



*Management's Discussion and Analysis*  
**For the three and six months ended June 30, 2012**

## *Forward-Looking Information*

The following Management's Discussion and Analysis (MD&A) highlights Inter Pipeline Fund's (Inter Pipeline) significant business results and statistics for the three and six month periods ended June 30, 2012, 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 2012 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), the expansion and integration of the Cold Lake and Polaris pipeline systems to provide transportation service to the Narrows Lake, Christina Lake and Foster Creek oil sands projects 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. (General Partner), the general partner of Inter Pipeline 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; including the further development of the Cold Lake, Corridor and Polaris pipeline systems; 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, instability and political and economic conditions in or 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; the potential delays and costs of overruns on construction projects, including, but not limited to the Polaris pipeline project for the Kearl oil sands project, the new pipeline connection to the Sunrise oil sands project and future expansions of the Cold Lake and Polaris pipeline systems; 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; 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 for further risk factors. 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 and six month periods ended June 30, 2012

The MD&A provides a detailed explanation of Inter Pipeline's operating results for the three and six month periods ended June 30, 2012, as compared to the three and six month periods ended June 30, 2011. The MD&A should be read in conjunction with the unaudited condensed interim consolidated financial statements (interim financial statements) and MD&A for the quarterly period ended June 30, 2011, the MD&A and audited consolidated financial statements for the year ended December 31, 2011, the Annual Information Form and other information filed by Inter Pipeline at [www.sedar.com](http://www.sedar.com).

Financial information presented in this MD&A is based on information in Inter Pipeline's interim financial statements prepared in accordance with International Accounting Standard 34 – *Interim Financial Reporting*.

This MD&A reports certain financial measures that are not recognized by Canadian generally accepted accounting principles (GAAP), as outlined in the CICA Handbook Part 1, and 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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## **SECOND QUARTER HIGHLIGHTS**

- Funds from operations\* (FFO) increased to \$107 million, up \$15 million or 17% over second quarter 2011 levels
- Low quarterly payout ratio before sustaining capital\* of 65.8%
- Cash distributions to unitholders totaled \$71 million or \$0.2625 per unit
- Net income increased to \$104 million, up \$43 million or 71% over second quarter 2011 results
- Quarterly throughput volumes on Inter Pipeline's oil sands and conventional oil pipeline systems averaged 967,500 barrels per day (b/d), or 30,100 b/d higher than second quarter 2011
- Volumes averaged 171,400 b/d on Inter Pipeline's conventional oil pipeline systems, an increase of 7,400 b/d or 5% over second quarter 2011 levels
- Issued \$400 million in senior medium-term notes at attractive interest rates

## **SUBSEQUENT EVENT**

- Announced \$2.1 billion integrated oil sands development program for Cold Lake and Polaris pipeline systems

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

## PERFORMANCE OVERVIEW

	Three Months Ended		Six Months Ended	
	June 30		June 30	
<i>(millions, except per unit and % amounts)</i>	2012	2011	2012	2011
<b>Revenues</b>				
Oil sands transportation	\$ 68.1	\$ 67.7	\$ 138.7	\$ 140.5
NGL extraction	106.3	137.4	243.0	297.3
Conventional oil pipelines	58.8	42.1	110.0	85.8
Bulk liquid storage	42.4	26.1	81.1	52.7
	\$ 275.6	\$ 273.3	\$ 572.8	\$ 576.3
<b>Funds from operations<sup>(1)</sup></b>				
Oil sands transportation	\$ 41.2	\$ 41.3	\$ 82.5	\$ 84.4
NGL extraction	48.5	42.8	105.5	95.8
Conventional oil pipelines	35.3	31.5	75.8	64.1
Bulk liquid storage	23.3	8.3	42.6	18.8
Corporate costs	(41.0)	(32.0)	(91.1)	(70.9)
	\$ 107.3	\$ 91.9	\$ 215.3	\$ 192.2
<b>Per unit<sup>(1)</sup></b>	\$ 0.40	\$ 0.35	\$ 0.81	\$ 0.74
<b>Net income</b>	\$ 104.4	\$ 61.0	\$ 184.0	\$ 125.5
Per unit – basic and diluted	\$ 0.39	\$ 0.24	\$ 0.69	\$ 0.49
<b>Cash distributions<sup>(2)</sup></b>	\$ 70.6	\$ 62.1	\$ 140.5	\$ 124.1
Per unit <sup>(2)</sup>	\$ 0.2625	\$ 0.2400	\$ 0.5250	\$ 0.4800
<b>Units outstanding (basic)</b>				
Weighted average	268.6	258.8	267.1	258.6
End of period	270.0	259.1	270.0	259.1
<b>Capital expenditures</b>				
Growth <sup>(1)</sup>	\$ 66.8	\$ 27.8	\$ 106.4	\$ 68.6
Sustaining <sup>(1)</sup>	7.0	4.4	13.3	7.2
	\$ 73.8	\$ 32.2	\$ 119.7	\$ 75.8
Payout ratio before sustaining capital <sup>(1)</sup>	65.8%	67.6%	65.3%	64.6%
Payout ratio after sustaining capital <sup>(1)</sup>	70.4%	71.0%	69.6%	67.1%
			As at	As at
			June 30	December 31
<i>(millions, except per unit and % amounts)</i>			2012	2011
Total assets			\$ 5,324.2	\$ 4,768.1
Total debt <sup>(3)</sup>			\$ 3,082.7	\$ 2,672.1
Total partners' equity			\$ 1,559.4	\$ 1,419.8
Enterprise value <sup>(1)</sup>			\$ 8,268.8	\$ 7,593.3
Total debt to total capitalization <sup>(1)</sup>			66.4%	65.3%
Total recourse debt to capitalization <sup>(1)</sup>			46.1%	38.9%

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

(2) Cash distributions are calculated based on the number of units outstanding at each record date.

(3) Total debt reported in the June 30, 2012 consolidated financial statements include long-term debt, short-term debt and commercial paper of \$3,067.5 million inclusive of discounts and debt transaction costs of \$15.2 million.

### **THREE MONTHS ENDED JUNE 30, 2012**

Inter Pipeline generated strong financial results in the second quarter of 2012 as funds from operations (FFO) increased 16.8% or \$15.4 million from \$91.9 million in the second quarter of 2011 to \$107.3 million in the second quarter of 2012. Inter Pipeline's payout ratio before sustaining capital was very positive at 65.8% for the three months ended June 30, 2012. The increase in FFO\* was largely driven by the acquisition of Inter Terminals in January 2012, higher volumes in the NGL extraction business and increased throughput volumes and tolls in the conventional oil pipelines business. These increases were partially offset by increased corporate costs.

In the second quarter of 2012, net income increased \$43.4 million or 71.1% to \$104.4 million from \$61.0 million in the second quarter of 2011. This increase in net income is primarily due to a favourable mark-to-market of derivative financial instruments which resulted in an unrealized gain, as well as the positive operating results discussed above. These increases are partially offset by higher depreciation and amortization and income taxes.

In the second quarter of 2012, total cash distributed to unitholders was \$70.6 million, an increase of 13.7% or \$8.5 million from the \$62.1 million distributed in the same period in 2011. The increase in cash distributions is primarily due to an increase in the monthly rate of cash distributions by \$0.0075 per unit effective December 2011. In addition, there were a higher overall number of units outstanding due to strong unitholder participation in Inter Pipeline's distribution reinvestment plan.

At June 30, 2012, Inter Pipeline's consolidated debt decreased \$63.1 million to \$3,082.7 million from \$3,145.8 million at March 31, 2012, while \$73.8 million was spent on capital projects.

### **SIX MONTHS ENDED JUNE 30, 2012**

For the six months ended June 30, 2012, Inter Pipeline also generated very strong financial results as FFO\* increased 12.0% or \$23.1 million from \$192.2 million in 2011 to \$215.3 million in 2012. Robust performance from all business segments resulted in an attractive payout ratio before sustaining capital\* of 65.3% for the six months ended June 30, 2012. FFO\* increased year to date 2012 for the same reasons discussed above.

Net income increased \$58.5 million or 46.6% to \$184.0 million year to date 2012 compared to \$125.5 million year to date 2011 for the same reasons discussed above.

For the six months ended June 30, 2012, total cash distributed to unitholders increased 13.2% or \$16.4 million from \$124.1 million in 2011 to \$140.5 million in 2012, for the same reasons mentioned above.

Inter Pipeline's consolidated debt increased \$410.6 million from \$2,672.1 million at December 31, 2011 to \$3,082.7 million at June 30, 2012. During this period Inter Pipeline completed the acquisition of Inter Terminals in Denmark, which was funded through an existing revolving credit facility, and expended \$119.7 million on capital projects. Inter Pipeline's total recourse debt to capitalization\* ratio increased from 38.9% at December 31, 2011 to 46.1% at June 30, 2012. When adjusted to include non-recourse debt of \$1,750.9 million held within Inter Pipeline's Corridor corporate entity, Inter Pipeline's total debt to total capitalization ratio was 66.4% at June 30, 2012, up slightly from 65.3% at December 31, 2011.

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

## **OUTLOOK**

Inter Pipeline's long-term business strategy is to acquire and develop long-life, high-quality energy infrastructure assets that generate sustainable and predictable cash flow. Through the continued execution of this strategy, Inter Pipeline has successfully positioned itself to execute a multi-billion dollar expansion of our energy infrastructure asset base. These large scale and accretive growth opportunities are expected to support stable and increasing returns to unitholders in the future.

With the continued development of Alberta's oil sands, the majority of Inter Pipeline's organic growth capital expenditure program, of up to \$3 billion over the next several years, is expected to focus on the oil sands transportation business segment. Significant near term energy infrastructure investments will be required to expand and create diluent and diluted bitumen transportation channels between major market hubs in Edmonton and Hardisty, Alberta and the Cold Lake and Athabasca oil sands regions.

