



Canadian Utilities (CDUAF)

Updated June 5th, 2020 by Nikolaos Sismanis

Key Metrics

Current Price:	\$24.58	5 Year CAGR Estimate:	13.2%	Market Cap:	\$6.64B
Fair Value Price:	\$30	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	08/07/2020
% Fair Value:	81%	5 Year Valuation Multiple Estimate:	4.9%	Dividend Payment Date¹:	09/01/2020
Dividend Yield:	5.6%	5 Year Price Target	\$39	Years Of Dividend Growth¹:	47
Dividend Risk Score:	A	Retirement Suitability Score:	A	Last Dividend Increase:	3%

Overview & Current Events

Canadian Utilities is a \$6.6 billion company with approximately 5,000 employees. ATCO owns 52% of Canadian Utilities. Based in Alberta, Canadian Utilities is a diversified global energy infrastructure corporation delivering solutions in Electricity, Pipelines & Liquid, and Retail Energy. The company prides itself on having Canada's longest consecutive years of dividend increases, with a 47-year streak. Unless otherwise noted, US\$ is used in this research report.

Canadian Utilities reported Q1 2020 results on 01/05/2020. EPS for the quarter amounted to \$0.37 lower than \$0.55 from Q1 2019, mainly due to the sale of the Canadian fossil fuel-based electricity generation portfolio, and the sale of Alberta PowerLine in Q3 and Q4 2019, respectively. Excluding these two sales, the company's earnings for the first quarter of 2020 were \$6 million higher than the same period in 2019. Increased earnings were achieved through cost efficiencies, growth in the base utility rate, and lower income taxes. During the quarter, the company used the proceeds from its sale of assets to invest \$192 million towards new projects, 96% of which was for regulated utilities. By investing in such stable, cash-flow generating projects, the company has been able to increase its bottom line along with its dividends for nearly half a century. Unlike other industries, whose cash flow is more cyclical, Canadian Utilities enjoys stability and predictable returns. This is especially the case with the current situation of Covid-19. The company should not be severely affected, as electricity distribution is an essential, recession-proof business. We estimate a slight drop in 2020's EPS against last year, caused slightly by COVID-19. However, the figure should be assisted by a stronger US\$ against the C\$.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$1.62	\$1.80	\$2.04	\$1.97	\$2.18	\$0.81	\$1.54	\$1.32	\$1.53	\$2.50	\$2.16	\$2.76
DPS	\$0.76	\$0.79	\$0.89	\$0.91	\$0.92	\$0.85	\$0.97	\$1.14	\$1.15	\$1.30	\$1.21	\$1.54
Shares²	251.7	251.7	255.1	255.3	258.4	262	264.7	267.2	269.4	271.5	272.6	290

As mentioned Canadian Utilities has stable business model that allows to slowly, but progressively, grow its earnings. The company consistently invests in new projects, and also benefits from the base rate increases, which grow at around 3% to 4% annually. Rate base increases as well as other growth projects and modest margin improvements gives us an expected growth rate of 5% annually. The dividend remains well-covered, leaving ample room for future dividend increases. U.S investors have enjoyed a lesser growth in their dividends than the Canadian ones over the past decade, due to the depreciation of \$CAD to \$USD. Regardless, the stock's impressive 10 year dividend CAGR of 9.6% is more than enough to compensate for FX, while progressively adding to investor's income. Considering the company's predictable cash flows and FX stability over the past year, we expect 2025 EPS and DPS of \$2.76 and \$1.54, respectively.

Similar to many utilities, Canadian Utilities issues more shares to fund future projects and CAPEX. However, the company is able to achieve a higher ROI from the funds raised than the cost of additional dividends on those new shares. As a result, dilution is not necessarily eroding shareholder value.

¹ Estimated dividend dates; Years of Dividend Growth and Last Dividend Increase based in C\$.

