6 | - |
| Total interest | 18.6 | 12.2 |
| Capitalized interest | (0.3) | (3.1) |
| Amortization of transaction costs on long-term debt | 0.2 | 0.2 |
| Accretion of decommissioning and environmental obligations | 0.4 | 0.3 |
| Total financing charges | $ 18.9 | $ 9.6 |

Financing charges during the first quarter of 2011 were $18.9 million, an increase of $9.3 million or 97% from the same period in 2010.

Interest on credit facilities increased approximately $2.9 million in the first quarter of 2011 compared to the same period in 2010. Average short-term interest rates were higher in the first quarter of 2011 compared to 2010. The weighted average interest rate on Inter Pipeline's credit facilities has increased approximately 70 basis points from 0.9% in the first quarter of 2010 to approximately 1.6% in 2011. Inter Pipeline's weighted average credit facility debt outstanding decreased approximately $4.9 million to $1,937.3 million in the first quarter of 2011 compared to $1,942.2 million in the same period in 2010.

* Please refer to the **NON-GAAP FINANCIAL MEASURES** section

In the first quarter of 2011, capitalized interest decreased $2.8 million compared to the same period in 2010. The decrease is primarily due to interest no longer being capitalized on the Corridor expansion project as it was placed into service and began generating revenue on January 1, 2011.

On February 2, 2011 Inter Pipeline issued $325 million of MTN Series 1 notes at a rate of 4.967% per annum due February 2, 2021 in the Canadian public debt market. The MTN Series 1 notes had the impact of increasing interest expense by $2.6 million over the first quarter of 2010.

In the first quarter of 2011, Corridor debenture interest expense increased $0.9 million compared to the same period in 2010. Interest rates on these debentures are fixed; however, Inter Pipeline had swap agreements in place on each of the $150 million series A and B debentures that exchanged the fixed rates for variable rates. On February 2, 2010, the series A debentures matured and the associated interest rate swap agreement was terminated. On the same day, Corridor issued $150 million 4.897% fixed rate series C senior, unsecured debentures that mature February 3, 2020 without acquiring a corresponding swap agreement.

Interest expense on the loans payable to the General Partner was consistent in both periods due to the fixed rate of interest on the loan and no change in principal balance during the period. Fixed interest rates on each of the $91.2 million and $288.6 million loans outstanding is 5.85% and 6.15%, respectively.

See the **LIQUIDITY AND CAPITAL RESOURCES** section for further information about Inter Pipeline's debt facilities and interest rate swaps.

## General and Administrative

| | Three Months Ended March 31 | |
|---|---|---|
| *(millions)* | 2011 | 2010 *(restated)* |
| Canada | $ 10.9 | $ 9.5 |
| Europe | 1.7 | 1.5 |
| | $ 12.6 | $ 11.0 |

General and administrative expenses in Canada increased $1.4 million in the first quarter of 2011 largely due to higher employee compensation expense and increased rent, which was partially offset by lower professional fees. Employee compensation expenses were higher primarily as a result of no longer capitalizing employee costs relating to the Corridor expansion project, the reallocation of certain employee groups to the corporate group and revaluation of Inter Pipeline's long-term deferred unit rights incentive plan costs due to a higher market value of Inter Pipeline's Class A units.

In the first quarter of 2011, general and administrative expenses relative to Inter Pipeline's European operations were slightly higher ($0.2 million) than the same period in 2010, due to higher employee costs and external services.

## Unrealized Change in Fair Value of Derivative Financial Instruments

Inter Pipeline's mark-to-market valuation of its derivative financial instruments unfavourably impacted net income by $10.3 million, in the first quarter of 2011. Increases in NGL forward prices between January and March of 2011, combined with increased NGL volumes under swap contracts, resulted in an unfavourable impact of $18.5 million to net income. This adjustment was partially offset by net favourable changes of $8.2 primarily relating to the mark-to-market of natural gas hedges, foreign currency, interest rate, electricity and heat rate swaps for the same period.

See the **RISK MANAGEMENT AND FINANCIAL INSTRUMENTS** section for additional information on Inter Pipeline's risk management initiatives.

## Fees to General Partner

The General Partner earned management fees from Inter Pipeline of $2.8 million in the first quarter of 2011 (Q1 2010 - $2.0 million). This fee is equivalent to 2% of "Operating Cash," as defined in the Limited Partnership Agreement (Partnership Agreement).

## Income Taxes

Consolidated income tax expense for the three months ended March 31, 2011 increased $10.6 million from $8.9 million in 2010 to $19.5 million in 2011. In June 2007, the Government of Canada enacted legislation imposing income taxes upon publicly traded income trusts and limited partnerships, including Inter Pipeline, effective January 1, 2011. Consequently, Inter Pipeline will be subject to income tax on its Canadian partnership income for the first time in the 2011 taxation year. As a result, Inter Pipeline has recognized $12.6 million in income tax expense for the three months ended March 31, 2011. In the UK, tax legislation has been passed which reduced the effective income tax rate from 27.0% to 26.0%, effective April 1, 2011. The effect of recognizing this change in UK income tax rates is a $1.7 million reduction in deferred income tax liabilities in the first quarter of 2011.

# SUMMARY OF QUARTERLY RESULTS

| | 2009[1] | | | 2010 | | | | 2011 |
|---|---|---|---|---|---|---|---|---|
| *(millions, except per unit and % amounts)* | Second Quarter | Third Quarter | Fourth Quarter | First Quarter *(restated)* | Second Quarter *(restated)* | Third Quarter *(restated)* | Fourth Quarter *(restated)* | First Quarter |
| **Revenue** | | | | | | | | |
| Oil sands transportation | $ 30.6 | $ 32.2 | $ 34.1 | $ 34.9 | $ 36.4 | $ 36.4 | $ 36.8 | $ 72.8 |
| NGL extraction[2] | 98.1 | 127.3 | 160.5 | 173.0 | 143.4 | 128.8 | 149.1 | 159.9 |
| Conventional oil pipelines | 39.8 | 36.1 | 34.3 | 37.6 | 37.7 | 41.4 | 40.7 | 43.7 |
| Bulk liquid storage | 28.8 | 28.9 | 28.2 | 26.0 | 23.9 | 25.1 | 25.9 | 26.6 |
| | $ 197.3 | $ 224.5 | $ 257.1 | $ 271.5 | $ 241.4 | $ 231.7 | $ 252.5 | $ 303.0 |
| **Funds from operations[3]** | | | | | | | | |
| Oil sands transportation | $ 17.9 | $ 18.6 | $ 19.4 | $ 18.6 | $ 18.9 | $ 18.4 | $ 17.9 | $ 43.1 |
| NGL extraction[2] | 25.2 | 40.9 | 40.8 | 47.6 | 42.3 | 40.2 | 46.8 | 53.0 |
| Conventional oil pipelines | 31.8 | 27.3 | 23.1 | 28.3 | 27.7 | 30.2 | 26.8 | 32.6 |
| Bulk liquid storage[4][5][6] | 9.9 | 20.7 | 10.3 | 10.2 | 15.3 | 5.9 | 8.4 | 10.5 |
| Corporate costs | (16.3) | (16.1) | (15.5) | (19.1) | (15.6) | (17.3) | (19.1) | (38.9) |
| | $ 68.5 | $ 91.4 | $ 78.1 | $ 85.6 | $ 88.6 | $ 77.4 | $ 80.8 | $ 100.3 |
| Per unit[3] | $ 0.30 | $ 0.37 | $ 0.31 | $ 0.33 | $ 0.35 | $ 0.30 | $ 0.31 | $ 0.39 |
| Net income | $ 39.3 | $ 51.9 | $ 23.1 | $ 61.3 | $ 68.1 | $ 46.5 | $ 60.1 | $ 64.5 |
| Per unit – basic & diluted | $ 0.18 | $ 0.21 | $ 0.08 | $ 0.24 | $ 0.26 | $ 0.19 | $ 0.23 | $ 0.25 |
| Cash distributions[7] | $ 48.6 | $ 52.4 | $ 54.5 | $ 57.6 | $ 57.8 | $ 57.9 | $ 59.3 | $ 62.0 |
| Per unit[7] | $ 0.210 | $ 0.210 | $ 0.215 | $ 0.225 | $ 0.225 | $ 0.225 | $ 0.230 | $ 0.240 |
| Units outstanding (basic) | | | | | | | | |
| Weighted average | 227.0 | 248.7 | 252.8 | 255.8 | 256.6 | 257.2 | 257.8 | 258.3 |
| End of period | 246.5 | 250.8 | 254.6 | 256.3 | 256.9 | 257.5 | 258.0 | 258.5 |
| Capital expenditures | | | | | | | | |
| Growth[3] | $ 46.0 | $ 417.0 | $ 53.5 | $ 31.2 | $ 34.2 | $ 36.5 | $ 221.0 | $ 40.8 |
| Sustaining[3] | 3.6 | 4.0 | 7.4 | 2.5 | 5.6 | 2.9 | 5.7 | 2.8 |
| | $ 49.6 | $ 421.0 | $ 60.9 | $ 33.7 | $ 39.8 | $ 39.4 | $ 226.7 | $ 43.6 |
| Payout ratio before sustaining capital[3] | 71.0% | 57.3% | 69.8% | 67.3% | 65.2% | 74.8% | 73.5% | 61.8% |
| Payout ratio after sustaining capital[3] | 75.0% | 60.0% | 77.1% | 69.3% | 69.6% | 77.6% | 79.1% | 63.6% |
| Total debt[8] | $ 2,246.0 | $ 2,610.8 | $ 2,619.7 | $ 2,576.8 | $ 2,585.4 | $ 2,603.1 | $ 2,801.2 | $ 2,762.4 |
| Total partners' equity | $ 1,315.5 | $ 1,319.3 | $ 1,320.1 | $ 1,304.4 | $ 1,324.5 | $ 1,329.7 | $ 1,328.0 | $ 1,339.8 |
| Enterprise value[3] | $ 4,392.9 | $ 5,038.2 | $ 5,372.4 | $ 5,611.4 | $ 5,655.7 | $ 6,134.0 | $ 6,651.2 | $ 7,178.1 |
| Total recourse debt to capitalization[3] | 32.3% | 35.2% | 35.7% | 34.6% | 34.5% | 35.0% | 41.0% | 42.0% |
| Total debt to total capitalization[3] | 63.1% | 66.4% | 66.5% | 66.4% | 66.1% | 66.2% | 67.8% | 67.3% |