In July, Inter Pipeline announced its largest ever organic development program totaling approximately \$2.1 billion. This capital is expected to be invested over the next three years to expand and integrate the Cold Lake and Polaris pipeline systems and connect to new production sites in the Cold Lake region. New pipelines and associated infrastructure assets will provide transportation service to the Foster Creek and Christina Lake oil sands projects operated by Cenovus Energy and the Narrows Lake project which is under development. To support initial engineering, design and early construction work for this development program and other oil sands related expansion projects, Inter Pipeline has backstopping agreements in place with producers totaling approximately \$295 million.

The Cold Lake portion of the development plan consists of multiple projects totaling approximately \$1.3 billion (Inter Pipeline's 85% share - \$1.1 billion) in new capital expenditures. New pipelines, ranging from 20 to 42 inches in diameter, will be constructed to twin the south leg of the Cold Lake mainline to Hardisty, to twin the Foster Creek extension, and to extend the Cold Lake system north to connect the Narrows Lake project. A total of approximately 400 kilometres (km) of new pipeline will be constructed. Other facility expansions and connections will also be completed to tie into the new oil sands projects. When completed, the Cold Lake pipeline system's mainline throughput capacity will increase by 550,000 b/d to approximately 1.2 million b/d.

The Polaris portion of the development plan is expected to cost approximately \$1.0 billion. A total of approximately 340 km of new pipeline will be constructed, including a new 50 km 24-inch diameter pipeline tying diluent receipt points in the Edmonton area to the Lamont pump station, and a new 290 km 30-inch diameter pipeline to connect the Lamont station to the Christina Lake production site. Approximately 100 km of new pipeline ranging from 12 to 16 inches in diameter will also be installed as part of the Narrows Lake and Foster Creek connections. Upon completion, the Polaris system will have approximately 820,000 b/d of diluent delivery capacity to the Athabasca and Cold Lake oil sands regions.

The projects related to the Foster Creek and Christina Lake facilities are expected to be completed by mid 2014. Those related to the Narrows Lake project are anticipated to be operational in mid 2016.

Oil sands pipeline development is expected to continue beyond these projects. Inter Pipeline is constructing more than 420,000 b/d of additional transportation capacity on the Polaris and Cold Lake systems beyond the initial requirements of the Foster Creek, Christina Lake and Narrows Lake projects. The two systems are therefore well positioned to capture additional third party transportation opportunities in the future.

In 2010, approval was granted by the Energy Resources Conservation Board for Taylor Processing Inc. to construct the Harmattan co-streaming project upstream of Inter Pipeline's NGL extraction facility at Cochrane, Alberta. Inter Pipeline requested leave to appeal the decision, and in October 2011 the appeal request was granted. In April 2012, the appeal was presented in the Alberta Court of Appeal. In July 2012, the Alberta Court of Appeal dismissed Inter Pipeline's appeal. While the Harmattan co-streaming project may reduce the gas available at the Cochrane facility, Inter Pipeline does not believe that the financial impact of Harmattan's co-stream operations will be material to overall financial results.

In the conventional oil pipelines segment, Inter Pipeline is well positioned to continue capturing benefits of new drilling and completion technologies. Despite recent market volatility, oil drilling activity remains strong in areas served by Inter Pipeline's conventional oil pipeline systems, particularly in the Viking and Pekisko formations. Recent drilling activity levels have led to pipeline throughput increases that have more than offset historical natural declines. Production growth in these active areas is expected to continue, which may stabilize and possibly grow overall throughput levels on Inter Pipeline's conventional oil pipeline systems over the near term.

While Inter Pipeline's various cash flow streams provide diversification and balance, the overall trend is towards the stable, long-term cash flows generated by our oil sands transportation assets. Inter Pipeline expects that the long-term and stable nature of typical oil sands transportation contracts will further increase the stability of its cash flow streams. These contracts are predominantly on cost-of-service terms that span multiple decades. Cost-of-service agreements are not subject to commodity price or volume fluctuations, and therefore add predictability to cash flow streams. The proportion of Inter Pipeline's FFO\* that is subject to commodity price fluctuations, primarily the sale of propane plus from the Cochrane NGL extraction facility, is expected to fall as cash flow from long-term stable contracts continues to increase.

Inter Pipeline's strong balance sheet remains key to our future development plans. Balance sheet flexibility and appropriate use of leverage facilitates ready access to public debt and equity markets, as evidenced in the second quarter when Inter Pipeline again successfully issued new public term debt at attractive rates. In the second quarter, Inter Pipeline issued \$400 million of 10-year senior unsecured medium-term notes (MTN) at 3.776%. This issue, the third in the past two years, increased Inter Pipeline's total public term debt to over \$900 million, with each highly successful issue being completed at favourable interest rates.

Inter Pipeline's investment grade credit ratings are key to maintaining an attractive cost of capital. This in turn, underpins Inter Pipeline's strategy of acquiring and developing long-life, high quality energy infrastructure assets on an accretive basis. Standard & Poor's (S&P) and DBRS have assigned credit ratings of BBB+ and BBB (high), respectively, each with a stable trend. Inter Pipeline (Corridor) Inc. has been assigned investment grade credit ratings of A2 (stable outlook) and A (stable outlook) from Moody's Investor Services (Moody's) and DBRS. Earlier in 2012, S&P increased Inter Pipeline (Corridor) Inc.'s rating from A- to A as a result of successfully completing the \$1.85 billion Corridor capacity expansion project. Inter Pipeline's MTNs were issued investment grade credit ratings of BBB+ and BBB (high) by S&P and DBRS, respectively.

Effective implementation of Inter Pipeline's long-term business strategy has left us well positioned to continue delivering stable and growing returns to our unitholders. Our extensive energy infrastructure asset base is well positioned to capture numerous organic growth opportunities. With a strong balance sheet and proven project management and operational skills, Inter Pipeline expects that we will be able to profitably develop these opportunities for the benefit of our unitholders.

## RESULTS OF OPERATIONS

### OIL SANDS TRANSPORTATION BUSINESS SEGMENT

Volumes (000s b/d)	Three Months Ended			Six Months Ended		
	2012	2011	% change	2012	2011	% change
Cold Lake (100% basis)	471.4	484.1	(2.6)	478.9	496.1	(3.5)
Corridor	324.7	289.3	12.2	308.6	279.4	10.5
	796.1	773.4	2.9	787.5	775.5	1.5

<i>(millions)</i>						
	2012	2011	% change	2012	2011	% change
Revenue <sup>(1)</sup>	\$ 68.1	\$ 67.7	0.6	\$ 138.7	\$ 140.5	(1.3)
Operating expenses <sup>(1)</sup>	\$ 16.3	\$ 17.3	(5.8)	\$ 34.3	\$ 37.1	(7.5)
Funds from operations <sup>(1)(2)</sup>	\$ 41.2	\$ 41.3	(0.2)	\$ 82.5	\$ 84.4	(2.3)
Capital expenditures <sup>(1)</sup>						
Growth <sup>(2)</sup>	\$ 31.3	\$ 20.6		\$ 60.0	\$ 56.6	
Sustaining <sup>(2)</sup>	0.9	0.3		1.7	0.4	
	\$ 32.2	\$ 20.9		\$ 61.7	\$ 57.0	

(1) Cold Lake pipeline system's revenue, operating expenses, FFO<sup>(2)</sup> 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.

### Volumes

In the three months ended June 30 2012, average volumes transported by the oil sands transportation business were 796,100 b/d, an increase of 22,700 b/d, compared to the same period in 2011. For the six months ended June 30, 2012, volumes transported by the oil sands transportation business averaged 787,500 b/d, an increase of 12,000 b/d compared to the same period in 2011.

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 Hardisty and Edmonton, Alberta. Average volumes transported on the Cold Lake pipeline system decreased 2.6% to 471,400 b/d during the second quarter and 3.5% to 478,900 b/d year to date in 2012, compared to the same periods in 2011. Cold Lake volumes fluctuate mainly due to the timing of steam injection cycles associated with certain shipper production processes. Volumes for the three and six months ended June 30, 2012, were also impacted by producer maintenance activities and a turnaround at the Foster Creek oil sands project in May 2012. Inter Pipeline anticipates volume growth on the Cold Lake pipeline system, which is consistent with shippers' published long-term 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. Average volumes transported on the Corridor pipeline system increased 35,400 b/d or 12.2% to 324,700 b/d in the second quarter and 29,200 b/d or 10.5% to 308,600 b/d year to date in 2012, compared to the same periods in 2011. The volume increase is primarily attributable to increased production levels from Athabasca Oil Sands Project's Jackpine mine.

### Revenue

Revenue in the oil sands transportation business increased \$0.4 million to \$68.1 million in the second quarter, while it decreased \$1.8 million to \$138.7 million year to date 2012, compared to the same periods in 2011.

Cold Lake pipeline system revenues increased \$1.7 million in the second quarter of 2012 and decreased \$0.3 million year to date 2012, compared to the same periods in 2011. Revenue increased in both periods primarily due to incremental revenue generated in 2012 that was associated with

volumes that were in excess of the previous ship-or-pay commitment which expired on December 31, 2011, as well as higher revenues on the Foster Creek extension and the Orion lateral. These increases were partially offset in the second quarter, and more than offset year to date 2012, by lower operating cost recoveries and reduced revenue from lower mainline volumes transported on the Cold Lake pipeline system, compared to the same periods in 2011.

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 have committed to utilizing these pipelines and paying for such usage over the term of the Cold Lake TSA which extends indefinitely subject to certain provisions in the agreement. Additional returns on capital invested and recovery of associated operating costs are also earned with respect to other agreements between Cold Lake and shippers utilizing the Cold Lake pipeline system.

