



Canadian Utilities (CDUAF)

Updated November 1st, 2020 by Nikolaos Sismanis

Key Metrics

Current Price:	\$24	5 Year CAGR Estimate:	10.0%	Market Cap:	\$6.48B
Fair Value Price:	\$25	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	11/04/2020
% Fair Value:	97%	5 Year Valuation Multiple Estimate:	0.6%	Dividend Payment Date¹:	12/01/2020
Dividend Yield:	5.3%	5 Year Price Target	\$32	Years Of Dividend Growth¹:	47
Dividend Risk Score:	A	Retirement Suitability Score:	A	Last Dividend Increase:	3%

Overview & Current Events

Canadian Utilities is a \$6.48 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 Q3 results on October 29th, 2020. Revenues and EPS for the quarter amounted to \$727 million and \$0.27, indicating a decrease of 17.7% and 72%, 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. Besides the decline in sales, the massive decline in net income was attributed to higher energy transmission and transportation costs due to COVID-19, as well as depreciation and impairment charges. The company is planning to use the proceeds from its asset sales to purchase other income-producing infrastructure operations, such as its recent acquisition of the Pioneer Pipeline for \$255 million. Through more acquisitions and normality to its operations restoring, we expect its EPS to return to around \$1.80, which we have used as a benchmark for our expected return calculations. However, the combination of its asset sales and challenges caused by the pandemic point towards a massively reduced FY2020 EPS of \$0.95. During the first nine months of 2020, the company has spent \$489 million on CAPEX, around \$100 million lower than last year, as it reserves liquidity during such times of economic uncertainty.

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	\$0.95	\$2.30
DPS	\$0.76	\$0.79	\$0.89	\$0.91	\$0.92	\$0.85	\$0.97	\$1.14	\$1.15	\$1.30	\$1.31	\$1.59
Shares²	251.7	251.7	255.1	255.3	258.4	262	264.7	267.2	269.4	271.5	278.8	300.0

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. We retain our slightly reduced DPS CAGR projections of 4%, as the company attempts to restore its profitability through acquisitions after its massive asset sales earlier in 2019. 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. Based on our return-to-normality EPS of ~\$1.80, we expect 2025 EPS and DPS of \$2.30 and \$1.59, respectively. Note that while the dividend for this year may look uncovered, excluding this year's significant depreciation and impairment charges (non-cash items), distributions remain well covered from operating

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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cash flows. Over the nine months ended September 30th, the company had generated \$900 million in cash flow from operations and paid \$475 million in dividends. Therefore, both distributions and its CAPEX needs are well covered (the latter can be reduced if needed.)

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	24.6	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%	5.0%

Canadian Utilities shares are currently attached to a juicy dividend yield of 5.3%, offering attractive tangible returns in the form of quarterly income. The stock's current P/E ratio of around 24.6 is mostly temporary, reflecting this year's net income challenges. 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 and consider our projected valuation multiple quite a safe bet.

Safety, Quality, Competitive Advantage, & Recession Resiliency

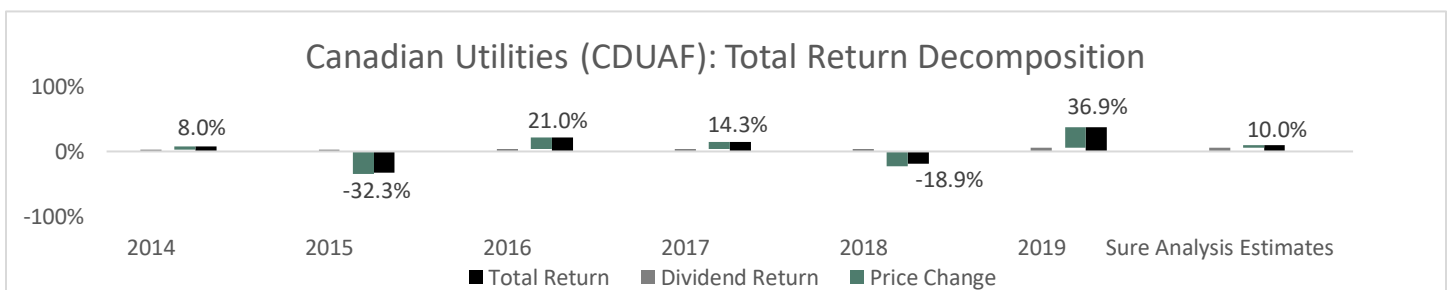
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	47%	44%	44%	46%	42%	105%	63%	86%	75%	52%	138%	69%

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. While Canadian Utilities' payout ratio is seemingly exceeding its profitability, these years' results are rather temporary, while distributions are still covered from its operating activities, as we mentioned earlier. By 2025 we expect the company's payout ratio to return to its usual range, below 70% of its net income.

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, while excluding its recent huge impairment charges, distributions remain covered. We believe that Canadian Utilities offers low volatility and a stable investment case during a time of sky-high valuations. We project medium-term returns of around 10%, powered by the stock's juicy yield, and modest EPS growth assisted by its above-average inflation rate increases. We rate it a buy.

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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