Income Investors: Should You Buy Fortis Inc. or Hydro One Ltd.?

Description

Investors have traditionally loved the income that comes from utility-company dividends.

Utilities might be the perfect income investment. Most deal almost exclusively in areas with regulated electricity and natural gas rates, which ensures healthy profits. And since most folks aren't about to cut out electricity and sit in the dark, investors know that the utility is going to get paid.

These days, many utilities don't even bother with billing. That part of the business is contracted out to a third party for a fee that customers end up paying. It ends up as things like "statement fees" on your bill.

But just because utilities are good businesses doesn't mean their stocks are a good investment. The market has been bidding up the price of dividend payers in this low-interest-rate environment to the point where some are trading at more than 20 times earnings. Traditionally, the valuation of slow-growth companies such as utilities have been more in the 12-15 times earnings range.

Two of Canada's leading utility providers are **Fortis Inc.** (TSX:FTS) and the recently IPOed **Hydro One Ltd.** (TSX:H). Both pay attractive dividends, and both operate in markets that are regulated.

Which should you choose for your portfolio? Let's take a closer look.

The case for Fortis

Fortis is a diverse operator with assets in Atlantic Canada, Ontario, Alberta, British Columbia, the United States, Central America, and the Caribbean.

Recent results have been solid. The company generated $0.54 per share in quarterly profit in the third quarter, which was up handsomely compared to the $0.06 in profits it recorded in the same period last year. Of course, last year's results were weighed down by UNS Energy, which was acquired in August 2014.

Analysts expect Fortis to come in at approximately $2.05 in earnings per share for 2015, excluding a one-time gain on the sale of its hotel portfolio, a deal which closed in October. That puts shares at 18.4

times normalized earnings.

Perhaps the biggest reason to buy Fortis shares is the company's history of steadily increasing dividends. It currently boasts a 43-year streak of annual dividend increases, the longest in Canada. And it just recently announced another dividend hike, which was its second of 2015.

Fortis is also aggressively expanding. It has already spent $1.7 billion in capital projects thus far in 2015, with plans to up that spending to $2.2 billion by the end of the year. It also plans to spend $1.9 billion in 2016 and $1.9 billion in 2017.

This expansion means Fortis is aggressively adding debt. It currently owes $12.2 billion in long-term debt as well as $1.8 billion in preferred shares. Right now the debt is manageable, but it should still be a little concerning for a shareholder.

The case for Hydro One

Hydro One is completely focused on the Ontario market. But that doesn't mean it can't grow.

There are multiple opportunities for the company to expand in Ontario itself. It could move into natural gas distribution, or it could expand its electric distribution business. In 2015 alone, it acquired more than 50,000 additional distribution customers.

Investors should like Hydro One's dividend. The quarterly dividend is $0.21 per share, which works out to a 3.7% yield on today's share price. The company has a target payout range of between 70% and 80% of earnings. Combine that with the steady cash flow potential of the business–after all, Ontario's market is completely regulated–and investors have a dividend that looks to be about as safe as they get. Investors can expect their first dividends in March 2016.

Hydro One also has a stronger balance sheet than Fortis. Counting its preferred shares, Fortis owes $14 billion in total debt compared to $28.6 billion in total assets for a debt-to-assets ratio of approximately 50%. Hydro One owes $8.7 billion compared to assets of $22.9 billion for a debt-to-assets ratio of 38%.

There's a lot to like about both companies, and both will likely be attractive investments over the long term. I prefer Hydro One at this point because of its solid balance sheet, its exposure to Ontario, and the potential for long-term growth. But there's nothing wrong with Fortis either. Perhaps investors should look at adding both to their portfolios.

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1. Editor's Choice

TICKERS GLOBAL

1. TSX:FTS (Fortis Inc.)

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