A Stable Utility for Growing Your Income

Description

Algonquin Power & Utilities Corp. (TSX:AQN)(NYSE:AQN) stock has below-average volatility because of the nature of its business. It provides products and services that are needed in all kinds of economic environments, and it generate stable and growing cash flows, which allow the utility to grow its dividend over time.

Algonquin positions itself for stable growth through a mix of regulated utilities and non-regulated power generation.

Algonquin's regulated utilities

Algonquin generates about three-quarters of its earnings before interest, taxes, depreciation, and amortization (EBITDA) from its regulated electricity, natural gas, and water distribution utilities across 12 U.S. states with a total of 757,000 customers. This part of the portfolio has returns on equity 9-10%.

Algonquin is always on the lookout to expand its fleet. In late August, the company announced it was working on acquiring a regulated utility distribution business in New York state from a subsidiary of **Enbridge**. Subject to regulatory approvals, the acquisition is expected to close sometime next yearand will add ~16,000 customers in a new jurisdiction.

Algonquin's power-generation portfolio

Algonquin generates about a quarter of its EBITDA from its power-generation portfolio, of which 70% is in the U.S. and 30% is in Canada. It has a net installed capacity of 1,500 megawatts across eight states and six provinces.

Moreover, 88% of its generation is under long-term power-purchase agreements with inflation escalations. Its average power-purchase agreement length is 16 years.

Algonquin expects to continue its focus on wind-power generation. In 2016, 64% of its renewable energy mix is wind. By 2020, it estimates to have wind as 81% of its power generation. Its other forms of generation include hydro, solar, and thermal.

Algonquin's dividend

Since most of Algonquin's assets are either regulated or have long-term purchase agreements, the company's earnings and cash flow generation are very predictable. This supports a safe dividend.

Compared to the second quarter in 2016, Algonquin's adjusted earnings and funds from operations increased by ~18% and ~5.7%, respectively, on a per-share basis in the second quarter of 2017. This was the result of the growth from its internal projects, the impact of rate increases from its utilities, and acquisitions.

Notably, Algonquin offers a U.S. dollar-denominated distribution, which will cause its yield to fluctuate — the stronger the U.S. dollar against the Canadian dollar, the higher the yield. Based on the recent foreign exchange rate, Canadian investors can get a yield of nearly 4.3%.

Management aims to increase the dividend per share by 10% per year through 2021, which should support steady share price appreciation over time.

Investor takeaway

An investment in Algonquin gets you a starting yield of nearly 4.3%, as well as a dividend that is expected to grow 10% per year for the next few years. Barring a market-wide correction, the stock's share price should also steadily move higher. In summary, Algonquin is a good idea for conservative investors and is a great buy on any meaningful dips.

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