(1) IFRS adoption is effective as of January 1, 2010 therefore the 2009 quarterly information is presented on a Canadian GAAP basis. Accordingly, the 2009 quarterly information may not be comparable to that for 2010 and 2011.
(2) Significant changes in propane-plus commodity prices and foreign exchange rates resulted in lower funds from operations in the second quarter of 2009.
(3) Please refer to the **NON-GAAP FINANCIAL MEASURES** section of this MD&A.
(4) In the third quarter of 2009, funds from operations in the bulk liquid storage business increased by $10.2 million due to a reclassification of cash proceeds received for customer storage fees paid in advance. On the consolidated statement of cash flows, these proceeds were reclassified from "net change in non-cash working capital" to "proceeds from long-term deferred revenue" which is included in the calculation of funds from operations.
(5) In the second quarter of 2010, funds from operations in the bulk liquid storage business increased $5.8 million due to cash proceeds received for customer storage fees paid in advance.
(6) In the third quarter of 2010, funds from operations for the bulk liquid storage business decreased $4.1 million due to a special defined benefit pension plan contribution.
(7) Cash distributions are calculated based on the number of units outstanding at each record date.
(8) Total debt includes long-term debt and short-term borrowings on demand loans before discounts and debt transaction costs.

# LIQUIDITY AND CAPITAL RESOURCES

Inter Pipeline's capital management objectives are aligned with its commercial growth strategies and long-term outlook for the business. The primary objectives are to maintain:

(i) stable cash distributions to unitholders over economic and industry cycles;
(ii) a flexible capital structure which optimizes the cost of capital within an acceptable level of risk; and
(iii) an investment grade credit rating.

Management may make adjustments to the capital structure for changes in economic conditions or the risk characteristics of the underlying assets. To maintain or modify the capital structure, Inter Pipeline may adjust the level of cash distributions paid to unitholders, issue new partnership units or new debt, renegotiate new debt terms or repay existing debt.

Inter Pipeline maintains flexibility in its capital structure to fund organic growth capital and acquisition programs throughout market and industry cycles. Funding requirements are projected to ensure appropriate sources of financing are available to meet future financial obligations and capital programs. Inter Pipeline generally relies on committed credit facilities and cash flow from its operations to fund capital requirements. At March 31, 2011, Inter Pipeline had access to committed credit facilities totaling $2.4 billion, of which approximately $673.9 million remains unutilized. On January 4, 2011, Inter Pipeline's access to committed credit facilities decreased from $2.9 billion to $2.4 billion as a result of the repayment and cancellation of approximately $460 million of recourse debt in the Corridor syndicated credit facility. Inter Pipeline also has access to demand facilities of approximately $60 million.

In addition to committed credit facilities Inter Pipeline issues equity capital from time to time to ensure its balance sheet remains well prepared for expected growth. Approximately $7.0 million of equity was issued through the distribution reinvestment plan during the first three months of 2011.

Taking market trends into consideration, Inter Pipeline regularly forecasts its operational activities and expected funds from operations* to ensure that sufficient funding is available for future capital programs and distributions to unitholders.

Inter Pipeline utilizes derivative financial instruments to minimize exposure to fluctuating commodity prices, foreign exchange and interest rates. Inter Pipeline's risk management policy defines and specifies the controls and responsibilities to manage market exposure to changing commodity prices (crude oil, natural gas, NGL and power) and changes within financial markets relating to interest rates and foreign exchange exposure. Further details of the risk management program are discussed in the **RISK MANAGEMENT AND FINANCIAL INSTRUMENTS** section.

In November 2010, Inter Pipeline filed a short form base shelf prospectus with Canadian regulatory authorities. Under provisions detailed in the short form base shelf prospectus, Inter Pipeline may offer and issue, from time to time: (i) Limited Partnership Units; (ii) debt securities and (iii) subscription receipts (collectively, the "Securities") of up to $1.5 billion aggregate initial offering price of Securities during the 25 month period that the short form base shelf prospectus is valid. Securities may be offered separately or together, in amounts, at prices and on terms to be determined based on market conditions at the time of sale and set forth in one or more prospectus supplements. On January 19, 2011 Inter Pipeline filed a related prospectus supplement for the issuance of up to $1.5 billion of senior unsecured medium-term notes (MTN). The prospectus supplement establishes Inter Pipeline with a MTN program that allows it to issue MTNs in the Canadian market.

On February 2, 2011 Inter Pipeline issued $325 million MTN Series 1 notes due February 2, 2021 in the Canadian public debt market. The MTN Series 1 notes were issued under Inter Pipeline's short form base shelf prospectus dated November 30, 2010, a related prospectus supplement dated January 19, 2011, and a related pricing supplement dated January 28, 2011. As a result of this issuance the amount that can be issued under the shelf prospectus and related prospectus supplement has been reduced to

* Please refer to the **NON-GAAP FINANCIAL MEASURES** section

$1.175 billion. These notes bear interest at the rate of 4.967% per annum payable semi-annually. Net proceeds from the offering were used to pay down a portion of Inter Pipeline's $750 million Unsecured Revolving Credit Facility which had increased in January 2011, following an approximate $460 million equity contribution to Corridor, pursuant to the terms of the Corridor FSA. S&P and DBRS assigned the MTN Series 1 notes investment grade credit ratings of BBB+ and BBB (high), respectively.

## CAPITAL STRUCTURE

| (millions, except % amounts) | Recourse | Non-recourse | March 31 2011 | December 31 2010 (restated) |
|---|---|---|---|---|
| **Credit facilities available** | | | | |
| Corridor syndicated facility | $ 27.5 | $ 1,654.0 | $ 1,681.5 | $ 2,142.0 |
| Inter Pipeline syndicated facility | 750.0 | - | 750.0 | 750.0 |
| | 777.5 | 1,654.0 | 2,431.5 | 2,892.0 |
| Demand facilities[1] | 20.0 | 40.0 | 60.0 | 60.0 |
| | $ 797.5 | $ 1,694.0 | $ 2,491.5 | $ 2,952.0 |
| **Total debt outstanding** | | | | |
| Recourse | | | | |
| Corridor syndicated facility | | | $ - | $ 386.6 |
| Inter Pipeline syndicated facility | | | 265.8 | 157.0 |
| Loan payable to General Partner | | | 379.8 | 379.8 |
| Senior Unsecured Medium-Term Notes | | | 325.0 | - |
| Non-recourse | | | | |
| Corridor syndicated facility | | | 1,491.8 | 1,577.8 |
| Corridor debentures | | | 300.0 | 300.0 |
| **Total debt[1][2]** | | | 2,762.4 | 2,801.2 |
| Total partners' equity | | | 1,339.8 | 1,328.0 |
| **Total capitalization[3]** | | | $ 4,102.2 | $ 4,129.2 |
| Total debt to total capitalization[3] | | | 67.3% | 67.8% |
| Total recourse debt to capitalization[3] | | | 42.0% | 41.0% |

(1) At March 31, 2011 and December 31, 2010, outstanding Corridor letters of credit were approximately $0.3 million, which are not included in the demand loan facilities or total debt outstanding in the table above.
(2) At March 31, 2011, total debt includes long-term debt of $2,754.7 million inclusive of discounts and debt transaction costs of $7.7 million.
(3) Please refer to the **NON-GAAP FINANCIAL MEASURES** section of this MD&A.

