



# Canadian Utilities (CDUAF)

Updated August 6<sup>th</sup>, 2020 by Nikolaos Sismanis

## Key Metrics

<b>Current Price:</b>	\$25	<b>5 Year CAGR Estimate:</b>	13.4%	<b>Market Cap:</b>	\$6.81B
<b>Fair Value Price:</b>	\$30	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	11/06/2020
<b>% Fair Value:</b>	82%	<b>5 Year Valuation Multiple Estimate:</b>	4.0%	<b>Dividend Payment Date<sup>1</sup>:</b>	12/01/2020
<b>Dividend Yield:</b>	5.3%	<b>5 Year Price Target</b>	\$39	<b>Years Of Dividend Growth<sup>1</sup>:</b>	47
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	A	<b>Last Dividend Increase:</b>	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 its Q2 results on July 30<sup>th</sup>, 2020. Revenues and EPS for the quarter amounted to \$556 million and \$0.26, indicating a decrease of 18% and 26%, respectively. These figures were not affected by FX changes, as the CAD/USD rate is currently almost identical to that of last year. Lower turnover were mainly due to foregone revenue following the sale of the company's fossil fuel-based electricity generation segment in Q3-2019 and the sale of Alberta PowerLine in Q4-2019. Turnover, however, was slightly offset by the overall electricity rates rising. Lower earnings were also attributed to regulatory decisions received in Q2-2019, which included \$15 million in adjusted earnings that were related to prior periods. Management mentioned that excluding asset sales and the one-off regulatory decision, EPS would be constant on a year-over-year basis. This indicates solid performance in its underlying business, with little to no effects related to COVID-19 and the overall economic environment, partially expected by operating in the regulated utility sector.

Over the first half of 2020, the company has spent \$337 million on CAPEX, around \$80 million lower than last year, as it reserves liquidity during such times of economic uncertainty. We retain our expected FY2020 EPS at \$2.16, as the company regrows its financials amid fewer sales due to assets sold.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$1.62	\$1.80	\$2.04	\$1.97	\$2.18	\$0.81	\$1.54	\$1.32	\$1.53	\$2.50	<b>\$2.16</b>	<b>\$2.76</b>
<b>DPS</b>	\$0.76	\$0.79	\$0.89	\$0.91	\$0.92	\$0.85	\$0.97	\$1.14	\$1.15	\$1.30	<b>\$1.31</b>	<b>\$1.59</b>
<b>Shares<sup>2</sup></b>	251.7	251.7	255.1	255.3	258.4	262	264.7	267.2	269.4	271.5	<b>272.8</b>	<b>300.0</b>

By benefiting from a stable business model, Canadian Utilities can slowly, but progressively, grow its earnings. The company consistently invests in new projects and 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, provides us an expected growth rate of 5% annually. However, we are slightly lowering our DPS CAGR projections from 5% to 4%, to reflect management's decelerated growth distributions as the company restores the part of its profitability lost by the sale of assets. 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, progressively growing investors' income.

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

<sup>2</sup> Share count is in millions.

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Considering the company's predictable cash flows and FX stability over the past year, we expect 2025 EPS and DPS of \$2.76 and \$1.67, respectively.

As is the case with the utility sector, Canadian Utilities issues shares consistently, to fund future projects and CAPEX. However, the company has historically achieved 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.

## 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	11.5	14.0
Avg. Yld.	3.5%	3.0%	2.7%	2.7%	2.7%	3.4%	3.6%	3.5%	4.6%	4.8%	5.3%	4.1%

Canadian Utilities shares are currently attached to a juicy dividend yield of 5.3%, offering attractive tangible returns in the form of quarterly income. Still, the stock's valuation is hovering at a decade low, at only 11.5 times its net income. Considering the company's stability in operations and decade-high dividend yield, we can see the stock's valuation multiple returning towards 14 in the medium-term. Approaching half a century of consecutive annual increases, we believe that the high yield will attract investor interest, hence expecting a valuation expansion.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

