Why You Should Avoid Fortis Inc. and Buy This Utility

Description

Utilities are known for having stable dividends. **Fortis Inc.** (TSX:FTS)(NYSE:FTS) in particular stands out from the group. The regulated utility is the top dividend-growth stock in Canada with more than 40 consecutive years of dividend growth.

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utility power supply

Fortis has been an outstanding investment, but…

Other than being an excellent income investment, Fortis's total returns have also been pretty amazing in the past 12 months. It returned 20% (16% came from price appreciation and 4% came from dividends).

However, the shares expanded from a multiple of 18.4 to about 20.3 in the process. Simply put, the shares are now fully valued.

Sure, you can still buy Fortis. But expect lower returns of roughly 8-10% in the next year or so.

Here's a better alternative

Like Fortis, **Algonquin Power & Utilities Corp.** (TSX:AQN) owns some assets in the U.S., thereby benefiting from a strong U.S. dollar against the loonie.

Another similarity with Fortis is that Algonquin owns some regulated assets. Specifically, the utility has a diversified distribution business, which provides water, electricity, and natural gas utility services to more than 560,000 U.S. customers.

Bigger yield and better valued

Moreover, Algonquin offers a higher dividend yield of 4.7% which is well covered by its cash flows with a payout ratio of 74%. And it has been hiking its dividend at an average rate of 9.9% per year since 2010. The fact that it pays a U.S. dollar–denominated dividend also benefits Canadian investors.

But more importantly, Algonquin trades at a discounted forward multiple of about 8.5, which is well below its normal multiple of 12.

High growth prospects

Algonquin's portfolio of non-regulated renewable assets with an installed capacity of 1,300 megawatts can add to its upside. From that portfolio, its 200-megawatt wind project in Minnesota just began commercial operation in August, and it will start adding to cash flows.

Additionally, the utility's generation-development project pipeline of about 500 megawatts is expected to spur growth as they come into service through 2018. Most have a contract life of 20 years. So, they will generate additional cash flows for the company for decades to come.

Conclusion

If you hold Fortis already, I'm not saying you should abandon the shares, as management already confidently forecasted it will hike its dividend per share by 6% per year through 2020. In other words, Fortis's dividend is safe and growing. The shares are just fully valued right now.

The story is different for Algonquin. Other than offering a safe dividend, it also trades at an attractive forward multiple and has a project pipeline to boost growth for the next couple of years.

So, it's not unreasonable to expect annualized returns of 16-22% (of which about 4.7% comes from its dividend) from Algonquin.

CATEGORY

1. Dividend Stocks
2. Investing

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2. TSX:AQN (Algonquin Power & Utilities Corp.)
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