The Best-Performing Utility on the TSX

Description

Which has been the best-performing utility on the Toronto Stock Exchange?

The first name that may come to mind is **Fortis**. Well, the regulated utility stock's one-year price return is -9%, which beat most of its peers but one — **Capital Power** (TSX:CPX). Capital Power stock has appreciated about 11% in the last year, beating the rest of its peers, of which most have declined 10-20% in the period.

Now, we all know that utilities offer stable dividends with decent yields. Even after throwing in the returns of their dividends, Capital Power still takes the lead with a one-year total return of about 19.5% compared to Fortis's roughly -5.4%.

Let's take a look at why Capital Power has outperformed in the first place.

Capital Power has improved the business

Capital Power bottomed in late 2015 and has essentially been on a tear since — having appreciated about 63% or delivered annualized total returns of about 24%.

Capital Power has a focus in Alberta. At the time, power prices in Alberta were horrible, which pressured the stock significantly. Since then, the utility has steadily improved the business. For example, it boosted its long-term contracted adjusted EBITDA from 67% in 2016 to 79% in 2017.

Its portfolio has about 11 years of weighted average contract term remaining. The improved operating environment in Alberta and the quality of its cash flow allowed Capital Power to increase its dividend per share by about 7% per year in the last three years.

Will Capital Power continue to outperform?

Capital Power has about 4,500 MW of generating capacity. It has been transitioning to a lower carbon footprint. For instance, it has a 1,200 MW of U.S. wind projects among other growth opportunities in its pipeline.

Management plans for growth capital spending of $400-500 million per year, which supports stable growth and its guided dividend growth of 7% per year through 2020. The utility aims for a sustainable payout of 45-55% of its adjusted funds from operations with its five-year average being 46% and in the range of 41-51%.

At $27.14 per share as of writing, the utility trades at about 5.7 times cash flow, which has expanded from a multiple of about four in late 2015. So, there’s little room for multiple expansion.

Buyers today should not expect Capital Power to outrageously outperform its peers going forward. However, with a yield of 6.6% and dividend growth of 7%, the utility may very well beat its peers by 1-2% through 2020.

A 1-2% beat compounded over the long haul is very meaningful. A 10% per year return over three years turns $10,000 into $13,310, while a 12% return turns into $14,049. What about in 10 years’ time? Well, $10,000 will turn into $25,937 for a 10% average rate of return and $31,058 for a 12% average rate of return.

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