² Share count is in millions.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	11.5	12.8	16.4	17.5	18.1	19.3	20.9	18.3	18.2	15.0	11.0	14.0
Avg. Yld.	3.5%	3.0%	2.7%	2.7%	2.7%	3.4%	3.6%	3.5%	4.6%	4.8%	5.4%	4.0%

The stock is currently offering an attractive investment case, for those seeking to capture the juicy 5+% dividend yield. Canadian Utilities is trading at a decade-low P/E ratio, near that of its Great Financial Crisis days, at around 11 times its current earnings. Investors can now for the first time over the past 10 years, initiate a position, or buy additional shares for their portfolio at such an attractive dividend yield. Moreover, a potential multiple expansion back towards the company's average P/E of around 15 could reward shareholders with significant capital gains. Considering the company's stability, consistent EPS growth, and stunning dividend record, the current valuation is attractive, and a unique income-capturing opportunity.

Safety, Quality, Competitive Advantage, & Recession Resiliency

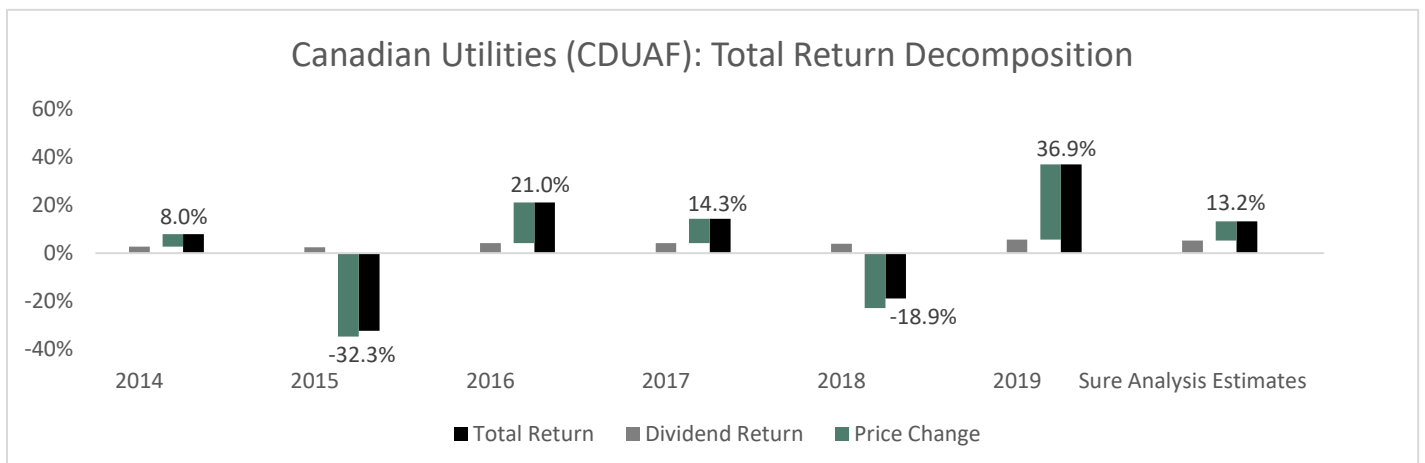
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	50%	49%	49%	45%	47%	39%	120%	74%	87%	85%	56%	56%

The company's competitive advantage lies in the moat regulated utilities are surrounded by. With no easy entry in the sector, regulated utilities enjoy an oligopolistic market, with little competition threat. The company's resiliency has been proven for decade after decade. Despite multiple recessions and uncertain environments over the past 47 years, the company has withstood every single one of them, while annually raising its dividend. The payout ratio is safe and reasonably conservative currently. We expect dividends to keep growing in line with earnings, maintaining a payout ratio of around 55% going forward.

