Should You Take Profits in Fortis Inc.?

Description

Fortis Inc. (TSX:FTS)(NYSE:FTS) is praised for its quality and stability, especially by long-term shareholders who have been investing in it for more than a decade and who may be approaching retirement. Fortis has evolved into a virtually regulated business whose returns and dividend growth are very predictable.

After increasing its dividend for 43 consecutive years, the North American utility still aims to grow its dividend per share on average by 6% per year through 2021, which will be impressive.

Investors may consider Fortis as a total returns or income investment. I'll discuss both viewpoints today.

The total returns perspective

This is the approach I took for my Fortis investment. Long-term investors may gasp at the fact that I took profit in the stock recently.

I'd bought some shares in October 2015 and February 2016 for an average cost of $37.56 per share, including fees. Both buys were made when Fortis shares were trading near a 4% yield. I didn't think the shares were particularly cheap at the time, as they were trading at a multiple of ~18.4 and ~17.4, respectively.

In about 18 months, my investment in Fortis delivered total returns of 29.17%, or an annualized return of 16.57%, which accounted for trading fees but not income taxes. This is an excellent return for an investment in a quality, stable company.

Being the “Steady Eddie” investment that Fortis is, the shares nudged higher in a market that has been generally trending up.

On Tuesday, the shares closed at about $46.50 per share, which turned out to be a multiple of 19.3.

Thomson Reuters has 12 analysts with a mean 12-month target of $49 per share on Fortis, which represents ~5.3% upside potential from the recent quotation. Adding in the dividend yield of ~3.4% implies near-term total returns of 8.7%.

To be conservative, let’s say an investment in Fortis today can return 6.7-8.7% in the next 12 months. Some investors may be happy with that estimated total return, but I feel I can invest elsewhere for a higher yield or higher total returns.

The income perspective

Income investors may argue that Fortis offers a safe yield and that as long as the utility continues to increase its dividend, they’ll continue to hold.

Based on the current quarterly dividend, Fortis’s payout ratio is expected to be about 65% this year. Adding that analysts estimate that the utility will grow its earnings per share by ~6% per year, Fortis certainly has the capacity to grow its dividend by ~6% per year.

Investor takeaway

Given that capital gains are more favourably taxed than dividends, I think investors can at least think about trading around their Fortis position for extra returns, even if they’re only using a part of their position to do so.

For income investors and retirees who are looking for consistent income, holding on to their shares after buying them at a reasonable price makes sense because safe dividends are more reliable than “emotional” share prices that are unpredictable.

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