



Advisor Commentary: Should You Buy Algonquin Power Stock? [PREMIUM]

Description

The analyst team I work with at *Stock Advisor Canada* has never been too keen on utility companies. Throughout the majority of our nine years working together, there have been better opportunities elsewhere — plenty of them.

To be sure, we're not entirely averse to the sector. It's just that the nature of it doesn't lend itself to outsized opportunities surfacing very often. This is where **Algonquin Power** ([TSX:AQN](#)) enters the fray today. It's a company that, on the surface, fits the profile of a "typical" steady utility. But because of an earnings report that sent its investors scurrying, the company's shares have dropped 33% in a few short weeks.

Declines of this magnitude aren't generally found in utility-land, and it behooves us to have a peak.

Algonquin Has a Huge Dividend Yield Right Now

Utilities are generally considered for their income first. Any growth beyond that serves as gravy. And thanks to the haircut the stock price has received, Algonquin's annual payout of \$0.98 per share equates to a dividend yield of 9.6%. That's attractive and has the potential to, on its own, provide a market-beating return over the next five years.

But ...

The thing is, there's little that suggests this dividend is even real. Check out the company's cash flow profile tabled below and compare it to the annual dividend obligation the company faces.

	2017	2018	2019	2020	2021	LTM
Cash from operations	\$326.6	\$530.4	\$611.3	\$505.2	\$157.5	\$531
Capital expenditures	\$565.1	\$466.4	\$581.3	\$786	\$1,345	\$1,191.1
Free cash flow	-\$238.5	\$64	\$30	-\$280.8	-\$1,187.5	-\$660.1

Dividend obligation \$127.5 \$166.4 \$196.4 \$253.8 \$307.1 \$366.1

In millions. Source: S&P Global Market Intelligence

Based on that profile, and given consistently negative free cash flow, Algonquin shouldn't even pay a dividend. This is a very capital-intensive business, and it's heavily reliant upon external sources of financing, debt and equity, to fuel its operations — even more so given the dividend obligation. Though not necessarily affordable, the dividend then is somewhat of a carrot to keep the equity financing channel open.

To be sure, this relationship works — not only for Algonquin but also many in the utility (and pipeline) sector. The problem for Algonquin is that, as mentioned, we have a stock price that's 33% lower than it was. Equity financing just got a whole bunch more expensive. In addition, interest rates are higher. Future debt financing is likely to be more expensive as well. Combined, this dividend becomes even less affordable than it was.

If you're hunting for utilities, or dividend income in general, we at *Stock Advisor Canada* suggest there are probably better ones out there to consider than Algonquin.

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