Algonquin Stock: Time to Buy or Better Luck Elsewhere?

Description

Even into 2023, **Algonquin Power and Utilities** (TSX:AQN) stock continues to disappoint investors. In 2022, its stock fell 48%! For a once safe utility, that is a precipitous drop.

What happened to Algonquin stock in 2022?

Algonquin's third-quarter 2022 results were less than satisfactory to investors. The company had loaded up on variable rate debt to fund an aggressive growth program. Consequently, the combination of rising interest rates and project delays lead to a drastic drop in earnings power. Management had to scramble to reduce its guidance for 2022 and 2023.

The market hates uncertainty and drastically sold off the stock as result. At one point, Algonquin's stock was yielding over 11%.

Shareholder update

Just last week, Algonquin management announced a new strategic update for shareholders. To right-side its balance sheet and maintain its credit rating, management cut its quarterly dividend by 40% from US$0.1808 per share to $0.1085. After the dividend reduction, Algonquin stock will yield closer to 6.5% than 10.9%.

Algonquin also ceased its DRIP (dividend-reinvestment program), which offered stock to be re-invested at a 3% discount to the market price.

Algonquin doubled down on its plan to acquire Kentucky Power, despite the large $2.5 billion price tag (and assumption of over $1 billion of debt). The Kentucky Power deal was declined by regulators in December. However, management has reapplied and hopes to complete the deal before its purchase contract expires in April 2023.

Management also announced plans to dispose $1 billion of assets over 2023.

What's next for Algonquin stock?

While the call addressed many outstanding issues since its third-quarter announcement, the market clearly was left wanting. The stock has fallen 8.4% since.

Many of the plans were outlined in general terms, and specifics were not detailed. As a result, there was a lot of uncertainty that investors continue to digest. Questions investors need to ask for the future include the following:

- How accretive will the Kentucky Power deal really be (especially with regulators potentially limiting rate base growth)?
- Can Algonquin complete the deal within the purchase contract timeline (by April 2023)?
- How expensive will it be to refinance the debt it assumes after completing the Kentucky Power deal?
- Capital markets have slowed because of interest rates. How strong is the market for its assets and will it get a good price?
- How can it grow earnings per share by 5-7% when the stock will be diluted 7% by convertible equity units in 2024?

These are just a few concerns to consider. The point is, there continues to be *a lot* of uncertainty surrounding the outlook for the stock and the business. Undoubtedly, Algonquin stock is cheap. In fact, it is one of the cheapest utility stocks in North America. Yet it is cheap because it very difficult to model its potential future earnings, given all the variables.

A buy or better luck elsewhere?

As a result, investors are likely best to just hold off and wait for management to *actually execute* its plan. So far, they haven't really proven themselves as prudent capital allocators. That likely continues to weigh on investor sentiment.

Certainly, Algonquin has some very good assets. If management can execute, there could be a recovery in the stock. Unfortunately, it is difficult to say when that will be and how long it will take.

You may be better off investing with tested pure-play utility stocks like **Fortis**, **Canadian Utilities**, and **Hydro One**, or more pure play renewable stocks like **Brookfield Renewable Partners** and **Northland Power**. If anything, the Algonquin story teaches us two principles: due diligence is key to investing success, and if it sounds too good to be true, it likely is.

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