Can Fortis Inc. Sustain its Current Growth Strategy?

Description

Fortis Inc. (TSX:FTS)(NYSE:FTS) came to the U.S. market with an initial public offering in October 2015 at $28.90 per share. Shares slumped initially following the launch, falling to $23.95 in January before going on a strong rally, up 51% in the 18 months that followed to sit at $36.23 as of Friday's close.

Fortis shares on the Canadian exchanges have enjoyed a similar fate over the past 10 years. Shares have gained, on average, 13.7% during the current bull market.

These returns are nothing to be shrugged at, especially viewed in combination with the company's 3.32% dividend yield.

Yet a lot of this momentum stems from the company's growth-by-acquisition strategy, which includes the acquisition of New York–based CH Energy Group Inc. for US$1.5 billion in 2013 and Arizona-based utility company UNS Energy Corp. for US$2.5 billion in 2014.

Not to mention Fortis's US$11.3 billion acquisition of ITC Holdings Corp, which extended the company's reach into the U.S. electricity transmission market (read: power lines) and, in doing so, made Fortis one of the 15 largest utility companies in North America.

There's no question that this would draw the attention of U.S. investors, particularly institutions, which are increasingly in search of yield, not to mention in search of growth in an economy which has seemingly been stuck in "lower for longer" mode for as long as anyone can remember.

The question investors need to be asking themselves is, is the current strategy sustainable?

A move south: the growth strategy

Leadership at Fortis suggests the greatest opportunity for the company to grow right now means being involved with infrastructure spending in the U.S. as Canada transitions away from coal-fired electricity generation toward more natural gas and renewable power.

The move south of the border makes all that much more sense when considering that utilities in Canada are Crown corporations, while the U.S. market consists of investor-owned utility companies, meaning the U.S. market is more open to transactions.

Growth, but growth fueled by debt

All is well and good with that strategy, provided someone is there to foot the bill. So far, its been the debtholders doing the bulk of the lifting.

The company has added US$15 billion of debt to the books since 2013.

This is great for shareholders of Fortis as the company's debtholders are essentially financing the company's growth agenda — an agenda which is, in turn, providing for the cash flow being used to pay shareholders' dividends.

And despite the massive amount of debt being accumulated, there may not be reason to panic just yet.

Fortis generated operating profits of over US$1.48 billion over the past 12 months. That compares to an interest expense of US$668, and when you consider US$983 million of non-cash charges, the company is in a comfortable position to service its current debt obligations.

Even a careful review of the company's debt maturities suggests that there shouldn't be any problems for at least the next several years.

The vast majority of the company's debt is due beyond 2021, meaning management will have ample time to refinance and roll over the debt when the opportunity strikes.

Should you buy?

Fortis is uniquely positioned as a utility operator with solid growth prospects.

The company operates in an industry characterized by price controls and regulation, so there isn't too much of an element of "surprise" to the shares.

Yet the company's track record of growth and translating acquisitions into returns that are above the company's cost of capital is impressive, to say the least.

Fortis makes sense for a conservatively managed dividend-growth strategy, and with shares presently 5% off their highs, right now might be a good time to buy on the dip.

Stay Foolish.

CATEGORY

1. Dividend Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:FTS (Fortis Inc.)
2. TSX:FTS (Fortis Inc.)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Dividend Stocks
2. Investing

Tags

1. Editor's Choice

Date
2025/07/27
Date Created
2017/08/11
Author
jphillips