There's Little Value in These Utilities Right Now

Description

Regulated utilities are seen as very safe investments because they're predictable. There's little uncertainty in their earnings and cash flow, making them good income investments. Additionally, investors can expect their dividends to increase over time.

However, higher interest rates have made regulated utilities less attractive investments. Furthermore, investors are paying high multiples for their growth rates today. You need to determine if it's worth it to buy now for the stable dividend income.

Long-term shareholders need to decide if they want these stabilizers (low-volatility stocks and safe dividend income) in their portfolios or if the capital is better invested in higher-growth ideas, especially after the recent market correction, which has made many higher-growth quality stocks cheaper.

Fortis is not cheap

A popular and highly praised regulated utility is **Fortis** (TSX:FTS)(NYSE:FTS). It has a solid portfolio of North American utility businesses, including ITC Holdings and UNS Energy, which make up about 37% and 19%, respectively, of its assets.

ITC is the largest independent electricity transmission company in the U.S. that is regulated by the Federal Energy Regulatory Commission. Arizona-based UNS Energy has 674,000 natural gas or electricity customers. Fortis's other U.S. asset is Central Hudson in New York. Its remaining operations are largely in British Columbia and Alberta.

Fortis has increased its dividend for 45 consecutive years with a five-year dividend-growth rate of 6.3%. Through 2023, it aims to increase its dividend by about 6% per year on average.

The problem is that at $44.20 per share as of writing, Fortis trades at a price-to-earnings ratio (P/E) of about 17.3, while it's estimated to increase its earnings per share (EPS) by about 4% per year over the next few years.

With a payout ratio of about 68%, Fortis can meet its dividend-growth guidance by expanding its payout ratio, even if it does experience a low growth rate, but that's not healthy to see over the long term.

Thomson Reuters analysts have a 12-month mean target of $48.50 per share on the stock for a near-term upside potential of 9.7%. Coupled with the 4% dividend yield, it represents near-term total returns potential of about 13.7%.

Emera is stable with lower growth

Emera (TSX:EMA) is another stable North American utility. Its portfolio is about 90% regulated. Emera has increased its dividend for 12 consecutive years with a 10-year dividend-growth rate of 9%.

Emera lowered its growth forecast last year. Through 2021, Emera's new plan is to increase its dividend per share by 4-5% per year on average, which is a lower rate than its forecasted EPS growth. This will help it reduce its payout ratio from about 83% and improve the safety of its long-term dividend.

At $42.93 per share as of writing, Emera trades at a P/E of about 15.3, while it's estimated to increase its EPS by about 5% per year over the next few years. Although not as pricey as high-quality Fortis, Emera is still an expensive stock.

Reuters analysts have a 12-month mean target of $47.60 per share on the stock for a near-term upside potential of 10.9%. Coupled with the 5.5% dividend yield, it represents near-term total returns potential of about 16.4%.

Investor takeaway

The market correction has made many stocks cheaper, making regulated utilities such as Fortis and Emera less appealing. Here are some much more attractive Foolish ideas.

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Date
2025/07/27
Date Created
2019/01/07
Author
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