Has Growth Dried Up at Hydro One Ltd.?

Description

Hydro One Ltd. (TSX:H) is an electricity transmission company with a transmission network that's virtually a monopoly in Ontario. For extremely cautious investors, Hydro One offers a solid 3.76% dividend yield that would be fine even through the harshest of economic downturns.

Hydro One has an extremely wide moat as it controls a majority of Ontario's transmission lines. The business is regulated, and cash flow streams are predictable, so the stock is boring, but boring stocks are exactly the types of stocks that conservative income investors should be looking for.

Hydro One is planning to invest $1.6 billion over the next five years to upgrade its current network and to acquire the remaining Ontario transmission lines. These initiatives may sound promising, but there's really not much room to grow in Ontario since Hydro One is already a dominant force with control of over 96% of Ontario's transmission network.

Hydro One's margins are not something to write home about. The business doesn't appear to be operating in the most efficient manner. So, going forward, there's an opportunity to cut costs to improve operational efficiency. If successful, Hydro One will be able to free up more cash that can go right back into the pockets of shareholders in the form of an upped dividend.

Further price increases may receive backlash

Ontario consumers aren't happy with high electricity prices, and this could make things really difficult for Hydro One to introduce price hikes over the next few years.

Since Hydro One has a virtual monopoly, consumers don't really have anywhere else to go. We live in an age where we depend on our electronic devices, so customers will have hefty bills to deal with, at least until the Ontario government steps in.

Customers have made their frustrations public, and it's quite possible that an Ontario government approved "Fair Hydro Plan" will prevent any unreasonable price hikes moving forward. The Fair Hydro Plan is the government's way of reducing the costs associated with home ownership, and it may cut electricity bills by about 25% to ensure greater fairness.

This is a major headwind for Hydro One that could hurt the magnitude of future dividend increases. The current dividend is still safe and worthy of a spot in a conservative income investor's portfolio, but dividend increases may be fewer and farther between, and the stock could experience some volatility over the next several months.

If dividend growth is what you're looking for, then you should probably forget about Hydro One for now. Although Hydro One has a virtual monopoly, it won't be able to crank up the hydro rates as easily anymore. A fairer rate may be locked in for the long term, and this isn't great news for dividend-growth investors.

If you're a defensive investor looking for stability, then you might want to buy shares on any signs of weakness that may happen going forward. Hydro One is still a sturdy business with a solid dividend, but due to headwinds, growth may be significantly slowed over the medium to long term.

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