Fortis Inc.: A Quality Dividend Growth Stock

Description

Investing in utilities can sometimes seem like watching paint dry. These companies, due to regulatory circumstances, control particular swatches of territory that make cash flow predictable, thus paying strong dividends – growth is just unlikely.

Fortis Inc. (TSX:FTS)(NYSE:FTS) is anything but boring, though. It has the predictable cash flow that comes from strong regulatory sources. This allows it to pay a strong yearly dividend that management continues to increase – something it has done every year for 43 years. For example, in 2006, it paid $0.67 per share in dividends. In 2016, that had grown to $1.53.

Separating from the pack

Not only does it have the great cash flow, it has broken the standard utility mold and has experienced tremendous growth due to its willingness to buy other utilities.

Three, in particular, stand out because it helped the company expand into the United States and made it one of the largest North American utilities.

The first two are pretty straightforward…

In 2012, it paid US$1.5 billion for CH Energy Group, a utility with 375,000 customers just north of New York City. It then acquired UNS Energy for US$4.3 billion, adding 663,000 Arizona customers to its portfolio.

However, even with these acquisitions, Fortis was still very much a Canadian utility. That changed when it bought ITC Holdings for US$11.3 billion, a deal that closed in October 2016. This added a massive network of 15,600 miles of high voltage lines across the Midwestern United States. More than 50% of the company’s overall earnings now originated in the United States thanks to this acquisition.

The geographic breakdown is as follows … The United States accounts for 55% of its pro forma earnings. Canada accounts for 35% and the Caribbean adds an additional 4%. It has some other sources to make up the remaining 6%.

Thanks to its willingness to spend money on acquisitions, Fortis has experienced incredible growth. And, going forward, management predicts that growth will be significant enough to continue boosting the dividend by approximately 6%, on average, per year through 2021. This goes back to its predictable earnings. Because it knows, roughly, how much it'll make, offering this sort of guidance is not that difficult.

There's only one downside to Fortis … It's expensive.

With interest rates so low for so long, investors clamored for other opportunities to earn cash flow without significant risk. Compared to other more speculative plays, investing in a utility was pretty much a no-brainer. This has pushed the price of shares up and, equally, depressed the yield to around 3.5%.

Unfortunately, I don't see this changing until interest rates increase even more and investors move into other income-generating assets. While I would prefer to pick up shares at a 4% yield, this stock is pretty comfortable trading in its current range that offers 3.5%. Ultimately, you're paying a premium for a high-growth dividend stock that will continue to add income to your portfolio. It's expensive, but sometimes you've got to pay to own a piece of a really great business.

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Author
jaycodon