inter pipeline

# Management's Discussion and Analysis

**For the three and six months ended June 30, 2016**

# FORWARD-LOOKING INFORMATION

The following **Management's Discussion and Analysis (MD&A)** highlights Inter Pipeline Ltd. and its subsidiaries (together, Inter Pipeline) significant business results and statistics for the three and six month periods ended June 30, 2016, to provide Inter Pipeline's shareholders and potential investors with information about Inter Pipeline, including management's assessment of its 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 may include, but are not limited to, statements regarding: 1) Inter Pipeline's beliefs that it is well positioned to maintain its current level of dividends to its shareholders through 2016 and beyond; 2) the maintenance of Inter Pipeline's dividend level combined with the tax treatment of dividends to its shareholders; 3) Inter Pipeline being well positioned to operate and grow in the future; 4) funds from operations projections; 5) timing for completion of various projects; 6) timing and cost schedules of capital projects; and, 7) capital expenditure 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 Inter Pipeline 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 its 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 affiliates; 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 and uncertainties associated with Inter Pipeline's ability to maintain its current level of cash dividends to its shareholders; 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 affiliates 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 of, and costs of overruns on, construction projects in all of Inter Pipeline's business units, including, but not limited to, Inter Pipeline's expansion of its pipeline systems; risks associated with the failure to finalize formal agreements with counterparties in circumstances where letters of intent or similar agreements have been executed and announced by Inter Pipeline; Inter Pipeline's ability to make capital investments and the amounts of capital investments; changes in laws and regulations, including environmental, regulatory and taxation laws, and the interpretation of such changes to Inter Pipeline's business; the risks associated with existing and potential future lawsuits and regulatory actions against Inter Pipeline and its affiliates; 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 cannot be determined 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, 2016

The MD&A provides a detailed explanation of Inter Pipeline's operating results for the three and six month periods ended June 30, 2016, as compared to the three and six month periods ended June 30, 2015. The MD&A should be read in conjunction with the June 30, 2016 unaudited condensed interim consolidated financial statements (interim financial statements), the interim financial statements and MD&A for the quarterly period ended June 30, 2015, the MD&A and audited consolidated financial statements for the year ended December 31, 2015, the **Annual Information Form**, and other information filed by Inter Pipeline at www.sedar.com.

Financial information presented in this MD&A is based on information in Inter Pipeline's consolidated financial statements prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

This MD&A reports certain financial measures that are not recognized by Canadian generally accepted accounting principles (GAAP), as outlined in the Chartered Professional Accountant (CPA) Handbook Part I, 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) of $197 million, a 9 percent increase over the second quarter of 2015
- NGL extraction business segment recorded FFO* of approximately $31 million, a 31 percent increase over the same period in 2015
- Generated net income of $123 million, a 67 percent increase from the second quarter of 2015
- Declared cash dividends of $131 million, or $0.39 per share
- Attractive quarterly payout ratio* of 70 percent
- Total pipeline throughput volumes averaged 1,213,900 barrels per day (b/d), a 14 percent increase over the same period in 2015
- Bulk liquid storage capacity utilization averaged 97 percent for the quarter, up from 93 percent in the second quarter of 2015

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* Please refer to the NON-GAAP FINANCIAL MEASURES section

# PERFORMANCE OVERVIEW

| (millions, except volumes, per share and % amounts) | Three Months Ended June 30 2016 | 2015 | Six Months Ended June 30 2016 | 2015 |
|---|---|---|---|---|
| Pipeline volumes (000s b/d) [1] | | | | |
| Oil sands transportation | **1,012.6** | 853.9 | **1,058.4** | 975.1 |
| Conventional oil pipelines | **201.3** | 208.5 | **204.9** | 211.4 |
| Total pipeline volumes | **1,213.9** | 1,062.4 | **1,263.3** | 1,186.5 |
| NGL extraction volumes (000s b/d) [1] | | | | |
| Ethane | **51.9** | 56.3 | **56.4** | 63.6 |
| Propane-plus | **42.2** | 34.1 | **43.6** | 38.0 |
| Total NGL extraction volumes | **94.1** | 90.4 | **100.0** | 101.6 |
| Utilization | | | | |
| Bulk liquid storage | **97%** | 93% | **97%** | 92% |
| Revenue | | | | |
| Oil sands transportation | **$ 193.3** | $ 182.7 | **$ 384.9** | $ 360.1 |
| Conventional oil pipelines | **85.6** | 74.7 | **167.1** | 152.5 |
| Bulk liquid storage | **61.3** | 44.4 | **127.1** | 92.5 |
| NGL extraction | **72.8** | 88.8 | **150.3** | 191.3 |
| | **$ 413.0** | $ 390.6 | **$ 829.4** | $ 796.4 |
| Funds from operations[2][3] | | | | |
| Oil sands transportation[3] | **$ 141.4** | $ 135.0 | **$ 280.8** | $ 265.2 |
| Conventional oil pipelines | **47.1** | 46.5 | **97.1** | 93.3 |
| Bulk liquid storage | **29.6** | 20.6 | **60.9** | 41.1 |
| NGL extraction | **30.5** | 23.3 | **54.1** | 52.0 |
| Corporate costs | **(51.9)** | (44.4) | **(110.2)** | (94.1) |
| | **$ 196.7** | $ 181.0 | **$ 382.7** | $ 357.5 |
| Per share[2] | **$ 0.58** | $ 0.54 | **$ 1.14** | $ 1.07 |
| Net income | **$ 122.9** | $ 73.8 | **$ 227.5** | $ 196.6 |
| Net income attributable to shareholders | **$ 114.4** | $ 65.3 | **$ 210.2** | $ 179.0 |
| Per share – basic | **$ 0.34** | $ 0.19 | **$ 0.62** | $ 0.54 |
| Per share – diluted | **$ 0.34** | $ 0.19 | **$ 0.62** | $ 0.54 |
| Dividends to shareholders | **$ 131.4** | $ 123.1 | **$ 262.7** | $ 244.9 |
| Per share[4] | **$ 0.3900** | $ 0.3675 | **$ 0.7800** | $ 0.7350 |
| Shares outstanding (basic) | | | | |
| Weighted average | **336.8** | 334.8 | **336.7** | 333.2 |
| End of period | **336.9** | 335.3 | **336.9** | 335.3 |
| Capital expenditures[5] | | | | |
| Growth[2] | **$ 27.7** | $ 67.8 | **$ 59.9** | $ 200.3 |
| Sustaining[2] | **10.0** | 10.0 | **28.0** | 19.5 |
| | **$ 37.7** | $ 77.8 | **$ 87.9** | $ 219.8 |
| Payout ratio[2] | **70.3%** | 71.9% | **72.4%** | 72.6% |

| (millions, except % amounts) | As at June 30 2016 | As at December 31 2015 |
|---|---|---|
| Total assets | **$ 8,869.7** | $ 9,029.4 |
| Total debt[6] | **$ 4,832.7** | $ 4,851.7 |
| Total shareholders' equity | **$ 2,692.8** | $ 2,821.1 |
| Enterprise value[2] | **$ 14,064.4** | $ 12,323.7 |
| Consolidated Net Debt to Total Capitalization[2] | **54.2%** | 52.8% |

(1) Cold Lake volumes and Empress V NGL production reported on a 100% basis.

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

(3) Funds from operations[2] include non-controlling interest amounts of $9.7 million and $19.8 million for the three and six months ended June 30, 2016, respectively ($9.8 million and $20.0 million for the three and six months ended June 30, 2015, respectively).

(4) Dividends to shareholders per share are calculated based on the number of common shares outstanding at each record date.

(5) Amounts reported on a 100% basis that includes non-controlling interest.

(6) Financial debt reported in the June 30, 2016 consolidated financial statements of $4,815.3 million, includes long-term debt, short-term debt and commercial paper of $4,832.7 million less discounts and debt transaction costs of $17.4 million.

## Three Months Ended June 30, 2016

In the second quarter, Inter Pipeline achieved strong financial results as FFO* increased $15.7 million or 8.7%, from $181.0 million in 2015 to $196.7 million in 2016. These positive results were driven by incremental FFO* contributions from all four of Inter Pipeline's business segments. The increase in FFO* can be largely accredited to the acquisition of Inter Terminals Sweden in June 2015 and increased utilization in the bulk liquid storage business, higher realized frac-spreads and lower fuel and power costs in the NGL extraction business, expanded transportation service on the Polaris pipeline system and an incremental contribution from midstream marketing activities in the conventional oil pipeline business. These positive operating results were partially offset by an increase in corporate costs due to higher rent, employee costs and current income taxes.

Inter Pipeline's net income increased in the second quarter by $49.1 million or 66.5% from $73.8 million in 2015 to $122.9 million in 2016. The increase in net income is primarily due to strong operating results discussed above and a decrease in deferred income taxes, partially offset by higher depreciation and amortization.

Total dividends to shareholders increased in the second quarter by $8.3 million or 6.7% from $123.1 million in 2015 to $131.4 million in 2016, largely from an increase in monthly dividend rates. Inter Pipeline announced a dividend rate increase in November 2015 of $0.09 per common share on an annualized basis. In the second quarter of 2016, Inter Pipeline's payout ratio* was 70.3%.

Inter Pipeline's total debt outstanding at June 30, 2016 was $4,832.7 million, a decrease of $17.5 million from $4,850.2 million at March 31, 2016, while investing $37.5 million (Inter Pipeline's share) on capital projects during this period. Total debt includes non-recourse debt held at Inter Pipeline (Corridor) Inc. of $1,509.0 million at June 30, 2016 and $1,525.0 million at March 31, 2016.

## Six Months Ended June 30, 2016

Inter Pipeline also generated strong financial results in the six months ended June 30, 2016. FFO* rose from $357.5 million in 2015 to $382.7 million in 2016, an increase of $25.2 million or 7.0%. The increase in FFO* is largely due to the same reasons discussed above.

Year to date, Inter Pipeline's net income increased $30.9 million from $196.6 million in 2015 to $227.5 million in 2016. Net Income increased as a result of higher FFO* as discussed above and a decrease in deferred income taxes, which was partially offset by a one-time onerous contract adjustment in the first quarter of 2016, as well as higher depreciation and amortization.

For the six months ended June 30, 2016, total dividends to shareholders increased $17.8 million or 7.3% from $244.9 million in 2015 to $262.7 million in 2016, for the same reasons indicated above. Inter Pipeline's payout ratio* for the six months ended June 30, 2016 was 72.4%.

