Down 18%, Is Fortis Stock a Buy?

Description

Any investment portfolios can benefit from low-beta dividend stocks, like **Fortis** (TSX:FTS) stock. It is down 18% from its 52-week and all-time high. However, the regulated utility that offers essential services is definitely a defensive pick in today's market in which Canada is expected to enter a recession next year.

Besides, it's unfair to quote how much a stock has fallen from its peak, because most investors don't actually end up buying at a recent peak. Instead, when a stock has a long-term upward trend, it's a good indicator for further research.

In the last 12 months, Fortis stock has only declined about 5.6%, which is very normal market volatility. If you explore other utilities, you'll notice that the whole sector has had a dip. Here's a utility exchange-traded fund that illustrates the point.

Why the dip in utilities?

The reason the utility sector has retreated has to do with the macro environment of higher interest rates. Utilities are capital intensive, and so their balance sheets are debt heavy. Rising interest rates can increase their cost of borrowing when it comes time to refinance their debt or if they need a new loan. Similarly, high inflation also increases their cost of operation. In turn, the utilities' growth is dampened.

Fortis stock: A stable dividend stock

Fortis has paid an increasing dividend for the 49th consecutive year this year. Only one other TSX stock has achieved this. Since Fortis is a regulated utility, it earns predictable returns on its investments. It boasts that 99% of its assets are regulated, which leaves little room for uncertainty.

It has a portfolio of 10 regulated utilities diversified across North America. And they're regulated under different jurisdictions. This diversity of earnings reduces risk.

Yahoo Finance indicates a recent beta of 0.19 for Fortis stock as well. In other words, FTS has very low volatility versus the market. However, in the long run, it has delivered total returns that match or beat the market — if investors buy the stock at a good valuation.

Valuation

At $53.46 per share, Fortis stock offers a decent yield of 4.2%. Its payout ratio is about 79% of this year's earnings. This dividend is safe because of the high certainty of its earnings. The quality utility commands a premium valuation and is fairly valued at the moment.

Growth

The utility just updated its five-year capital plan that involves investments of $22.3 billion to grow its rate base from $34 billion to $46.1 billion by 2027. This equates to a rate base growth rate of approximately 6.2%. Since 83% is in small projects versus 17% in major projects, it's a low-risk capital plan that is highly executable.

The plan would also maintain its regulated assets at 99% of total assets. The plan is 57% funded by cash from operations and only 33% by debt. Other than 10% of the plan funded by shareholder dividend reinvestment, it would not necessarily need to push out new equity to fund these projects.

Based on this capital plan, management targets to increase its dividend by 4-6% per year through 2027.

Fortis stock can deliver total returns of about 9% over the next five years. If you're a conservative investor seeking passive income and low volatility, you can look into buying shares at current levels or on further dips.

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