Inter Pipeline's capital under management includes financial debt and partners' equity. Capital availability is monitored through a number of measures, including total recourse debt to capitalization and recourse debt to EBITDA*. Capital management objectives are to provide access to capital at a reasonable cost while maintaining an investment grade long-term corporate credit rating and ensure compliance with all debt covenants. Financial covenants on Inter Pipeline's credit facilities are based on the amount of recourse debt outstanding. Management's objectives are to remain well below its maximum target ratio of 65% recourse debt to capitalization and maximum recourse debt to EBITDA* ratio of 4.25. Recourse debt is attributed directly to Inter Pipeline and used in the calculation of its financial covenants. Inter Pipeline's recourse debt to capitalization* ratio was a favourable 42.0% at March 31, 2011. Adjusting for the impact of non-recourse debt of $1,791.8 million, Inter Pipeline's consolidated debt to total capitalization ratio at March 31, 2011 was 67.3%.

At March 31, 2011, approximately $1,866.6 million or 67.6% of Inter Pipeline's total consolidated debt was exposed to variable interest rates, however debt financing costs related to $1,641.8 million of

* Please refer to the **NON-GAAP FINANCIAL MEASURES** section

Corridor debt outstanding are directly recoverable through the terms of the Corridor FSA. Therefore, Inter Pipeline's direct interest rate risk associated with variable rate debt is only attributable to $224.8 million or 8.1% of total outstanding debt. When deemed appropriate, Inter Pipeline enters into interest rate swap agreements to manage its interest rate risk exposure. In 2001, Inter Pipeline entered into two fixed interest rate swap agreements to manage a portion of its variable interest rate risk exposure. In 2007, Inter Pipeline acquired two variable interest rate swap agreements to manage fixed interest rate exposure on Corridor's 5 and 10-year debentures. The interest rate swap associated with Corridor's 5-year debentures was terminated when the underlying debenture matured on February 2, 2010.

| | | March 31 2011 | | December 31 2010 |
|---|---|---|---|---|
| Maturity date | Fixed Rate Per Annum (excluding applicable margin) | Notional Balance (millions) | Fixed Rate Per Annum (excluding applicable margin) | Notional Balance (millions) |
| Corridor debentures | | | | |
| - Fixed to floating rate swap | | | | |
| Series B - February 2, 2015 | 5.033% | $ 150.0 | 5.033% | $ 150.0 |
| | | $ 150.0 | | $ 150.0 |
| Inter Pipeline syndicated facility | | | | |
| - Floating to fixed rate swap | | | | |
| December 30, 2011[1] | 6.300% | $ 26.0 | 6.300% | $ 26.0 |
| December 31, 2011 | 6.310% | 15.0 | 6.310% | 15.0 |
| | | $ 41.0 | | $ 41.0 |

(1) The notional principal balance of the $26.0 million interest rate swap is reduced by $1.0 million each year for the term of the arrangement.

The following earnings coverage ratios are calculated on a consolidated basis for the twelve month periods ended March 31, 2011 and December 31, 2010.

| | Twelve months ended | |
|---|---|---|
| | March 31 | December 31 |
| *(times)* | 2011 | 2010 |
| Interest coverage on long-term debt [1][2] | 4.9 | 5.0 |

(1) Please refer to the **NON-GAAP FINANCIAL MEASURES** section of this MD&A.
(2) Net income plus income taxes and interest expense, divided by the sum of interest expense and capitalized interest.

Investment grade, long-term corporate credit ratings are maintained by Inter Pipeline Fund with DBRS and S&P, and by Corridor with DBRS, S&P and Moody's. On July 20, 2010, DBRS upgraded Inter Pipeline's corporate credit rating to BBB (high) from BBB, with a stable trend. Concurrent with DBRS' upgrade to Inter Pipeline's rating, on July 20, 2010; DBRS also upgraded Corridor's long-term corporate credit rating from A (low) to A, with a stable trend. On December 17, 2010, S&P upgraded the long-term corporate credit rating on Inter Pipeline Fund to BBB+ from BBB, with a stable outlook. Corridor's series B and C debentures have been assigned investment grade credit ratings of A, A3 and A- from DBRS, Moody's and S&P, respectively. On February 2, 2011, S&P and DBRS assigned Inter Pipeline's MTN Series 1 notes investment grade credit ratings of BBB+ and BBB (high), respectively. As a result of the MTN Series 1 notes rating, DBRS has cancelled Inter Pipeline's issuer's rating in accordance with their policies.

## CONTRACTUAL OBLIGATIONS, COMMITMENTS AND GUARANTEES

The following table summarizes Inter Pipeline's commitment profile and future contractual obligations at March 31, 2011. Management intends to finance these commitments through existing credit facilities and cash flow from operations. Longer term commitments will be funded through Inter Pipeline's capital management policies as discussed in the section above.

| *(millions)* | Total | Less than one year | One to five years | After five years |
|---|---|---|---|---|
| Capital expenditure projects[1] | | | | |
| Oil sands transportation | $ 141.1 | $ 95.2 | $ 45.9 | $ - |
| NGL extraction | 53.0 | 11.1 | 41.9 | - |
| Conventional oil pipelines | 4.9 | 4.9 | - | - |
| Bulk liquid storage | 7.5 | 7.5 | - | - |
| Growth capital[2] | 206.5 | 118.7 | 87.8 | - |
| Sustaining capital[2] | 15.2 | 15.2 | - | - |
| | 221.7 | 133.9 | 87.8 | - |
| Total debt[3] | | | | |
| Corridor syndicated facility | 1,491.8 | - | 1,491.8 | - |
| Inter Pipeline syndicated facility | 265.8 | - | 265.8 | - |
| Loan to General Partner | 379.8 | - | 379.8 | - |
| Corridor debentures | 300.0 | - | 150.0 | 150.0 |
| 4.967% Unsecured Medium-Term Notes, Series 1 | 325.0 | - | - | 325.0 |
| | 2,762.4 | - | 2,287.4 | 475.0 |
| Other obligations | | | | |
| Derivative financial instruments | 46.0 | 34.8 | 11.2 | - |
| Operating leases | 92.2 | 7.0 | 26.3 | 58.9 |
| Purchase obligations | 104.0 | 3.2 | 18.3 | 82.5 |
| Long term portion of incentive plan | 1.8 | - | 1.8 | - |
| Working capital deficit[2] | 58.7 | 58.7 | - | - |
| | $ 3,286.8 | $ 237.6 | $ 2,432.8 | $ 616.4 |

(1) Capital expenditure commitments in "less than one year" represent expected expenditures for the remaining months of 2011.
(2) Please refer to the **NON-GAAP FINANCIAL MEASURES** section of this MD&A.
(3) At March 31, 2011, outstanding Corridor letters of credit of approximately $0.3 million were not included in the total $2,762.4 million of debt outstanding in the table above.

Inter Pipeline plans to invest approximately $206.5 million in organic growth capital projects over the 2011 to 2012 period which includes capital costs for the $150 million Polaris oil sands diluent transportation project and $50 million for a liquid sweetening project at the Cochrane NGL extraction facility. Inter Pipeline is also committed to investing capital in the bulk liquid storage business to comply with the UK's post Buncefield regulations. Potential solutions are being evaluated and expenditures are estimated to be in the range of $4.7 million to $9.3 million over the next eight years.

Inter Pipeline's debt outstanding at March 31, 2011 matures at various dates up to February 2021. Corridor's series B debentures will mature in February 2015 and Corridor's series C debentures mature February 3, 2020. Amounts drawn on tranches A and B of Corridor's syndicated facility will mature in 2012. Amounts drawn on tranche D of this facility will mature the earlier of August 2012 and the commencement or suspension true-up date of the Corridor expansion project. Inter Pipeline's loan payable to the General Partner and Inter Pipeline syndicated facility mature in periods between 2012 and 2014. Inter Pipeline's $325 million MTN Series 1 notes mature on February 2, 2021.

The following future obligations resulting from normal course of operations would be primarily funded from operations in the respective periods that they become due or may be funded through long-term debt:

(i) Derivative financial instruments are utilized to manage market risk exposure to changes in commodity prices, foreign currencies and interest rates in future periods. This future obligation is an estimate of the fair value liability on an undiscounted basis for financially net settled derivative contracts outstanding at March 31, 2011, based upon the various contractual maturity dates.