Inter Pipeline's total debt outstanding decreased $19.0 million from $4,851.7 million at December 31, 2015 to $4,832.7 million at June 30, 2016, while investing $87.5 million (Inter Pipeline's share) in capital projects. Total debt includes $1,509.0 million of non-recourse debt held at Inter Pipeline (Corridor) Inc. at June 30, 2016, compared to $1,536.2 million at December 31, 2015.

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* Please refer to the NON-GAAP FINANCIAL MEASURES section

# OUTLOOK

Inter Pipeline owns and operates world scale energy infrastructure assets in western Canada and Europe. Our long-term strategy is to acquire and develop high-quality assets that generate stable and predictable cash flow, while delivering strong returns to shareholders. In 2016, Inter Pipeline remains focused on leveraging value from our strategically located and diversified asset base, controlling costs and capturing additional growth opportunities across the business.

Our oil sands transportation business segment is anchored by long-term commercial arrangements with creditworthy counterparties. Bitumen blend and diluent volumes transported in the second quarter of 2016 continue to demonstrate Inter Pipeline’s resiliency in this lower commodity price environment, averaging over 1,012,000 b/d.

Inter Pipeline has over 2.5 million b/d of pipeline capacity on its three major oil sands pipeline systems. This includes approximately 1.2 million b/d of bitumen blend capacity on the Cold Lake pipeline system, 865,000 b/d of diluent capacity on the Polaris pipeline system and 465,000 b/d of bitumen blend capacity on the Corridor pipeline system. Ultimate throughput capacities of 1.9 million b/d, 1.3 million b/d and 1.4 million b/d on the Cold Lake, Polaris and Corridor pipeline systems, respectively, can be achieved through the addition of pump stations and associated infrastructure. Inter Pipeline continues to pursue opportunities to utilize available excess capacity.

In the conventional oil pipelines segment, the outlook remains stable despite reduced drilling activity around our Central Alberta and Bow River pipeline systems. Demand for transportation services in low cost basins, such as the Viking formation surrounding our Mid Saskatchewan pipeline system, continues to attract new pipeline connections and storage opportunities albeit at a moderated pace. Midstream marketing activities are generating additional cash flow in this business segment with increased blending activity. To further capture additional conventional oil volumes, Inter Pipeline is nearing completion of a 400,000 barrel crude oil storage expansion project at the Kerrobert Terminal. This $65 million project is expected to be ready for service in the third quarter of 2016 and will support both operational and merchant storage opportunities on the Mid-Saskatchewan pipeline system.

Inter Pipeline’s European bulk liquid storage business diversifies our asset base by both geography and market. Demand for oil and chemical storage in Europe remains strong with average utilization rates for this business segment improving to 97% during the quarter, up from 93% a year ago. The increase is primarily the result of stronger contango pricing relationships in certain petroleum product futures markets.

Our NGL extraction business is comprised of three straddle plants that are among the largest in North America. The Cochrane and Empress V and II facilities are strategically located on Alberta’s major natural gas export pipeline systems. Natural gas throughput volumes remained strong during the second quarter of 2016 largely due to increased demand for low-cost Canadian natural gas from the United States west-coast region. Higher throughput resulted in a notable increase in propane-plus volumes, up over 8,000 b/d compared to the same period in 2015.

Inter Pipeline continues to maintain a strong balance sheet with significant liquidity available on our $1.25 billion committed credit facility. Maintaining financial flexibility is extremely important, especially to facilitate the funding of our capital programs and other future initiatives. As at June 30, 2016, Inter Pipeline had $557 million of available capacity on its revolving credit facility. Inter Pipeline also ended the quarter with a consolidated net debt to total capitalization ratio* of 54.2%, which is within management's targeted level of 50% to 55%.

As a result of our strong financial position and the stable nature of our business, Inter Pipeline remains committed to maintaining our investment grade credit ratings. Standard & Poor's (S&P) and DBRS Limited (DBRS) have assigned Inter Pipeline credit ratings of BBB+ and BBB (high), respectively, each with a stable trend. Inter Pipeline (Corridor) Inc. has investment grade credit ratings of A (stable outlook) from S&P and DBRS and A2 (stable outlook) from Moody's Investors Service (Moody's).

The FFO* that underpins our monthly dividend is stable, diversified and largely supported by investment grade counterparties. Our extensive energy infrastructure base continues to be well positioned to compete for future, accretive growth opportunities both locally and internationally. With a strong balance sheet and proven operational capabilities, Inter Pipeline is well positioned to continue to generate long-term positive results for our shareholders.

# RESULTS OF OPERATIONS

## Oil Sands Transportation Business Segment

| | Three Months Ended June 30 | | | Six Months Ended June 30 | | |
|---|---|---|---|---|---|---|
| *Volumes (000s b/d)* | **2016** | 2015 | *% change* | **2016** | 2015 | *% change* |
| Cold Lake (100% basis) | **522.7** | 519.0 | *0.7* | **543.3** | 551.1 | *(1.4)* |
| Corridor | **327.9** | 215.1 | *52.4* | **348.7** | 297.2 | *17.3* |
| Polaris | **162.0** | 119.8 | *35.2* | **166.4** | 126.8 | *31.2* |
| | **1,012.6** | 853.9 | *18.6* | **1,058.4** | 975.1 | *8.5* |

| *(millions)* | Three Months 2016 | Three Months 2015 | % change | Six Months 2016 | Six Months 2015 | % change |
|---|---|---|---|---|---|---|
| Revenue[1] | **$ 193.3** | $ 182.7 | *5.8* | **$ 384.9** | $ 360.1 | *6.9* |
| Operating expenses[1] | **$ 31.9** | $ 32.7 | *(2.4)* | **$ 65.0** | $ 64.2 | *1.2* |
| Funds from operations[1][2] | **$ 141.4** | $ 135.0 | *4.7* | **$ 280.8** | $ 265.2 | *5.9* |
| Capital expenditures[1] | | | | | | |
| Growth[2] | **$ 2.4** | $ 25.0 | | **$ 7.4** | $ 106.3 | |
| Sustaining[2] | **0.2** | 0.7 | | **0.3** | 0.6 | |
| | **$ 2.6** | $ 25.7 | | **$ 7.7** | $ 106.9 | |

(1) For the three and six month periods ended June 30, 2016, Cold Lake pipeline system includes the following amounts relating to non-controlling interest: revenue - $12.4 million and $24.9 million ($12.6 million and $25.1 million in 2015), respectively; operating expenses - $2.4 million and $4.6 million ($2.6 million and $4.7 million in 2015), respectively; FFO(2) - $9.7 million and $19.8 million ($9.8 million and $20.0 million in 2015), respectively; and capital expenditures - $0.2 million and $0.4 million ($1.0 million and $6.5 million in 2015), respectively.

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

### Volumes

Oil sands transportation volumes averaged 1,012,600 b/d in the second quarter, an increase of 158,700 b/d or 18.6%, and 1,058,400 b/d year to date in 2016, an increase of 83,300 b/d or 8.5%, over the comparable periods in 2015.

* Please refer to the NON-GAAP FINANCIAL MEASURES section

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. Cold Lake pipeline system volumes increased 3,700 b/d in the current quarter and decreased 7,800 b/d year to date in 2016, compared to the same periods in 2015. Volumes were impacted, in both periods to varying degrees, by increased volumes from Imperial's Cold Lake, FCCL Partnership's (FCCL), a business venture between Cenovus Energy and ConocoPhillips, Foster Creek and Canadian Natural Resources' (CNR) Kirby South oil sands projects, offset by lower volumes from CNR's Wolf Lake facility. Volumes on the Cold Lake pipeline system typically fluctuate with the timing of steam injection cycles associated with certain shippers' production processes; however volume growth is anticipated over the long-term, which is consistent with shippers' published forecasts.

The Corridor pipeline system transports diluent from the Scotford upgrader located northeast of Edmonton, Alberta to the Muskeg River and Jackpine mines near Fort McMurray, Alberta and diluted bitumen produced from the mines back to the Scotford upgrader. In addition, feedstock and upgraded products are shipped between the Scotford upgrader and certain pipeline terminals in Edmonton. Corridor pipeline system volumes increased 112,800 b/d in the second quarter and 51,500 b/d year to date in 2016, compared to the same periods in 2015. Transportation volumes in 2015 were impacted by maintenance activities at the Scotford upgrader in the second quarter of 2015, while 2016 transportation volumes were impacted by a turnaround at the Scotford upgrader in the first quarter of 2016. Wildfires in the Fort McMurray region resulted in a temporary shut down on a portion of the Corridor pipeline system, and did not materially impact producers' transportation volumes.

The Polaris pipeline system provides diluent transportation service from the Edmonton area to the Athabasca and Cold Lake areas of Alberta. In the three and six months ended June 30, 2016, Polaris pipeline system volumes increased 42,200 b/d and 39,600 b/d, respectively, over the comparable periods in 2015. Volumes increased largely due to incremental diluent deliveries for Imperial's Kearl expansion beginning in the third quarter of 2015, as well as additional deliveries to Suncor's oil sands facilities, Husky's Sunrise, CNR's Kirby South and Athabasca Oil Corporation's (AOC) Hangingstone oil sands projects. Wildfires in the Fort McMurray region caused portions of the Polaris pipeline system to temporarily shut down for precautionary measures and also impacted various producers' demand for diluent volumes.

## Revenue

The oil sands transportation business earns revenue for the transportation of petroleum products which are underpinned by a range of long-term cost-of-service contracts as defined in the adjusted EBITDA by contract type disclosure in the **NON-GAAP FINANCIAL MEASURES** section.

Revenue from the oil sands transportation business increased $10.6 million or 5.8% to $193.3 million in the current quarter and $24.8 million or 6.9% to $384.9 million year to date in 2016, over the comparable periods in 2015.

Cold Lake pipeline system revenue decreased $1.6 million and $1.8 million in the three and six months ended June 30, 2016, respectively, compared to the same periods in 2015. The decrease in both periods is largely due to lower operating cost recoveries, while the year to date variance was also impacted by reduced capital fee revenue from lower volumes transported.

Revenue from the Corridor pipeline system decreased $2.1 million and $3.5 million in the three and six months ended June 30, 2016, respectively, compared to the same periods in 2015. The decrease is due to reduced operating cost recoveries, lower return on debt from a reduction in interest rates, lower return on equity arising from a decrease in the long-term Government of Canada benchmark bond interest rate and the declining nature of Corridor's rate base.

Polaris pipeline system revenue increased $14.3 million in the current quarter and $30.1 million year to date in 2016, over the same periods in 2015. The expanded diluent transportation service in 2015 to FCCL's Foster Creek, Imperial's Kearl and AOC's Hangingstone oil sands projects resulted in higher capital fee revenue. Revenue also increased from incremental fees from Husky's Sunrise and Suncor's oil sands projects and increased operating cost recoveries.

