Algonquin Power Stock: How Low Could It Go in 2023?

Description

Investors perceive utilities as defensives because of their less-volatile stocks and stable dividends. These characteristics have been lacking in **Algonquin Power & Utilities** (TSX:AQN) stock for the last few months. After an investor update last week, AQN shares resumed weakness and lost another 11%. So, since November, AQN shares have lost 41% and are currently trading at their eight-year lows.

What's next for AQN stock?

Algonquin helped quell some uncertainties as it released its 2023 guidance last week. As expected, the company cut its 2023 dividend by 40% and also called off the dividend reinvestment plan. The dividend cut will retain cash and provide more financial flexibility to the company. Algonquin saw a significant increase in its interest expenses last year amid a rapid rise in interest rates. That notably brought down its Q3 2022 income, which came as a shock for investors.

Algonquin expects adjusted net earnings of $0.55 to $0.61 per share in 2023. So, considering this year's expected quarterly dividend of $0.1085 per share, the payout ratio comes to around 75%. Note that even after the cut, AQN stock yields a decent 5%, close to its peers.

Peer TSX utility stocks keep trading strong

Utility investors do not like such crude surprises. Many utility names like **Fortis** and **Canadian Utilities** have a history of raising shareholder payouts for many consecutive decades. Their steady operations and earnings growth offer stability and reliability.

Although utility names underperform growth stocks in bull markets, they provide important stability to portfolios in uncertain times. Algonquin has surprised investors on that front, as we can see in the recent sell-off. But it was never a typical utility. It has been a highly capital-intensive business like a traditional utility but focused on growth.

Algonquin has significant exposure to renewable operations, which fueled faster earnings growth over the years. As a result, AQN saw industry-leading financial growth and value creation in the last decade.

Apart from a dividend cut, Algonquin has taken up asset sales worth $1 billion. The proceeds will be used to repay debt and also to fund growth. During its recent investor update, it also clarified that it is going to continue to pursue the Kentucky Power acquisition. Equity dilution is also on the cards, but not for this year. The company expects to sell 77 million shares by Q2 2024.

Over the next couple of quarterly earnings, Algonquin investors will have more clarity on how the changed strategic direction plays out. Interest rates are expected to rise further in the new year and might pause in the second half of 2023. But that will increase Algonquin's debt servicing costs, again denting its profitability.

The Foolish takeaway

AQN stock might continue to trade weak in the short term, given the recently released gloomy outlook. It will be interesting to watch how its quarterly earnings shape up this year.

One important thing to note is that management has admitted that it's not happy with the company's recent performance. The sense of urgency and desperation was quite clear in the investor call last week. Their increased skin in the game might also help rebuild investor sentiment.

It is anybody's guess where AQN shares could go from here. But the downside looks limited, considering there are no more surprises, as the damage already seems priced in.

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