Why I Would Avoid Fortis Inc. Despite the Company's Strong Q3 Results

Description

Fortis Inc. (TSX:FTS)(NYSE:FTS) released its third-quarter results today. The company posted sales of $1.9 billion, which grew 24% year over year. Earnings per share of $0.66 also increased from $0.45 a year ago, as the company saw its net income more than double last year's tally.

Let's take a deeper look at the impressive results to see what was behind the company's strong growth this quarter.

Acquisitions help accelerate growth

It was back in October 2016 that Fortis completed its acquisition of ITC Holdings Corp., which is the largest deal the company has ever completed. Fortis has made multiple acquisitions in the U.S. to grow its business over the years, and ITC specifically had a big impact in Q3 since prior year sales for Fortis would have not included its results.

In Q3, ITC contributed $376 million in revenue. The lack of that revenue would have resulted in sales for Fortis being flat from the prior year.

The other U.S. segments were down 2%, while Canadian operations were up 2.5% year over year, although in total dollars, the increase amounted to just an extra $15 million to the company's top line. The Caribbean, which makes up the smallest segment for the company, saw sales of $77 million drop from $79 million a year ago.

ITC's revenues of $376 million in Q3 were second among all segments and was only bested by UNS Energy, another U.S. acquisition made back in 2013, which contributed $599 million in sales.

Breakdown of earnings by segment

The company’s U.S. operations contributed $216 million of the $278 in net earnings in Q3. UNSEnergy led the way with earnings of $112 million, followed by ITC adding $89 million to the company’sbottom line. Earnings from the U.S. grew by 86% as a result of ITC not being included in the prioryear’s results.

Canadian operations contributed $43 million to earnings and were up 19% year over year.

Foreign exchange brings down supply costs

Despite seeing a 24% increase in its top line, the company’s energy supply costs declined 5% as a result of favourable foreign-exchange fluctuations.

Other costs pushed up from ITC acquisition

Operating expenses rose 15%, and depreciation and amortization was also up 24% year over year, which Fortis claims was mainly due to the ITS acquisition.

Improved cash flow

As a result of the strong quarter, Fortis saw its cash from operations reach $800 million, which is up 67% from the $478 million that the company recorded a year ago.

Is Fortis a buy?

I’m not a big fan of acquisition-based growth because of all the challenges it presents, and it makes a company’s operations all that more complicated when you are dealing with integrations and potentially all sorts of resistance that can hurt a company’s financials without ever being evident to investors.

It all sounds good on paper to acquire companies to grow, but oftentimes it doesn’t work out as well as planned and could just end up saddling the acquirer with rising costs and losses. The impact of foreign exchange shouldn’t be underestimated either, as the company’s high exposure to U.S. currency fluctuations presents investors with an added risk.

Fortis a good and stable buy, and the company provides a great dividend for investors looking for income. However, even then, I’d still prefer a dividend stock that has more growth potential.

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