Interest Rate Hikes: Are Utility Stocks in Trouble?

Description

Central banks, including the Bank of Canada and the Federal Reserve, have begun increasing the benchmark interest rate to help curtail high inflation. **CIBC** chief economist Avery Shenfeld expects three more 0.25% hikes to end at an overnight rate of 1.25% by the end of 2022.

Many investment portfolios have utility stocks as anchors. Should utility stockholders be worried that utility stocks could be in trouble because of their large debt levels?

Fortis stock example

Utility stocks tend to carry large debt on their balance sheets. Most can do so and steer clear of trouble because of their stable earnings. For example, **Fortis** (TSX:FTS)(NYSE:FTS) stock has long been hailed as a formidable dividend stock with almost half a century of dividend increases. In other words, through the decades, it has raised dividends through falling and rising interest rates and contracting and expanding economies.

Its debt-to-assets ratio at the end of 2021 was 63.7%, which is not that different from 2019’s 62.3%. The change of its long-term liabilities to total liabilities to 64.5% at the end of 2021 was also immaterial to 2019’s 64.6%. Additionally, its interest expense declined by $32,000 versus in 2019. So, it actually saved on borrowing costs.

Throwing in that Fortis stock has reported highly predictable earnings and increasing earnings per share (EPS) in the long run and that it has maintained a sustainable payout ratio throughout the years, Fortis stock is the last defensive stock you’d want to sell in a highly uncertain market.

The only factor that deters me from buying Fortis stock today is its full valuation. To better protect new money, it’s better to wait for a better valuation — either from a pullback in the near term or from a catch-up of its EPS to its stock price.

Brookfield Renewable stock example

Let's go through another example. **Brookfield Renewable Partners** (TSX:BEP.UN)(NYSE:BEP) is a renewable utility stock with hydroelectric, wind, solar, and storage facilities in North America, South America, Europe, and Asia. It has increased its cash distribution for about a decade. Management is inclined to continue its dividend-growth streak. Its recent dividend hikes have been in the 5% range.

At the end of 2021, its debt-to-assets ratio was 57%, which is a material increase from 2019's 49.2%. Its long-term liabilities to total liabilities also increased correspondingly to 60.8% from 2019's 58.8%. Its interest expense rose by US$299 thousand as a result. However, we can explain the increased debt levels with the rapid growth of the utility. Its total assets have increased 56.5% to close to US$55.9 billion from the end of 2019 to the end of 2021.

Brookfield Renewable still has a long growth runway in the span of multi-decades. The dividend stock has rallied in the last couple of months and is now fully valued, according to Yahoo Finance's analyst consensus price target of US$40.46. Interested investors should see if they can buy BEP stock at a bigger margin of safety throughout the year, as interest rate hikes will probably trigger a dip.

Bottom line

As the two examples show, investors should study each potential investment carefully to determine if a utility stock will be in trouble in the face of rate hikes.

CATEGORY

1. Investing
2. Stocks for Beginners

TICKERS GLOBAL

1. NYSE:BEP (Brookfield Renewable Partners L.P.)
2. NYSE:FTS (Fortis Inc.)
3. TSX:BEP.UN (Brookfield Renewable Partners L.P.)
4. TSX:FTS (Fortis Inc.)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Smart News
8. Yahoo CA

PP NOTIFY USER

1. kayng
2. kduncombe

Category

1. Investing
2. Stocks for Beginners

Date
2025/08/30
Date Created
2022/03/15
Author
kayng