## Operating Expenses

Operating expenses in the oil sands transportation business segment typically have a limited impact on Inter Pipeline's FFO*, as substantially all operating expenditures are recovered from the shippers on the Cold Lake, Corridor and Polaris pipeline systems. Operating expenses from the oil sands transportation business decreased $0.8 million in the current quarter and increased $0.8 million year to date in 2016, compared to the same periods in 2015.

In the three and six months ended June 30, 2016, operating expenses from the Cold Lake pipeline system decreased $1.6 million and $0.6 million, respectively, over the comparable periods in 2015. The decrease is primarily due to lower fuel and power costs as a result of lower power pricing and consumption, offset in part by higher property tax and employee costs associated with Cold Lake's mainline expansion.

Operating expenses from Corridor pipeline system decreased $1.2 million in the second quarter and $2.0 million year to date in 2016, compared to the same periods in 2015. The reduction is largely due to the timing of certain integrity related costs and various cost optimization initiatives.

Operating costs increased in the three and six months ended June 30, 2016, on the Polaris pipeline system by $2.0 million and $3.4 million, respectively, over the comparable periods in 2015. The increase is largely due to higher general operating costs associated with increased volumes from the pipeline system expansion and higher property taxes.

## Capital Expenditures

In the second quarter of 2016, the oil sands transportation business incurred total growth capital expenditures* of $2.4 million relating to various facility and system upgrades and enhancements.

* Please refer to the NON-GAAP FINANCIAL MEASURES section

## Conventional Oil Pipelines Business Segment

| | Three Months Ended June 30 | | | Six Months Ended June 30 | | |
|---|---|---|---|---|---|---|
| *Volumes (000s b/d)* | **2016** | 2015 | *% change* | **2016** | 2015 | *% change* |
| Bow River | **90.1** | 99.6 | *(9.5)* | **90.7** | 101.5 | *(10.6)* |
| Central Alberta | **29.7** | 32.5 | *(8.6)* | **29.6** | 33.6 | *(11.9)* |
| Mid-Saskatchewan | **81.5** | 76.4 | *6.7* | **84.6** | 76.3 | *10.9* |
| | **201.3** | 208.5 | *(3.5)* | **204.9** | 211.4 | *(3.1)* |
| *(millions, except per barrel amount)* | | | | | | |
| Revenue | **$ 85.6** | $ 74.7 | *14.6* | **$ 167.1** | $ 152.5 | *9.6* |
| Midstream product purchases | **$ 18.4** | $ 12.1 | *52.1* | **$ 35.6** | $ 27.0 | *31.9* |
| Operating expenses | **$ 19.6** | $ 16.9 | *16.0* | **$ 33.8** | $ 31.8 | *6.3* |
| Funds from operations[1] | **$ 47.1** | $ 46.5 | *1.3* | **$ 97.1** | $ 93.3 | *4.1* |
| Revenue per barrel[2] | **$ 2.92** | $ 2.94 | *(0.7)* | **$ 2.92** | $ 2.95 | *(1.0)* |
| Capital expenditures | | | | | | |
| Growth[1] | **$ 16.7** | $ 36.9 | | **$ 33.4** | $ 84.3 | |
| Sustaining[1] | **1.2** | 1.3 | | **1.8** | 2.3 | |
| | **$ 17.9** | $ 38.2 | | **$ 35.2** | $ 86.6 | |

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

(2) Revenue per barrel represents total revenue of the conventional oil pipelines business segment less midstream marketing revenue, revenue from take-or-pay contracts for volume shortfalls and revenue/expense from over/short volumes, divided by actual volumes.

### Volumes

In the three and six months ended June 30, 2016, average conventional oil pipeline volumes decreased 7,200 b/d or 3.5% and 6,500 b/d or 3.1%, respectively, compared to the same periods in 2015. Bow River pipeline system volumes decreased 9,500 b/d in the current quarter and 10,800 b/d year to date in 2016, from the comparable periods in 2015. These decreases are largely due to reduced producer activity levels as a result of lower commodity prices, natural production declines, as well as third party refinery issues which impacted first quarter south bound volumes. Central Alberta pipeline system volumes decreased 2,800 b/d and 4,000 b/d in the three and six months ended June 30, 2016, respectively, from the same periods in 2015, largely due to lower volumes at third party truck terminals and a reduction in producer activity. Mid-Saskatchewan pipeline system volumes increased 5,100 b/d in the second quarter and 8,300 b/d year to date in 2016, over the same periods in 2015. Volumes on the Mid-Saskatchewan heavy oil system increased as a result of certain connection reactivations, while the light oil system benefitted from the completion of several expansion projects in mid-2015 to accommodate increased regional production from the Viking light oil play.

### Revenue

The conventional oil pipelines business earns revenue for the transportation of petroleum products in accordance with a number of long-term and short-term fee-based contracts, while its midstream marketing activities generate revenue under a number of short-term commodity-based contracts. Please refer to the adjusted EBITDA by contract type disclosure in the **NON-GAAP FINANCIAL MEASURES** section for further information.

Conventional oil pipelines revenue increased $10.9 million and $14.6 million in the three and six months ended June 30, 2016, respectively, compared to the same periods in 2015. Midstream marketing revenue increased $12.0 million in the second quarter and $17.5 million year to date in 2016, over the comparable periods in 2015, due to higher blending activity, which was offset in part by lower West Texas Intermediate (WTI) oil prices. In the three and six months ended

June 30, 2016, transportation revenue decreased $1.1 million and $2.9 million, respectively, largely due to lower overall pipeline system volumes.

### Midstream Product Purchases

Midstream product purchases increased $6.3 million in the current quarter and $8.6 million year to date in 2016, over the same periods in 2015, largely due to increased blending activity.

### Operating Expenses

Operating expenses in the conventional oil pipelines business increased $2.7 million and $2.0 million in the three and six months ended June 30, 2016, respectively, over the comparable periods in 2015. The increase is largely due to several non-routine maintenance and environmental remediation events, as well as higher employee related costs.

### Capital Expenditures

The conventional oil pipelines business incurred total growth capital expenditures* of $16.7 million in the second quarter of 2016. Growth capital expenditures* of $14.3 million relate to the 400,000 barrel crude oil storage expansion project at the Kerrobert Terminal on the Mid-Saskatchewan pipeline system, for a total project spend to date of approximately $47 million and a total estimated cost of the project of $65 million. The remaining growth capital expenditures* of $2.4 million relate to various pipeline system enhancements and facility upgrades.

## Bulk Liquid Storage Business Segment

| | Three Months Ended June 30 | | | Six Months Ended June 30 | | |
|---|---|---|---|---|---|---|
| | **2016** | 2015 | *% change* | **2016** | 2015 | *% change* |
| Utilization | **97%** | 93% | *4.3* | **97%** | 92% | *5.4* |
| *(millions)* | | | | | | |
| Revenue | **$ 61.3** | $ 44.4 | *38.1* | **$ 127.1** | $ 92.5 | *37.4* |
| Operating expenses | **$ 24.6** | $ 18.3 | *34.4* | **$ 50.1** | $ 36.3 | *38.0* |
| Funds from operations(1) | **$ 29.6** | $ 20.6 | *43.7* | **$ 60.9** | $ 41.1 | *48.2* |
| Capital expenditures | | | | | | |
| Growth(1) | **$ 8.2** | $ 5.7 | | **$ 18.4** | $ 9.2 | |
| Sustaining(1) | **2.2** | 2.8 | | **3.7** | 5.4 | |
| | **$ 10.4** | $ 8.5 | | **$ 22.1** | $ 14.6 | |

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

### Utilization

Inter Pipeline operates a bulk liquid storage business branded as Inter Terminals with operations in the United Kingdom (UK), Germany, Ireland, Denmark and Sweden. Inter Terminals is one of the largest independent bulk liquid storage businesses in Europe, with a combined storage capacity of approximately 27 million barrels located across 16 terminals. These terminals are strategically located with five terminals at the coastal ports of Immingham, Teesside and Tyneside in the UK, one terminal on the Shannon estuary in Ireland, two terminals on the Rhine River at Mannheim, Germany, four coastal terminals in Denmark located on the Danish Straits and four coastal terminals in Sweden located along the Baltic Sea and Danish Straits.

* Please refer to the NON-GAAP FINANCIAL MEASURES section

Average utilization rates increased in the second quarter from 93% in 2015 to 97% in 2016 and year to date from 92% in 2015 to 97% in 2016. The increase reflects higher demand across Inter Terminals business, with utilization increases at Sweden, Denmark and the UK in the second quarter and year to date in 2016, over the comparable periods in 2015.

## Revenue

The bulk liquid storage business earns revenue for bulk liquid storage and handling services that are underpinned by a range of long-term and short-term fee-based contracts. Please refer to the adjusted EBITDA by contract type disclosure in the **NON-GAAP FINANCIAL MEASURES** section for further information.

Revenue in the bulk liquid storage business increased $16.9 million in the second quarter and $34.6 million year to date in 2016, over the same periods in 2015. The increase is primarily due to the inclusion of revenue from Inter Terminals Sweden for the entire period in 2016, as opposed to from the acquisition date of June 10th in 2015. Revenue also increased from the Denmark terminals as a result of higher utilization, rates and activity levels. In the UK, higher utilization rates also led to an increase in revenue in both periods of 2016. However, this was more than offset on a year to date basis from higher revenue in 2015 from a non-recurring release of deferred revenue on termination of a contract. Foreign currency translation adjustments resulted in higher revenue for the three and six months ended June 30, 2016, compared to the same periods in 2015.

See the **Foreign Exchange Rates** section below for further information on changes in rates.

## Foreign Exchange Rates

| | Three Months Ended June 30 | | | Six Months Ended June 30 | | |
|---|---|---|---|---|---|---|
| *(dollars)* | **2016** | 2015 | *% change* | **2016** | 2015 | *% change* |
| Euro/CAD | **$ 1.4553** | $ 1.3598 | *7.0* | **$ 1.4854** | $ 1.3782 | *7.8* |
| Pound Sterling/CAD | **$ 1.8487** | $ 1.8843 | *(1.9)* | **$ 1.9081** | $ 1.8817 | *1.4* |

## Operating Expenses

Operating expenses in the bulk liquid storage business increased $6.3 million and $13.8 million for the three and six months ended June 30, 2016, respectively, compared to the same periods in 2015. The increases are primarily due to higher operating expenses from Inter Terminals Sweden due to the timing of acquisition as discussed in the revenue section above. Foreign currency translation adjustments also resulted in higher operating expenses in the current quarter and year to date in 2016, compared to the same periods in 2015.

