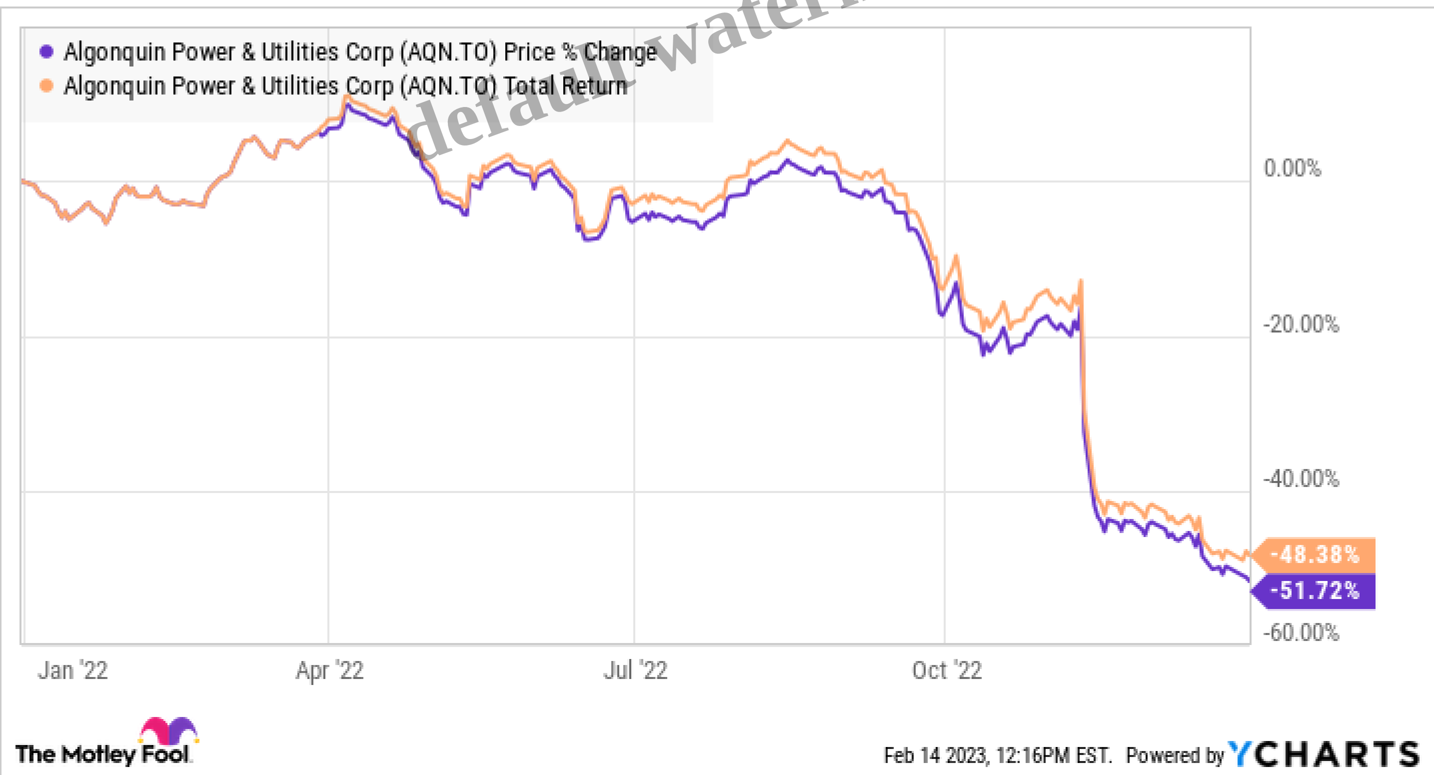
Could Algonquin Stock Be a Big Winner in 2023?

Description

Algonquin Power & Utilities (TSX:AQN) stock was a loser in 2022. Investors lost more than half of their investment from the declined stock price. If you account for the dividends paid out, investors only did negligibly better by getting a return of about -48% for the year.



AQN price and total return data by YCharts

Sometimes, losers turn out to be winners. Could Algonquin stock be a big winner in 2023? First, let's investigate why the utility stock performed poorly in 2022.

Why did the dividend stock perform poorly in 2022?

Utility stocks are typically considered as safe dividend stocks in investment portfolios. Surely, it wasn't the case last year for Algonquin stock, which caused massive losses for investors who sold their stake in late 2022.

The fact is that Algonquin was more aggressive in its capital plan than the typical utility. It had a more leveraged balance sheet, which would probably have been fine were interest rates to stay low. However, after over a decade of low interest rates, we were suddenly swirled into a rising interest rate environment, as the Bank of Canada turned hawkish to counter high inflation.

The aggressive interest rate hikes last year compared to the recent history caught many companies off guard. Those that were overly leveraged, particularly ones with exposure to variable interest rates, like Algonquin, were hit the hardest.

In a higher interest rate environment, Algonquin and its investors alike had to reset their growth expectations of the leveraged company. Consequently, the dividend stock cut its dividend by 40% last month as a part of this reset. The higher interest rate environment is also weighing on stock valuations, in general, as fixed-income investments like bonds, for example, become more competitive for capital from investors.

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From 2011 to 2021, Algonquin stock returned about 15% per year! According to the Rule of 72, it means the stock doubled investors' investment every five years or so. In that period, the company grew from a small base and took advantage of low interest rates.

Stocks are forward looking. Right now, interest rates are still relatively high, and they could stay at this level for awhile, if inflation stays stubbornly high. Based on today's conditions, the utility stock trades at a small discount and offers a dividend yield of about 5.9%. Last month, the company stated that it was committed to its investment-grade credit rating of BBB. And with its reset growth plan and lowered dividend that's more sustainable, Algonquin stock could deliver satisfactory total returns over the next five years.

It's even possible for it to be a big winner in 2023 if interest rates start declining in the second half of the year, as some economists forecast. Typically, turnarounds take longer than that, though. So, Algonquin stock has a higher chance of being a big winner for investors with a longer investment horizon.

The dividend stock is set to report its fourth-quarter and full-year 2022 results on March 17. Look out for that for the latest updates on the company. Meanwhile, it may serve you better to check out the best Canadian stocks to buy.

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