



Is Fortis's Acquisition Strategy Good for Investors?

Description

Based in St. John's, NL, **Fortis** ([TSX: FTS](#)) is the largest investor-owned gas and electric distribution utility in Canada. One of the company's current business building strategies is growth through acquisitions. It has a strategy of investing in high-quality regulated utility assets in Canada and the United States. The company has made a move to acquire **UNS Energy** ([NYSE: UNS](#)) based in Tucson, Arizona.

Utility regulation

Electric and natural gas utilities delivering retail service are regulated by state, federal, and local agencies in the U.S. These agencies govern the prices charged, the terms of companies' service to customers, its budgets and construction plans, as well as its programs for energy efficiency and other services. In essence, regulation supplants competition as the determining factor of prices.

For Q1 2014, Fortis' regulated utilities contributed earnings of \$162 million. This represents an increase of \$17 million over the previous quarter. In 2013, Canadian regulated utilities contributed earnings of \$346 million to Fortis. This was \$1 million higher than 2012 earnings of \$345 million. Non-regulated generation contributed earnings of \$39 million (an increase of \$22 million from 2012).

Enbridge ([TSX: ENB](#))([NYSE: ENB](#)) recently received approval in Ontario from the provincial regulatory body, the Ontario Energy Board, to raise rates charged to consumers by 40%. Last week, Enbridge Gas Distribution authorized a significant investment in its Greater Toronto Area system. The company said this will provide benefits to customers, enhancing reliability as well as access to lower-cost natural gas.

UNS Energy acquisition

Recently, the Federal Energy Regulatory Commission (FERC) approved Fortis' acquisition of UNS Energy. The ruling is the next stage toward concluding the transaction. UNS Energy is a vertically integrated utility services holding company. Via three subsidiaries, it engages in the regulated electric generation and energy delivery business. It does so chiefly in Arizona. UNS serves roughly 656,000 electricity and gas customers.

UNS Energy's Q1 2014 net income was \$15 million, or \$0.37 per diluted share of common stock, versus net income of \$11 million, or \$0.27 per diluted share in Q1 2013. The company's primary subsidiary is Tucson Electric Power Company (TEP). TEP reported net income of \$9 million in Q1 2014 versus net income of \$1 million in the same period in 2013. The improvement was mainly because of TEP's new rate structure (effective July 1, 2013).

Fortis believes that the UNS Energy acquisition will be accretive to earnings per common share of Fortis in the first full year after closing. This is exclusive of one-time acquisition-related charges. The closing of the acquisition of UNS Energy is expected to take place by the end of this year.

Fortis indicates that the UNS Energy acquisition will enhance the geographic diversification of its regulated assets. This will result in no more than one-third of total assets being situated in any one regulatory jurisdiction.

Acquisition of electrical utility assets of the city of Kelowna, B.C.

FortisBC Electric acquired the electrical utility assets of Kelowna, B.C., for approximately \$55 million in March of 2013. This allows FortisBC Electric to directly serve approximately 15,000 customers that the city previously served.

This past February, the FortisBC Energy companies received regulatory approval for the amalgamation of its regulated utilities. The regulator approved the adoption of common rates for the majority of natural gas customers. This is to be phased in over a three-year period. The expectation is that the amalgamation will be effective on or about December 31, 2014.

And then there's the dividends

On March 1, 2014, Fortis paid a dividend of 32 cents per common share. This represents an increase from 31 cents for Q4 2013. This is a 3.2% increase in the quarterly dividend. It converts into an annualized dividend of \$1.28. Moreover, it extends Fortis' record of annual common share dividend increases to 41 consecutive years.

Acquisitions can be a two-edged sword for publicly traded companies. Stakeholders want to see economies of scale achieved through acquisitions and ultimately significant contributions to bottom lines. Fortis's bold initiatives on the acquisitions front have the potential to increase shareholder returns. I believe it is a company worth researching as an addition to a stock portfolio.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:ENB (Enbridge Inc.)
2. TSX:ENB (Enbridge Inc.)
3. TSX:FTS (Fortis Inc.)

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Author

mugulini

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