(ii) Operating leases and purchase obligations represent minimum payment obligations associated with leases and normal operating agreements for periods up to 2090.

(iii) Working capital deficiencies arise primarily from capital expenditures outstanding in accounts payable at the end of a period, and fluctuate with changes in commodity prices.

(iv) Inter Pipeline has obligations of $23.4 million under its employee incentive plan, of which $21.6 million is included in the working capital deficit.

(v) Present value of estimated expenditures expected to be incurred on decommissioning of active pipeline systems, NGL extraction plants and leased bulk liquid storage sites and remediation of known environmental liabilities is $35.3 million at March 31, 2011. Since there is no specified timing for payment of these obligations, they were excluded from the table above.

## CASH DISTRIBUTIONS TO UNITHOLDERS

| | Three Months Ended March 31 | |
|---|---|---|
| *(millions)* | 2011 | 2010 *(restated)* |
| Cash provided by operating activities | $ 136.8 | $ 126.2 |
| Net change in non-cash working capital | (36.5) | (40.6) |
| Less sustaining capital expenditures[1] | (2.8) | (2.5) |
| Cash available for distribution[1] | 97.5 | 83.1 |
| Change in discretionary reserves | (35.5) | (25.5) |
| Cash distributions | $ 62.0 | $ 57.6 |
| Cash distributions per unit[2] | $ 0.240 | $ 0.225 |
| Payout ratio before sustaining capital[1] | 61.8% | 67.3% |
| Payout ratio after sustaining capital[1] | 63.6% | 69.3% |
| Growth capital expenditures[1] | $ 40.8 | $ 31.2 |
| Sustaining capital expenditures[1] | 2.8 | 2.5 |
| | $ 43.6 | $ 33.7 |

(1) Please refer to the **NON-GAAP FINANCIAL MEASURES** section of this MD&A.
(2) Cash distributions are calculated based on the number of units outstanding at each record date.

It is the policy of the General Partner to provide unitholders with stable cash distributions over time. As a result, not all cash available for distribution is distributed to unitholders. Rather, a portion of cash available for distribution is reserved and reinvested in the business to effectively manage its capital structure, and in particular, debt levels. The General Partner makes its cash distribution decisions based on the underlying assumptions in each year's annual operating and capital budget and long-term forecast, consistent with its policy to provide unitholders with stable cash distributions.

"Cash available for distribution" is a non-GAAP financial measure that the General Partner uses in managing Inter Pipeline's business and in assessing future cash requirements that impact the determination of future distributions to unitholders. Inter Pipeline defines cash available for distribution as

cash provided by operating activities less net changes in non-cash working capital and sustaining capital expenditures. The impact of net change in non-cash working capital is excluded in the calculation of "Cash available for distribution" primarily to compensate for the seasonality of working capital throughout the year. Certain Inter Pipeline revenue contracts dictate an exchange of cash that differs, on a monthly basis, from the recognition of revenue. Within a 12-month calendar year, there is minimal variation between revenue recognized and cash exchanged. Inter Pipeline therefore excludes the net change in non-cash working capital in its calculation of cash available for distribution to mitigate the quarterly impact this difference has on cash available for distribution. The intent is to not skew the results of Inter Pipeline in any quarter for exchanges of cash, but to focus the results on cash that is generated in any reporting period.

In addition, in determining actual cash distributions, Inter Pipeline applies a discretionary reserve to cash available for distribution, which is designed to ensure stability of distributions over economic and industry cycles and to enable Inter Pipeline to absorb the impact of material one-time events. Therefore, not all cash available for distribution is necessarily distributed to unitholders. The reconciliation is prepared using reasonable and supportable assumptions, reflecting Inter Pipeline's planned course of action in light of management and the board of directors' judgment regarding the most probable set of economic conditions. Investors should be aware that actual results may vary, possibly materially, from such forward-looking adjustments.

The discretionary reserve increased approximately $35.5 million in the first quarter of 2011 due primarily to the strong operating results of Inter Pipeline's business segments. Inter Pipeline will continue to manage the discretionary reserve and future cash distributions in accordance with its policy of attempting to manage the stability of distributions through industry and economic cycles.

The tables below show Inter Pipeline's cash distributions paid relative to cash provided by operating activities and net income (loss) for the periods indicated. See the **OUTLOOK** section of this report and **RISK FACTORS** section for further information regarding the sustainability of cash distributions.

| | Three Months Ended March 31 | | Years Ended December 31 | | | |
|---|---|---|---|---|---|---|
| *(millions)* | 2011 | 2010 | 2010 | 2009[1] | 2008[1] | 2007[1] |
| Cash provided by operating activities | $ 136.8 | $ 126.2 | $ 349.6 | $ 281.8 | $ 321.1 | $ 234.1 |
| Cash distributions | (62.0) | (57.6) | (232.6) | (202.4) | (186.6) | (171.7) |
| Excess | $ 74.8 | $ 68.6 | $ 117.0 | $ 79.4 | $ 134.5 | $ 62.4 |

| | Three Months Ended March 31 | | Years Ended December 31 | | | |
|---|---|---|---|---|---|---|
| *(millions)* | 2011 | 2010 *(restated)* | 2010 *(restated)* | 2009[1] | 2008[1] | 2007[1] |
| Net income (loss) | $ 64.5 | $ 61.3 | $ 236.0 | $ 157.7 | $ 249.7 | $ (80.0) |
| Cash distributions | (62.0) | (57.6) | (232.6) | (202.4) | (186.6) | (171.7) |
| Excess (shortfall) | $ 2.5 | $ 3.7 | $ 3.4 | $ (44.7) | $ 63.1 | $ (251.7) |

(1) IFRS adoption is effective as of January 1, 2010 therefore the 2007, 2008 and 2009 annual information is presented on a Canadian GAAP basis.

Cash distributions in all periods are less than cash provided by operating activities and for three months ended March 31, 2011 and 2010 and for the years ended December 31, 2010 and 2008 were less than net income. Net income (loss) includes certain non-cash expenses such as depreciation and amortization, deferred income taxes and unrealized changes in the fair value of derivative financial instruments, therefore cash distributions may exceed net income.

The overall cash distributions of Inter Pipeline are governed by the Partnership Agreement, specifically section 5.2, that specifies the terms for Inter Pipeline to make distributions of cash. Distributable Cash is defined to generally mean cash from operating, investing and financing activities, less certain items, including any cash withheld as a reserve that the General Partner determines to be necessary or

appropriate for the proper management of Inter Pipeline and its assets. As a result of the General Partner's discretion to establish reserves under the Partnership Agreement, cash distributed to unitholders is always equal to Distributable Cash.

## OUTSTANDING UNIT DATA

Inter Pipeline's outstanding units at March 31, 2011 are as follows:

| *(millions)* | Class A | Class B | Total |
|---|---|---|---|
| Units outstanding | 258.2 | 0.3 | 258.5 |

At May 3, 2011 Inter Pipeline had 258.4 million Class A units and 0.3 million Class B units for a total of 258.7 million units outstanding.

## RISK MANAGEMENT AND FINANCIAL INSTRUMENTS

### MARKET RISK MANAGEMENT

Inter Pipeline utilizes derivative financial instruments to manage liquidity and market risk exposure to changes in commodity prices, foreign currencies and interest rates. Risk management policies are intended to minimize the volatility of Inter Pipeline's exposure to commodity price, foreign exchange and interest rate risk to assist with stabilizing funds from operations*. Inter Pipeline endeavours to accomplish this primarily through the use of derivative financial instruments. Inter Pipeline's policy prohibits the use of derivative financial instruments for speculative purposes. All hedging policies are authorized and approved by the board of directors through Inter Pipeline's risk management policy.

Inter Pipeline has the following types of derivative financial instruments: commodity price swap agreements, foreign currency exchange contracts, power price hedges and heat rate and interest rate swap agreements. The mark-to-market or fair value of these financial instruments is recorded as an asset or liability and any change in the fair value recognized as an unrealized change in fair value of these derivative financial instruments in the calculation of net income. When the financial instrument matures, any realized gain or loss is recorded in net income.

In the following sections, sensitivity analyses are presented to provide an indication of the amount that an isolated change in one variable may have on net income and are based on derivative financial instruments and long-term debt outstanding at March 31, 2011. The analyses are hypothetical and should not be considered to be predictive of future performance. Changes in fair value generally cannot be extrapolated based on one variable because the relationship with other variables may not be linear. In reality, changes in one variable may magnify or counteract the impact of another variable which may result in a significantly different conclusion.