## Capital Expenditures

The bulk liquid storage business incurred $8.2 million of growth capital expenditures* in the second quarter of 2016, mainly relating to a number of tank life extensions, tank modification projects and tank re-activations. Approximately $1 million of the growth capital expenditures* related to the construction of six new tanks at a German terminal for a total of approximately $8 million spent to date, and a total estimated project cost of $9 million.

In the second quarter of 2016, $2.2 million of sustaining capital expenditures* were incurred in the bulk liquid storage business largely relating to environmental performance enhancement initiatives, other terminal infrastructure and safety improvement projects.

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* Please refer to the NON-GAAP FINANCIAL MEASURES section

## NGL Extraction Business Segment

| | Three Months Ended June 30 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2016 | | | | 2015 | | | |
| | *mmcf/d* | *(000s b/d)* | | | *mmcf/d* | *(000s b/d)* | | |
| Facility | Throughput | Ethane | Propane-plus | Total | Throughput | Ethane | Propane-plus | Total |
| Cochrane | **1,834** | **32.5** | **30.2** | **62.7** | 1,758 | 37.5 | 27.0 | 64.5 |
| Empress V (100% basis) | **916** | **19.4** | **12.0** | **31.4** | 725 | 18.8 | 7.1 | 25.9 |
| Empress II | **-** | **-** | **-** | **-** | - | - | - | - |
| | **2,750** | **51.9** | **42.2** | **94.1** | 2,483 | 56.3 | 34.1 | 90.4 |

| | Six Months Ended June 30 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2016 | | | | 2015 | | | |
| | *mmcf/d* | *(000s b/d)* | | | *mmcf/d* | *(000s b/d)* | | |
| Facility | Throughput | Ethane | Propane-plus | Total | Throughput | Ethane | Propane-plus | Total |
| Cochrane | **1,910** | **35.3** | **31.1** | **66.4** | 1,799 | 41.7 | 28.1 | 69.8 |
| Empress V (100% basis) | **944** | **21.1** | **12.5** | **33.6** | 844 | 21.9 | 9.9 | 31.8 |
| Empress II | **-** | **-** | **-** | **-** | - | - | - | - |
| | **2,854** | **56.4** | **43.6** | **100.0** | 2,643 | 63.6 | 38.0 | 101.6 |

| | Three Months Ended June 30 | | | Six Months Ended June 30 | | |
|---|---|---|---|---|---|---|
| *(millions)* | **2016** | 2015 | *% change* | **2016** | 2015 | *% change* |
| Revenue(1) | **$ 72.8** | $ 88.8 | *(18.0)* | **$ 150.3** | $ 191.3 | *(21.4)* |
| Shrinkage gas(1) | **$ 25.7** | $ 40.6 | *(36.7)* | **$ 62.1** | $ 91.8 | *(32.4)* |
| Operating expenses(1) | **$ 16.6** | $ 24.9 | *(33.3)* | **$ 34.0** | $ 47.2 | *(28.0)* |
| Funds from operations(1)(2) | **$ 30.5** | $ 23.3 | *30.9* | **$ 54.1** | $ 52.0 | *4.0* |
| Capital expenditures(1) | | | | | | |
| Growth(2) | **$ 0.4** | $ 0.2 | | **$ 0.7** | $ 0.5 | |
| Sustaining(2) | **0.9** | 1.1 | | **7.3** | 5.0 | |
| | **$ 1.3** | $ 1.3 | | **$ 8.0** | $ 5.5 | |

(1) Revenue, shrinkage gas, operating expenses, FFO(2) and capital expenditures for the Empress V NGL straddle plant are recorded based on Inter Pipeline's 50% ownership.

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

## Volumes

Inter Pipeline's NGL straddle plants processed natural gas throughput volumes of 2,750 million cubic feet per day (mmcf/d) in the current quarter and 2,854 mmcf/d year to date in 2016, an increase of 267 mmcf/d and 211 mmcf/d, respectively, over the comparable periods in 2015.

At the Cochrane plant, average throughput volumes increased 76 mmcf/d in the second quarter and 111 mmcf/d year to date in 2016 over the same periods in 2015. Throughput volumes at the Cochrane plant are largely impacted by, and fluctuate with, demand for Canadian natural gas in the United States (US) west-coast region. Ethane deliveries from the Cochrane and Empress V plants are subject to third party downstream facility constraints resulting in partial reinjection of ethane volumes.

Average throughput volumes increased in the three and six months ended June 30, 2016, at the Empress V plant by 191 mmcf/d and 100 mmcf/d, respectively, compared to the same periods in 2015. The Empress II plant did not receive throughput volumes in the three and six months ended June 30, 2016 and 2015, which does not impact operating results due to cost-of-service commercial arrangements in place. Natural gas throughput volumes at the Empress plants are dependent on the level of natural gas exported from Alberta's eastern border and are reliant on successfully attracting border gas flows to the straddle plants.

## Revenue

The NGL extraction business earns revenue from the recovery of certain higher value hydrocarbon liquids, namely ethane and propane-plus, from export-destined natural gas streams pursuant to a combination of commodity-based, fee-based and cost-of-service contracts. Please refer to the adjusted EBITDA by contract type disclosure in the **NON-GAAP FINANCIAL MEASURES** section for further information.

Revenue from the NGL extraction business decreased $16.0 million and $41.0 million in the three and six months ended June 30, 2016, respectively, compared to the same periods in 2015. Revenue declined as a result of lower product pricing and a reduction in ethane volumes. Increased revenue from higher propane-plus volumes from the Cochrane plant partially offset these decreases.

## Frac-spread

| | Three Months Ended June 30 | | | |
|---|---|---|---|---|
| *(dollars)* | | **2016** | | 2015 |
| | *USD/USG (1)* | *CAD/USG (1)* | *USD/USG (1)* | *CAD/USG (1)* |
| Market frac-spread | **$ 0.460** | **$ 0.592** | $ 0.346 | $ 0.425 |
| Realized frac-spread | **$ 0.448** | **$ 0.577** | $ 0.347 | $ 0.426 |

| | Six Months Ended June 30 | | | |
|---|---|---|---|---|
| *(dollars)* | | **2016** | | 2015 |
| | *USD/USG (1)* | *CAD/USG (1)* | *USD/USG (1)* | *CAD/USG (1)* |
| Market frac-spread | **$ 0.377** | **$ 0.498** | $ 0.357 | $ 0.442 |
| Realized frac-spread | **$ 0.378** | **$ 0.499** | $ 0.361 | $ 0.446 |

(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 any hedged production. Natural gas purchased for shrinkage is based on the actual combination of the monthly index and daily price of AECO paid. 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.

In the three and six months ended June 30, 2016, realized frac-spreads increased from $0.35 USD/USG to $0.45 USD/USG and from $0.36 USD/USG to $0.38 USD/USG, respectively, compared to the same periods in 2015. The 5-year and 15-year simple average market frac-spreads at December 31, 2015 were $0.85 USD/USG and $0.59 USD/USG, respectively.

### Shrinkage Gas

Shrinkage gas represents natural gas bought by Inter Pipeline to replace the heat content of liquids extracted from natural gas processed at the straddle plants. The price for shrinkage gas is based on a combination of daily and monthly index AECO natural gas prices. In the three and six months ended June 30, 2016, shrinkage gas expense decreased $14.9 million and $29.7 million, respectively, compared to the same periods in 2015, due to a decrease in AECO natural gas prices and lower volumes. The weighted average monthly AECO prices* decreased in the second quarter from $2.53 per gigajoule (GJ) in 2015 to $1.18/GJ in 2016 and year to date from $2.67/GJ in 2015 to $1.59/GJ in 2016.

### Operating Expenses

Operating expenses decreased in the NGL extraction business by $8.3 million and $13.2 million for the three and six months ended June 30, 2016, respectively, from the same periods in 2015. The reduction is largely due to lower fuel and power costs as a result of lower natural gas and power pricing, as well as lower general operating and maintenance costs. Average Alberta power pool prices decreased in the second quarter from $57.22/MWh in 2015 to $15.00/MWh in 2016 and year to date from $43.20/MWh in 2015 to $16.55/MWh in 2016.

### Capital Expenditures

The NGL extraction business incurred $0.4 million in growth capital expenditures† in the second quarter of 2016 for equipment upgrades at the Cochrane plant. In addition, $0.9 million in sustaining capital expenditures† were incurred in the current quarter on processing system upgrades at the Cochrane plant.

## Other Expenses

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| *(millions)* | **2016** | 2015 | **2016** | 2015 |
| Income tax expense | **$ 37.1** | $ 71.4 | **$ 69.1** | $ 105.7 |
| Depreciation and amortization | **55.2** | 43.5 | **110.1** | 85.9 |
| Financing charges | **35.0** | 33.9 | **70.3** | 68.0 |
| General and administrative | **24.4** | 19.2 | **69.7** | 39.7 |
| Loss on disposal of assets | **1.6** | 3.7 | **2.1** | 2.5 |
| Unrealized change in fair value of derivative financial instruments | **-** | (0.4) | **-** | (0.3) |

### Income Tax Expense

Consolidated income tax expense decreased $34.3 million and $36.6 million in the three and six months ended June 30, 2016, compared to the same periods in 2015. This decrease is primarily due to a one-time deferred income tax expense of $35.9 million recognized in the second quarter of 2015 for the increase in Alberta provincial corporate tax rate from 10% to 12%.

### Depreciation and Amortization

In the three and six months ended June 30, 2016, depreciation and amortization of tangible and intangible assets increased $11.7 million and $24.2 million, respectively, over the comparable periods in 2015. This increase is primarily due

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

† Please refer to the NON-GAAP FINANCIAL MEASURES section

to depreciation of assets acquired with Inter Terminals Sweden in June 2015, new assets now in service and accelerated amortization of certain intangible assets in the NGL extraction business.

## Financing Charges

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| *(millions)* | **2016** | 2015 | **2016** | 2015 |
| Interest on credit facilities | **$ 8.2** | $ 8.7 | **$ 16.7** | $ 17.9 |
| Interest on Corridor Debentures | **1.9** | 1.8 | **3.7** | 3.8 |
| Interest on Medium-Term Notes Series 1 to 7 | **23.7** | 23.7 | **47.2** | 45.2 |
| Total interest | **33.8** | 34.2 | **67.6** | 66.9 |
| Capitalized interest | **(0.3)** | (1.6) | **(0.3)** | (1.8) |
| Amortization of transaction costs on financial debt | **0.8** | 0.8 | **1.6** | 1.6 |
| Accretion of provisions and pension plan funding charges | **0.7** | 0.5 | **1.4** | 1.3 |
| Total financing charges | **$ 35.0** | $ 33.9 | **$ 70.3** | $ 68.0 |

Total financing charges in the three and six months ended June 30, 2016 increased $1.1 million and $2.3 million, respectively, over the comparable periods in 2015.

