Why Algonquin Power & Utilities Stock Slid 49.3% Last Year

Description

The Canadian utilities sector is usually considered a defensive, lower volatility pick, but there can still be substantial variation within it. Last year, a surprise underperformer – to the shock of many investors – was **Algonquin Power & Utilities** (TSX:AQN).

Long-loved for its dividend and earnings growth, AQN crashed sharply from $15.29 per share on November 10th, 2022 to a 52-week low of $8.70 by late December. The negative catalyst? A poor third-quarter earnings report outlining a substantial miss on the bottom line. Let's see what happened.

2022 headwinds

Arun Banskota, President and Chief Executive Officer of AQN, blamed "increasing interest rates and the timing of tax incentives related to certain renewable energy projects" as the culprit behind AQN's earnings coming in under expectations.

The source of ire for investors was AQN's reported adjusted net earnings of $73.5 million, which marked a significant 25% year-over-year decrease compared to Q3 2021. Adjusted earnings per share, or EPS, came in at $0.11, a 27% decrease year over year.

These dismal results were primarily caused by higher interest expenses of $23.3 million. This risk factor is one that is present for the broad utilities sector, and not just AQN. Utilities are particularly sensitive to interest rate changes as they often borrow heavily to support growth. Utility companies can face significant headwinds when rates go up, as they did in 2022.

Alternatives to AQN

With its current share price at the time of writing of $9.20, AQN's forward annual dividend rate of $0.98 represents an 11.15% dividend yield. This is high enough to be enticing, but investors should be aware of "yield traps" before they flock to lock in a low yield on cost.

In my opinion, AQN's prospects depend on how the macroeconomic environment plays out. If inflation continues to remain sticky, both the Federal Reserve and Bank of Canada are likely to press on with their existing pace of interest rate hikes. This will create further headwinds for AQN.

Investors looking for a more defensive, income-oriented utility sector play for a volatile, sideways trading market can consider covered call exchange-traded funds instead. These ETFs provide high monthly income, which tends to increase during periods of greater market volatility.

A great pick here is the **BMO Covered Call Utilities ETF** (TSX:ZWU). This ETF holds a portfolio of 75 Canadian and U.S. utilities, pipeline, and gas stocks. Thanks to the covered call overlay, ZWU is currently paying an annualized distribution yield of 8.27% monthly.

A great way to invest for income is using ZWU as the core of your portfolio and supplementing it with a few stock picks (and the Fool has some great alternatives to AQN to put on your watchlist).

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