Is Fortis Inc. Worth the Premium You'll Have to Pay?

Description

Good income stocks come at a price. It's not often that you'll happen upon a diamond in the rough before anyone else in the market does, so you're likely buying a great income stock at a bit of a premium. **Fortis Inc.** (TSX:FTS)(NYSE:FTS) is an example of this. It has a long history of paying dividends, and it has an aggressive dividend-growth strategy.

Unfortunately, this strategy comes at a cost. You're going to pay a bit more for the 3.5% yield. So, the question you have to ask is whether or not Fortis and its dividend is worth the premium you'll have to pay.

I say yes, and here's why…

Fortis is one of the largest utilities in North America with 3.2 million customers. All told, its customers are spread across five Canadian provinces, three Caribbean countries, and nine U.S. states. It has achieved this sort of reach through a series of smart and well-executed acquisitions.

Part of what makes Fortis worth the premium is the stability of the dividend, which stems from its predictable revenue thanks to regulated rates. According to Fortis's Q2 report, its mid-year rate base is approximately $26 billion with regulated Canadian and Caribbean accounting for 47%, regulated independent transmission accounting for 28%, and regulated U.S. electric and gas accounting for 25%.

On top of that, its pro forma operating earnings are also geographically diverse. Canada accounts for 35%, the United States accounts for 55%, and the Caribbean is a stable 4%. And there are a few other energy projects. Between the regulated and geographic breakdowns, the company is in a solid position.

Fortis achieved this position through a series of major acquisitions. Its first success was the takeover of CH Energy Group for US$1.5 billion, adding 375,000 total customers in counties just north of New York City. It expanded to Arizona with the purchase of UNS Energy for US$4.3 billion. This deal added 663,000 customers to the books.

The acquisition that really changed the composition of the company was the US$11.3 billion takeover of ITC Holdings. This deal closed in October 2016 and added a network of 15,600 miles of high voltage lines that run through much of the Midwestern United States. With this acquisition, we saw the United States become greater than 50% of the company's overall earnings.

Like I said, the stability of Fortis's earnings makes the dividend a sure thing, which adds to the premium. And the dividend is growing fast. In 2006, the company paid out $0.67. Fast forward a decade, and that dividend is now $1.53. This is a compound annual growth rate of 9%

And the growth isn't stopping. In 2015, management offered dividend guidance that would see average dividend growth of 6% through 2021.

The problem with paying a premium for shares of a company is that your upside is limited. However, your downside is also limited. While I would obviously prefer to see the yield approach 4%, the company is already beginning to rise again after dropping 5%, so I don't see that yield happening. Therefore, I recommend picking up shares now and biting whenever the stock has a dip.

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