Can Algonquin Sustain its Sky-High Yield?

Description

The equity markets have taken investors on a roller-coaster ride in 2022. The triple whammy of rising interest rates, inflation, and supply chain disruptions are impacting both revenues and profit margins of companies. Further, higher cost of debt and sky-high commodity prices have resulted in tepid consumer demand.

The federal banks are tightening their monetary policy but are also risking the prospect of an economic recession in 2023. On the flip side, the broader market selloff has driven the dividend yields of TSX stocks significantly higher. As dividend yields and share prices are inversely related, you can consider buying quality dividend stocks trading at a discount in 2022.

Investing in dividend stocks can help you create an alternative passive-income stream as well as benefit from long-term capital gains. But not every dividend-paying stock is a good investment.

Let's take a look at one such dividend stock trading on the TSX to see if it can sustain its lofty yield in 2023.

Is AQN the best TSX dividend stock for annual passive income?

Algonquin Power (TSX:AQN) is focused on delivering sustainable and profitable growth to shareholders, allowing it to support an investment-grade credit rating. In the last month, shares of AQN have declined by a whopping 30%, increasing its dividend yield to a tasty 9.60%.

In the third quarter (Q3) of 2022, the company increased revenue by 26% year over year. However, its net loss widened by 600%, while operating cash flow declined by 41% compared to the year-ago period.

Algonquin attributed its losses to an increase in production costs, interest rates as well as supply chain disruptions, which hurt its renewable energy projects.

AQN also lowered its adjusted earnings forecast to between US$0.66 and US$0.69 per share in 2022 compared to its earlier guidance of earnings between US$0.72 and US$0.77 per share. So, AQN stock is priced at 15 times forward earnings, which is not too steep.

Algonquin Power & Utilities may continue to be impacted by higher interest rates as more than a fifth of its debt is tied to variable rates. So, an increase of 100-basis points in interest rates will drive interest expenses higher by US$16 million each year. It also has around US$100 million of debt maturing in 2023, driving its cash balance lower in the near term.

Is AQN stock a buy or a sell?

Most energy companies will wrestle with a higher cost of debt in the next two years and will even have to refinance a portion of these debts. So, investors can expect earnings growth to remain under pressure going forward.

However, utilities are rate regulated and should be able to raise rates over time, thereby improving cash flows. Further, AQN is well poised to take advantage of its expanding base of clean energy assets, which should drive future cash flows higher.

The company currently serves more than one million customers in the Americas. Moreover, once the acquisition of Kentucky Power is closed, its regulated business will also swell and add to its existing rate base.

AQN has been among the worst performers on the TSX in 2022. But it's also trading at a discount of 60% to consensus price target estimates. After accounting for its dividend yield, annual returns might be closer to 70% in the next 12 months.

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