# 3 Big Reasons Why I'm Avoiding Fortis Inc.

## Description

Over the last few decades, there haven't been many investments much better than **Fortis Inc.** ( TSX:FTS).



Over the last 20 years, an investment in Fortis that included reinvested dividends has increased 15.9% annually. That's enough to turn a $10,000 initial investment into something worth more than $192,000.

Those are the kinds of investments that can really turn the performance of a whole portfolio.

For many investors, all they need to see is Fortis's history of growing its yield to know it'll continue to be a good buy going forward. The company has hiked its dividend every year it has been publicly traded, starting in 1972. That kind of record simply cannot be topped by any other Canadian stock.

Fortis has plenty of other things going for it as well. It continues to grow by making acquisitions, especially in the United States. In 2012 the company had revenue of $3.6 billion. In 2017 analysts expect it'll have a top line of more than $9 billion.

I don't want to take anything away from the performance of the company, because management has done a terrific job. But at the same time, I just can't bring myself to invest in Canada's largest utility. Here are the three main reasons why.

**Increasing leverage**

Fortis has been busy acquiring assets over the last few years. In 2012 it spent US$1.5 billion on CH Energy Group. It followed that up with a US$4.3 billion acquisition of UNS Energy in 2013, and the purchase of ITC Holdings for US$11.3 billion.

With these acquisitions came a lot of debt. At the end of 2012, including preferred shares, the company owed $7.3 billion to creditors. These days, that number is closer to $14 billion.

Yes, Fortis has substantially increased both revenue and earnings during that period. Over the last 12 months, operating income has been $1.37 billion compared to $785 million in 2012. That's a good thing; it shows the company can continue to service its debt.

But at the same time, I worry about the impact of higher interest rates on a balance sheet that has deteriorated. An increase in rates of just 1% could potentially impact income by $100 million or more. Add in some other unexpected issues, and investors could see some real weakness in earnings.

Which brings me to the second point…

**An ever-widening valuation**

As interest rates have continued to fall, investors have flocked to companies like Fortis that offer attractive yields and a history of dividend growth that exceeds inflation. This has caused the company's valuation to become stretched.

With shares above $40 each and earnings expectations for 2016 coming in at just over $2 per share, Fortis trades at approximately 20 times earnings. Back in late 2013, when shares were struggling, the valuation was closer to 17 times earnings. And back in 2009-2011, shares could be had for approximately 15 times earnings.

Fortis will never trade at crazy valuations. But at the same time, a return from 20 times earnings to 15-16 times earnings isn't out of the question–a move that could take 20% off the price of the stock.



**Technology**

I continue to be nervous about technology changing the world of utilities forever.

Solar power technology continues to impress. New advancements are making panels more efficient than ever. Enterprising companies have introduced real innovations like roof shingles and windows with solar panels built in.

The big kicker is battery technology. Producing solar power during the day isn't hard. Storing it in a cost-effective way is the challenge. Battery technology continues to get better with some experts predicting we're only five or 10 years away from being able to sell batteries cheap enough to power a whole house at a reasonable price.

Technology is a risk in just about every industry, but I think it could very easily add plenty of frustrations for a company like Fortis in the next decade.

**Conclusion**

If Fortis shares traded at a cheap valuation, it would be easy to ignore the increasing debt load or the risk from new technology. But they don't.

Fortis may continue to outperform going forward. The company owns great assets and has one of the best management teams. That's just not enough for me to put shares in my portfolio.

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nelsonpsmith