Hydro One Ltd.: Time to Sell Following the 2017/2018 OEB Decision?

Description

Hydro One Ltd. (TSX:H) sounds like the perfect business for risk-adverse income investors to own. The company pretty much has a monopoly over Ontario's transmission network (~96% control), and with the recent acquisition of Avista Corp., it appears that larger dividend hikes could be in the cards over the long term. But when we dig a bit deeper, it things look bleak for Hydro One, at least in the near term.

Owning a business that has a virtual monopoly has its perks. The business is regulated and the cash flow streams are as close to a guarantee as that you're going to find. That means the dividend will remain intact, even through the worst of recessions, which is great news for retirees whose objective is to obtain a consistent, steady stream of income throughout their retirements.

One major problem with having such control over a market is that regulators are likely to prevent price hikes, so the customers aren't gouged when it comes to pricing. Ontario consumers have made their distaste with electricity prices very public, and that's likely going to dampen Hydro One's earnings, which will likely hurt long-term dividend growth.

The Ontario Energy Board (OEB) recently announced its decision on Hydro One's 2017/2018 transmission revenue requirement and rate settlement application. Hydro One is set to experience lower capital expenditures of $950 million for 2017 and $1 billion for 2018 — a decrease of $126.1 million and $122.2 million, respectively. This reduction is expected to hurt the company's earnings, albeit slightly. A guidance downgrade from the management team is likely, which could cause shares to take a short-term dip.

Valuation

Shares of Hydro One currently trade at a 20.94 price-to-earnings multiple, a 1.4 price-to-book multiple, a 2.1 price-to-sales multiple, and a 7.7 price-to-cash flow multiple. Shares are by no means cheap at these levels, but don't fret, as I think shares could become cheaper as investors start to grow impatient with Hydro One and the aftermath from the disappointing OEB decision.

Bottom line

Shares of Hydro One currently have a bountiful 3.89% dividend yield. If stability is what you're after, then you can get it with Hydro One; however, you'll probably take a short-term hit on the chin, as shares are likely to take a dip as regulators continue to drag Hydro One to the ground.

Although shares are cheap and the dividend is attractive, I'd steer clear for now, as a better entry point will probably present itself sometime over the next year. If the yield hits 4.2%, then it may be time to scale into a position, but only if you value dividend stability over growth.

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Date
2025/09/09
Date Created
2017/10/13
Author
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