Algonquin Power & Utilities Stock Just Hit 52-Week Lows: Is it a Good Stock to Buy?

Description

Algonquin Power & Utilities (TSX:AQN) hit its 52-week low in mid-January, as the management provided a bleak business update. The update was more of a financial restructuring to improve the utility company's financial flexibility. However, the January 12th update did not impact the stock much. It fell 7.6% in the first few days but recovered to the January 10th level. This momentum shows that investors had already priced in a weak business update after the company's third-quarter earnings. Is this a good stock to buy at the current dip?

Why did Algonquin Power & Utilities stock hit a new low?

Algonquin Power & Utilities stock is trading above $9.5 — its lowest level in over seven years. The stock fell more than 30% in November 2022, when the company reported a 27% dip in adjusted net earnings, despite a 26% increase in revenue. It lowered its 2022 net earnings outlook to $0.66-$0.69. The company expects its net earnings per share to fall further ($0.55 to $0.61) in 2023. What is eating up Algonquin's earnings, despite rising revenue?

	Q3 2022	**Q2 2022**	**Q3 2021**
Interest Expense	$75 million	$64.6 million	$51.7 million
Change in fair value of investments	($300.4 million)	($143.5 million)	($139.1 million)

Algonquin Power & Utilities's Q3 2022 non-operating expenses.

High-interest rate on debt

It's the $7.7 billion in debt, of which 22% is subject to variable interest rates. For every 100-basis-point hike in interest rates, Algonquin's annual interest expense increases by $16 million. Its interest expense increased by $38 million in nine months ended September 30, 2022, partly because of the debt it took for the $609 million acquisition of Liberty NY Water.

Now, Algonquin is eyeing the Kentucky Power acquisition for $2.6 billion, of which $1.2 billion is to be funded by debt. This acquisition would add over $2.0 billion of regulated rate base assets and be accretive in its first full year. But with Fed keeping interest rates between 4% and 5% throughout the year, the interest expense could eat up the earnings and synergies. Despite this, Algonquin is pursuing the acquisition for long-term growth.

Change in fair value of investments

The interest expense was the least of Algonquin’s worries. Algonquin has two business segments:

- Regulated Services Group: It gives stable cash flow from utility bills for electricity, water, and gas.
- Renewable Energy Group (REG): It owns an interest in a project, transitions it into renewable energy, and sells it while securing the contract for its maintenance and operations.

Algonquin records some of its REG investments at fair value. The weak macroeconomic environment has been pulling down the value of renewable energy projects. In the first nine months of 2022, Algonquin reported a loss of $484.4 million on the fair value of its investments. Till the macroeconomic situation improves, these losses will keep eating up earnings, but not its cash flows.

What will eat up Algonquin’s cash are delays in the construction and completion of some projects and the resulting increase in project costs.

Algonquin’s 2023 restructuring measures

The Fed is likely to continue increasing interest rates and keep them high, which could slow the economy. With financing at a tight spot, an entire year of rising variable interest rates makes any new capital investment less lucrative. Hence, Algonquin is reducing its capital spending and has cut dividends by 40%, bringing the dividend yield to 4.45% from the previous 10%.

The company is moving from growth to optimization, a normal recourse companies take in a recession when the business environment is weak. It is focusing on reducing debt to increase financial flexibility.

Is Algonquin stock a buy at the dip?

While Algonquin’s renewable energy segment is struggling, its regulated service segment continues to generate regular cash flow. The above restructuring is the right way forward for the company to sustain a looming recession. Any update on the Kentucky Power acquisition could bring significant movement in the stock.

Algonquin stock is a buy at the current dip, as it could give capital appreciation when the macro environment improves while giving a 4.45% dividend yield. But diversify your portfolio by investing in some of the best Canadian stocks.

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