Should You Buy Canadian Utilities Limited or ATCO Ltd. After the Dip?

Description

Utilities are great investments for those looking for steady and stable returns that provide a decent income that grows at a rate that outpaces inflation. Utilities make excellent core holdings in any portfolio, specifically ones that are income oriented.

Both **Canadian Utilities Limited** (TSX:CU) and **ATCO Ltd.** (TSX:ACO.X) dropped 5-6% after their earnings report. Now, Canadian Utilities yields close to 3.4% and ATCO yields 3.6%. Are they a good buy after the dip?

Canadian Utilities

It is one of the biggest utilities in Canada, and owns regulated electric and gas distribution and transmission assets in Alberta with roughly 1.4 million retail distribution customers. Its $17 billion of assets include 86,000 km of power lines, 63,000 km of pipelines, and 16 power plants. It has a power-generating capacity of 3,890 megawatts.

Canadian Utilities is close to its 52-week low and 20% from its 52-week high. So, with an initial look, it's a good bargain at $35. Comparing its price-to-earnings ratio (P/E) to past decade trading levels, Canadian Utilities is indeed on the lower end. The same goes for its price-to-book (P/B) and price-to-cash-flow (P/CFL) ratios.

At best, Canadian Utilities is priced at a slight discount, and at worst it is fairly valued today. For ownership in a quality, stable business, it is not a bad time to buy Canadian Utilities.

ATCO

ATCO has roughly $18 billion worth of assets. It is a diversified global corporation engaged in structure and logistics (manufacturing, logistics, and noise abatement), utilities (pipelines, natural gas and electricity transmission, and distribution) and energy (power generation and sales, industrial water infrastructure, natural gas gathering, processing, storage, and liquids extraction).

ATCO is also close to its 52-week low and 25% from its 52-week high. With an initial look, it's a good bargain at $37.50. Comparing its P/E to the past decade trading levels, ATCO is trading at a sensible valuation. Its P/B and P/CFL indicate it may be slightly undervalued. For ownership in a quality, stable business, it is not a bad time to buy ATCO.

Comparing the two utilities

Yield: The higher the yield, the more income shareholders receive. Canadian Utilities yields 3.4% at about $35, while ATCO yields 2.6% at about $37.50.

Dividend growth: Dividend growth encourages price appreciation of the security. From 2008 to 2014 Canadian Utilities's dividend increased by 60%, while ATCO's increased by 83%.

For the record, Canadian Utilities has hiked its dividend for 43 years in a row, while ATCO has increased its for 21 consecutive years.

EPS growth: A healthy dividend is supported by growing earnings. From 2008 to 2014 Canadian Utilities's EPS increased by a compounded annual growth rate (CAGR) of 5.4%. On the other hand, ATCO's EPS increased by a CAGR of 5.9% in the same period.

Payout ratio: The lower the payout ratio, the safer the yield. Canadian Utilities's payout ratio is about 47%, while ATCO's is about 27%. ATCO probably maintains a lower payout ratio because it's not just in the predictable utility business.

Quality: Both companies has an S&P credit rating of A, and similar debt-to-cap levels around 50%.

Valuation: Canadian Utilities is awarded a slight premium multiple of 16, while ATCO typically trades at multiple of close to 12.

In conclusion

ATCO actually owns about 53% of Canadian Utilities. So, if you want to own both companies in one go, you can buy ATCO. That said, ATCO pays a lower yield to start, but history shows it may compensate that with higher growth. Its diversified business could be a double-edged sword in that if one business segment is not doing well, another may be doing fine. At the same time, it may not have a core strength because it is diversified in several businesses.

If you're looking for a pure utility that has a long history of paying and growing dividends, Canadian Utilities is a more predictable choice, and also pays a higher dividend. The fact that it has been awarded a premium multiple historically indicates it may be a higher-quality business.

Still, if you're looking for high-growth potential in addition to utility exposure, it's a good time to ease into ATCO after the dip.

Both companies pay out eligible dividends, so investors can hold them in a non-registered account. If you have room in a TFSA, RRSP, or an RESP for your child, you can choose to hold them there to minimize taxes.

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