Why I Prefer This Company Over Canadian Utilities Limited and Fortis Inc.

Description

It's pretty obvious why Canada's utility stocks are popular investments.

All you need to look at is the predictability of cash flows. Unless you're fine with sitting in the dark, you're going to pay your power bill. It's even more important for businesses to make sure the lights stay on. I'll cut an awful lot from my life before I cut the power.

Most places offer power producers a pretty sweet deal for setting up there. With Alberta being the main exception in Canada, electricity rates tend to be regulated to ensure both steady profits for power producers and reasonable prices for consumers. Demand plus steadily increasing prices tends to be a pretty successful investing equation.

The two finest utilities in Canada are **Fortis Inc.** (TSX:FTS) and **Canadian Utilities Limited** (TSX:CU). Each of these companies have a diverse set of assets, and consecutive annual dividend raises that stretch out for decades. Both these companies have raised dividends for more than 40 years consecutively.

Fortis has steadily built up a terrific stash of assets. It owns power-generating facilities across Canada, the United States, and in the Caribbean. It also owns natural gas infrastructure across North America, as well as real estate assets in Atlantic Canada, and a collection of hotels across the country. It has recently announced plans to sell some of its real estate assets.

Canadian Utilities also has a diverse collection of assets with a greater concentration on Canada. It owns electricity generation plants, electric distribution assets, and natural gas pipelines. It also has a small subsidiary that owns gas pipelines in Australia, as well as one that makes Atco trailers.

The issues

While these two companies own great assets, they also come with a great deal of debt. Utilities often have a lot of debt, since it's part of their business and cash flows are so predictable. But over the last few years, both of these companies have gorged on cheap debt.

Currently, Fortis has a market cap of $9.8 billion, while owing some $14 billion in debt and preferred shares. Canadian Utilities has a similarly bloated debt load, owing $9 billion compared to a market value of $9.1 billion.

Since the Great Recession, both of these companies have greatly increased their debt loads. At the end of 2010 Fortis owed just over $1 billion in total debt, while Canadian Utilities owed $3.4 billion. Yes, both companies have used that debt to expand, but often investors don't realize just how much each of these companies have expanded their balance sheets in just the last five years.

The alternative

Investors worried about the potential ramifications of taking on all that debt might be better off searching elsewhere for their utility exposure.

TransAlta Renewables Inc. (TSX:RNW) is a company that's currently struggling simply because of its association with its parent's woes. The market hates the parent **TransAlta** because of its exposure to coal, which accounts for about 40% of its earnings. But Renewables has zero exposure to coal; it owns hydro, wind, and natural gas assets.

Although Renewables has a higher P/E ratio compared with its peers, investors would be wise to look past the obvious numbers. Through the first six months of the year, it generated $85 million in free cash flow, a number that will likely go up sharply through the second half of the year because of a recent acquisition—not bad for a company with just a $2 billion market cap.

If you compare the three companies from an enterprise value-to-EBITDA perspective, Renewables is much cheaper than its two larger competitors. Renewables has an EV/EBITDA ratio of 8.7, while both Fortis and Canadian Utilities have numbers close to 11.

Plus, Renewables pays a very sweet dividend, with a yield of nearly 8%. The company has committed to raising the dividend once a project in Australia comes online as well. And best of all? It has hardly any debt, owing just $666 million compared to equity of just under $2 billion.

It's going to be interesting to see how Fortis and Canadian Utilities fare in a world where the cost of debt looks likely to increase. I think at this point investors should switch over to a utility with less debt, like TransAlta Renewables.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

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2. TSX:FTS (Fortis Inc.)
3. TSX:RNW (TransAlta Renewables)

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Date
2025/08/21
Date Created
2015/09/11
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