Better Buy: Algonquin Stock, Brookfield Renewable, or Fortis?

Description

If you are looking for passive income, Canadian utility stocks can be a great place to look. However, not all Canadian utilities are created equal. Investors need to be aware of the tradeoff between income, growth, and value in this sector.

Three well-known Canadian utility stocks are **Algonquin Power and Utilities** (TSX:AQN), **Brookfield Renewable Partners** (TSX:BEP.UN), and **Fortis** (TSX:FTS). Each has different strengths and weaknesses. Below is a discussion of why I would buy two and avoid one today.

Algonquin Power: Beware of the high dividend yield

It has been a rough few days for Algonquin Power stock. After disappointing third-quarter 2022 results, its stock has fallen by over 34%. Its stock has lost nearly $2.7 billion in value over the past two trading days.

Why the massive decline? Not only were earnings below expectations, but the utility reduced its 2022 earnings guidance. The company has an outsized level (over 20% of debt) of variable rate debt and fast-rising rates are eating into earnings.

Algonquin management noted that it will likely have to revise its long-term capital growth plan. That plan was initially projecting market-leading 7-9% earnings-per-share growth for the coming years ahead. Even the most bullish analysts were shocked and drastically reduced their ratings on the stock.

Today, Algonquin stock is very cheap at only 13.9 times earnings. Likewise, it has a massive 7.9% dividend yield.

However, given the potential for declining earnings and Algonquin's elevated debt levels (eight times net debt-to-EBITDA, or earnings before interest, taxes, depreciation, and amortization), its dividend is in jeopardy of not being adequately covered. With this in mind, I would be very cautious investing in Algonquin stock right now.

Brookfield Renewable Partners: Growth but elevated debt

While Algonquin focuses on utilities and renewable power, Brookfield Renewables is a pure-play renewable energy stock. Since the late summer, its stock is down almost 20%. While it has underperformed, it has delivered pretty good results this year.

In its recent third quarter, funds from operation (FFO) increased 15.7% to $243 million, or $0.38 per unit. It has secured over $12 billion of funds to invest in a broad range of renewable power projects this year. It operates 23 gigawatts of power today. However, it has a growth pipeline that is over four times that size! It targets 12-15% total annual returns for shareholders.

Like Algonquin stock, Brookfield has a lot of debt at eight times net debt-to-EBITDA. However, 97% is fixed with most debt being very long dated. Brookfield stock earns a 4.3% dividend that is covered by a 77% payout ratio.

Fortis: As safe as it gets

Fortis is the most defensive stock of these three utilities. Its transmission and distribution assets are 99% regulated. In its recent third quarter, it delivered solid 8% earnings-per-share growth. Despite that, its stock is down 17% this year.

Fortis announced a new $22.3 billion capital plan for the coming five years. It expects to grow its rate base by over 6% a year. However, it lowered its annual expected dividend-growth rate to a range of 4-6% (down from 6%). Given the current interest rate and economic environment, it hopes to lower its payout ratio and remain cautious.

Fortis operates with a net debt-to-EBITDA ratio of 6.5 times, which is significantly below Algonquin stock and Brookfield. Fortis has almost no reliance on equity to fund its growth program, so that is very positive. With a dividend of 4.09%, Fortis stock is at a fair value and looks like a good buy for conservative investors.

CATEGORY

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

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Date
2025/08/12
Date Created
2022/11/20
Author
robbybrown