Why This Utility Is Attractive Today for Growth and Income

Description

Algonquin Power & Utilities Corp. (TSX:AQN)(NYSE:AQN) is a North American utility that's about one-third the size of **Fortis Inc.** based on total assets.

In addition to its relatively small size, Algonquin's recent developments empower it to potentially deliver higher income, income growth, and price appreciation compared to the industry for the next three to five years.

Algonquin just finished acquiring Empire District Electric on January 1 for about $3.2 billion. This transaction is meaningful to Algonquin in multiple ways.

It increases the utility's distribution customers by about 38% and almost doubles its power-generation installed capacity. Algonquin's growth doesn't stop there.

First, let's see how Empire contributes to Algonquin.

What does Empire District Electric bring?

Empire operates in the states of Missouri, Kansas, Oklahoma, and Arkansas, thereby expanding Algonquin's presence in the United States. Empire added 218,000 electric, natural gas, or water customers to Algonquin's distribution portfolio.

The acquisition boosts Algonquin's regulated asset mix because Empire is a regulated utility. Algonquin has about 70% of regulated operations after the acquisition.

This makes Algonquin's earnings and earnings growth more predictable and reliable than it was before. In turn, Algonquin's dividend is also safer.

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Algonquin's improved profile

After the Empire transaction, Algonquin has become a more diversified North American utility with $10 billion of total assets. It serves more than 782,000 water, electricity, and natural gas customers in the U.S.

Moreover, Algonquin has an installed capacity of 2,500 MW powered by wind, solar, hydroelectric and thermal energy.

Empire also added about 1,900 km of electric transmission lines and roughly 136 km of natural gas pipelines to Algonquin's portfolio.

Dividend growth

Other than the Empire acquisition, which makes up about 35% of Algonquin's growth plan through 2021, the utility also has nearly $6.3 billion of growth projects across its businesses.

Management expects earnings and cash flow growth to support annualized dividend growth of 10% through 2021. This rate is at the high end of the growth spectrum in the utility world.

Dividend

Algonquin offers a U.S. dollar–denominated dividend that totals an annual payout of US$0.4236 per share. At about $11.23 per share, the utility yields 5.1% based on the current currency exchange of US$1 to CAD$1.34.

Assuming a more conservative currency exchange of US$1 to CAD$1.20, Algonquin would yield a little more than 4.5%. This would still be 18% higher than the **iShares S&P/TSX Capped Utilities Index Fund's** 3.8%. In this utility index fund, Algonquin is the seventh-largest holding out of 16 holdings.

Summary

Due to its small size and five-year growth plan, Algonquin is expected to outperform the utility industry. It offers an above-average yield of 5.1%, which management aims to grow 10% per year.

If the U.S. dollar weakens from here, investors can still expect a yield of 4.5% based on the current quarterly dividend. Because the shares are fairly valued, an estimated annualized return of roughly 14% is reasonable for the next three to five years, barring the occurrence of a market crash.

If Algonquin shares dipped lower, it'd be a great opportunity to buy for a higher yield.

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