Buy or Sell?: Emera (TSX:EMA) Grows Dividends With Asset Sales

Description

Investors reacted weakly to **Emera** (TSX:EMA) earnings on Monday, despite the 40% gain in the stock price in the past year. Emera's share price was flat on the market open after the company reported earnings-per-share growth for Q2 2019.

Earnings per share for Q2 2019 grew 13% to $0.43 per share over the same quarter last year. Scott Balfour, Emera's CEO, has been re-allocating capital among businesses and selling assets to optimize the company's dividend growth.

Investors might question whether the dividend optimization strategy is a genuine attempt to grow earnings or a well-spun red flag. This year, Emera has divested four natural gas facilities and property in Florida. The company claims that asset sales will fund other projects.

Currently, Emera issues a dividend of $0.5875 per quarter at an annual yield of 4.24% at the current share price. TFSA investors may be tempted to add Emera to their portfolios due to the combination of substantial 52-week capital gains and a high dividend yield. However, the stock is unlikely to continue its strong market performance next year.

There are more innovative utility companies on the Toronto Stock Exchange (TSX) with defensible market price performance and a larger global footprint. Instead of investing in Emera, TFSA investors should look into **Northland Power** and **Algonquin Power & Utilities**. These companies offer high dividends and shrewd earnings growth strategies.

Northland and Algonquin are winning profitable contracts in northwestern Europe and Southeast Asia to provide clean energy in high-growth markets. In particular, Southeast Asia and China are making healthy transitions into clean energy over air quality concerns.

Emera

Emera is a global energy service and utility corporation. The company owns a 145-kilometre natural gas pipeline in New Brunswick which supplies natural gas to the northeastern United States. Most of the company's U.S. customers are located in Florida, New Mexico, and Maine, although recent asset sales in Florida and Maine reduces market penetration.

Emera reports 130,000 customers on Barbados Island and over 500,000 customers in Nova Scotia.

Tax-Free Savings Account investors interested in high dividends could consider Emera an excellent investment, but it's not without risk. The company's strategy for earnings growth is shrouded in mystery. Emera has not been particularly communicative about how the company plans to reinvest the revenue from the asset sales to grow future cash flows from operations.

In 2018, Emera grew retained earnings by a modest 21% and the levered free cash flow is currently negative $1.17 billion. The company is highly indebted with obligations totaling over $1.5 billion in a low-profit margin industry. Selling assets might be its only way to obtain extra cash to pay expenses.

Foolish takeaway

TFSA investors should take caution when investing in Emera. The company is struggling to keep up with industry innovations into green technology in southeast Asia and northwestern Europe.

Given Emera's negative free cash flows, the company is probably unable to obtain additional credit to invest in future earnings growth. These constraints will prevent the company from innovating as quickly as Northland Power and Algonquin. Unless Emera announces new critical contracts and financing opportunities, there is insufficient evidence to substantiate the company's capital gains.

Investors interested in purchasing shares in the utility industry should look for two things: clean energy investments and competitive contract awards.

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