Revenue from the Corridor pipeline system decreased \$1.3 million in the second quarter and \$1.5 million year to date 2012, compared to the same periods in 2011. The decrease in revenue was primarily due to a lower return on equity as the long-term Government of Canada (GOC) benchmark bond interest rate declined approximately 116 basis points for the quarter and 110 basis points year to date 2012, compared to the same periods in 2011. In addition, revenue decreased as a result of lower recoverable operating costs as discussed below. These decreases in revenue were partially offset by an increase in rate base debt financing costs and related revenue. Average blended short-term and long-term interest rates used to finance the Corridor rate base increased approximately 28 basis points for the quarter and 29 basis points year to date 2012, compared to the same periods in 2011.

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 all debt financing costs, 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 FFO 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 the long-term GOC bond rate upon which the annual return on equity is determined, and changes to Corridor's rate base.

### **Operating Expenses**

In the oil sands transportation business segment, operating expenses typically have a limited impact on Inter Pipeline's cash flow. On the Cold Lake pipeline system substantially all operating expenditures are recovered from the shippers and on the Corridor pipeline system there is full recovery of the expenditures. Similar to Corridor, there will be a full recovery of the expenditures on the Polaris pipeline system once it begins operation in late 2012. For the three and six months ended June 30, 2012, operating expenses in the oil sands transportation business decreased \$1.0 million and \$2.8 million, respectively, compared to the same periods in 2011.

For the three and six months ended June 30, 2012, operating expenses on the Cold Lake pipeline system decreased \$0.4 million and \$2.2 million, respectively, compared to the same periods in 2011. The decreases in both periods are primarily due to lower power costs and lower non-routine maintenance costs. These lower costs were partially offset by higher right-of-way costs in the second quarter of 2012 and higher integrity costs for the year to date 2012, compared to the same periods in 2011. Average Alberta power pool prices decreased 22.9% from \$51.90/MWh in the second quarter of 2011 to \$40.03/MWh in the second quarter of 2012 and 25.1% from \$66.88/MWh year to date 2011 to \$50.07 MWh year to date 2012.

Operating expenses on the Corridor pipeline system were \$0.6 million lower for both the three and six months ended June 30, 2012, compared to the same periods in 2011. The decrease in both periods is primarily due to lower employee costs.

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

## Capital Expenditures

Growth capital expenditures\* incurred on the Cold Lake pipeline system were \$21.4 million in the second quarter of 2012. Of this amount \$8.8 million relates to a west leg expansion project, for a total of \$16.3 million (\$19.2 million – 100%) spent on the project to date. This project will expand capacity on the west mainline leg of the Cold Lake system. Bitumen blend capacity will be increased from approximately 535,000 b/d to roughly 650,000 b/d by expanding existing pump stations and the addition of two new pump stations. The west leg capacity project is expected to cost \$90.0 million (100%), with an in service date of mid 2013. The remaining expenditures relate to other growth initiatives, most of which are backstopped by future potential shippers.

The Corridor pipeline system incurred growth capital expenditures\* of \$0.5 million in the second quarter of 2012 which primarily relate to the purchase of equipment to be used in the event of an emergency repair.

In the second quarter of 2012, total growth capital expenditures\* on the Polaris pipeline system were \$9.4 million. Facility and pipeline construction activities relating to the connection of the Kearl and Sunrise oil sands projects continued with \$5.4 million spent in the second quarter of 2012 for a total of \$89.0 million spent on the project to date. Beginning in the second half of 2012 and 2013, the Polaris pipeline system will provide diluent transportation services for the Kearl and Sunrise oil sands projects, respectively. The Polaris system utilizes an existing 12-inch diameter pipeline that has been idled as a result of the recently completed Corridor expansion project. The rate base net book value of the 12-inch diameter pipeline will be deducted from Corridor's rate base prior to beginning diluent service for the Kearl project. The estimated total capital expenditures to connect the Polaris pipeline to the Kearl and Sunrise projects, and diluent receipt points in the Edmonton area was revised from \$115 million to \$105 million to reflect updated cost estimates. The remaining Polaris pipeline system growth capital expenditures\* of \$4.0 million were spent on various other growth initiatives.

## NGL EXTRACTION BUSINESS SEGMENT

		Three Months Ended June 30						
		2012		2011				
		<i>mmcf/d</i>	<i>(000s b/d)</i>	<i>mmcf/d</i>	<i>(000s b/d)</i>			
Facility	Throughput	Ethane	Propane-plus	Total	Throughput	Ethane	Propane-plus	Total
Cochrane	1,595	47.9	23.7	71.6	1,544	48.0	22.7	70.7
Empress V (100% basis)	833	12.7	10.3	23.0	898	22.1	10.1	32.2
Empress II	370	7.3	4.5	11.8	-	-	-	-
	2,798	67.9	38.5	106.4	2,442	70.1	32.8	102.9

		Six Months Ended June 30						
		2012		2011				
		<i>mmcf/d</i>	<i>(000s b/d)</i>	<i>mmcf/d</i>	<i>(000s b/d)</i>			
Facility	Throughput	Ethane	Propane-plus	Total	Throughput	Ethane	Propane-plus	Total
Cochrane	1,737	52.1	24.6	76.7	1,714	51.2	24.3	75.5
Empress V (100% basis)	832	17.5	8.9	26.4	974	23.3	10.8	34.1
Empress II	185	3.7	2.3	6.0	141	2.6	1.4	4.0
	2,754	73.3	35.8	109.1	2,829	77.1	36.5	113.6

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

(millions)	Three Months Ended			Six Months Ended		
	2012	2011	% change	2012	2011	% change
Revenue <sup>(1)</sup>	\$ 106.3	\$ 137.4	(22.6)	\$ 243.0	\$ 297.3	(18.3)
Shrinkage gas <sup>(1)</sup>	\$ 36.7	\$ 70.8	(48.2)	\$ 92.7	\$ 148.8	(37.7)
Operating expenses <sup>(1)</sup>	\$ 21.1	\$ 24.0	(12.1)	\$ 44.6	\$ 52.7	(15.4)
Funds from operations <sup>(1)(2)</sup>	\$ 48.5	\$ 42.8	13.3	\$ 105.5	\$ 95.8	10.1
Capital expenditures <sup>(1)</sup>						
Growth <sup>(2)</sup>	\$ 5.3	\$ 2.1		\$ 10.2	\$ 3.3	
Sustaining <sup>(2)</sup>	0.4	1.0		0.8	2.0	
	\$ 5.7	\$ 3.1		\$ 11.0	\$ 5.3	

(1) Revenue, shrinkage gas, operating expenses, FFO<sup>(2)</sup> 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

For the three and six months ended June 30, 2012, Inter Pipeline's three NGL extraction plants processed average natural gas throughput volumes of 2,798 million cubic feet per day (mmcf/d) and 2,754 mmcf/d, an increase of 356 mmcf/d and a decrease of 75 mmcf/d, respectively, compared to the same periods in 2011.

At the Empress V and II facilities, fluctuations in natural gas exports from Alberta's eastern border resulted in average throughput volumes being 305 mmcf/d higher in the quarter, but 98 mmcf/d lower year to date in 2012, compared to the same periods in 2011. Facility throughputs are largely dependent on successfully attracting border gas flows to the extraction plants.

Average throughput volumes were slightly higher at the Cochrane facility for the three and six months ended June 30, 2012, compared to the same periods in 2011, as demand for Canadian natural gas in the US west-coast region remained strong.

Ethane volumes at the Empress V and Cochrane facilities were adversely affected by petrochemical plant outages at Fort Saskatchewan and Joffre, Alberta, during the second quarter of 2012.

## 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.

For the three months ended June 30, 2012, revenue decreased \$31.1 million to \$106.3 million, while for the six months ended June 30, 2012 revenue decreased \$54.3 million to \$243.0 million, compared to the same periods in 2011. The decreases are largely due to lower ethane and propane-plus pricing.

## Frac-spread

		Three Months Ended June 30			
(dollars)		2012		2011	
		USD/USG <sup>(1)</sup>	CAD/USG <sup>(1)</sup>	USD/USG <sup>(1)</sup>	CAD/USG <sup>(1)</sup>
Market frac-spread		\$ 1.031	\$ 1.038	\$ 1.279	\$ 1.236
Realized frac-spread		\$ 1.001	\$ 1.009	\$ 1.029	\$ 0.995

		Six Months Ended June 30			
(dollars)		2012		2011	
		USD/USG <sup>(1)</sup>	CAD/USG <sup>(1)</sup>	USD/USG <sup>(1)</sup>	CAD/USG <sup>(1)</sup>
Market frac-spread		\$ 1.149	\$ 1.153	\$ 1.225	\$ 1.197
Realized frac-spread		\$ 1.077	\$ 1.082	\$ 1.009	\$ 0.986

(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 decreased from \$1.03 USD/USG to \$1.00 USD/USG in the second quarter of 2012 and increased from \$1.01 USD/USG to \$1.08 USD/USG year to date 2012, compared to the same periods in 2011. Market frac-spreads for the three months ended June 30, 2012 were above the 5-year and 15-year simple average market frac-spread of \$0.86 USD/USG and \$0.45 USD/USG, respectively, calculated at December 31, 2011.

## Shrinkage

Shrinkage gas represents natural gas bought by Inter Pipeline to replace the heat content of liquids extracted from natural gas processed at the extraction facilities. The price for shrinkage gas is based on a combination of daily and monthly index AECO natural gas prices. For the three and six months ended June 30, 2012, shrinkage gas decreased \$34.1 million and \$56.1 million, respectively, as a result of lower AECO natural gas prices, compared to the same periods in 2011. For the three and six months ended June 30, 2012, the weighted average monthly AECO price\* decreased 50.8% from \$3.54 per gigajoule (GJ) to \$1.74/GJ and 42.1% from \$3.56/GJ to \$2.06/GJ, respectively, compared to the same periods in 2011.