Capitalized interest decreased $1.3 million in the current quarter and $1.5 million year to date in 2016, compared to the same periods in 2015, as there were fewer capital projects with related interest costs being capitalized.

Interest on medium-term notes was the same for the second quarter of 2015 and 2016, and was $2.0 million higher year to date in 2016 compared to the same period in 2015, due to the timing of issuance of Series 7 on March 23, 2015.

Interest on credit facilities decreased $0.5 million and $1.2 million in the three and six months ended June 30, 2016, over the same period in 2015, due to a decline in weighted average short-term interest rates, offset in part by higher average debt levels.

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

## General and Administrative

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| *(millions)* | **2016** | 2015 | **2016** | 2015 |
| Canada | **$ 17.8** | $ 14.3 | **$ 55.0** | $ 29.7 |
| Europe | **6.6** | 4.9 | **14.7** | 10.0 |
| | **$ 24.4** | $ 19.2 | **$ 69.7** | $ 39.7 |

Canadian general and administrative expenses increased $3.5 million and $25.3 million in the three and six months ended June 30, 2016, respectively, over the same periods in 2015. The increase is primarily due to higher rent and employee expenses, offset in part by a foreign exchange gain. Inter Pipeline's head office was relocated to new premises in the first quarter of 2016, resulting in higher rent costs, as well as a one-time adjustment in rent expense of $14.9 million in the first quarter of 2016, for the difference between future lease obligations and the estimated sublease recoveries as the previous non-cancellable office leases were deemed to be onerous contracts. Higher long-term incentive plan expense was the primary driver for the increase in employee costs as a result of an increase in Inter Pipeline's share price during the second quarter and year to date in 2016, over the comparable periods in 2015.

European general and administrative costs increased $1.7 million in the current quarter and $4.7 million year to date in 2016, compared to the same periods in 2015. The increase is largely due to the inclusion of general and administrative costs from Inter Terminals Sweden which was acquired in June 2015 and higher foreign exchange currency losses.

## Loss on Disposal of Assets

Inter Pipeline incurred a loss on disposal of assets of $1.6 million in the current quarter largely related to a turbine exchange in the NGL extraction business and the disposal of various assets in the bulk liquid storage business. Year to date in 2016, a loss on disposal of assets of $2.1 million was recorded which also included de-recognition of certain assets in the bulk liquid storage business.

# SUMMARY OF QUARTERLY RESULTS

| (millions, except volume, per share and % amounts) | 2014 Third Quarter | 2014 Fourth Quarter | 2015 First Quarter | 2015 Second Quarter | 2015 Third Quarter | 2015 Fourth Quarter | **2016 First Quarter** | **2016 Second Quarter** |
|---|---|---|---|---|---|---|---|---|
| **Pipeline volumes *(000s b/d)*** [1] | | | | | | | | |
| Oil sands transportation | 942.3 | 1,023.9 | 1,097.7 | 853.9 | 1,119.9 | 1,111.8 | **1,104.2** | **1,012.6** |
| Conventional oil pipelines | 202.6 | 213.2 | 214.2 | 208.5 | 209.4 | 214.8 | **208.5** | **201.3** |
| Total pipeline volumes | 1,144.9 | 1,237.1 | 1,311.9 | 1,062.4 | 1,329.3 | 1,326.6 | **1,312.7** | **1,213.9** |
| **NGL extraction volumes *(000s b/d)*** [1] | | | | | | | | |
| Ethane | 48.2 | 66.6 | 71.0 | 56.3 | 62.0 | 59.1 | **60.9** | **51.9** |
| Propane-plus | 33.0 | 36.8 | 42.0 | 34.1 | 40.8 | 41.3 | **44.9** | **42.2** |
| Total NGL extraction volumes | 81.2 | 103.4 | 113.0 | 90.4 | 102.8 | 100.4 | **105.8** | **94.1** |
| **Utilization** | | | | | | | | |
| Bulk liquid storage | 78% | 84% | 90% | 93% | 93% | 97% | **98%** | **97%** |
| **Revenue** | | | | | | | | |
| Oil sands transportation | $ 128.2 | $ 140.5 | $ 177.4 | $ 182.7 | $ 195.2 | $ 213.4 | **$ 191.6** | **$ 193.3** |
| Conventional oil pipelines | 89.6 | 87.1 | 77.8 | 74.7 | 80.9 | 89.0 | **$ 81.5** | **$ 85.6** |
| Bulk liquid storage | 41.6 | 39.5 | 48.1 | 44.4 | 57.1 | 64.8 | **$ 65.8** | **$ 61.3** |
| NGL extraction | 120.2 | 123.0 | 102.5 | 88.8 | 91.0 | 88.5 | **$ 77.5** | **$ 72.8** |
| | $ 379.6 | $ 390.1 | $ 405.8 | $ 390.6 | $ 424.2 | $ 455.7 | **$ 416.4** | **$ 413.0** |
| **Funds from operations** [2] | | | | | | | | |
| Oil sands transportation | $ 82.5 | $ 97.2 | $ 130.2 | $ 135.0 | $ 146.1 | $ 157.8 | **$ 139.4** | **$ 141.4** |
| Conventional oil pipelines | 48.7 | 46.8 | 46.8 | 46.5 | 49.8 | 51.5 | **$ 50.0** | **$ 47.1** |
| Bulk liquid storage | 19.8 | 15.8 | 20.5 | 20.6 | 29.0 | 28.2 | **$ 31.3** | **$ 29.6** |
| NGL extraction | 34.4 | 24.7 | 28.7 | 23.3 | 23.6 | 25.2 | **$ 23.6** | **$ 30.5** |
| Corporate costs | (44.4) | (24.8) | (49.7) | (44.4) | (43.3) | (51.3) | **$ (58.3)** | **$ (51.9)** |
| | $ 141.0 | $ 159.7 | $ 176.5 | $ 181.0 | $ 205.2 | $ 211.4 | **$ 186.0** | **$ 196.7** |
| Per share [2] | $ 0.43 | $ 0.49 | $ 0.53 | $ 0.54 | $ 0.61 | $ 0.63 | **$ 0.55** | **$ 0.58** |
| Net income | $ 95.0 | $ 79.6 | $ 122.8 | $ 73.8 | $ 128.4 | $ 138.0 | **$ 104.6** | **$ 122.9** |
| Net income attributable to shareholders | $ 91.4 | $ 75.6 | $ 113.7 | $ 65.3 | $ 118.7 | $ 129.7 | **$ 95.8** | **$ 114.4** |
| Per share – basic | $ 0.28 | $ 0.24 | $ 0.34 | $ 0.19 | $ 0.35 | $ 0.39 | **$ 0.28** | **$ 0.34** |
| Per share – diluted | $ 0.28 | $ 0.23 | $ 0.34 | $ 0.19 | $ 0.35 | $ 0.39 | **$ 0.28** | **$ 0.34** |
| Dividends to shareholders [3] | $ 104.7 | $ 114.9 | $ 121.8 | $ 123.1 | $ 123.5 | $ 128.7 | **$ 131.3** | **$ 131.4** |
| Per share [3] | $ 0.3225 | $ 0.3525 | $ 0.3675 | $ 0.3675 | $ 0.3675 | $ 0.3825 | **$ 0.3900** | **$ 0.3900** |
| Shares outstanding (basic) | | | | | | | | |
| Weighted average | 324.2 | 325.8 | 331.5 | 334.8 | 335.8 | 336.3 | **336.6** | **336.8** |
| End of period | 325.4 | 326.2 | 334.2 | 335.3 | 336.2 | 336.4 | **336.7** | **336.9** |
| Capital expenditures [4] | | | | | | | | |
| Growth [2] | $ 256.6 | $ 150.3 | $ 132.5 | $ 67.8 | $ 43.4 | $ 52.6 | **$ 32.2** | **$ 27.7** |
| Sustaining [2] | 11.7 | 12.7 | 9.5 | 10.0 | 12.3 | 27.8 | **18.0** | **10.0** |
| | $ 268.3 | $ 163.0 | $ 142.0 | $ 77.8 | $ 55.7 | $ 80.4 | **$ 50.2** | **$ 37.7** |
| Payout ratio [2] | 76.6% | 74.0% | 73.3% | 71.9% | 63.6% | 63.8% | **74.6%** | **70.3%** |
| Total assets | $ 8,548.2 | $ 8,647.2 | $ 8,733.8 | $ 8,955.5 | $ 9,010.4 | $ 9,029.4 | **$ 8,921.9** | **$ 8,869.7** |
| Total debt [5] | $ 4,396.3 | $ 4,590.7 | $ 4,680.7 | $ 4,865.1 | $ 4,876.2 | $ 4,851.7 | **$ 4,850.2** | **$ 4,832.7** |
| Total shareholders' equity | $ 2,566.9 | $ 2,548.1 | $ 2,737.6 | $ 2,732.2 | $ 2,805.4 | $ 2,821.1 | **$ 2,752.9** | **$ 2,692.8** |
| Enterprise value [2] | $ 16,223.6 | $ 16,314.8 | $ 15,590.4 | $ 14,487.4 | $ 13,153.2 | $ 12,323.7 | **$ 13,857.0** | **$ 14,064.4** |
| Consolidated Net Debt to Total Capitalization [2] | 50.1% | 52.2% | 51.4% | 52.8% | 52.7% | 52.8% | **53.8%** | **54.2%** |

(1) Cold Lake volumes and Empress V NGL production reported on a 100% basis.

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

(3) Dividends to shareholders are calculated based on the number of common shares outstanding at each record date.

(4) Amounts reported on a 100% basis that includes non-controlling interest.

(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 dividends to shareholders 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.

Inter Pipeline's capital under management includes financial debt and shareholders' equity. 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 dividends paid to shareholders, issue new common or preferred shares, issue new debt, renegotiate existing debt terms or repay existing debt.

Inter Pipeline maintains flexibility in its capital structure to fund 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 FFO[*] in excess of dividends to fund capital requirements. At June 30, 2016, Inter Pipeline had access to committed credit facilities totaling $2.8 billion, of which $748.0 million remained unutilized, and demand facilities totaling $99.4 million of which $93.4 million remained unutilized. Certain facilities are available to specific subsidiaries of Inter Pipeline.