Final Thoughts & Recommendation

We believe that Canadian Utilities is a buy for income-oriented investors who seek stable and predictable returns. The latest dividend increase of 3% in local currency may be lower than the 5-year average, indicating slower dividend growth. However, as the company retains more cash to invest in future projects and pay down its debts, the dividend yield remains very attractive and the payout ratio is safe. During uncertain times like this, Canadian Utilities offers low volatility and a stable investment case. We believe that the stock is a buy, currently trading at around 81% of its fair price, while at a decade low P/E ratio. In total we expect total returns of 13.2% annually over the next 5 years.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	\$2,618	\$3,033	\$3,040	\$3,283	\$3,261	\$2,557	\$2,567	\$3,152	\$3,378	\$2,942
Gross Profit	\$2,076	\$2,018	\$2,104	\$2,266	\$2,137	\$1,910	\$2,009	\$2,144	\$2,240	\$2,188
Gross Margin	79.3%	66.5%	69.2%	69.0%	65.5%	74.7%	78.3%	68.0%	66.3%	74.4%
SG&A Exp.	\$525	\$446	\$497	\$498	\$463	\$363	\$293	\$272	\$330	\$258
D&A Exp.	\$326	\$374	\$412	\$464	\$466	\$503	\$433	\$461	\$492	\$439
Operating Profit	\$764	\$942	\$943	\$1,033	\$922	\$639	\$898	\$917	\$835	\$963
Operating Margin	29.2%	31.0%	31.0%	31.5%	28.3%	25.0%	35.0%	29.1%	24.7%	32.7%
Net Profit	\$434	\$521	\$553	\$570	\$644	\$276	\$468	\$397	\$489	\$717
Net Margin	16.6%	17.2%	18.2%	17.4%	19.8%	10.8%	18.2%	12.6%	14.5%	24.4%
Free Cash Flow	\$244	-\$14	-\$870	-\$517	-\$596	-\$43	\$248	\$73	-\$205	\$185
Income Tax	\$155	\$189	\$156	\$182	\$187	\$161	\$178	\$133	\$174	\$40

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	9,323	11,248	13,287	14,135	14,388	13,021	13,945	16,572	16,020	15,344
Cash & Equivalents	\$540	\$574	\$351	\$468	\$302	\$350	\$256	\$304	\$400	\$745
Accounts Receivable	\$357	\$399	\$533	\$448	\$418	\$312	\$384	\$469	\$496	\$389
Inventories	\$82	\$77	\$79	\$85	\$73	\$32	\$28	\$32	\$23	\$23
Goodwill & Int. Ass.	\$255	\$285	\$331	\$347	\$341	\$349	\$390	\$448	\$463	\$482
Total Liabilities	\$5,585	\$7,148	\$8,890	\$9,070	\$9,558	\$8,558	\$9,294	\$11,530	\$11,202	\$10,046
Long-Term Debt	\$3,403	\$4,468	\$5,502	\$5,910	\$6,305	\$5,759	\$6,214	\$7,890	\$7,694	\$6,864
Shareholder's Equity	\$3,232	\$3,391	\$3,670	\$4,019	\$3,870	\$3,259	\$3,401	\$3,714	\$3,592	\$4,020
D/E Ratio	0.91	1.09	1.25	1.17	1.31	1.33	1.38	1.61	1.64	1.33

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	4.8%	5.1%	4.5%	4.2%	4.5%	2.0%	3.5%	2.6%	3.0%	4.6%
Return on Equity	14.2%	15.7%	15.7%	14.8%	16.3%	7.7%	14.1%	11.1%	13.4%	18.8%
ROIC	6.2%	6.6%	6.0%	5.5%	5.8%	2.6%	4.4%	3.3%	3.8%	5.8%
Shares Out.	251.9	255.4	256.0	259.3	262.8	265.3	267.8	270.1	272.1	273.2
Revenue/Share	\$10.39	\$11.88	\$11.87	\$12.66	\$12.41	\$9.64	\$9.59	\$11.67	\$12.41	\$10.77
FCF/Share	\$0.97	-\$0.06	-\$3.40	-\$1.99	-\$2.27	-\$0.16	\$0.93	\$0.27	-\$0.75	\$0.68

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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