## Operating Expenses

Operating expenses for the three and six months ended June 30, 2012, decreased \$2.9 million and \$8.1 million, respectively, compared to the same periods in 2011. The decreases in operating expenses for both periods are primarily due to lower fuel and power costs. Other operating costs were also lower in the second quarter of 2012 due to lower general operating and maintenance costs. Year to date 2012, other operating costs were higher due to several one time maintenance costs.

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

## Capital Expenditures

The NGL extraction business incurred growth capital expenditures\* of \$5.3 million, in the second quarter of 2012, of which \$4.6 million relates to a liquid sweetening project at the Cochrane facility. The remaining growth capital expenditures\* relate to various other projects at the Cochrane and Empress facilities.

## CONVENTIONAL OIL PIPELINES BUSINESS SEGMENT

	Three Months Ended			Six Months Ended		
	June 30			June 30		
<i>Volumes (000s b/d)</i>	2012	2011	% change	2012	2011	% change
Bow River	106.3	105.3	0.9	109.3	107.4	1.8
Central Alberta	26.9	26.3	2.3	26.3	26.5	(0.8)
Mid-Saskatchewan	38.2	32.4	17.9	39.8	33.5	18.8
	171.4	164.0	4.5	175.4	167.4	4.8
<i>(millions)</i>						
Revenue	\$ 58.8	\$ 42.1	39.7	\$ 110.0	\$ 85.8	28.2
Midstream product purchases	\$ 12.8	\$ -	100.0	\$ 12.8	\$ -	100.0
Operating expenses	\$ 11.9	\$ 10.7	11.2	\$ 22.1	\$ 20.9	5.7
Funds from operations <sup>(1)</sup>	\$ 35.3	\$ 31.5	12.1	\$ 75.8	\$ 64.1	18.3
Revenue per barrel <sup>(2)</sup>	\$ 2.75	\$ 2.60	5.8	\$ 2.87	\$ 2.64	8.7
Capital expenditures						
Growth <sup>(1)</sup>	\$ 26.3	\$ 0.3		\$ 29.2	\$ 0.4	
Sustaining <sup>(1)</sup>	0.2	1.0		1.0	1.3	
	\$ 26.5	\$ 1.3		\$ 30.2	\$ 1.7	

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

(2) Revenue per barrel represents total revenue of the conventional oil pipelines business segment less midstream marketing revenue divided by actual volumes.

## Volumes

Volumes transported on the conventional oil pipeline systems in the second quarter were 171,400 b/d (an increase of 4.5%) and 175,400 b/d year to date 2012 (an increase of 4.8%), compared to the same periods in 2011. Average volumes on the Mid-Saskatchewan pipeline increased approximately 5,800 b/d or 17.9% in the second quarter and approximately 6,300 b/d or 18.8% year to date, compared to the same periods in 2011. This positive change is due to increased production from new horizontal well drilling in the Viking light oil play. For the three and six months ended June 30, 2012, Bow River pipeline volumes increased 1,000 b/d and 1,900 b/d, respectively, compared to the same periods in 2011, primarily due to increased drilling activity in the Pekisko tight oil play. Volumes on the Central Alberta pipeline system were consistent in the second quarter and year to date 2012, compared to the same periods in 2011.

## Revenue

For the three and six months ended June 30, 2012, revenues in the conventional oil pipelines business increased \$16.7 million and \$24.2 million, respectively, compared to the same periods in 2011. The increase in both periods is primarily due to revenues from midstream marketing activities, which Inter Pipeline internalized on April 1, 2012, as the agreement with Nexen Marketing expired. Revenue also increased in both periods due to increased mainline tolls (average increase of 6% in both January of 2012 and July of 2011) and increased transportation volumes as discussed above.

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

## Midstream Product Purchases

Midstream product purchases of \$12.8 million for the three and six months ended June 30, 2012, relate to product purchases for Inter Pipeline's midstream marketing activities, which began on April 1, 2012 as discussed above.

## Operating Expenses

Operating expenses increased for both the second quarter and year to date 2012 by \$1.2 million, compared to the same periods in 2011. The increases in both periods are primarily due to trucking costs for Inter Pipeline's midstream marketing activities and an increase in long-term environmental liabilities, which were partially offset by lower general operating and remediation costs. Higher operating expenses were also partially offset in the second quarter by lower integrity costs due to the timing of these costs in 2012.

## Capital Expenditures

In the second quarter of 2012, the conventional oil pipelines business incurred growth capital expenditures\* of \$26.3 million, of which \$24.0 million relates to the midstream marketing business for line fill. The remaining growth capital expenditures\* primarily relate to facility upgrades on the Mid-Saskatchewan pipeline system.

## BULK LIQUID STORAGE BUSINESS SEGMENT

	Three Months Ended			Six Months Ended		
	June 30			June 30		
	2012	2011	% change	2012	2011	% change
Utilization	94.8%	97.4%	(2.7)	91.9%	98.0%	(6.2)
<i>(millions)</i>						
Revenue	\$ 42.4	\$ 26.1	62.5	\$ 81.1	\$ 52.7	53.9
Operating expenses	\$ 15.7	\$ 13.3	18.0	\$ 31.8	\$ 26.6	19.5
Funds from operations <sup>(1)</sup>	\$ 23.3	\$ 8.3	180.7	\$ 42.6	\$ 18.8	126.6
Capital expenditures						
Growth <sup>(1)</sup>	\$ 3.9	\$ 4.8		\$ 7.0	\$ 8.3	
Sustaining <sup>(1)</sup>	4.8	1.9		8.6	2.6	
	\$ 8.7	\$ 6.7		\$ 15.6	\$ 10.9	

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

## Utilization

Inter Pipeline operates a bulk liquid storage business through two wholly owned subsidiaries, Simon Storage Limited (Simon Storage) and Inter Terminals Denmark A/S (Inter Terminals). Simon Storage owns and operates six bulk liquid storage terminals located in the United Kingdom (UK) and Ireland and two inland terminals located on the Rhine River in Germany, with a combined liquid storage capacity of approximately 8.1 million barrels. Inter Terminals owns and operates four coastal bulk liquid storage terminals located in Denmark, with a combined storage capacity of approximately 10.8 million barrels.

Despite uncertainties in the European economic environment, bulk liquid storage demand has remained relatively strong with tank utilization averaging 94.8% in the second quarter and 91.9% year to date 2012. Utilization rates at Inter Terminals were 96.8% in the second quarter and 91.5% year to date 2012, while Simon Storage utilization rates were 92.1% in the second quarter and 92.3% year to date 2012. The lack of a strong contango in certain petroleum product markets has temporarily resulted in slightly lower utilization rates. Demand for storage fluctuates historically due to market conditions within industry sectors, which Simon Storage and Inter Terminals manage through customer and product diversification.

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

## **Revenue**

The business activities of Simon Storage and Inter Terminals consist primarily of bulk liquid storage, handling and blending 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.

Revenue increased in the bulk liquid storage business in the three and six months ended June 30, 2012 by \$16.3 million and \$28.4 million, respectively, compared to the same periods in 2011. The increase is primarily due to the acquisition of Inter Terminals in January 2012, which increased revenue by \$17.5 million in the second quarter and by \$31.1 million year to date 2012. This increase in revenue in both periods was partially offset by lower ancillary services revenue in Simon Storage resulting from decreased activity levels, as well as 2011 contract termination fees and an insurance settlement that increased revenue in the prior periods. In addition, foreign currency translation adjustments decreased revenue by \$0.1 million in the quarter and \$0.3 million year to date 2012, compared to the same periods in 2011. The average Euro/Pound Sterling rate decreased from 0.88 in the second quarter of 2011 to 0.81 in the second quarter of 2012, and from 0.87 year to date 2011 to 0.82 year to date 2012. This was partially offset in both periods by an increase in the Pound Sterling/CAD exchange rate from 1.58 to 1.60 in the second quarter of 2011 to 2012 and from 1.58 to 1.59 year to date 2011 to 2012.

## **Operating Expenses**

For the three and six months ended June 30, 2012, operating expenses increased by \$2.4 million and \$5.2 million, respectively, compared to the same periods in 2011. The increase in both periods is primarily due to the acquisition of Inter Terminals in January 2012 which increased operating expenses by \$3.2 million in the second quarter and by \$6.6 million year to date 2012. These increases were partially offset in both periods by lower operating, fuel and power and ancillary services costs in Simon Storage as a result of decreased activity.

## **Capital Expenditures**

Growth capital expenditures in the bulk liquid storage business were \$3.9 million in the second quarter of 2012. The expenditures primarily relate to a number of tank replacements for the storage of gas condensate and heavy fuel oils, as well as tank life extensions and tank modification projects at Immingham pursuant to long-term storage agreements. In the second quarter of 2012, sustaining capital expenditures were \$4.8 million, primarily relating to expenditures on Inter Terminals environmental performance enhancement initiatives, and other improvement projects on terminal infrastructure and safety.

## **Acquisition of Inter Terminals**

On January 11, 2012, Inter Pipeline completed the acquisition of four petroleum storage terminals in Denmark, referred to collectively as Inter Terminals, from a subsidiary of DONG Energy A/S. The acquisition was valued at \$459 million plus closing adjustments and the assumption of surplus cash, for a total cash consideration of \$509 million, and was funded from Inter Pipeline's existing revolving credit facility. The acquisition has more than doubled Inter Pipeline's total bulk liquid storage capacity in Western Europe, adding scale and diversification to European storage operations.