#### NGL Extraction Business

**Frac-spread Risk Management**

Inter Pipeline is exposed to frac-spread risk which is the difference between the weighted average propane-plus price at Mont Belvieu, Texas and the monthly index price of AECO natural gas purchased for shrinkage calculated in USD/USG. Derivative financial instruments are utilized to manage frac-spread risk. Inter Pipeline transacts with third party counterparties to sell a notional portion of its NGL products and purchase related notional quantities of natural gas at fixed prices. NGL price swap agreements are transacted in US currency therefore Inter Pipeline also enters into foreign exchange contracts to sell US dollars to convert notional US dollar amounts in the NGL swaps.

* Please refer to the **NON-GAAP FINANCIAL MEASURES** section

The following table presents the proportion of future propane-plus volumes hedged under contracts outstanding and the average net price of the frac-spread hedges at March 31, 2011 and May 3, 2011. The CAD/USG average prices would approximate the following USD/USG prices based on the average USD/CAD forward curve at March 31, 2011 and May 3, 2011, respectively.

| | May 3, 2011 | | | March 31, 2011 | | |
|---|---|---|---|---|---|---|
| | % Forecast Propane-plus Volumes Hedged | Average Price (USD/USG) | Average Price (CAD/USG) | % Forecast Propane-plus Volumes Hedged | Average Price (USD/USG) | Average Price (CAD/USG) |
| April to December 2011 | 60% | $ 0.88 | $ 0.84 | 60% | $ 0.87 | $ 0.84 |
| January to December 2012 | 50% | $ 0.99 | $ 0.95 | 37% | $ 0.90 | $ 0.88 |
| January to December 2013 | 27% | $ 0.99 | $ 0.95 | 13% | $ 0.94 | $ 0.93 |

Based on propane-plus volume hedges outstanding at March 31, 2011, the following table illustrates how a 10% change in NGL and AECO natural gas commodity prices and foreign exchange rates in isolation could individually impact the mark-to-market valuation of Inter Pipeline's derivative financial instruments and consequently after-tax income assuming rates associated with each of the other components and all other variables remain constant:

| *(millions)* | Fair value of derivative financial instruments | Change in net income based on 10% increase in prices/rates[1] | Change in net income based on 10% decrease in prices/rates[1] |
|---|---|---|---|
| NGL[2] | $ (35.3) | $ (18.1) | $ 18.1 |
| AECO natural gas | (8.2) | 4.7 | (4.7) |
| Foreign exchange | 8.5 | (15.6) | 15.6 |
| Frac-spread risk management | $ (35.0) | | |

(1) Negative amounts represent a liability increase or asset decrease.
(2) Assumes that a commodity price change will impact all propane, normal butane, isobutane and pentanes-plus products linearly.

### Power Price Risk Management

Inter Pipeline uses derivative financial instruments to manage power price risk in its NGL extraction and conventional oil pipelines business segments. Inter Pipeline enters into financial heat rate swap and power price swap contracts to manage power price risk exposure in these businesses.

Based on heat rate swaps outstanding in the NGL extraction business at March 31, 2011, a 10% change in Alberta power pool commodity prices in isolation with all other variables held constant, could potentially change the mark-to-market valuation of Inter Pipeline's derivative financial instruments used to manage power price risk and consequently after-tax income by approximately $0.4 million. A 10% change in AECO natural gas prices in isolation with all other variables held constant, could potentially change the mark-to-market valuation of Inter Pipeline's derivative financial instruments used to manage power price risk and consequently after-tax income by approximately $0.2 million.

Based on electricity price swap agreements outstanding in the conventional oil pipelines business at March 31, 2011, a 10% change in Alberta power pool commodity prices in isolation with all other variables held constant, could potentially change the mark-to-market valuation of Inter Pipeline's derivative financial instruments used to manage power price risk and consequently after-tax income by approximately $0.1 million.

## Bulk Liquid Storage Business

### Foreign Exchange Risk Management

Inter Pipeline is exposed to currency risk resulting from the translation of assets and liabilities of its European bulk liquid storage operations and transactional currency exposures arising from purchases in currencies other than Inter Pipeline's functional currency, the Canadian dollar. Transactional foreign currency risk exposures have not been significant historically, therefore are generally not hedged; however, Inter Pipeline may decide to hedge this risk in the future.

## Corporate

### Interest Rate Risk Management

Inter Pipeline's exposure to interest rate risk primarily relates to its long-term debt obligations and fair valuation of its floating-to-fixed interest rate swap agreements. Inter Pipeline manages its interest rate risk by balancing its exposure to fixed and variable rates while minimizing interest costs. When deemed appropriate, Inter Pipeline enters into interest rate swap agreements to manage its interest rate price risk exposure.

Based on the variable rate obligations outstanding at March 31, 2011, a 1% change in interest rates at this date could affect interest expense on credit facilities by approximately $4.3 million for the three months ending March 31, 2011, assuming all other variables remain constant. Of this amount, $3.7 million relates to the $1.7 billion Corridor credit facility and are recoverable through the terms of the Corridor FSA, therefore the after-tax income impact would be $0.5 million. A 1% change in interest rates at March 31, 2011 could also affect the mark-to-market valuation of Inter Pipeline's derivative financial instruments used to manage interest rate risk and consequently after-tax income by approximately $0.2 million, assuming all other variables remain constant.

## Realized and Unrealized Gains (Losses) on Derivative Instruments - Held-for-Trading

Derivative financial instruments designated as "held-for-trading" are recorded on the consolidated balance sheet at fair value. Any gain or loss upon settlement of these contracts is recorded as a realized gain or loss in net income. Prior to settlement, any change in the fair value of these instruments is recognized in net income as an unrealized change in fair value of derivative financial instruments.

The fair values of derivative financial instruments are calculated by Inter Pipeline using a discounted cash flow methodology with reference to actively quoted forward prices and/or published price quotations in an observable market and market valuations provided by counterparties. Forward prices for NGL swaps are less transparent because they are less actively traded. These forward prices are assessed based on available market information for the time frames for which there are derivative financial instruments in place. Fair values are discounted using a risk-free rate plus a credit premium that takes into account the credit quality of the instrument.

(Losses) gains on derivative financial instruments recognized in the calculation of net income are as follows:

| | Three Months Ended March 31 | |
|---|---|---|
| *(millions)* | 2011 | 2010 |
| **Realized (loss) gain on derivative financial instruments** | | |
| Revenues | | |
| NGL swaps | $ (7.0) | $ (1.4) |
| Foreign exchange swaps (frac-spread hedges) | 1.5 | 0.1 |
| | (5.5) | (1.3) |
| Shrinkage gas expense | | |
| Natural gas swaps | (3.1) | (2.1) |
| Operating expenses | | |
| Electricity price swaps | 0.3 | (0.1) |
| Heat rate swaps | 1.4 | (0.1) |
| | 1.7 | (0.2) |
| Financing charges | | |
| Interest rate swaps | 0.7 | 1.4 |
| Total realized loss on derivative financial instruments | (6.2) | (2.2) |
| **Unrealized (loss) gain on derivative financial instruments** | | |
| NGL swaps | (18.5) | 14.6 |
| Natural gas swaps | 2.7 | (13.7) |
| Foreign exchange swaps (frac-spread hedges) | 3.9 | 4.3 |
| Electricity price swaps | 0.4 | (0.1) |
| Heat rate swaps | 0.9 | 1.5 |
| Interest rate swaps | 0.5 | 0.7 |
| Transitional transfers [1] | (0.2) | (0.2) |
| Total unrealized (loss) gain on derivative financial instruments | (10.3) | 7.1 |
| Total (loss) gain on derivative financial instruments | $ (16.5) | $ 4.9 |

(1) Transfer of gains and losses on derivatives previously designated as cash flow hedges from accumulated other comprehensive income.

## CREDIT RISK

Inter Pipeline's credit risk exposure relates primarily to customers and financial counterparties holding cash and derivative financial instruments, with a maximum exposure equal to the carrying amount of these instruments. Credit risk is managed through credit approval and monitoring procedures. The creditworthiness assessment takes into account available qualitative and quantitative information about the counterparty including, but not limited to, financial status and external credit ratings. Depending on the outcome of each assessment, guarantees or some other credit enhancement may be requested as security. Inter Pipeline attempts to mitigate its exposure by entering into contracts with customers that may permit netting or entitle Inter Pipeline to lien or take product in kind and/or allow for termination of the contract on the occurrence of certain events of default. Each business segment monitors outstanding accounts receivable on an ongoing basis.

