Is Fortis Inc. a Low-Risk Investment?

Description

Fortis Inc. (TSX:FTS)(NYSE:FTS) is often praised for its quality. Is it a low-risk investment? The quick answer is yes and no. The business is low risk, but the stock's valuation is not.

What's low risk about Fortis?

Fortis's utility operations are largely regulated. Specifically, about 97% of its assets are regulated. So, Fortis's earnings and returns are mostly predictable. Its regulated assets include electric utilities (44% of its earnings), electric transmission (i.e., ITC)(37%), and gas utilities (16%). As of the third quarter, Fortis's weighted average allowed return on equity is 9.75%.

People use electricity and gas as usual, no matter what the economy does. So, Fortis's products and services are needed in all economic environments.

Because of Fortis's stable nature, it tends to do well in recessions. In the last recession, from peak to trough, the stock fell ~24%.

This seems like a lot, but it fared better than, say, the Canadian banks, which fell as much as ~50%. Though, to be fair, the last recession was triggered by a financial crisis. So, naturally, banks were hit harder.

Also to give a clearer picture, I should note that Fortis was trading at an extended price-to-earnings multiple (P/E) of ~22.8 at the start of the recession. And that the stock was super cheap — trading at a P/E of ~14.1 at the trough. The stock normally trades at a P/E of above 19.

What's risky about Fortis today?

Fortis's share price isn't exactly cheap. At Friday's market close price of $47.44 per share, Fortis traded at a P/E of ~18.9. Some value investors would say that there isn't a big enough margin of safety in the stock.

However, in today's market, other investors may think it's all right to pay a fair price for a quality company such as Fortis.

It's true that Fortis is, at best, fully valued, but it actually hasn't been cheap for a number of years. Since the summer of 2010, Fortis has consistently traded at a P/E of 18 or higher.

Going forward, the Street consensus estimates Fortis will grow its earnings per share by 5.2-5.5% per year for the next three to five years. Is it worth it to pay a P/E of close to 19 for that growth?

Here's what analysts think. The Street consensus from **Thomson Reuters** has a positive outlook on Fortis and gives the stock a 12-month target of $50.50 per share, which represents ~6.4% upside potential.

Investor takeaway

Fortis's business is low risk, and it also offers a safe, growing dividend. It offers a yield of nearly 3.6% and aims for dividend growth of 6% per year through 2020.

The key thing that makes Fortis a little risky for new money today is its valuation. At best, the shares are fully valued. Investors who'd bought the shares at a lower valuation might opt to hold on to the quality shares for its stability and dividends.

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