Operating results for Inter Terminals have been included in the consolidated financial statements since January 11, 2012. Inter Terminals contributed \$17.5 million and \$3.7 million to revenue and net income, respectively, for the three months ended June 30, 2012. Inter Terminals contributed \$31.1 million and \$9.2 million to revenue and net income, respectively from the date of acquisition to June 30, 2012.

As a result of this transaction, an acquisition fee of \$4.6 million was paid during the first quarter of 2012 to the General Partner, pursuant to the terms of the Limited Partnership Agreement (LPA).

The acquisition was accounted for by the acquisition method as at the closing date of January 11, 2012. Determinations of fair value often require management to make assumptions and estimates about future events. Changes in any of the assumptions or estimates used in determining the fair

value of acquired assets and liabilities, including closing adjustments, could impact the carrying amounts assigned. The preliminary allocation of the consideration transferred, subject to closing adjustments or changes in estimates, was as follows:

Cash	\$ 48.3
Non-cash working capital	15.2
Property, plant and equipment	342.2
Goodwill	111.2
Intangible assets	20.7
Decommissioning obligation	(18.4)
Deferred income tax liability	(9.8)
	\$ 509.4

## OTHER EXPENSES

<i>(millions)</i>	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Depreciation and amortization	\$ 34.1	\$ 25.1	\$ 61.8	\$ 49.5
Financing charges	25.0	20.1	48.3	39.0
Provision for income taxes	32.6	21.7	55.2	41.2
General and administrative	13.9	13.1	29.0	25.7
Acquisition fee to General Partner	-	-	4.6	-
Management and incentive fees to General Partner	3.3	2.4	7.0	5.2
Unrealized change in fair value of derivative financial instruments	(52.1)	(6.0)	(55.2)	4.3
Gain on disposal of assets	(0.1)	(0.1)	(0.1)	(0.2)

## Depreciation and Amortization

For the three and six months ended June 30, 2012, depreciation and amortization of tangible and intangible assets increased primarily due to the acquisition of Inter Terminals.

## Financing Charges

<i>(millions)</i>	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Interest on credit facilities	\$ 8.9	\$ 7.3	\$ 18.5	\$ 15.0
Interest on loan payable to General Partner	5.8	5.8	11.6	11.6
Interest on Corridor Debentures	2.5	2.5	5.0	5.0
Interest on MTN Series 1, 2 and 3	7.4	4.0	13.3	6.6
Total interest	24.6	19.6	48.4	38.2
Capitalized interest	(0.9)	(0.1)	(2.7)	(0.4)
Amortization of transaction costs on long-term and short-term debt and commercial paper	0.8	0.3	1.6	0.5
Accretion of provisions	0.5	0.3	1.0	0.7
Total financing charges	\$ 25.0	\$ 20.1	\$ 48.3	\$ 39.0

For the three and six months ended June 30, 2012, total financing charges increased \$4.9 million and \$9.3 million, respectively, compared to the same periods in 2011. The increase in financing charges is primarily due to the acquisition of Inter Terminals in January 2012, which was funded through Inter Pipeline's existing credit facility.

Interest on MTNs increased \$3.4 million in the second quarter of 2012 and \$6.7 million year to date 2012, due to the timing of issuances of the MTN Series 1, 2 and 3. Inter Pipeline issued the MTNs to the Canadian public debt as follows: February 2, 2011 - \$325 million of MTN Series 1 at a rate of

4.967% per annum due February 2, 2021; July 29, 2011 - \$200 million of MTN Series 2 at a rate of 3.839% per annum due July 30, 2018; and May 28, 2012 - \$400 million of MTN Series 3 at a rate of 3.776% per annum due May 30, 2022.

Interest on credit facilities increased \$1.6 million in the second quarter of 2012 and \$3.5 million year to date 2012, compared to the same period in 2011. This increase is due to higher average short-term interest rates and increased debt levels. The weighted average interest rate on Inter Pipeline's credit facilities increased approximately 10 basis points from 1.5% in the second quarter of 2011 to 1.6% in second quarter of 2012. The weighted average credit facility debt outstanding increased \$66.7 million to \$1,838.0 million in the second quarter of 2012 compared to \$1,771.3 million in the second quarter of 2011. For the six months ended June 30, 2012, the weighted average interest rate increased approximately 10 basis points from 1.5% in 2011 to 1.6% in 2012, while the weighted average debt outstanding increased \$43.2 million from \$1,853.8 million in 2011 to \$1,897.0 million in 2012.

Interest expense on Corridor debentures is consistent for the three and six months ended June 30, 2012, compared to the same periods in 2011. Interest rates on the Series B and C debentures are fixed; however, Corridor has a swap agreement in place on the \$150 million Series B debentures that exchanged the fixed rates for variable rates.

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 are 5.85% and 6.15%, respectively.

Capitalized interest for the three and six months ended June 30, 2012 increased by \$0.8 million, and \$2.3 million, respectively, compared to the same periods in 2011. This increase primarily relates to capitalized interest attributed to the construction of the Polaris and Cold Lake pipeline systems and a liquid sweetening project at the Cochrane NGL extraction facility.

Amortization of transaction costs on long-term and short-term debt and commercial paper increased due to new issuances, for the three and six months ended June 30, 2012 by \$0.5 million and \$1.1 million, respectively. Accretion of decommissioning and environmental provisions are \$0.2 million higher in the second quarter of 2012 and \$0.3 million higher year to date 2012, compared to the second quarter of 2011, due to an increase in decommissioning provisions relating to the acquisition of Inter Terminals.

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

### Income Taxes

For the three and six months ended June 30, 2012, consolidated income tax expense of \$32.6 million and \$55.2 million, respectively, increased \$11.0 million and \$14.0 million, respectively, compared to the same periods in 2011. The increase in income tax expense for both periods is primarily due to higher consolidated income before taxes.

### General and Administrative

(millions)	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2012	2011	2012	2011
Canada	\$ 11.0	\$ 9.7	\$ 23.4	\$ 20.6
Europe	2.9	3.4	5.6	5.1
	\$ 13.9	\$ 13.1	\$ 29.0	\$ 25.7

Canadian general and administrative expenses for the three and six months ended June 30, 2012 increased \$1.3 million and \$2.8 million, respectively, compared to the same period in 2011. The

increases in both periods are primarily due to higher long-term incentive plan costs, employee costs and legal fees, which were partially offset by lower information technology costs.

Inter Pipeline's European general and administrative costs decreased \$0.5 million in the second quarter of 2012 as acquisition costs for Inter Terminals were higher in the second quarter of 2011. However, for the six month period ended June 30, 2012, European general and administrative costs were \$0.5 million higher than the same period in 2011, due to higher acquisition costs incurred year to date in 2012.

### **Fees to General Partner**

The General Partner earned management fees from Inter Pipeline of \$2.9 million in the second quarter (second quarter 2011 - \$2.4 million) for a total of \$6.2 million for the first six months in 2012 (six months ended June 30, 2011 - \$5.2 million). This fee is equivalent to 2% of "Operating Cash," as defined in the LPA. In the second quarter of 2012, an incentive fee to the General Partner of \$0.4 million was also accrued for a total of \$0.8 million year to date 2012, as annualized Distributable Cash for 2012 is expected to be in excess of \$1.01 per unit annually (three and six months ended June 30, 2011 - \$nil). Acquisition fees of \$4.6 million related to the acquisition of Inter Terminals were also paid to the General Partner in the first quarter of 2012.

See the **TRANSACTIONS WITH RELATED PARTIES** section for additional information on fees to the General Partner.

### **Unrealized Change in Fair Value of Derivative Financial Instruments**

For the three and six months ended June 30, 2012, the mark-to-market valuation of Inter Pipeline's derivative financial instruments resulted in an increase to net income of \$52.1 million and \$55.2 million, respectively.

The mark-to-market adjustment on NGL swaps was the primary driver for this increase, amounting to \$46.8 million in the second quarter for price and volume changes between April and June of 2012 and \$51.0 million year to date 2012 for price and volume changes between January and June of 2012. Net income was also favourably impacted by mark-to-market adjustments on natural gas swaps of \$6.8 million in the second quarter and \$1.9 million year to date 2012, for price and volume changes between April and June of 2012 and between January and June of 2012, respectively. The mark-to-market on net foreign currency swaps decreased net income in the second quarter of 2012 by \$1.5 million reflecting the change in forward prices in the quarter and increased net income by \$2.3 million year to date 2012 for the change in forward prices during this period.

