



## Algonquin Power Stock: A Smart Investment or a Value Trap?

### Description

After large swings in the last few months, **Algonquin Power** ([TSX:AQN](#)) stock is settling at around \$10-a-share levels. Many investors now think that it's a bargain buy as a lower earnings growth outlook and dividend cut have already been priced in. However, there are more uncertainties that could weigh on the stock going forward. Here is my take on whether it's a smart buy today or a value trap.

### Should you buy AQN stock now?

Algonquin expects to earn \$0.58 per share this year on an adjusted basis, indicating an approximately 13% drop year over year. For 2023, the utility will pay a quarterly dividend of \$0.1085 per share. Though it represents a [dividend](#) cut of 40% from last year, it still implies a decent payout ratio of 75%. AQN stock, as a result, has declined more than 30% since November 2022.

Such a drawdown is quite rare among utilities. Utility investors prefer stability. Their low return prospect is justified due to their lower risks with much lower volatility. So, Algonquin's negative surprises left investors dumbfounded late last year.

Owing to rapidly increasing interest rates since last year, Algonquin's variable debt load turned bitter, pulling down its profits substantially. In the last nine months ending on September 30, 2022, AQN reported interest expenses of \$197 million, a nearly 24% increase year over year. Notably, peers have relatively lower exposure to variable debt. So, the impact of higher rates on them was fairly limited.

### Algonquin Power in 2023

However, we are still in the middle of the policy-tightening cycle. Though the pace of hikes has slowed down this year, and the cycle could end soon, how higher interest expenses play out for Algonquin remains to be seen. The utility forecasts a \$16 million higher interest outgo for every 100-bps interest rate hike.

Its Kentucky Power acquisition will likely add around a billion of debt to its balance sheet. Higher-than-

expected interest expenses could further dent investor sentiment. Moreover, the company has already announced a share buyback plan for next year, which will dilute existing shareholders' stake.

Algonquin displayed a strong track record in the last decade. Its combination of regulated operations along with a non-regulated renewable portfolio enabled stability with growth. Adjusted EBITDA (earnings before interest, tax, depreciation, and amortization) growth since 2016 came in at around 25% compounded annually, way higher than the industry average. AQN stock notably outperformed its peers in the last decade.

Investors are surely hoping for no more off-putting surprises from Algonquin. How its quarterly earnings play out will define the path for its stock going forward.

However, it might take time for the green power producer to get on that growth path again. Despite the expanding rate base, the utility's leverage makes it a relatively risky bet. To be precise, Algonquin's net debt-to-EBITDA ratio stood above 8x recently, far higher than peers. The ratio is a leverage metric and indicates how many years a company would take to repay debt.

## Peers offer better risk-reward

As these uncertainties could weigh on AQN stock, I would be interested in more stable names like **Fortis** ([TSX:FTS](#)). Although FTS is a relatively expensive name from a [valuation](#) standpoint, its proven dividend reliability makes the premium justified. Note that both AQN and FTS currently offer a dividend yield of around 4%.

The investment decision comes down to the risk-return tradeoff – how much risk an investor should take in exchange for a specific amount of return. AQN still seems like a high-risk bet considering the uncertainties. The stock might not witness a strong comeback anytime soon. In comparison, Fortis continues to play well, irrespective of broader markets. So, if you want to achieve stable returns without sacrificing a night's sleep, FTS is an apt bet.

### CATEGORY

1. Energy Stocks
2. Investing

### TICKERS GLOBAL

1. TSX:AQN (Algonquin Power & Utilities Corp.)
2. TSX:FTS (Fortis Inc.)

### PARTNER-FEEDS

1. Business Insider
2. Flipboard
3. Koyfin
4. Msn
5. Newscred
6. Quote Media
7. Sharewise

8. Smart News
9. Yahoo CA

#### **PP NOTIFY USER**

1. cleona
2. vinitkularni20

#### **Category**

1. Energy Stocks
2. Investing

#### **Date**

2025/09/26

#### **Date Created**

2023/02/03

#### **Author**

vinitkularni20

default watermark

default watermark