



1 Oversold Dividend Stock to Buy in February 2023

Description

Algonquin Power & Utilities ([TSX:AQN](#)) stock halved last year, as an aggressive interest rate hike reversed the course of its debt-funded capital spending. The stock went into the oversold category, as the company reported a [weak 2022 outlook](#) in December and signaled a dividend cut. It was because higher interest rates put pressure on the company's earnings and made it difficult to sustain its high dividend yield. The stock dipped 40% in December 2022 — in sync with the 40% dividend cut in January.

However, Algonquin stock rebounded partially, surging about 15% year to date. Behind this 2023 growth was Algonquin's interest rate sensitivity and the update on the Kentucky Power acquisition.

Why is Algonquin stock sensitive to the interest rate?

Algonquin has a utility business that generates regular and stable cash flows and a [renewable power](#) business that creates volatility. In the 2011-2021 decade, the company took advantage of a low-interest rate environment and accumulated \$7.7 billion in debt, of which 22% has variable interest rates. Its acquisitions and projects generate regular cash flows, but any plant outages or project delays reduce cash flows.

In 2022, Algonquin acquired Liberty NY Water for \$609 million by raising debt. But Fed's interest rate hikes left Algonquin with an additional \$38 million interest expense, and it was not prepared for this. As utility rates are regulated, Algonquin couldn't pass on the rising debt expense to utility customers. Moreover, its power business faced project delays adding to its cost over and above the interest expense that grew \$16 million annually for every 100-basis-point rate hike.

Hence, Algonquin's third-quarter adjusted net earnings fell 27%, despite a 26% increase in revenue. It even reduced its net earnings outlook for 2022 (\$0.66 to \$0.69) and 2023 (\$0.55 to \$0.61). That explains why the stock fell between August and October 2022, when Fed accelerated its interest rate hikes.

Tight financing conditions discourage capital spending.

Is Kentucky Power acquisition good for Algonquin shareholders?

Algonquin's management decided to take some drastic steps to reduce capital spending and preserve cash to service its debt. It slashed its [dividend](#) by 40%, paused its dividend-reinvestment plan (DRIP) and focused its priorities on debt repayment. It plans to sell \$1 billion worth of assets and use the proceeds to pay down debt and maintain its BBB credit rating.

All these moves were in the right direction in a tight monetary policy environment. But the company is determined to go through with its \$2.6 billion Kentucky Power acquisition. Around \$1.2 billion of the deal is expected to be funded by debt. The acquisition could have been accretive in a normal business environment. But a high interest rate makes this acquisition less accretive, given the massive debt involved.

The acquisition deal was expected to close by the end of January, but it didn't. Algonquin refiled the application to the Federal Energy Regulatory Commission for approval. But the delay in approval made analysts optimistic that the acquisition might fall apart. A \$65 million termination fee is better for Algonquin than taking the burden of higher interest expense. The delay in the Kentucky Power deal sent Algonquin's stock soaring this year.

If the acquisition is not the right way forward, what is?

Algonquin stock's turnaround story

Algonquin's management is shifting its focus from growth to optimization — a normal recourse in a weak macro environment. Repaying debt will increase its financial flexibility and open up more space for dividend growth in the long term.

Currently, the stock is trading closer to a 14-day Relative Strength Index (RSI) of 38, which signifies that most trades are still inclined towards selling. RSI measures the speed and change of price movements within the 0-100 range. An RSI below 30 indicates the stock is oversold.

The stock's actual dividend yield after the cut is 4.1%. The company has just begun the turnaround story and could take three to five years or more to realize returns. Turnaround stocks may give tepid growth in the short term but have the potential to double your money in a year or two once they start realizing returns from the turnaround.

You can buy and forget this stock for the next five years for better returns and dividends.

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