Forget Fortis (TSX:FTS): This Dirt-Cheap Utility Stock Pays a 5.2% Dividend

Description

Many investors love **Fortis** (TSX:FTS)(NYSE:FTS), and it's easy to see why.

Let's start with the main reason, which is the company's dividend-growth history. Fortis has raised its dividend each and every year since the early 1970s, which immediately makes it an excellent choice for investors looking for an annual raise.

Fortis knows this streak is important to investors and has already told them it expects to raise the dividend through at least 2024, targeting 6% annual increases. If it can achieve those results — and I don't see any reason why it wouldn't — then Fortis will have a lot of happy shareholders.

The underlying truth behind all those dividend increases is, Fortis is an excellent business. The company has assets spread out across North America and even into Central America and the Caribbean — power and natural gas utilities that generate steady returns. Yes, these are heavily regulated businesses, but state and provincial governments know that if a utility can't make money, then it won't invest in their jurisdiction.

Fortis plans to spend some $18 billion on growth projects over the next five years, with a focus on smaller, safer projects and renewable energy. Fortis, like many of its peers, is taking steps to be greener while also generating attractive returns for shareholders.

There's just one problem with Fortis. It's an excellent company and everyone knows it. Thus, the stock is expensive. Fortis should earn $2.50 to $2.60 per share in 2019. The stock is currently flirting with $58 per share. That gives us an expensive valuation of approximately 23 times earnings. The dividend yield isn't that impressive either; shares pay just a 3.3% dividend.

Fortunately for value investors, there's a much cheaper choice.

Enter Capital Power

Although **Capital Power** (TSX:CPX) isn't exactly in the same business as Fortis — it owns power plants, while Fortis owns the infrastructure that delivers the energy to your home — it still has a lot in common with Canada's largest utility. Capital Power generates plenty of predictable cash flow — capital it then uses to both expand its network and pay a succulent dividend.

Let's start with Capital Power's growth potential. Today, the company owns 26 different power plants across North America, with a strong focus on wind and natural gas as generation sources. These plants produce some 6,200 megawatts of energy, making Capital Power one of North America's largest producers. The company has another 800 megawatts of production in development, and it's always on the lookout for other power plants to acquire.

Investors have two big problems with Capital Power — issues management have worked hard to nullify.

Firstly, a big chunk of the company's assets were invested in coal-fired power plants. These assets are being converted to natural gas — a process that will be completed in a few years. And new assets have been acquired outside Alberta to help solve the other big problem investors had with the company, which was too much exposure to a volatile economy with a strong link to oil.

Capital Power plans to spend $500 million each year on growth projects, leveraging its solid balance sheet to really help supercharge growth. Remember, this company isn't really that big; it has a market cap of under $4 billion today.

Despite this growth potential, Capital Power shares are still very cheap. The company projects it'll earn just under $5 per share in adjusted funds from operations in 2020. Shares currently trade at $37.41 each. That puts the stock at just 7.5 times forward adjusted funds from operations. That's a very cheap multiple, even after the stock is up more than 20% over the last year.

This also means the firm can afford a succulent dividend. The current yield is 5.2%, with a payout ratio of approximately 40% of adjusted funds from operations. The company has grown its dividend by 7% annually since 2013 and has already told investors to expect another 7% raise in 2020 and a 5% increase in 2021.

The bottom line

I prefer Capital Power over Fortis for two important reasons. Firstly, the stock is much cheaper. And secondly, you get a much higher dividend yield today without sacrificing dividend-growth potential. That's why I own Capital Power in my portfolio. Maybe you should, too.

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