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

## SUMMARY OF QUARTERLY RESULTS

(millions, except per unit and % amounts)	2010		2011				2012	
	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter
<b>Revenue</b>								
Oil sands transportation	\$ 36.4	\$ 36.8	\$ 72.8	\$ 67.7	\$ 73.0	\$ 71.3	\$ 70.6	\$ 68.1
NGL extraction	128.8	149.1	159.9	137.4	158.2	129.1	136.7	106.3
Conventional oil pipelines	41.4	40.7	43.7	42.1	45.7	46.3	51.2	58.8
Bulk liquid storage	25.1	25.9	26.6	26.1	25.2	26.5	38.7	42.4
	\$ 231.7	\$ 252.5	\$ 303.0	\$ 273.3	\$ 302.1	\$ 273.2	\$ 297.2	\$ 275.6
<b>Funds from operations<sup>(1)</sup></b>								
Oil sands transportation	\$ 18.4	\$ 17.9	\$ 43.1	\$ 41.3	\$ 41.8	\$ 39.5	\$ 41.3	\$ 41.2
NGL extraction <sup>(2)</sup>	40.2	46.8	53.0	42.8	62.6	44.1	57.0	48.5
Conventional oil pipelines	30.2	26.8	32.6	31.5	35.6	33.5	40.5	35.3
Bulk liquid storage <sup>(3)</sup>	5.9	8.4	10.5	8.3	9.0	9.4	19.3	23.3
Corporate costs	(17.3)	(19.1)	(38.9)	(32.0)	(37.1)	(36.4)	(50.1)	(41.0)
	\$ 77.4	\$ 80.8	\$ 100.3	\$ 91.9	\$ 111.9	\$ 90.1	\$ 108.0	\$ 107.3
Per unit <sup>(1)</sup>	\$ 0.30	\$ 0.31	\$ 0.39	\$ 0.35	\$ 0.43	\$ 0.35	\$ 0.41	\$ 0.40
Net income	\$ 46.5	\$ 60.1	\$ 64.5	\$ 61.0	\$ 76.6	\$ 45.8	\$ 79.6	\$ 104.4
Per unit – basic & diluted	\$ 0.19	\$ 0.23	\$ 0.25	\$ 0.24	\$ 0.29	\$ 0.17	\$ 0.30	\$ 0.39
Cash distributions <sup>(4)</sup>	\$ 57.9	\$ 59.3	\$ 62.0	\$ 62.1	\$ 62.5	\$ 65.1	\$ 69.9	\$ 70.6
Per unit <sup>(4)</sup>	\$ 0.2250	\$ 0.2300	\$ 0.2400	\$ 0.2400	\$ 0.2400	\$ 0.2475	\$ 0.2625	\$ 0.2625
Units outstanding (basic)								
Weighted average	257.2	257.8	258.3	258.8	259.9	262.7	265.7	268.6
End of period	257.5	258.0	258.5	259.1	261.2	264.2	267.2	270.0
Capital expenditures								
Growth <sup>(1)</sup>	\$ 36.5	\$ 221.0	\$ 40.8	\$ 27.8	\$ 29.8	\$ 34.2	\$ 39.6	\$ 66.8
Sustaining <sup>(1)</sup>	2.9	5.7	2.8	4.4	5.0	7.2	6.3	7.0
	\$ 39.4	\$ 226.7	\$ 43.6	\$ 32.2	\$ 34.8	\$ 41.4	\$ 45.9	\$ 73.8
Payout ratio before sustaining capital <sup>(1)</sup>	74.8%	73.5%	61.8%	67.6%	55.8%	72.3%	64.7%	65.8%
Payout ratio after sustaining capital <sup>(1)</sup>	77.6%	79.1%	63.6%	71.0%	58.5%	78.5%	68.7%	70.4%
Total debt <sup>(5)</sup>	\$ 2,603.1	\$ 2,801.2	\$ 2,762.4	\$ 2,738.2	\$ 2,719.1	\$ 2,672.1	\$ 3,145.8	\$ 3,082.7
Total partners' equity	\$ 1,329.7	\$ 1,328.0	\$ 1,339.8	\$ 1,346.7	\$ 1,404.4	\$ 1,419.8	\$ 1,493.7	\$ 1,559.4
Enterprise value <sup>(1)</sup>	\$ 6,134.0	\$ 6,651.2	\$ 7,178.1	\$ 6,847.2	\$ 6,901.1	\$ 7,593.3	\$ 8,374.5	\$ 8,268.8
Total debt to total capitalization <sup>(1)</sup>	66.2%	67.8%	67.3%	67.0%	65.9%	65.3%	67.8%	66.4%
Total recourse debt to capitalization <sup>(1)</sup>	35.0%	41.0%	42.0%	41.5%	40.1%	38.9%	48.2%	46.1%

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

(2) In the third quarter of 2011, FFO<sup>(1)</sup> increased in the NGL extraction business by \$20.5 million due to a one time pricing adjustment relating to propane-plus sales at the Cochrane NGL extraction plant from 2007 to 2011.

(3) In the third quarter of 2010, FFO<sup>(1)</sup> for the bulk liquid storage business decreased \$4.1 million due to a special defined benefit pension plan contribution.

(4) Cash distributions are calculated based on the number of units outstanding at each record date.

(5) Total debt includes long-term debt, short-term debt and commercial paper 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 acquisitions through market and industry cycles. Funding requirements are projected to ensure appropriate sources of financing are available to meet future financial obligations and capital expenditure programs. Inter Pipeline generally relies on committed credit facilities and cash flow from its operations to fund capital requirements. At June 30, 2012, Inter Pipeline had access to committed credit facilities totaling \$2.3 billion, of which approximately \$822.1 million remains unutilized, and demand facilities totaling \$45 million of which \$44.8 million remains unutilized. Certain facilities are available to specific subsidiaries of Inter Pipeline.

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 \$105.0 million of equity was issued through the distribution reinvestment plan during the first six months of 2012.

Taking market trends into consideration, Inter Pipeline regularly forecasts its operational activities and expected FFO 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 MTNs. The prospectus supplement establishes Inter Pipeline with a MTN program that allows it to issue MTNs in the Canadian market. In 2011, Inter Pipeline issued \$325 million MTN Series 1 and \$200 million MTN Series 2.

On May 28, 2012 Inter Pipeline issued \$400 million of MTN Series 3 due May 30, 2022, in the Canadian public debt market. The MTN Series 3 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 May 23, 2012. Net proceeds from the offering were used to repay a portion of Inter Pipeline's existing revolving credit facility. As a result of the issuance of the

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

MTN Series 1, 2 and 3, the amount that can be issued under the shelf prospectus and related prospectus supplements has been reduced from \$1.5 billion to \$575 million.

## CAPITAL STRUCTURE

			June 30	December 31
(millions, except % amounts)	Recourse	Non-recourse	2012	2011
<b>Credit facilities available</b>				
Corridor syndicated facility	\$ -	\$ 1,550.0	\$ 1,550.0	\$ 1,550.0
Inter Pipeline syndicated facility	750.0	-	750.0	750.0
	750.0	1,550.0	2,300.0	2,300.0
Demand facilities <sup>(1)</sup>	20.0	25.0	45.0	45.0
	\$ 770.0	\$ 1,575.0	\$ 2,345.0	\$ 2,345.0
<b>Total debt outstanding</b>				
Recourse				
Inter Pipeline syndicated facility			\$ 27.0	\$ -
Loan payable to General Partner			379.8	379.8
MTN Series 1, 2 and 3			925.0	525.0
Non-recourse				
Corridor syndicated facility			1,450.9	1,467.3
Corridor debentures			300.0	300.0
<b>Total debt<sup>(1)(2)</sup></b>			<b>3,082.7</b>	<b>2,672.1</b>
Total partners' equity			1,559.4	1,419.8
<b>Total capitalization<sup>(3)</sup></b>			<b>\$ 4,642.1</b>	<b>\$ 4,091.9</b>
Total debt to total capitalization <sup>(3)</sup>			66.4%	65.3%
Total recourse debt to capitalization <sup>(3)</sup>			46.1%	38.9%

(1) At June 30, 2012, outstanding Corridor letters of credit were approximately \$0.2 million were not included in the total debt outstanding in the table above.

(2) At June 30, 2012, total debt includes long-term debt, short-term debt and commercial paper outstanding of \$3,067.5 million inclusive of discounts and debt transaction costs of \$15.2 million.

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

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 ensuring compliance with all debt covenants. Management's objectives are to remain well below its maximum target ratio of 65% recourse debt to capitalization and maximum senior 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 46.1% at June 30, 2012. Adjusting for the impact of non-recourse debt of \$1,750.9 million, Inter Pipeline's consolidated debt to total capitalization ratio at June 30, 2012 was 66.4%.

At June 30, 2012, approximately \$1,627.9 million or 52.8% of Inter Pipeline's total consolidated debt was exposed to variable interest rates. Of this amount \$1,600.9 million or 98.3% relates to Corridor debt outstanding and is directly recoverable through the terms of the Corridor FSA. When deemed appropriate, Inter Pipeline enters into interest rate swap agreements to manage its interest rate risk exposure. In 2007, Inter Pipeline acquired an interest rate swap agreement to manage fixed interest rate exposure on Corridor's Series B debentures.

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

	June 30		December 31	
	2012		2011	
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

The following earnings coverage ratios are calculated on a consolidated basis for the twelve month periods ended June 30, 2012 and December 31, 2011.

	Twelve Months Ended	
(times)	June 30	December 31
	2012	2011
Interest coverage on long-term debt <sup>(1)(2)</sup>	5.4	5.1

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

(2) Net income plus income taxes and interest expense, divided by the sum of interest expense and capitalized interest. Long-term debt for this calculation includes commercial paper and current portion of long-term debt.

The following investment grade, long-term corporate credit ratings or senior unsecured debt ratings are maintained by Inter Pipeline and by Corridor.

	Credit Rating	Trend/Outlook
Inter Pipeline Fund		
S&P	BBB+	Stable
DBRS	BBB (high)	Stable
Inter Pipeline (Corridor) Inc.		
S&P	A	Stable
DBRS	A	Stable
Moody's	A2	Stable

## CONTRACTUAL OBLIGATIONS, COMMITMENTS AND GUARANTEES

The following table summarizes Inter Pipeline's commitment profile and future contractual obligations at June 30, 2012. Management intends to finance short-term commitments either through existing or renegotiated 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.