Inter Pipeline may also issue equity capital to ensure its balance sheet remains well prepared for expected growth. During the three and six months ended June 30, 2016, approximately $5.7 million and $12.1 million, respectively, of equity was issued through the dividend reinvestment plan.

Inter Pipeline has a current short form base shelf prospectus with Canadian regulatory authorities that was filed in December 2015. Under provisions detailed in the short form base shelf prospectus, Inter Pipeline may offer and issue, from time to time: (i) common shares; (ii) preferred shares; (iii) debt securities; and (iv) subscription receipts (collectively, the "Securities") of up to $3.0 billion aggregate 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. As at June 30, 2016, no Securities have been issued under the base shelf prospectus.

Inter Pipeline may utilize derivative financial instruments to minimize exposure to fluctuating commodity prices, foreign exchange and interest rates. Inter Pipeline's market 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.

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* Please refer to the NON-GAAP FINANCIAL MEASURES section

## Credit Facilities and Debt Outstanding

| (millions) | | Recourse | | Non-recourse | | June 30 2016 | | December 31 2015 |
|---|---|---|---|---|---|---|---|---|
| **Credit facilities available** | | | | | | | | |
| Corridor syndicated credit facility | $ | - | $ | 1,550.0 | **$** | **1,550.0** | $ | 1,550.0 |
| Inter Pipeline syndicated credit facility | | 1,250.0 | | - | | **1,250.0** | | 1,250.0 |
| | | 1,250.0 | | 1,550.0 | | **2,800.0** | | 2,800.0 |
| Demand facilities[1][2] | | 74.4 | | 25.0 | | **99.4** | | 105.8 |
| | $ | 1,324.4 | $ | 1,575.0 | **$** | **2,899.4** | $ | 2,905.8 |
| | | | | | | | | |
| **Total debt outstanding[2]** | | | | | | | | |
| Inter Pipeline Ltd. | | | | | | | | |
| Inter Pipeline syndicated credit facility | | | | | **$** | **693.0** | $ | 664.0 |
| Medium-Term Notes Series 1 to 7 | | | | | | **2,625.0** | | 2,625.0 |
| Inter Terminals demand facility[1] | | | | | | **5.7** | | 26.5 |
| Inter Pipeline (Corridor) Inc. | | | | | | | | |
| Corridor syndicated credit facility | | | | | | **1,359.0** | | 1,386.2 |
| Corridor Debentures | | | | | | **150.0** | | 150.0 |
| Total debt outstanding[2][3] | | | | | **$** | **4,832.7** | $ | 4,851.7 |

(1) Demand facilities consist of: Inter Pipeline's $40 million demand facility; Corridor's $25 million demand facility; and Inter Terminals Limited and Inter Terminals EOT ApS Pound Sterling 20 million demand facility which was converted at a Pound Sterling/CAD rate of 1.7197 at June 30, 2016.

(2) At June 30, 2016, outstanding Inter Pipeline letters of credit of approximately $0.3 million were not included in total debt outstanding.

(3) Financial debt reported in the June 30, 2016 consolidated financial statements of $4,815.3 million, includes long-term debt, short-term debt and commercial paper outstanding of $4,832.7 million less discounts and debt transaction costs of $17.4 million.

Inter Pipeline's debt outstanding at June 30, 2016, matures at various dates up to May 2044 as follows:

| (millions) | | Amount | Rate | Maturity date |
|---|---|---|---|---|
| **Inter Pipeline Ltd.** | | | | |
| Inter Pipeline syndicated credit facility | $ | 693.0 | Variable | December 4, 2020 |
| Medium-Term Notes | | | | |
| Series 1 | | 325.0 | 4.967% | February 2, 2021 |
| Series 2 | | 200.0 | 3.839% | July 30, 2018 |
| Series 3 | | 400.0 | 3.776% | May 30,2022 |
| Series 4 | | 500.0 | 3.448% | July 20, 2020 |
| Series 5 | | 500.0 | 4.637% | May 30, 2044 |
| Series 6 | | 400.0 | CDOR plus 49 bps | May 30, 2017 |
| Series 7 | | 300.0 | 3.173% | March 24, 2025 |
| **Inter Pipeline (Corridor) Inc.** | | | | |
| Corridor syndicated credit facility | | 1,359.0 | Variable | December 13, 2019 |
| Corridor Debentures | | 150.0 | 4.897% | February 3, 2020 |
| **Inter Terminals Limited and Inter Terminals EOT ApS** | | | | |
| Pound Sterling 20 million demand facility | | 5.7 | Variable | Demand |

## Financial Covenants

Inter Pipeline was in compliance with all covenants under its credit facilities and medium-term notes as at June 30, 2016.

The following table provides a listing of the key financial covenants as at June 30, 2016:

| | Maximum Ratio | June 30 2016 |
|---|---|---|
| **Inter Pipeline Ltd.** | | |
| Inter Pipeline syndicated credit facility | | |
| Consolidated Net Debt to Total Capitalization(1)(2)(3)(4) | 65% | 54.2% |
| Medium-Term Notes Series 1 to 7 | | |
| Funded Debt to Total Capitalization(2)(5)(6) | 70% | 51.6% |
| | | |
| **Inter Pipeline (Corridor) Inc.** | | |
| Corridor syndicated credit facility | | |
| Corridor Debentures | | |
| Rate Base Debt to Rate Base(7)(8) | 75% | 73.3% |

(1) "Consolidated Net Debt" includes the aggregate amount of all debt of the borrower and its restricted subsidiaries, but excludes debt of any unrestricted subsidiary which is not guaranteed by the borrower or any restricted subsidiary, subordinated debt, non-recourse debt and debt attributable to any non-controlling interest, less cash and cash equivalents owned by the borrower and its restricted subsidiaries, but excluding any such cash or cash equivalents owned by an unrestricted subsidiary or attributable to any non-controlling interest, provided that the use or application of such cash and cash equivalents is not encumbered or restricted by contract or regulatory requirements.

(2) Inter Pipeline (Corridor) Inc. is not considered a restricted subsidiary under Inter Pipeline's syndicated credit facility or medium-term note indenture and, as a result, its debt and assets are excluded from all financial covenant calculations under those agreements.

(3) "Total Capitalization" for Inter Pipeline's syndicated credit facility covenant is the sum of debt, but excluding non-recourse debt, debt attributable to unrestricted subsidiaries or any non-controlling interest, plus convertible debentures, plus consolidated shareholders' equity of the borrower, but excluding any shareholders' equity from or attributable to non-recourse assets, unrestricted subsidiaries or any non-controlling interest, plus a $243.8 million adjustment related to Canadian SIFT legislation.

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

(5) "Funded Debt" includes long-term debt of the issuer and its restricted subsidiaries, but excluding non-recourse debt, subordinated debt and any obligations of the issuer to a restricted subsidiary or of a restricted subsidiary to the issuer or another restricted subsidiary.

(6) "Total Capitalization" for Inter Pipeline's medium-term notes covenant is the sum of Funded Debt plus subordinated debt, plus consolidated equity, plus the amount of any minority interests in restricted subsidiaries, plus a $243.8 million adjustment related to Canadian SIFT legislation.

(7) "Rate Base Debt" includes all Corridor debt excluding debt incurred in connection with financing additions to the rate base prior to the time those additions form part of the rate base, debt incurred to fund recoverable expenditures under the Corridor Firm Service Agreement (FSA) and subordinated debt.

(8) "Rate Base" includes the invested capital to bring the asset to service pursuant to the Corridor FSA.

The Corridor pipeline system is operated under the Corridor FSA, which is a long-term cost-of-service contract that provides for the recovery of debt financing costs, substantially all operating costs, rate base depreciation and taxes, in addition to providing a return on equity. As a result, Corridor's FFO* is not impacted by throughput volumes or commodity price fluctuations. Inter Pipeline actively manages Corridor's debt level to ensure the actual rate base debt to rate base ratio is very close to the benchmark criteria (i.e. not more than 75%) to optimize its defined capital structure.

At June 30, 2016, approximately $2,457.7 million or 50.9% of Inter Pipeline's total debt outstanding was exposed to variable interest rates. Of this amount $1,359.0 million or 55.3% relates to Corridor debt outstanding and its financing costs are directly recoverable through the terms of the Corridor FSA. When deemed appropriate, Inter Pipeline may enter into interest rate swap agreements to manage its interest rate risk exposure.

* Please refer to the NON-GAAP FINANCIAL MEASURES section

The following interest coverage* ratio is calculated on a consolidated basis for the twelve month periods ended June 30, 2016 and December 31, 2015.

| | Twelve Months Ended | |
|---|---|---|
| | June 30 | December 31 |
| *(times)* | **2016** | 2015 |
| Interest coverage[1][2] | **5.4** | 5.4 |

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

(2) Net income attributable to shareholders plus income taxes and borrowing costs, divided by the sum of borrowing costs, capitalized borrowing costs and any retirement of obligations.

## Credit Ratings

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

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

* Please refer to the NON-GAAP FINANCIAL MEASURES section

## Contractual Obligations, Commitments and Guarantees

The following table summarizes Inter Pipeline's expected capital spending profile and future contractual obligations at June 30, 2016. Management intends to finance short-term commitments either through existing or renegotiated credit facilities and FFO* in excess of dividends. Longer term commitments will be funded through Inter Pipeline's capital management policies as discussed earlier in the **LIQUIDITY AND CAPITAL RESOURCES** section.

| *(millions)* | Total | Less than one year | One to five years | After five years |
|---|---|---|---|---|
| Capital expenditure projects(1)(2) | | | | |
| Oil sands transportation(2) | $ 334.4 | $ 26.8 | $ 263.8 | $ 43.8 |
| Conventional oil pipelines | 25.6 | 25.3 | 0.3 | - |
| Bulk liquid storage | 36.3 | 18.5 | 17.8 | - |
| NGL extraction | 3.3 | 3.3 | - | - |
| Growth capital funded by Inter Pipeline(2)(3) | 399.6 | 73.9 | 281.9 | 43.8 |
| Sustaining capital funded by Inter Pipeline(2)(3) | 32.6 | 32.6 | - | - |
| | 432.2 | 106.5 | 281.9 | 43.8 |
| Total debt(4)(5)(6) | | | | |
| Corridor syndicated credit facility(5) | 1,359.0 | 1,359.0 | - | - |
| Inter Pipeline syndicated credit facility | 693.0 | - | 693.0 | - |
| Corridor Debentures | 150.0 | - | 150.0 | - |
| Medium-Term Notes Series 1 to 7 | 2,625.0 | 400.0 | 1,025.0 | 1,200.0 |
| Inter Terminals demand facility | 5.7 | 5.7 | - | - |
| | 4,832.7 | 1,764.7 | 1,868.0 | 1,200.0 |
| Other obligations | | | | |
| Operating leases | 339.8 | 25.5 | 97.9 | 216.4 |
| Purchase obligations | 198.8 | 39.7 | 54.8 | 104.3 |
| Long-term portion of incentive plan | 6.8 | - | 6.8 | - |
| Adjusted working capital deficit(3) | 42.6 | 42.6 | - | - |
| | $ 5,852.9 | $ 1,979.0 | $ 2,309.4 | $ 1,564.5 |

(1) Capital expenditures classified as "less than one year" represent expected spending for the remaining months in 2016.