Concentrations of credit risk associated with accounts receivable relate to a limited number of principal customers in the oil sands transportation and NGL extraction business segments, the majority of which are affiliated with investment grade corporations in the energy and chemical industry sectors. At March 31, 2011, accounts receivable associated with these two business segments were $74 million or 71% of total accounts receivable outstanding. Inter Pipeline believes the credit risk associated with the remainder of accounts receivable is minimized due to diversity across business units and customers.

With respect to credit risk arising from cash and cash equivalents, deposits and derivative financial instruments, Inter Pipeline believes the risk of non-performance of counterparties is minimal as cash, deposits and derivative financial instruments outstanding are predominantly held with major financial institutions or investment grade corporations.

Inter Pipeline actively monitors the risk of non-performance of its customers and financial counterparties. At March 31, 2011, accounts receivable outstanding meeting the definition of past due and impaired is immaterial.

## TRANSACTIONS WITH RELATED PARTIES

No revenue was earned from related parties in the quarters ended March 31, 2011 or 2010.

Upon acquisition of the General Partner in 2002, Pipeline Assets Corp. (PAC), the sole shareholder of the General Partner, assumed the obligations of the former general partner of Inter Pipeline under a support agreement. The support agreement obligates the affiliates controlled by PAC to provide certain personnel and services if requested by the General Partner, to fulfill its obligations to administer and operate Inter Pipeline's business. Such services are incurred in the normal course of operations and amounts paid for such services are at cost for the services provided. No amounts have been paid under the terms of the support agreement since PAC acquired its interests in the General Partner.

The General Partner's 0.1% interest in Inter Pipeline, represented by Class B units, is controlled by PAC. The General Partner is a wholly owned subsidiary of PAC, a corporation controlled solely by the Chairman of the Board of the General Partner. Certain officers and directors of the General Partner have non-voting shares in PAC that entitle them to dividends. Officers and directors of the General Partner received a cumulative total of $0.3 million (2010 - $0.2 million) in dividends in 2010 from PAC pursuant to their ownership of non-voting shares.

Under the Partnership Agreement, the General Partner is entitled to recover all direct and indirect expenses, including general and administrative expenses, incurred on behalf of Inter Pipeline. The General Partner also receives an annual base fee equal to 2% of Inter Pipeline's annual "Operating Cash" as defined in the Partnership Agreement. In addition, the General Partner is entitled to earn an annual incentive fee of between 15% and 35% of Inter Pipeline's annual Distributable Cash as defined in the Partnership Agreement in excess of $1.01 per unit to $1.19 per unit respectively; an acquisition fee of 1.0% of the purchase price of any assets acquired by Inter Pipeline (excluding the pipeline assets originally acquired); and a disposition fee of 0.5% of the sale price of any assets sold by Inter Pipeline. See the **Other Expenses** section of **RESULTS OF OPERATIONS** for details of fees paid to the General Partner during the period.

In 2004, Inter Pipeline entered into a loan agreement with the General Partner for $379.8 million. At the same time, the General Partner had received $379.8 million by way of a Private Placement note issuance to a combination of American and Canadian institutional investors and immediately loaned the funds to Inter Pipeline. At March 31, 2011, interest payable to the General Partner on the loan was $9.9 million (March 31, 2010 - $10.0 million). This loan to Inter Pipeline from the General Partner has the identical repayment terms and commitments as the notes payable by the General Partner to the institutional note holders, except for an interest rate increase of 0.05% over the rates payable on the notes issued by the General Partner. Inter Pipeline has guaranteed the notes issued by the General Partner to the note holders. The guarantee may be exercised in the event of default by the General Partner pursuant to the terms of the Note Purchase Agreement and is equal to the amount of principal outstanding at the time of default, including a premium of 50 bps over the implied yield to maturity, accrued interest and, if applicable, swap breakage costs.

Amounts due to/from the General Partner and its affiliates related to services are non-interest bearing and have no fixed repayment terms with the exception of the loan agreement with the General Partner as noted above. At March 31, 2011, there were amounts owed to the General Partner by Inter Pipeline of $1.0 million (March 31, 2010 – $0.7 million).

## CONTROLS AND PROCEDURES

In conjunction with the adoption of IFRS, Inter Pipeline's compliance group monitored controls over the IFRS conversion project which resulted in minor changes and updates to internal controls. Management has evaluated the impact of the conversion to IFRS on its accounting and financial reporting systems and has updated the systems to enable our reporting of historical Canadian GAAP information related to the initial IFRS adoption and for future periods to be reported under IFRS.

## CRITICAL ACCOUNTING ESTIMATES

The preparation of Inter Pipeline's consolidated financial statements requires management to make critical and complex judgments, estimates and assumptions about future events, when applying GAAP, that have a significant impact on the financial results reported. These judgments, estimates, and assumptions are subject to change as future events occur or new information becomes available. Readers should refer to note 2 *Summary of Significant Accounting Policies* (**Note 2**) of the March 31, 2011 interim financial statements for a list of Inter Pipeline's significant accounting policies.

The amounts recorded for fair value of derivative financial instruments, intangible assets, goodwill, property, plant and equipment, provisions, employee benefits, deferred taxes and depreciation and amortization are based on estimates. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future years could be material. With the transition to IFRS and resulting changes to Inter Pipeline's accounting policies, see the Changes in Accounting Policies section below and Note 2 as mentioned in the previous paragraph for further discussion on these specific estimates.

## CHANGES IN ACCOUNTING POLICIES

### International Financial Reporting Standards (IFRS)

The Canadian Accounting Standards Board (AcSB) requires all Canadian publicly accountable enterprises to adopt IFRS for interim and annual reporting periods for fiscal years beginning on or after January 1, 2011. Consequently, Inter Pipeline is presenting its first IFRS interim financial reporting results under the principles of IFRS, with fiscal 2010 results restated for comparative purposes beginning in the current quarter of 2011.

The same accounting policies and methods of computation are followed in the March 31, 2011 interim financial statements as compared with the most recent consolidated annual financial statements for the year ended December 31, 2010, except as described below. The accounting policies in Note 2 to the March 31, 2011 interim financial statements have been applied consistently in preparing the interim financial statements for the three month period ended March 31, 2011 and the IFRS consolidated balance sheets as at December 31, 2010 and March 31, 2011. The accounting policies in Note 2 were also applied in preparing the opening IFRS consolidated balance sheet as at January 1, 2010 (the Transition Date) except where certain IFRS 1 exemptions were utilized. Inter Pipeline's IFRS adoption date is January 1, 2011.

In preparing the opening January 1, 2010 IFRS consolidated balance sheet and the interim consolidated financial statements for the three month period ended March 31, 2010, Inter Pipeline has adjusted amounts reported previously in the consolidated financial statements prepared in accordance with its previous basis of accounting, Canadian GAAP. Readers should refer to and read the following in conjunction with Note 21 of the March 31, 2011 interim financial statements for a summary of Inter Pipeline's IFRS transition including application of exemptions, reconciliations of Canadian GAAP to IFRS and explanations of reconciling items.

### Transition to IFRS

IFRS 1 sets forth guidance for the initial adoption of IFRS. Under IFRS 1 the standards are applied retrospectively at the Transition Date with all adjustments to assets and liabilities taken to retained earnings unless certain mandatory exceptions and optional exemptions are applied. Inter Pipeline elected to take the following IFRS 1 optional exemptions:

### Provisions, Contingent Liabilities and Contingent Assets

IAS 37 – *Provisions, contingent liabilities and contingent assets* (IAS 37) currently requires a provision to be recognized when: (i) there is a present obligation (legal or constructive) as a result of a past transaction or event; (ii) it is probable that an outflow of resources will be required to settle the obligation; and (iii) a reliable estimate can be made of the obligation. The provision recognized should represent the entity's best estimate of the current value of the obligation using a discount rate that reflects the current market assessment of the time value of money and should not reflect risks for which future cash flow estimates have been adjusted. Provisions are to be reviewed at the end of each reporting period and adjusted accordingly to reflect the entity's best estimate. Changes in discount rates or current decommissioning cost estimates will result in changes to the amount of the provision recorded with an offsetting charge to the value of property, plant and equipment and corresponding changes to the respective accretion or financing charge and depreciation expenses.

IAS 37 suggests that an entity should be able to determine a range of possible outcomes, and therefore should be able to determine a 'best estimate' of the obligation using the mid-point of the range if each point in the range is as likely as any other. Canadian GAAP also requires an entity to recognize a contingent liability such as an environmental liability, using a best estimate; however requires an entity to record the obligation at the lowest point in the range if no point within the range was a better estimate than any other point.

#### Decommissioning Obligation

Under Canadian GAAP, Inter Pipeline did not record a decommissioning obligation for the pipelines and related facilities in the oil sands transportation and conventional oil pipelines business units under the rationale that insufficient information was available to determine the probability of estimate with respect to the timing of settlement and the magnitude of the potential obligation.

