Add This Utility Company for Long-Term Dividend Growth and Capital Appreciation

Description

Much of the time income investors look at the largest stocks on the **S&P/TSX Composite Index**. For a number of months, there have been numerous deals in these names. Companies like **Emera Inc.** (TSX:EMA) and **BCE Inc.** (TSX:BCE)(NYSE:BCE) are yielding between 5.5%-6%.

But they are slower-growing companies, so investors should try to find businesses that operate in similar spaces that offer higher yields and the potential for more capital growth.

One interesting smaller-cap alternative in the utility space is **Capital Power Corp. (**TSX:CPX). This company is primarily focused on renewable energy production, although it has acquired an interest in C2CNT, a company that produces carbon nanotubes. While this is outside the scope of its general business model, it is an interesting opportunity for the company.

This company has demonstrated that it has the capacity for growth. When other utility companies have experienced price declines, Capital Power's share price has actually increased.

The company experienced an 81% increase in its year-over-year revenue in the second quarter, and net cash flows from operating activities increased by 40%.

Its adjusted funds from operations (AFFO) increased by 73% over that period, supporting its dividend and dividend growth.

In the second quarter, Capital Power increased its dividend by 7%, continuing a trend of dividend increases that stretch back for years. The current dividend is over 6%, providing significant income for dividend-focused investors.

The company is focused on continuing these dividend increases as growth continues, with its target payout ratio of 45-55% of AFFO supporting further dividend growth if AFFO continues to increase.

On a valuation basis, the company is not terribly expensive. It trades at around its book value, making it one of the cheaper utility companies. Although it has trailing price to earnings of around 50, the estimated forward price to earnings is a more reasonable 16. Even after the recent run-up in the stock price, Capital Power is still worth buying today.

Probably the biggest issue with the company, which is pretty much a concern with any utility company, is the amount of debt the company has on its books. These companies tend to be capital-intensive businesses that use a lot of debt to fund their acquisitions and expansions.

Once the projects are online, however, they usually are contracted for years at a time. Capital power is no different, with a number of its projects contracted for several years, giving the company relatively clear earnings visibility.

Capital Power is a suitable alternative to the larger, more established utility companies. Its dividend is certainly appealing, especially given its potential for further growth.

The biggest downside stems from the fact that so much of its business comes from one area of the country, Alberta. As we have seen, that particular region can be quite volatile given its dependency on a volatile commodity.

But the company does have significant operations in the United States as well. Its continued expansion should help capital power build its business and diversify its portfolio geographically and by currency. This company would be a good addition to a dividend portfolio.

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Date
2025/08/22
Date Created
2018/09/24
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