(2) Inter Pipeline's expected growth and sustaining capital(3) spending profile including the 15% non-controlling interest in Cold Lake is $471.2 million.

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

(4) At June 30, 2016, outstanding Inter Pipeline letters of credit of approximately $0.3 million were not included in total debt outstanding. Financial debt reported in the June 30, 2016 consolidated financial statements of $4,815.3 million, includes long-term debt, short-term debt and commercial paper of $4,832.7 million less discounts and debt transaction costs of $17.4 million.

(5) 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 2019.

* Please refer to the NON-GAAP FINANCIAL MEASURES section

The following future obligations resulting from the 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) Operating leases and purchase obligations represent minimum payment obligations associated with leases and normal operating agreements for periods up to 2094.

(ii) Working capital deficiencies* arise primarily from capital expenditures outstanding in accounts payable and accrued liabilities at the end of a period.

(iii) Inter Pipeline has obligations of $30.9 million under its employee long-term incentive plan, of which $24.1 million is included in the working capital deficit*.

(iv) Present value of estimated expenditures expected to be incurred in the longer term on decommissioning of active pipeline systems, NGL straddle plants and leased bulk liquid storage sites and remediation of known environmental liabilities is $95.5 million at June 30, 2016. Due to the uncertainty of timing for payment of these obligations, they were excluded from the table above.

# DIVIDENDS TO SHAREHOLDERS

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| *(millions, except per share and % amounts)* | **2016** | 2015 | **2016** | 2015 |
| Cash provided by operating activities | **$ 213.0** | $ 163.3 | **$ 388.3** | $ 321.9 |
| Net change in non-cash operating working capital | **(16.3)** | 17.7 | **(5.6)** | 35.6 |
| Less funds from operations[1] attributable to non-controlling interest | **(9.7)** | (9.8) | **(19.8)** | (20.0) |
| Funds from operations[1] attributable to shareholders | **$ 187.0** | $ 171.2 | **$ 362.9** | $ 337.5 |
| Dividends to shareholders | **$ 131.4** | $ 123.1 | **$ 262.7** | $ 244.9 |
| Dividends per share[2] | **$ 0.3900** | $ 0.3675 | **$ 0.7800** | $ 0.7350 |
| Payout ratio[1] | **70.3%** | 71.9% | **72.4%** | 72.6% |

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

(2) Dividends to shareholders are calculated based on the number of common shares outstanding at each record date.

Inter Pipeline's objective is to provide shareholders with stable dividends over economic and industry cycles. As a result, not all FFO* attributable to shareholders are distributed to shareholders. A portion is withheld and reinvested in the business to effectively manage its capital structure, and in particular, debt levels. Inter Pipeline sets dividend levels based on the underlying assumptions in each year's annual operating and capital budget and long-term forecast, consistent with its goal to provide shareholders with stable dividends. Dividends are determined at the discretion of Inter Pipeline's Board of Directors, subject to certain legal requirements, and are payable when declared.

FFO* is a non-GAAP financial measure that Inter Pipeline uses in managing its business and in assessing future cash requirements that impact the determination of future dividends to shareholders. Inter Pipeline expresses FFO* attributable to shareholders as cash provided by operating activities less net changes in non-cash working capital and FFO* attributable

* Please refer to the NON-GAAP FINANCIAL MEASURES section

to non-controlling interest. The impact of net change in non-cash working capital is excluded in the calculation of FFO*
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 FFO* to mitigate its quarterly impact. 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.

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

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| *(millions)* | **2016** | 2015 | **2016** | 2015 |
| Cash provided by operating activities | **$ 213.0** | $ 163.3 | **$ 388.3** | $ 321.9 |
| Less cash provided by operating activities attributable to non-controlling interest | **(10.5)** | (16.2) | **(20.2)** | (18.4) |
| Dividends to shareholders | **(131.4)** | (123.1) | **(262.7)** | (244.9) |
| Excess | **$ 71.1** | $ 24.0 | **$ 105.4** | $ 58.6 |

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| *(millions)* | **2016** | 2015 | **2016** | 2015 |
| Net income attributable to shareholders | **$ 114.4** | $ 65.3 | **$ 210.2** | $ 179.0 |
| Dividends to shareholders | **(131.4)** | (123.1) | **(262.7)** | (244.9) |
| Shortfall | **$ (17.0)** | $ (57.8) | **$ (52.5)** | $ (65.9) |

Cash provided by operating activities in all periods was greater than dividends to shareholders plus cash provided by operating activities attributable to non-controlling interest. Dividends were greater than net income attributable to shareholders as net income also includes certain non-cash expenses such as depreciation and amortization, deferred income taxes and unrealized changes in the fair value of derivative financial instruments.

## OUTSTANDING SHARE DATA

Inter Pipeline's outstanding common shares at June 30, 2016 are as follows:

| *(millions)* | Total |
|---|---|
| Common shares outstanding | 336.9 |

At August 2, 2016, Inter Pipeline had 337.0 million common shares outstanding.

* Please refer to the NON-GAAP FINANCIAL MEASURES section

# RISK MANAGEMENT AND FINANCIAL INSTRUMENTS

## Market Risk Management

Inter Pipeline may utilize derivative financial instruments to manage liquidity and market risk exposure to changes in commodity prices, foreign currencies and interest rates. Market risk management strategies 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 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 market risk management policy.

Inter Pipeline may enter 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 long-term debt, short-term debt and commercial paper outstanding at June 30, 2016. 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 may be utilized to manage frac-spread risk. As at June 30, 2016, there are no frac-spread hedges outstanding.

#### POWER PRICE RISK MANAGEMENT

Inter Pipeline may use 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, 2016, there are no electricity price swap or heat rate 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

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* Please refer to the NON-GAAP FINANCIAL MEASURES section

historically, therefore are generally not hedged; however, Inter Pipeline may decide to hedge this risk in the future. As at June 30, 2016, there are no foreign currency exchange hedges outstanding.

### Corporate

#### INTEREST RATE RISK MANAGEMENT

Inter Pipeline's exposure to interest rate risk primarily relates to its long-term debt obligations and fair value 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 may enter into interest rate or cross-currency swap agreements to manage its interest rate price risk exposure. As at June 30, 2016, there are no interest rate hedges outstanding.

Based on the variable rate obligations outstanding at June 30, 2016, a 1% change in interest rates at this date would have changed interest expense for the three and six months ended June 30, 2016, by approximately $6.1 million and $12.2 million, respectively, assuming all other variables remain constant. Of this amount, $3.4 million and $6.8 million for the three and six months ended June 30, 2016, respectively, relate to Corridor's syndicated credit facility and is recoverable through the terms of the Corridor FSA, therefore the after-tax income impact for the three and six months ended June 30, 2016 would be $2.0 million and $4.0 million, respectively.

## Credit Risk

Inter Pipeline's credit risk exposure relates primarily to the non-performance of its customers and financial counterparties holding cash, accounts receivable, and prepaid expenses and other deposits. Credit risk is managed through Inter Pipeline's credit management policy, which establishes guidelines for defining and measuring credit risk, determining credit risk thresholds and monitoring credit risk exposures to counterparties and vendors. The creditworthiness assessment takes into account available qualitative and quantitative information about the counterparty including, but not limited to, business performance, financial status and external credit ratings. Depending on the outcome of each assessment, guarantees or some other form of 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 a 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, 2016, accounts receivable associated with these two business segments were $90.9 million or 60.6% 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 segments 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 and deposits 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. Accounts receivable are deemed past due if they are aged greater than 60 days and are considered to be impaired if one or more events have occurred that would impact the estimated future cash flows of that asset. At June 30, 2016, accounts receivable outstanding meeting the definition of either past due or impaired are insignificant.

# TRANSACTIONS WITH RELATED PARTIES

No revenue was earned from related parties in the three and six month periods ended June 30, 2016 or 2015.

# CONTROLS AND PROCEDURES

Management has made no material changes to the disclosure controls and procedures and internal controls over financial reporting during the second quarter of 2016.

# CRITICAL ACCOUNTING ESTIMATES

The preparation of Inter Pipeline's interim 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 3 *Summary of Significant Accounting Policies* of the December 31, 2015 audited consolidated financial statements for a list of Inter Pipeline's significant accounting policies.

The amounts recorded for derivative financial instruments, business combinations, consolidation of non-controlling interest, non-financial asset impairment, property, plant and equipment, provisions, deferred income 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.

Inter Pipeline's interim financial statements for the three and six months ended June 30, 2016 have been presented in accordance with International Accounting Standards (IAS) 34 *Interim Financial Reporting* and have been prepared by management following the same accounting policies and methods of computation as disclosed in the audited consolidated financial statements for the year ended December 31, 2015.

# FUTURE ACCOUNTING PRONOUNCEMENTS

Certain new standards, interpretations and amendments to existing standards were issued by the IASB that are mandatory for accounting periods beginning on or after January 1, 2015 or later periods with early adoption permitted. The standards impacted are as follows:

## IFRS 15 *Revenue from Contracts with Customers* (IFRS 15)

IFRS 15 replaces IAS 18 *Revenue*, IAS 11 *Construction Contracts* and related interpretations and shall be applied to annual periods beginning on or after January 1, 2018, with early adoption permitted. IFRS 15 establishes a control based revenue recognition model under which revenue is recognized when control of the underlying goods or services for the particular performance obligation is transferred to the customer. Inter Pipeline is currently assessing the impact of IFRS 15; however the extent of the impact has not yet been determined.

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

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* and shall be applied to annual periods beginning on or after January 1, 2018 with early adoption permitted. IFRS 9 establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows. Inter Pipeline is currently assessing the impact of IFRS 9; however the extent of the impact has not yet been determined.