<i>(millions)</i>	Total	Less than one year	One to five years	After five years
Capital expenditure projects <sup>(1)</sup>				
Oil sands transportation	\$ 418.2	\$ 387.0	\$ 31.2	\$ -
NGL extraction	43.5	27.8	15.7	-
Conventional oil pipelines	4.8	4.8	-	-
Bulk liquid storage	9.0	9.0	-	-
Growth capital <sup>(2)</sup>	475.5	428.6	46.9	-
Sustaining capital <sup>(2)</sup>	32.7	32.7	-	-
	508.2	461.3	46.9	-
Total debt <sup>(3)</sup>				
Corridor syndicated facility <sup>(4)</sup>	1,450.9	1,450.9	-	-
Inter Pipeline syndicated facility	27.0	-	27.0	-
Loan to General Partner	379.8	91.2	288.6	-
Corridor debentures	300.0	-	150.0	150.0
4.967% MTN Series 1	325.0	-	-	325.0
3.839% MTN Series 2	200.0	-	-	200.0
3.776% MTN Series 3	400.0	-	-	400.0
	3,082.7	1,542.1	465.6	1,075.0
Other obligations				
Derivative financial instruments	19.0	13.7	5.3	-
Operating leases	88.0	7.1	27.3	53.6
Purchase obligations	157.9	22.0	34.7	101.2
Long-term portion of incentive plan	3.5	-	3.5	-
Working capital deficit <sup>(2)</sup>	48.1	48.1	-	-
	\$ 3,907.4	\$ 2,094.3	\$ 583.3	\$ 1,229.8

(1) Capital expenditure commitments in "less than one year" represent expected expenditures for the remaining months of 2012.

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

(3) At June 30, 2012, outstanding Corridor letters of credit of approximately \$0.2 million were not included in the total \$3,082.7 million of debt outstanding in the table above.

(4) Principal obligations are related to commercial paper. This amount is fully supported and management expects that it will continue to be supported by Corridor's fully committed syndicated credit facility that has no repayment requirements until December 2015.

Inter Pipeline plans to invest approximately \$475.5 million in organic growth capital projects over the 2012 to 2013 period which includes capital costs for the \$105 million Polaris oil sands diluent transportation project, the \$90 million (100%) Cold Lake west leg capacity project and the \$53 million liquid sweetening project at the Cochrane NGL extraction facility. In addition, capital costs also include costs relating to initial engineering, design and early construction work to expand and integrate the Cold Lake and Polaris pipeline systems to provide transportation service to the Narrows Lake, Christina Lake and Foster Creek oil sands projects, of which approximately \$225 million has been backstopped. Inter Pipeline is also committed to investing capital in the bulk liquid storage business to comply with UK's storage and containment regulations. Potential solutions are being evaluated and expenditures are estimated to be in the range of \$4.8 million to \$9.6 million over the next eight years.

Inter Pipeline's debt outstanding at June 30, 2012, matures at various dates up to February 2021. Corridor's Series B debentures mature on February 2, 2015, and Corridor's Series C debentures

mature on February 3, 2020. On December 15, 2011, Corridor entered into a \$1.55 billion senior unsecured syndicated revolving credit facility that has an initial maturity date of December 15, 2015. On December 5, 2011, Inter Pipeline entered into a \$750 million senior unsecured syndicated revolving credit facility with a maturity date of December 5, 2016. Inter Pipeline's and Corridor's credit facilities can be extended beyond their initial maturity date under certain circumstances. Inter Pipeline's loans payable to the General Partner of \$91.2 million and \$288.6 million mature on October 28, 2012 and October 28, 2014, respectively. Inter Pipeline's MTN Series 1, 2 and 3 mature on February 2, 2021, July 30, 2018 and May 30, 2022, respectively.

The following future obligations resulting from normal course of operations will be primarily funded from FFO\* in the respective periods that they become due or may be funded through 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 of the liability on an undiscounted basis for financially net settled derivative contracts outstanding at June 30, 2012, 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 current income taxes payable and 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 \$25.1 million under its employee long-term 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 \$56.9 million at June 30, 2012. Due to the uncertainty of timing for payment of these obligations, they were excluded from the table above.

## CASH DISTRIBUTIONS TO UNITHOLDERS

<i>(millions)</i>	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2012	2011	2012	2011
Cash provided by operating activities	\$ 133.9	\$ 100.4	\$ 195.0	\$ 237.2
Less net change in non-cash operating working capital	(26.6)	(8.5)	20.3	(45.0)
Less sustaining capital expenditures <sup>(1)</sup>	(7.0)	(4.4)	(13.3)	(7.2)
Cash available for distribution <sup>(1)</sup>	100.3	87.5	202.0	185.0
Change in discretionary reserves <sup>(1)</sup>	(29.7)	(25.4)	(61.5)	(60.9)
Cash distributions	\$ 70.6	\$ 62.1	\$ 140.5	\$ 124.1
Cash distributions per unit <sup>(2)</sup>	\$ 0.2625	\$ 0.2400	\$ 0.5250	\$ 0.4800
Payout ratio before sustaining capital <sup>(1)</sup>	65.8%	67.6%	65.3%	64.6%
Payout ratio after sustaining capital <sup>(1)</sup>	70.4%	71.0%	69.6%	67.1%
Growth capital expenditures <sup>(1)</sup>	\$ 66.8	\$ 27.8	\$ 106.4	\$ 68.6
Sustaining capital expenditures <sup>(1)</sup>	7.0	4.4	13.3	7.2
	\$ 73.8	\$ 32.2	\$ 119.7	\$ 75.8

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

(2) Cash distributions are calculated based on the number of units outstanding at each record date.

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

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<sup>\*</sup> is distributed to unitholders. Rather, a portion of cash available for distribution<sup>\*</sup> 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<sup>\*</sup>" 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<sup>\*</sup> 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<sup>\*</sup>" 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<sup>\*</sup> to mitigate the quarterly impact this difference has on cash available for distribution<sup>\*</sup>. 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<sup>\*</sup> to cash available for distribution<sup>\*</sup>, 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<sup>\*</sup> 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<sup>\*</sup> increased approximately \$29.7 million in the second quarter of 2012 and \$61.5 million year to date due primarily to the strong operating results of Inter Pipeline's business segments. Inter Pipeline will continue to manage the discretionary reserve<sup>\*</sup> and future cash distributions in accordance with its policy of attempting to manage the stability of distributions through industry and economic cycles.

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<sup>\*</sup> Please refer to the **NON-GAAP FINANCIAL MEASURES** section

The tables below show Inter Pipeline's cash distributions paid relative to cash provided by operating activities and net income 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 June 30	Six Months Ended June 30	2011	2010	2009 <sup>(1)</sup>	Years Ended December 31 2008 <sup>(1)</sup>
<i>(millions)</i>	2012	2012				
Cash provided by operating activities	\$ 133.9	\$ 195.0	\$ 460.5	\$ 349.6	\$ 281.8	\$ 321.1
Cash distributions	(70.6)	(140.5)	(251.7)	(232.6)	(202.4)	(186.6)
Excess	\$ 63.3	\$ 54.5	\$ 208.8	\$ 117.0	\$ 79.4	\$ 134.5

	Three Months Ended June 30	Six Months Ended June 30	2011	2010	2009 <sup>(1)</sup>	Years Ended December 31 2008 <sup>(1)</sup>
<i>(millions)</i>	2012	2012				
Net income	\$ 104.4	\$ 184.0	\$ 247.9	\$ 236.0	\$ 157.7	\$ 249.7
Cash distributions	(70.6)	(140.5)	(251.7)	(232.6)	(202.4)	(186.6)
Excess (shortfall)	\$ 33.8	\$ 43.5	\$ (3.8)	\$ 3.4	\$ (44.7)	\$ 63.1

(1) IFRS adoption is effective as of January 1, 2011 and restated for 2010 as required for comparative purposes, therefore the 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. Cash distributions were also less than net income in all periods, except for the years ended 2011 and 2009. Net income 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 LPA, specifically section 5.2, which 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 LPA, cash distributed to unitholders is always equal to Distributable Cash.

## OUTSTANDING UNIT DATA

Inter Pipeline's outstanding units at June 30, 2012 are as follows:

<i>(millions)</i>	Class A	Class B	Total
Units outstanding	269.7	0.3	270.0

At July 31, 2012, Inter Pipeline had 270.6 million Class A units and 0.3 million Class B units for a total of 270.9 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 FFO\*. 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 enters into 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 and short-term debt and commercial paper outstanding at June 30, 2012. 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.

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 June 30, 2012. The CAD/USG average prices would approximate the following USD/USG prices based on the average USD/CAD forward curve at June 30, 2012.

	June 30, 2012			
	% Forecast Propane-plus Volumes Hedged	Average Price (USD/USG)	Average Price (CAD/USG)	
July to December 2012	50%	\$ 0.94	\$ 0.96	
January to December 2013	49%	\$ 0.95	\$ 0.97	

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

Based on propane-plus volume hedges outstanding at June 30, 2012, 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:

<i>(millions)</i>	Fair value of derivative financial instruments	Change in net income based on 10% increase in prices/rates <sup>(1)</sup>	Change in net income based on 10% decrease in prices/rates <sup>(1)</sup>
NGL <sup>(2)</sup>	\$ 37.3	\$ (7.9)	\$ 7.9
AECO natural gas	(13.6)	2.0	(2.0)
Foreign exchange	(4.9)	(10.8)	10.8
Frac-spread risk management	\$ 18.8		

(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. When deemed appropriate, Inter Pipeline enters into financial heat rate swap and power price swap contracts to manage power price risk exposure in these businesses. As at June 30, 2012, there are no heat rate or electricity price swap agreements outstanding.

### 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 June 30, 2012, a 1% change in interest rates at this date could affect interest expense on credit facilities by approximately \$3.7 million and \$7.4 million, for the three and six months ended June 30, 2012, respectively, assuming all other variables remain constant. Of these amounts \$3.6 million and \$7.2 million for the three and six months ended June 30, 2012, respectively, relate to the \$1,550 million unsecured revolving credit facility and are recoverable through the terms of the Corridor FSA, therefore the after-tax income impact on Inter Pipeline for the three and six months ended June 30, 2012, would be \$0.1 million for both periods.

