One Huge Reason Why I'm Avoiding Fortis Inc.

Description

Fortis Inc. (TSX:FTS) is one of Canada's most consistent stocks.

The country's largest publicly traded supplier of power and natural gas provides services to folks in Atlantic Canada, Ontario, Alberta, British Columbia, the United States, and the Caribbean. It also boasts a commercial real estate portfolio that includes 37 hotels, office buildings, and malls, located mostly in Atlantic Canada. The company is currently exploring selling off its real estate division.

These are the kinds of sectors that are associated with stability. No matter how bad the overall economy gets, people are going to continue to pay for heat and lights. You'll cut out a lot of other spending before sitting in the dark.

Even the dividend is a model of consistency. The company's dividend has increased annually for more than 40 years, a feat unmatched by any other publicly traded company in Canada. That's the kind of record dividend growth investors dream about.

There are a lot of reasons to like Fortis. There's also one big reason to not like it, which is enough for me to stay far away from the stock.

It's expensive

There are two things that attract me to a stock. I'm looking for good assets that are for sale for a good price. Fortis satisfies the first criteria, but is pretty weak in the second.

Currently, the company's shares trade hands at almost 30 times earnings, which is a huge multiple for a power producer without any particular growth avenues outside of making additional acquisitions. Competing power producers on the TSX trade at much lower multiples, which make them much more compelling, even though Fortis is the strongest of them all.

Fortis is even expensive on a forward earnings basis. Shares currently trade hands at just under $40 each, while earnings are projected to be $2.06 in 2015 and $2.12 in 2016. That puts shares at just under 20x earnings, which isn't cheap for a company projected to grow earnings just 3%.

Could it be that investors are willing to give the company a premium because of its generous dividend? If any company deserves that sort of premium, it would be Fortis. But that doesn't mean investors should just blindly pay for quality. If you're patient, quality will go on sale.

Meanwhile, **Canadian Utilities Limited** (TSX:CU) has a dividend record almost as good as Fortis's, yet it only trades at 16.2 times trailing earnings, and about 17 times its estimated 2015 earnings. The difference between 17 and 20 times earnings doesn't look like much, but Canadian Utilities is 15% cheaper on that metric.

One of the reasons why Fortis investors are willing to pay a premium for shares is because of the company's exposure to the United States. As the Canadian dollar continues to weaken against the greenback, that's good news for Fortis's earnings, which get converted back to Canadian dollars.

But I remember when companies like Fortis were struggling because the strength in the Canadian dollar made decent results look poor. It turned out that buying the stock during that time was a pretty good idea. Over the short-term, markets will overreact to currency moves. Are Fortis's shares overly expensive because investors expect the Canadian dollar to continue weakening against the U.S. dollar?

Fortis is a great company, and I'd love to own it. But at current levels, it's just a little too expensive for my tastes. Considering the lack of organic growth, I'd only be willing to pay 15 times earnings for the name. With shares currently 33% more expensive than that, I think passing on this dividend champion is a pretty easy decision.

CATEGORY

1. Dividend Stocks
2. Investing

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2. TSX:FTS (Fortis Inc.)

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