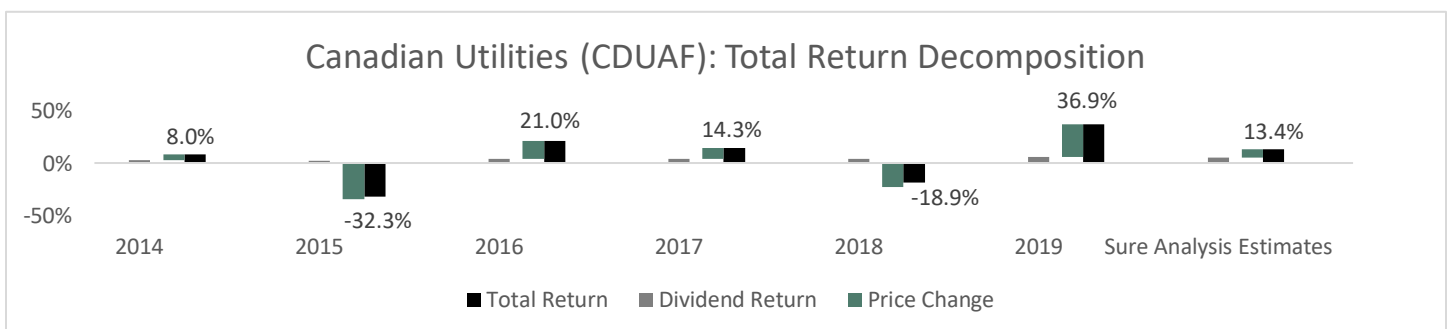
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	47%	44%	44%	46%	42%	105%	63%	86%	75%	52%	61%	58%

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 one of them while raising its dividend. Based on our expected FY2020 EPS, the payout ratio stands at around 61%, which means that the company should easily finance its distributions, even if its financials were to worsen temporarily.

## Final Thoughts & Recommendation

We believe that Canadian Utilities is an excellent buy for income-oriented investors who seek stable and predictable returns. The latest dividend increase of 3% in local currency may indicate a slowdown compared to its 5-year average. 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. We believe that Canadian Utilities offers low volatility and a stable investment case during a time of sky-high valuations. Trading at a decade-low P/E ratio and at 82% our estimated fair value, we project medium-term returns of around 13.4%, subject to a potential valuation multiple expansion.

## Total Return Breakdown by Year



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## Income Statement Metrics

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

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total Assets</b>	9,323	11,248	13,287	14,135	14,388	13,021	13,945	16,572	16,020	15,344
<b>Cash &amp; Equivalents</b>	\$540	\$574	\$351	\$468	\$302	\$350	\$256	\$304	\$400	\$745
<b>Accounts Receivable</b>	\$357	\$399	\$533	\$448	\$418	\$312	\$384	\$469	\$496	\$389
<b>Inventories</b>	\$82	\$77	\$79	\$85	\$73	\$32	\$28	\$32	\$23	\$23
<b>Goodwill &amp; Int. Ass.</b>	\$255	\$285	\$331	\$347	\$341	\$349	\$390	\$448	\$463	\$482
<b>Total Liabilities</b>	\$5,585	\$7,148	\$8,890	\$9,070	\$9,558	\$8,558	\$9,294	\$11,530	\$11,202	\$10,046
<b>Long-Term Debt</b>	\$3,403	\$4,468	\$5,502	\$5,910	\$6,305	\$5,759	\$6,214	\$7,890	\$7,694	\$6,864
<b>Shareholder's Equity</b>	\$3,232	\$3,391	\$3,670	\$4,019	\$3,870	\$3,259	\$3,401	\$3,714	\$3,592	\$4,020
<b>D/E Ratio</b>	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
<b>Return on Assets</b>	4.8%	5.1%	4.5%	4.2%	4.5%	2.0%	3.5%	2.6%	3.0%	4.6%
<b>Return on Equity</b>	14.2%	15.7%	15.7%	14.8%	16.3%	7.7%	14.1%	11.1%	13.4%	18.8%
<b>ROIC</b>	6.2%	6.6%	6.0%	5.5%	5.8%	2.6%	4.4%	3.3%	3.8%	5.8%
<b>Shares Out.</b>	251.9	255.4	256.0	259.3	262.8	265.3	267.8	270.1	272.1	273.2
<b>Revenue/Share</b>	\$10.39	\$11.88	\$11.87	\$12.66	\$12.41	\$9.64	\$9.59	\$11.67	\$12.41	\$10.77
<b>FCF/Share</b>	\$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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