Inter Pipeline has developed a methodology for estimating the costs associated with pipeline decommissioning, including applying ranges and probabilities of outcomes, to determine a decommissioning obligation. The obligations are discounted to their present value using a pre-tax risk-free rate under IFRS, whereas under Canadian GAAP a credit-adjusted risk-free rate was used.

The IFRS 1 transition rules have been utilized and the adjustment to the decommissioning liability has been calculated in accordance with IAS 37 at the Transition Date. The offsetting adjustment to property, plant and equipment was calculated by discounting the revised decommissioning liability back to when the liability first arose using the best estimate of the historical discount rates and applying depreciation to that amount up to the Transition Date. This was calculated using the existing depreciation policy for the underlying assets.

#### Environmental Liabilities

Under Canadian GAAP, Inter Pipeline recorded its best estimate of specific environmental remediation costs arising from claims, assessments, litigation and penalties as contingent liabilities on an undiscounted basis.

Under IFRS, these environmental remediation costs would be considered a provision, requiring calculation of its present value using a discount rate to factor in the associated time value of money for those costs expected to be incurred in future years. IFRS also requires a midpoint to be used to calculate the settlement value if all outcomes are equally likely. The adjustment reflects the difference between the minimum value under Canadian GAAP compared to the midpoint under IFRS as well as the undiscounted environmental liability under Canadian GAAP and the revised discounted liability under IFRS at Transition Date, offset entirely to opening partners' equity. The adjustment reflects the present value of the liability, with the change in the liability included in financing charges.

### Employee Benefits

IAS 19 – *Employee Benefits* provides an entity with three options to recognize actuarial gains or losses. The "corridor" approach allows an entity to recognize actuarial gains or losses as income or expense over a defined amortization period. The second option allows an entity to adopt a more systematic method that would result in faster recognition of gains or losses in income. The third option allows an entity to recognize actuarial gains or losses in other comprehensive income in the period in which they occur providing it applies this policy to all of its defined benefit plans and all actuarial gains and losses. IFRS 1

provides transitional relief to recognize all unrealized actuarial gains or losses outstanding at the date of transition in other comprehensive income.

Under Canadian GAAP, Inter Pipeline recognized actuarial gains and losses using the "corridor" approach. The excess of accumulated actuarial gains and losses over 10% of the greater of the accrued benefit obligation and the fair value of plan assets was amortized as a component of pension expense over the expected average remaining service period of the employee group.

Upon initial adoption of IFRS, Inter Pipeline has retrospectively applied IAS 19 and has elected to recognize all actuarial gains and losses immediately in other comprehensive income as they arise without recycling to the income statement in subsequent periods.

Inter Pipeline has chosen not to utilize the IFRS 1 exemption option to recognize all cumulative actuarial gains and losses that existed at the Transition Date in opening partners' equity for all of its employee benefit plans, and therefore has retroactively restated the impact associated with immediate recognition of actuarial gains and losses in other comprehensive income. Consequently, all previously unrecognized actuarial gains and losses under Canadian GAAP are recognized in other comprehensive income and reserves.

In addition, under Canadian GAAP, Inter Pipeline expensed past service costs over the weighted average service life of active employees remaining in the plan. Under IFRS, Inter Pipeline expenses the cost of past service benefits awarded to employees under post-employment benefit plans over the periods in which the benefits vest, which usually corresponds to the period in which the benefits are granted.

Subsequent to the Transition Date, the pension expense, pension reserve and pension liability have been adjusted to reflect the new accounting policy adopted for the treatment of actuarial gains and losses and past service costs.

### Share Based Payments

Similar to Canadian GAAP, IFRS 2 – *Share Based Payments* (IFRS 2) requires Inter Pipeline to estimate the number of share based payment awards under its deferred unit rights plan (DURP) expected to vest on maturity.

Under Canadian GAAP, the liability and related compensation expense of Inter Pipeline's DURP was calculated assuming all Deferred Unit Rights (DURs) would vest, with the effect of forfeitures included as they actually occurred. Under IFRS, the expense related to share-based payments must be accrued using an estimated forfeiture rate, trued up for the number of awards actually vested at each vesting date.

Under IFRS 2, Inter Pipeline must include an estimate of awards that may be forfeited prematurely, with changes in the estimate to be accounted for prospectively. GAAP differs as it allows an entity to recognize the effect of actual forfeitures as they occur and does not require an entity to include an estimate of future forfeitures.

Inter Pipeline has chosen to utilize the IFRS 1 exemption associated with share based payments, and therefore has retroactively restated the impact associated with estimating DUR forfeiture rates only for DURs not vested at January 1, 2010. This resulted in a decrease to the LTIP liability and an increase to total partners' equity on the IFRS opening balance sheet. On full vesting of the DURs, total compensation expense will represent actual compensation expense under both IFRS and GAAP, however, over the vesting period there may be timing differences in the recognition of compensation expense.

### Cumulative Translation Differences

In accordance with IFRS transitional provisions, Inter Pipeline has elected to reset the balance of its cumulative unrealized loss on translating financial statements of self-sustaining foreign operations to be zero on the Transition Date. This requires Inter Pipeline to reclassify these cumulative unrealized losses from accumulated other comprehensive loss to partners' equity, which will have no net impact on Inter Pipeline's total partners' equity. Adjustments recognized subsequent to the Transition Date reflect the translation of all Canadian GAAP and IFRS differences arising in foreign operations.

### Asset Impairment

IAS 36 - *Impairment of Assets* (IAS 36) is similar to Canadian GAAP as both standards require an entity to (i) perform a goodwill impairment test annually and (ii) assess whether there is an indication that its other tangible and intangible assets may be impaired taking into consideration both external and internal sources of information. Canadian GAAP generally used a two-step approach to impairment testing: first comparing asset carrying values with undiscounted future cash flows to determine whether impairment exists; and then measuring any impairment by comparing asset carrying values with fair values. IAS 36 requires assets to be assessed for impairment for each CGU defined as the smallest identifiable group of assets that generates cash inflows largely independent of the cash flows from other assets or group of assets. IAS 36 uses a one-step approach for both testing for and measurement of impairment for each CGU. Asset carrying values are compared directly with the asset's fair value or recoverable amount using the higher results from one of two asset valuation models: fair value less costs to sell and value in use. This may potentially result in more write downs where carrying values of assets were previously supported under Canadian GAAP on an undiscounted cash flow basis, but could not be supported on a discounted cash flow basis. Under IFRS, any write down of asset value (except goodwill) may be reversed in future periods when circumstances have changed such that the impairments have been reduced. Canadian GAAP prohibits reversal of impairment losses.

On transition to IFRS, an entity is required to reassess whether there would be impairment of its goodwill applying the requirements of IAS 36. Inter Pipeline assessed its goodwill for impairment in accordance with the requirements of IAS 36 and determined that no impairment existed as at the IFRS transition date of January 1, 2010.

### Business Combinations

In accordance with IFRS transitional provisions, Inter Pipeline elected to apply IFRS related to business combinations prospectively from January 1, 2010. As such, Canadian GAAP balances relating to business combinations entered into before that date, including goodwill, have been carried forward without adjustment. In accordance with IFRS, transaction costs that were previously deferred under Canadian GAAP subsequent to January 1, 2010 have been expensed as required by IFRS 3 *Business Combinations*.

### Income Taxes

On transition to IFRS, Inter Pipeline's deferred tax liability was impacted by the tax effects resulting from the IFRS changes discussed previously in this section of the MD&A. Inter Pipeline recognized a decrease in the deferred tax liability with a corresponding increase to total partners' equity on the IFRS opening balance sheet.

### Future

Certain new standards, interpretations and amendments to existing standards were issued by the IASB that are mandatory for accounting periods beginning after January 1, 2011 or later periods. Inter Pipeline is assessing the impact of these pronouncements on its balance sheet and results, however it is not anticipated that any of these changes will have a material impact. The standards impacted are as follows:

#### IFRS 1 *First-time Adoption of International Financial Reporting Standards*

IFRS 1 was amended for severe hyperinflation and removal of fixed dates for first-time adopters and is effective for annual periods beginning on or after July 1, 2011.

#### IFRS 7 *Financial Instruments: Disclosures (IFRS 7)*

IFRS 7 was amended for additional disclosure requirements related to the transfer of financial assets and is effective for annual periods beginning on or after July 1, 2011. The amendments require an entity to provide the required disclosures for all transferred financial assets that are not derecognized and for any continuing involvement in a transferred asset.

