Should You Buy This Unusual Utility Company?

Description

Utilities are boring. There's no other way to describe them. But boring isn't inherently bad; utilities provide an essential function. Their business model makes utilities predictable, which is why they're considered safer investments and many income investors pick them up.

Essentially, a utility charges rates that are regulated through long-term contracts. This limits the upside potential, but it also limits downside, as the energy costs stay relatively constant. Given that utilities tend to pay a pretty good dividend, investors are comfortable knowing that they'll get their check on a regular basis.

But **Fortis Inc.** (TSX:FTS)(NYSE:FTS) is a different kind of utility, and is anything but a boring utility stock.

Whereas most utilities are stuck in their particular jurisdiction and are content to operate that way, Fortis and its investors wanted more. So, back in 2012, Fortis made its first successful expansion south of the border. It paid US$1.5 billion to acquire CH Energy Group, the holding company of Central Hudson. Fortis immediately gained 300,000 electricity customers and 75,000 natural gas customers throughout the upstate New York deal.

In 2013, Fortis paid US$2.5 billion for UNS Energy, adding 650,000 natural gas and electricity customers. Fortis was quickly becoming more U.S. than Canadian with every acquisition.

The ultimate win for Fortis occurred when Fortis bought ITC Holdings for US$11.3 billion. Fortis became one of the 15 largest North American public utilities by enterprise value with this deal, and its geographic earnings breakdown finally switched, with 60% now coming from the United States.

Buying these U.S. companies turned out to be great wins for Fortis due to significant increases in its rate base. Excluding the U.S. acquisitions, the rate base would have increased by a CAGR of 7% from 2012-2017, which isn't bad. But when you include the U.S. acquisitions, the rate base increased by a CAGR of 24%. And over the past three years, the adjusted earnings per share increased by a 13.1% CAGR.

But it's not just the acquisitions that are helping Fortis grow. The company has $14.5 billion in capital projects lined up over the next five years, which should help its cash flow grow organically. For example, Fortis continues to work on the Wataynikaneyap Transmission Power Project, which will connect remote communities in Northern Ontario to the grid.

With all of this growth, you can expect the dividends to follow. Management increased the yield by 6.25% back in October, increasing it to $0.425 per quarter. Looking forward, management expects an average annual increase of 6% between now and 2022. Should that occur, investors should expect a $0.568 per share dividend. At its current share prices, it gets a yield at a cost of 5.22%.

Fortis is very much a long-term play. Buy now and with compounding returns, you'll generate ever-growing returns in the future. Because of how regulated the business is, I see little reason why income investors shouldn't buy this company.

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