Can Fortis (TSX:FTS) Stock Continue to Outperform in 2020 and Beyond?

Description

Much has been said about **Fortis** (TSX:FTS)(NYSE:FTS). We all agree that it is a great utility with geographically diversified operations and stable earnings growth. Its consecutive dividend growth for 47 years makes it stand tall among Canadian utility names. But will these dividends sustain in the longer term? Let's dig a little deeper into Fortis.

Large regulated operations

Fortis operates in five Canadian provinces, nine U.S. states, and three Caribbean countries. It collectively serves approximately 3.3 million customers. The utility generates almost all of its profits from regulated operations. These large-scale regulated operations enable stable and predictable earnings, which eventually facilitates stable dividends.

Fortis's EPS has grown around 3% compounded annually in the last three years. Utilities generally grow very slowly, and thus this might not bother investors much. Fortis aims to invest $18.3 billion in capital projects, which will grow its rate base to an estimated $38.4 billion through 2024. That represents an estimated rate-base growth of approximately 7% compounded annually for the next five years.

A rate base is a value of the utility's assets with which it is allowed to earn a specified rate of return set by regulators. Interestingly, Fortis management expects to increase its dividends by an average 6% per year through 2024. In the last five years, the utility increased its dividends by 7% compounded annually.

Stable payout ratio

Fortis had a payout ratio of close to 70% based on its earnings in the nine months ended September 30, 2019. Utility companies normally give away a large chunk of their profits to shareholders in the form of dividends. Thus, Fortis's high dividend-payout ratio is not rare. Its five-year average payout ratio also comes around 70%.

Fortis stock is currently trading at a dividend yield of 3.3%, close to the broader market's average. The stock has already started off to a great start in 2020 and is up almost 10% so far this year. In comparison, **Emera**, Fortis's relatively smaller peer, offers a yield of 4.1% at the moment. It is also up almost 10% YTD. Both Emera and Fortis stocks are currently trading at their respective all-time highs.

One might wonder that if these stocks are trading at record highs, will it be prudent to enter at these levels? Notably, a pullback from these levels can't be ruled out completely. However, from a valuation perspective, Fortis stock does not look significantly expensive. It is trading 16 times its trailing 12-month earnings per share. For slow-growing stocks such as utilities, the multiple might be expensive for some. Emera stock looks a tad expensive in relative terms against Fortis. It is trading 20 times its historical earnings.

Over the past 12 months, Fortis stock has returned almost 30% (including dividends) while peer Emera has returned approximately 35%.

Conclusion

Utility stocks are perceived as bond substitutes mainly due to their stable dividends. Even if they exhibit a momentary weakness, dividend income compensates investors' returns to some extent. Notably, utilities' earnings are not susceptible to business or economic cycles. Thus, even in case of extreme negative events like recession, utilities generally remain relatively stable. In the case of Fortis, its steady dividends and expected stable earnings probably make it a “sleep-well-at-night” kind of stock for the long term.

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