### Realized and Unrealized Gains (Losses) on Derivative Instruments – Fair Value Through Profit or Loss

Derivative financial instruments designated as "fair value through profit or loss" 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.

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

<i>(millions)</i>	Three Months Ended		Six Months Ended	
	2012	2011	2012	2011
<b>Realized gain (loss) on derivative financial instruments</b>				
Revenues				
NGL swaps	\$ 4.2	\$ (8.6)	\$ 2.1	\$ (15.6)
Foreign exchange swaps (frac-spread hedges)	(0.3)	1.8	(0.3)	3.3
	3.9	(6.8)	1.8	(12.3)
Shrinkage gas expense				
Natural gas swaps	(4.8)	(3.0)	(8.3)	(6.1)
	(4.8)	(3.0)	(8.3)	(6.1)
Operating expenses				
Electricity price swaps	-	0.1	-	0.4
Heat rate swaps	-	0.5	-	1.9
	-	0.6	-	2.3
Financing charges				
Interest rate swaps	1.2	0.7	2.4	1.4
	1.2	0.7	2.4	1.4
General and administrative				
Foreign exchange swaps	0.9	-	0.9	-
	0.9	-	0.9	-
<b>Total realized gain (loss) on derivative financial instruments</b>	<b>1.2</b>	<b>(8.5)</b>	<b>(3.2)</b>	<b>(14.7)</b>
<b>Unrealized gain (loss) on derivative financial instruments</b>				
NGL swaps	46.8	6.4	51.0	(12.1)
Natural gas swaps	6.8	0.3	1.9	3.0
Foreign exchange swaps (frac-spread hedges)	(2.1)	(0.4)	2.3	3.5
Electricity price swaps	-	(0.1)	-	0.3
Heat rate swaps	-	(0.4)	-	0.5
Interest rate swaps	-	0.4	-	0.9
Foreign exchange swaps (other)	0.6	-	-	-
Transitional transfers <sup>(1)</sup>	-	(0.2)	-	(0.4)
<b>Total unrealized gain (loss) on derivative financial instruments</b>	<b>52.1</b>	<b>6.0</b>	<b>55.2</b>	<b>(4.3)</b>
<b>Total gain (loss) on derivative financial instruments</b>	<b>\$ 53.3</b>	<b>\$ (2.5)</b>	<b>\$ 52.0</b>	<b>\$ (19.0)</b>

(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 June 30, 2012, accounts receivable associated with these two business segments were \$54.7 million or 53.4% 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 June 30, 2012, 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 three month periods ended June 30, 2012 or 2011.

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 \$0.4 million in dividends in the second quarter of 2012 (second quarter of 2011 - \$0.5 million) totaling \$1.3 million for the six months ended June 30, 2012 (six months ended June 30, 2011 - \$0.8 million), from PAC pursuant to their ownership of non-voting shares.

Under the LPA, the General Partner is entitled to recover all direct and indirect expenses, including general and administrative expenses, incurred on behalf of Inter Pipeline or in the performance of its duties as General Partner 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 LPA. In addition, as an incentive to the General Partner to enhance the profitability of Inter Pipeline and the cash distributions paid in respect of Inter Pipeline's units, the General Partner is entitled to earn an annual incentive fee calculated as a percentage of available Distributable Cash (as defined in the LPA). The percentage of available Distributable Cash payable to the General Partner as an incentive fee will be 15% of available Distributable Cash in excess of \$1.01 per unit annually but less than or equal to \$1.10 per unit annually, 25% of available Distributable Cash in excess of \$1.10 per unit annually but less than or equal to \$1.19 per unit annually and 35% of available Distributable Cash in excess of \$1.19 per

unit annually. The incentive fee is paid at the time of distribution of Distributable Cash for the last calendar month of each year. In addition, the General Partner is entitled to be paid an acquisition fee equal to 1.0% of the purchase price of any New Assets (as defined in the LPA) acquired by Inter Pipeline, and a disposition fee equal to 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 June 30, 2012, interest payable to the General Partner on the loan was \$4.1 million (December 31, 2011 - \$4.1 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 a 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 June 30, 2012, there were amounts owed to the General Partner by Inter Pipeline of \$0.7 million (December 31, 2011 - \$0.9 million).

## **CONTROLS AND PROCEDURES**

There have been no significant changes in Inter Pipeline's internal control over financial reporting (ICFR) during the period January 1, 2012 to June 30, 2012 that have materially affected, or are reasonably likely to materially affect, Inter Pipeline's ICFR.

Management has limited the scope of their design of disclosure controls and procedures (DC&P) and ICFR to exclude controls, policies and procedures of the recently acquired Inter Terminals, the results of which are consolidated in Inter Pipeline's interim financial statements at March 31 and June 30, 2012.

In January 2012, Inter Pipeline acquired Inter Terminals. Where possible, Inter Terminals has adopted Inter Pipeline's DC&P and ICFR. For business processes unique to Inter Terminals, management is committed to completing DC&P and ICFR before the end of the first quarter of the 2013 fiscal year.

## **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* of the December 31, 2011 consolidated 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.

## **ACCOUNTING POLICIES ADOPTED IN 2012**

### **Inter Terminals Property, Plant and Equipment**

Depreciation of the property, plant and equipment is calculated on a straight-line basis over the estimated service life of the assets, the majority of which ranges from four to 70 years.

### **INTER TERMINALS INTANGIBLE ASSETS**

Intangible assets consist of customer contracts with agreed guaranteed payments for storage revenue and minimum throughput volumes. These assets are being amortized over the remaining lives of the contracts on a contract-by-contract basis, the majority of which ranges from eight months to 30 months.

### **MIDSTREAM MARKETING**

On April 1, 2012, Inter Pipeline internalized midstream marketing blending and handling services in its conventional oil pipelines business segment, which were previously provided by a third party. As a result, Inter Pipeline acquired line fill which is accounted for in accordance with Inter Pipeline's existing accounting policies. Volumes purchased by Inter Pipeline to be used in the blending process that are then resold at a pre-arranged agreed-upon differential, are recognized on a net basis. Sales of additional volumes created through the blending process are recognized on a gross basis with corresponding product purchases of blend components.

## **RISK FACTORS**

During the second quarter of 2012, there were no significant changes to Inter Pipeline's operating activities that would affect the disclosure of risk factors as discussed in its 2011 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", "discretionary reserve", "EBITDA", "funds from operations", "funds from operations per unit", "enterprise value", "interest coverage on long-term debt", "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 and current portion of long-term debt.

<i>(millions)</i>	June 30 2012	December 31 2011
Current assets		
Cash and cash equivalents	\$ 34.8	\$ 50.0
Accounts receivable	106.3	109.1
Prepaid expenses and other deposits	27.6	10.9
Current liabilities		
Cash distributions payable	(23.6)	(23.1)
Accounts payable and accrued liabilities	(150.7)	(162.5)
Current income taxes payable	(30.4)	(49.8)
Deferred revenue	(12.1)	(4.6)
Adjusted working capital deficiency	\$ (48.1)	\$ (70.0)

**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.

**Discretionary reserve** is calculated as cash available for distribution less actual cash distributions. This measure is used by the investment community to determine the amount of cash reserved and reinvested in the business.

**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.

<i>(millions)</i>	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2012	2011	2012	2011
Net income	\$ 104.4	\$ 61.0	\$ 184.0	\$ 125.5
Depreciation and amortization	34.1	25.1	61.8	49.5
Gain on disposal of assets	(0.1)	(0.1)	(0.1)	(0.2)
Non-cash expense (recovery)	2.7	1.8	(0.4)	(2.7)
Unrealized change in fair value of derivative financial instruments	(52.1)	(6.0)	(55.2)	4.3
Deferred income tax expense	18.3	10.1	25.2	14.3
Proceeds from long-term leasehold inducements	-	-	-	1.5
Funds from operations	107.3	91.9	215.3	192.2
Total interest less capitalized interest	23.8	19.5	45.7	37.8
Current income tax expense	14.3	11.5	30.0	26.9
EBITDA	\$ 145.4	\$ 122.9	\$ 291.0	\$ 256.9

**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:

	June 30 2012	December 31 2011
<i>(millions, except per unit amounts)</i>		
Closing unit price	\$ 19.21	\$ 18.63
Total closing number of Class A and B units	270.0	264.2
Total debt	5,186.1 3,082.7	4,921.2 2,672.1
Enterprise value	\$ 8,268.8	\$ 7,593.3

**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 June 30			
		2012			2011
<i>(millions)</i>		Growth	Sustaining	Total	Total
Oil sands transportation	\$	31.3	\$ 0.9	\$ 32.2	\$ 20.9
NGL extraction		5.3	0.4	5.7	3.1
Conventional oil pipelines		26.3	0.2	26.5	1.3
Bulk liquid storage		3.9	4.8	8.7	6.7
Corporate		-	0.7	0.7	0.2
	\$	66.8	\$ 7.0	\$ 73.8	\$ 32.2

		Six Months Ended June 30			
		2012			2011
<i>(millions)</i>		Growth	Sustaining	Total	Total
Oil sands transportation	\$	60.0	\$ 1.7	\$ 61.7	\$ 57.0
NGL extraction		10.2	0.8	11.0	5.3
Conventional oil pipelines		29.2	1.0	30.2	1.7
Bulk liquid storage		7.0	8.6	15.6	10.9
Corporate		-	1.2	1.2	0.9
	\$	106.4	\$ 13.3	\$ 119.7	\$ 75.8

**Interest coverage on long-term debt** is calculated as net income before income taxes and interest expense divided by total interest expense. Long-term debt for this calculation includes commercial paper and current portion of long-term debt. 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 purposes 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](http://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 2nd day of August, 2012.**