### IFRS 16 *Leases* (IFRS 16)

IFRS 16 replaces IAS 17 *Leases* and shall be applied to annual periods beginning on or after January 1, 2019, with early adoption permitted. IFRS 16 establishes a single, on-balance sheet accounting model for lessees which will result in the recognition of a lease liability for the obligation to make lease payments and a right-of-use asset for the right to use the underlying asset for the lease term. Inter Pipeline is currently assessing the impact of IFRS 16; however, the extent of the impact has not yet been determined.

## RISK FACTORS

During the second quarter of 2016, there were no significant changes to Inter Pipeline's operating activities that would affect the disclosure of risk factors as discussed in its 2015 annual MD&A.

## NON-GAAP FINANCIAL MEASURES

Certain non-GAAP financial measures referred to in this MD&A, namely "adjusted working capital deficiency", "EBITDA", "adjusted EBITDA", "Consolidated Net Debt to Total Capitalization", "enterprise value", "funds from operations", "funds from operations per share", "growth capital expenditures", "sustaining capital expenditures", "interest coverage", and "payout ratio" 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 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 dividends. 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, commercial paper and current portion of long-term debt. This financial measure is used by Inter Pipeline in the Contractual Obligations, Commitments and Guarantees table in the **LIQUIDITY AND CAPITAL RESOURCES** section of this MD&A to capture other working capital items not specifically included in the table.

| (millions) | June 30 **2016** | December 31 2015 |
|---|---|---|
| Current assets | | |
| Cash and cash equivalents | **$ 40.2** | $ 40.3 |
| Accounts receivable | **150.0** | 183.1 |
| Prepaid expenses and other deposits | **17.9** | 26.9 |
| Current liabilities | | |
| Dividends payable | **(43.8)** | (43.8) |
| Accounts payable, accrued liabilities and provisions | **(181.3)** | (220.6) |
| Current income taxes payable | **(11.9)** | (29.6) |
| Deferred revenue | **(13.7)** | (7.5) |
| Adjusted working capital deficiency | **$ (42.6)** | $ (51.2) |

**EBITDA and adjusted EBITDA** are reconciled from the components of net income as noted below. EBITDA is expressed as net income before total interest less capitalized interest, income taxes, depreciation and amortization; adjusted EBITDA also includes additional adjustments for loss (gain) on disposal of assets, non-cash expense (recovery), non-cash financing charges and unrealized change in fair value of derivative financial instruments. These additional adjustments are made to exclude various non-cash items, or items of an unusual nature that are not reflective of ongoing operations. These adjustments are also made to better reflect the historical measurement of EBITDA used in the investment community as an approximate measure of an entity's operating cash flow based on data from its income statement.

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| (millions) | **2016** | 2015 | **2016** | 2015 |
| Net income | **$ 122.9** | $ 73.8 | **$ 227.5** | $ 196.6 |
| Financing charges | **35.0** | 33.9 | **70.3** | 68.0 |
| Current income tax expense | **21.7** | 14.0 | **40.7** | 28.3 |
| Deferred income tax expense | **15.4** | 57.4 | **28.4** | 77.4 |
| Depreciation and amortization | **55.2** | 43.5 | **110.1** | 85.9 |
| EBITDA | **$ 250.2** | $ 222.6 | **$ 477.0** | $ 456.2 |
| Loss on disposal of assets | **1.6** | 3.7 | **2.1** | 2.5 |
| Non-cash financing charges | **(1.5)** | (1.4) | **(3.0)** | (3.0) |
| Non-cash expense (recovery) | **1.6** | 3.0 | **14.6** | (4.6) |
| Unrealized change in fair value of derivative financial instruments | **-** | (0.4) | **-** | (0.3) |
| Adjusted EBITDA | **$ 251.9** | $ 227.5 | **$ 490.7** | $ 450.8 |
| Less adjusted EBITDA attributable to non-controlling interest | **(9.7)** | (9.9) | **(19.8)** | (20.1) |
| Adjusted EBITDA attributable to shareholders | **$ 242.2** | $ 217.6 | **$ 470.9** | $ 430.7 |

**Adjusted EBITDA by contract type** is a percentage of adjusted EBITDA, reconciled in the table above, based on (i) cost-of-service contracts which generally provide for a return on invested capital and recovery of substantially all operating costs. This includes both cost-of-service contracts (agreements that are not impacted by throughput volume or commodity price fluctuations) and modified cost-of-service contracts (agreements that may have throughput volume exposure in certain circumstances) collectively referred to as cost-of-service contracts, (ii) fee-based contracts are generally subject to throughput volume and operating cost exposure, but not commodity price fluctuations, and (iii) commodity-based contracts are generally subject to throughput volume, operating cost and commodity price fluctuations. This measure, in combination with other measures, is used by the investment community to assess the overall stability and predictability of the business.

| | Six Months Ended June 30 | |
|---|---|---|
| | **2016** | 2015 |
| **Adjusted EBITDA by contract type** | | |
| Cost-of-service | **61%** | 62% |
| Fee-based | **30%** | 30% |
| Commodity-based | **9%** | 8% |

| | Cost-of-service | Fee-based | Commodity-based |
|---|---|---|---|
| **Contract type by business segment** | | | |
| Oil sands transportation | √ | - | - |
| Conventional oil pipelines | - | √ | √ |
| Bulk liquid storage | - | √ | - |
| NGL extraction | √ | √ | √ |

**Consolidated Net Debt to Total Capitalization** is disclosed and discussed in the Financial Covenant table of the **LIQUIDITY AND CAPITAL RESOURCES** section of this report. This measure in combination with other measures, are used by the investment community to assess the financial strength of the business.

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

| *(millions, except per share amounts)* | June 30 **2016** | December 31 2015 |
|---|---|---|
| Closing share price | **$ 27.40** | $ 22.21 |
| Total closing number of common shares outstanding | **336.9** | 336.4 |
| | **9,231.7** | 7,472.0 |
| Total debt | **4,832.7** | 4,851.7 |
| Enterprise value | **$ 14,064.4** | $ 12,323.7 |

**Funds from operations** are reconciled from the components of net income as noted below. Funds from operations is expressed before changes in non-cash working capital, see the **DIVIDENDS TO SHAREHOLDERS** section of this report for further discussion. Funds from operations per share are calculated on a weighted average basis using basic common shares outstanding during the period. These measures, together with other measures, are used by the investment community to assess the source, sustainability and cash available for dividends.

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| *(millions)* | **2016** | 2015 | **2016** | 2015 |
| Net income | **$ 122.9** | $ 73.8 | **$ 227.5** | $ 196.6 |
| Depreciation and amortization | **55.2** | 43.5 | **110.1** | 85.9 |
| Loss on disposal of assets | **1.6** | 3.7 | **2.1** | 2.5 |
| Non-cash expense (recovery) | **1.6** | 3.0 | **14.6** | (4.6) |
| Unrealized change in fair value of derivative financial instruments | **-** | (0.4) | **-** | (0.3) |
| Deferred income tax expense | **15.4** | 57.4 | **28.4** | 77.4 |
| Funds from operations | **$ 196.7** | $ 181.0 | **$ 382.7** | $ 357.5 |
| Less funds from operations attributable to non-controlling interest | **(9.7)** | (9.8) | **(19.8)** | (20.0) |
| Funds from operations attributable to shareholders | **$ 187.0** | $ 171.2 | **$ 362.9** | $ 337.5 |
| | | | | |
| Funds from operations | **$ 196.7** | $ 181.0 | **$ 382.7** | $ 357.5 |
| Total interest less capitalized interest | **33.5** | 32.5 | **67.3** | 65.0 |
| Current income tax expense | **21.7** | 14.0 | **40.7** | 28.3 |
| Adjusted EBITDA | **$ 251.9** | $ 227.5 | **$ 490.7** | $ 450.8 |
| Less adjusted EBITDA attributable to non-controlling interest | **(9.7)** | (9.9) | **(19.8)** | (20.1) |
| Adjusted EBITDA attributable to shareholders | **$ 242.2** | $ 217.6 | **$ 470.9** | $ 430.7 |

**Growth capital expenditures** are generally defined as expenditures which are recoverable or 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 | | | |
|---|---|---|---|---|
| | | | **2016** | 2015 |
| *(millions)* | Growth | Sustaining | Total | Total |
| Oil sands transportation | **$ 2.4** | **$ 0.2** | **$ 2.6** | $ 25.7 |
| Conventional oil pipelines | **16.7** | **1.2** | **17.9** | 38.2 |
| Bulk liquid storage | **8.2** | **2.2** | **10.4** | 8.5 |
| NGL extraction | **0.4** | **0.9** | **1.3** | 1.3 |
| Corporate | **-** | **5.5** | **5.5** | 4.1 |
| Capital expenditures | **$ 27.7** | **$ 10.0** | **$ 37.7** | $ 77.8 |
| Capital expenditures funded by Inter Pipeline[1] | **$ 27.5** | **$ 10.0** | **$ 37.5** | $ 76.8 |

| | Six Months Ended June 30 | | | |
|---|---|---|---|---|
| | | | **2016** | 2015 |
| *(millions)* | Growth | Sustaining | Total | Total |
| Oil sands transportation | **$ 7.4** | **$ 0.3** | **$ 7.7** | $ 106.9 |
| Conventional oil pipelines | **33.4** | **1.8** | **35.2** | 86.6 |
| Bulk liquid storage | **18.4** | **3.7** | **22.1** | 14.6 |
| NGL extraction | **0.7** | **7.3** | **8.0** | 5.5 |
| Corporate[2] | **-** | **14.9** | **14.9** | 6.2 |
| Capital expenditures | **$ 59.9** | **$ 28.0** | **$ 87.9** | $ 219.8 |
| Capital expenditures funded by Inter Pipeline[1] | **$ 59.5** | **$ 28.0** | **$ 87.5** | $ 213.3 |

(1) Capital expenditures funded by Inter Pipeline exclude the 15% non-controlling interest in Cold Lake.

(2) Corporate sustaining capital predominately relates to leasehold improvement costs for the new office space.

**Interest coverage** is calculated as net income attributable to shareholders plus income taxes, and borrowing costs, divided by the sum of borrowing costs, capitalized borrowing costs and any retirement of obligations. This measure is used by the investment community to determine the ease with which borrowing costs are satisfied.

**Payout ratio** is calculated by expressing dividends declared to shareholders for the period as a percentage of funds from operations attributable to shareholders. This measure, in combination with other measures, is used by the investment community to assess the sustainability of the current dividends.

# ADDITIONAL INFORMATION

Additional information relating to Inter Pipeline, including Inter Pipeline's **Annual Information Form** is available on SEDAR at www.sedar.com

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

**Dated at Calgary, Alberta this 4th day of August, 2016**