



## Not Every Electric Utility Is Created Equal

### Description

Investing in utilities, especially electric utilities, is typically perceived by investors to be a low-risk investment that is guaranteed to produce long-term income and steady growth. That has led to companies such as **Fortis Inc.** [becoming popular](#) among investors seeking less-risky income-producing stocks.

However, not all utilities are created equal. One which demonstrates the pitfalls that exist is the story of electric utility **Atlantic Power Corporation** (TSX:ATP)(NYSE:AT), which is due to release its first-quarter 2018 results after the market closes this afternoon. Despite management's upbeat perspective, Atlantic Power is down by 15% over the last year, and there are signs that there is further pain ahead.

### Now what?

Atlantic Power's tale of woe started back in 2013 when it committed the cardinal sin of overleveraging its balance sheet to acquire assets of questionable quality, as it sought to bulk up its operations and hence earnings. Since then, it has struggled to reduce debt to manageable levels, rein in costs, and restructure its operations to boost profitability. This has weighed heavily on its stock, causing it to trade at nearly half of its price in late 2014 when the long-term impact of those misadventures became apparent.

A key problem facing Atlantic Power is that it is struggling to become profitable. For 2017 it reported a net loss of almost US\$99 million, which, while smaller than the US\$113 million recorded for 2016, is the fourth annual consecutive net loss since 2013.

As part of its strategy of making its operations nimbler, Atlantic Power has focused on strengthening its balance sheet. Since embarking on this strategy, the utility has reduced leverage by US\$1 billion, seeing debt fall from a massive 9.5 times EBITDA in 2013 to a manageable 3.3 times EBITDA at the end of 2017.

Nonetheless, initiatives aimed at reducing debt and rationalizing Atlantic Power's operations have seen its business significantly reduced in size. By the end of 2017, it had 1,280 megawatts of installed capacity, which is 1.5 times lower than the 2,026 megawatts which existed at the end of 2013. It is the

marked decline in the size of Atlantic Power's business along with a 4% year-over-year decline in power generation for 2017 and the history of net losses that are weighing on its market value.

Another aspect of Atlantic Power's operations that is impacting its longer-term outlook has been management's decision to reduce the company's renewable power assets. This occurred because it was believed that they were not efficient enough and were impacting its ability to grow earnings proportionate to costs.

This will negatively affect Atlantic Power's ability to benefit from the [secular trend](#) to cleaner, more sustainable electricity generation, particularly in a post-Paris Agreement world. Most Canadian provinces and more than half of the U.S. states have implemented policies mandating that a certain proportion of total electricity production must come from renewable sources.

Atlantic Power's immediate future does not appear so bright either. Forecast 2018 EBITDA is expected to be 36% lower than 2017, primarily because of the expiration of substantial number of power-purchase agreements and higher costs. That certainly doesn't bode well for Atlantic Power's market value.

### **So what?**

It is difficult, if not impossible, to see Atlantic Power being able to unlock value for investors at any time during the immediate future. While its long-term outlook remains uncertain with the utility likely to experience further headwinds. The combination of these factors will weigh on its share price, meaning there is little to no upside available for investors, making it a poor investment.

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