#### IAS 12 *Income Taxes (IAS 12)*

IAS 12 was amended for deferred tax and specifically the recovery of underlying assets and is effective for annual periods beginning on or after January 1, 2012. The amendments provide guidance on the measurement of deferred tax assets and liabilities arising from either non-depreciable assets measured using the revaluation model in IAS 16 *Property, Plant and Equipment* or deferred tax assets and liabilities arising from investment property that is measured using the fair value model in IAS 40 *Investment Property*.

### IFRS 9 *Financial Instruments (IFRS 9)*

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* and shall be applied to annual periods beginning on or after January 1, 2013 with early adoption permitted.

### Exposure Draft - Joint Arrangements

Exposure Draft 9 – *Joint Arrangements* (ED 9) is now expected to become an IFRS in the second quarter of 2011 replacing IAS 31 *Interests in Joint Ventures*. ED 9 sets out the basis of accounting required for arrangements whereby assets, operations or entities are under joint control. The exposure draft currently proposes that entities account for interests in jointly controlled entities using the equity method of accounting and proposes elimination of the option to proportionately consolidate these entities.

Currently, Inter Pipeline uses the proportionate consolidation method to account for its 85% interest in the Cold Lake LP and 50% interest in the assets of the Empress V facility. Under the proposed ED 9, Cold Lake LP may be considered a jointly controlled entity, therefore may be required to be accounted for under the equity method of accounting versus proportionate consolidation. Empress V assets would be considered jointly controlled assets, therefore would continue to be accounted for under an accounting method similar to proportionate consolidation. As this is an exposure draft, the full extent of the impact of applying ED 9 cannot be made at this time, pending further certainty as to the final standard on accounting for joint arrangements.

### Other Exposure Drafts

Exposure drafts on revenue recognition and leases have been released which are expected to become IFRS in the second quarter of 2011. Inter Pipeline is currently assessing the impact of these exposure drafts.

## RISK FACTORS

During the first quarter of 2011, there were no significant changes to Inter Pipeline's operating activities that would affect the disclosure of risk factors as discussed in its 2010 annual MD&A.

## NON-GAAP FINANCIAL MEASURES

Certain financial measures referred to in this MD&A, namely "adjusted working capital deficiency", "cash available for distribution", "EBITDA", "enterprise value", "funds from operations", "funds from operations per unit", "payout ratio after sustaining capital", "payout ratio before sustaining capital", "growth capital expenditures", "sustaining capital expenditures", "total debt to total capitalization" and "total recourse debt to capitalization" are not measures recognized by GAAP. These non-GAAP financial measures do not have standardized meanings prescribed by GAAP and therefore may not be comparable to similar measures presented by other entities. Investors are cautioned that these non-GAAP financial measures should not be construed as alternatives to other measures of financial performance calculated in accordance with GAAP.

The following non-GAAP financial measures are provided to assist investors with their evaluation of Inter Pipeline, including their assessment of its ability to generate cash and fund monthly distributions. Management considers these non-GAAP financial measures to be important indicators in assessing its performance.

**Adjusted working capital deficiency** is calculated by subtracting current liabilities from current assets including cash and excluding the fair value of derivative financial instruments.

| (millions) | March 31 2011 | December 31 2010 (restated) |
|---|---|---|
| Current assets | | |
| Cash and cash equivalents | $ 29.1 | $ 22.5 |
| Accounts receivable | 105.4 | 129.5 |
| Prepaid expenses and other deposits | 9.7 | 13.1 |
| Current liabilities | | |
| Cash distributions payable | (20.7) | (20.6) |
| Accounts payable and accrued liabilites | (145.0) | (157.0) |
| Current income taxes payable | (15.5) | (0.8) |
| Deferred revenue | (21.7) | (6.3) |
| Adjusted working capital deficiency | $ (58.7) | $ (19.6) |

**Cash available for distribution** includes cash provided by operating activities less net changes in non-cash working capital and sustaining capital expenditures. This measure is used by the investment community to calculate the annualized yield of the units.

**EBITDA and funds from operations** are reconciled from the components of net income as noted below. Funds from operations are expressed before changes in non-cash working capital. **Funds from operations per unit** are calculated on a weighted average basis using basic units outstanding during the period. These measures, together with other measures, are used by the investment community to assess the source and sustainability of cash distributions.

| (millions) | Three Months Ended March 31 2011 | 2010 (restated) |
|---|---|---|
| Net income | $ 64.5 | $ 61.3 |
| Depreciation and amortization | 24.4 | 24.8 |
| Gain on disposal of assets | (0.1) | - |
| Non-cash recovery | (4.5) | (1.6) |
| Unrealized change in fair value of derivative financial instruments | 10.3 | (7.1) |
| Deferred income tax expense | 4.2 | 8.2 |
| Proceeds from long-term leasehold inducements | 1.5 | - |
| Funds from operations | 100.3 | 85.6 |
| Total interest less capitalized interest | 18.3 | 9.1 |
| Current income tax expense | 15.4 | 0.6 |
| EBITDA | $ 134.0 | $ 95.3 |

**Enterprise value** is calculated by multiplying the period-end closing unit price by the total number of units outstanding and adding total debt (excluding discounts and debt transaction costs). This measure, in combination with other measures, is used by the investment community to assess the overall market value of the business. Enterprise value is calculated as follows:

| (millions, except per unit amounts) | March 31 2011 | December 31 2010 |
|---|---|---|
| Closing unit price | $ 17.1 | $ 14.92 |
| Total closing number of Class A and B units outstanding | 258.5 | 258.0 |
| | 4415.7 | 3,850.0 |
| Total debt | 2762.4 | 2,801.2 |
| Enterprise value | $ 7,178.1 | $ 6,651.2 |

**Growth capital expenditures** are generally defined as expenditures which incrementally increase cash flow or earnings potential of assets, expand the capacity of current operations or significantly extend the life of existing assets. This measure is used by the investment community to assess the extent of discretionary capital spending.

**Sustaining capital expenditures** are generally defined as expenditures which support and/or maintain the current capacity, cash flow or earnings potential of existing assets without the associated benefits characteristic of growth capital expenditures. This measure is used by the investment community to assess the extent of non-discretionary capital spending.

| | | | Three Months Ended March 31 | |
|---|---|---|---|---|
| | | | 2011 | 2010 |
| *(millions)* | Growth | Sustaining | Total | Total |
| Oil sands transportation | $ 36.0 | $ 0.1 | $ 36.1 | $ 25.6 |
| NGL extraction | 1.2 | 1.0 | 2.2 | 1.0 |
| Conventional oil pipelines | 0.1 | 0.3 | 0.4 | 2.6 |
| Bulk liquid storage | 3.5 | 0.7 | 4.2 | 3.2 |
| Corporate | - | 0.7 | 0.7 | 1.3 |
| | $ 40.8 | $ 2.8 | $ 43.6 | $ 33.7 |

**Interest coverage on long-term debt** is calculated as net income before income taxes and interest expense divided by total interest expense. This measure is used by the investment community to determine the ease with which interest expense is satisfied on long-term debt.

**Payout ratio after sustaining capital** is calculated by expressing cash distributions declared for the period as a percentage of cash available for distribution after deducting sustaining capital expenditures for the period. This measure, in combination with other measures, is used by the investment community to assess the sustainability of the current cash distributions.

**Payout ratio before sustaining capital** is calculated by expressing cash distributions paid for the period as a percentage of cash available for distribution before deducting sustaining capital. This measure, in combination with other measures, is used by the investment community to assess the sustainability of the current cash distributions.

**Total debt to total capitalization** is calculated by dividing the sum of total debt including demand facilities and excluding discounts and debt transaction costs by total capitalization. Total capitalization includes the sum of total debt (as above) and partners' equity. Similarly, **total recourse debt to capitalization** is calculated by dividing the sum of debt facilities outstanding with recourse to Inter Pipeline (excluding discounts and debt transaction costs) by total capitalization excluding outstanding debt facilities with no recourse to Inter Pipeline. These measures, in combination with other measures, are used by the investment community to assess the financial strength of the entity.

## ELIGIBLE INVESTORS

Only persons who are residents of Canada, or if partnerships, are Canadian partnerships, in each case for purpose of the Income Tax Act (Canada) are entitled to purchase and own Class A units of Inter Pipeline.

## ADDITIONAL INFORMATION

Additional information relating to Inter Pipeline, including Inter Pipeline's **Annual Information Form**, is available on SEDAR at www.sedar.com. Inter Pipeline's Statement of Corporate Governance is included in Inter Pipeline's **Annual Information Form**.

The MD&A has been reviewed and approved by the Audit Committee and the Board of Directors of the General Partner.

**Dated at Calgary, Alberta this 5th day of May, 2011.**