



Canadian Utilities (CDUAF)

Updated March 3rd, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	\$24	5 Year CAGR Estimate:	9.9%	Market Cap:	\$6.55B
Fair Value Price:	\$25	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	05/06/2021
% Fair Value:	97%	5 Year Valuation Multiple Estimate:	0.6%	Dividend Payment Date¹:	06/01/2021
Dividend Yield:	5.8%	5 Year Price Target	\$32	Years Of Dividend Growth¹:	48
Dividend Risk Score:	D	Retirement Suitability Score:	B	Last Dividend Increase:	1.1%

Overview & Current Events

Canadian Utilities is a \$6.55 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 48-year streak. Unless otherwise noted, US\$ is used in this research report.

Canadian Utilities reported its full-year results for the period ended December 31st, on February 25th, 2021. Revenues and EPS for the year amounted to \$2.54 billion and \$1.05, indicating a decrease of 17.9% and 58%, respectively. These figures were not very much affected by FX changes, as the CAD/USD rate is currently almost identical to that of last year.

Lower turnover was mainly due to foregone revenue following the sale of the company's fossil fuel-based electricity generation segment in Q3-2019 and Alberta PowerLine in Q4-2019. Turnover, however, was slightly offset by the overall electricity rates, which keep on rising at an annual rate. The massive decline in net income was attributed to higher energy transmission and transportation costs due to COVID-19 and depreciation and one-off 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 new cash flows from its acquisitions and normality to CU's operations restoring, we expect its FY2021 EPS to return to around \$1.55, which we have used as a benchmark for our expected return calculations. During this past quarter, the company increased its dividend per share by 1.1% to an annualized rate of C\$1.76, or around US\$1.40. This marks the company's 48th consecutive annual dividend increase.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$1.80	\$2.04	\$1.97	\$2.18	\$0.81	\$1.54	\$1.32	\$1.53	\$2.50	\$1.05	\$1.55	\$1.98
DPS	\$0.79	\$0.89	\$0.91	\$0.92	\$0.85	\$0.97	\$1.14	\$1.15	\$1.30	\$1.38	\$1.40	\$1.58
Shares²	252	255	255	258	262	265	267	269	272	325	330	380

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, amid the company's latest, quite humble dividend increase, we lower our expected DPS CAGR estimates from 4% to 2.5%. The company will likely want to improve its payout ratio before its new projects start producing enough cash flows to re-accelerate dividend growth. 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 ~\$1.55, we expect 2025 EPS and DPS of \$1.98 and \$1.58, respectively.

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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	12.8	16.4	17.5	18.1	19.3	20.9	18.3	18.2	15.0	22.9	15.5	16.0
Avg. Yld.	3.0%	2.7%	2.7%	2.7%	3.4%	3.6%	3.5%	4.6%	4.8%	4.8%	5.8%	5.0%

Canadian Utilities' shares are currently attached to a juicy dividend yield of 5.8%, offering attractive tangible returns in the form of quarterly income. It's also the highest yield the stock has sustained in over 20 years, which makes this legendary dividend payer the most attractive it has even been in decades from an income standpoint. The stock's current P/E ratio of around 15.5 is slightly lower than its historical average, which makes sense considering the company's decelerated growth and recent efforts to modernize itself through its asset sales/acquisitions. Considering the company's stability in operations and decade-high dividend yield, we can see the stock's valuation multiple slightly expanding towards 16 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

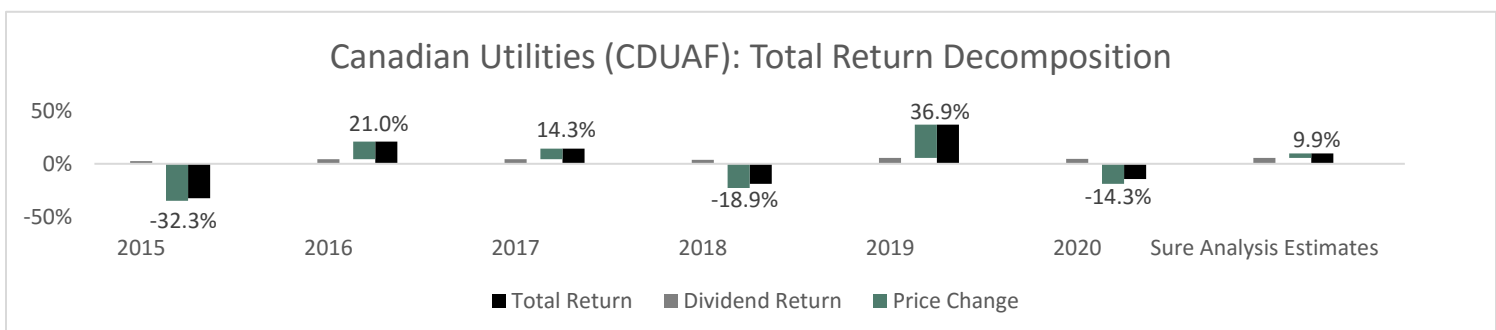
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Payout	44%	44%	46%	42%	105%	63%	86%	75%	52%	131%	90%	80%

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 48 years, the company has withstood every one of them while raising its dividend. While Canadian Utilities' payout ratio is seemingly getting compressed over the past couple of years, though dividends are in reality more cozily covered from its operating cash flows if we are to exclude depreciation and amortization. By 2026 we expect the company's payout ratio to return to more comfortable levels, utilizing around 80% 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 1.1% in local currency may indicate a slowdown compared to its 5-year average of 6.3%. 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 chargers, dividends remain well-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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	\$3,033	\$3,040	\$3,283	\$3,261	\$2,557	\$2,567	\$3,152	\$3,378	\$2,942	\$2,413
Gross Profit	\$2,018	\$2,104	\$2,266	\$2,137	\$1,910	\$2,009	\$2,144	\$2,240	\$2,188	\$1,877
Gross Margin	66.5%	69.2%	69.0%	65.5%	74.7%	78.3%	68.0%	66.3%	74.4%	77.8%
SG&A Exp.	\$446	\$497	\$498	\$463	\$363	\$293	\$272	\$330	\$258	\$255
D&A Exp.	\$374	\$412	\$464	\$466	\$503	\$433	\$461	\$492	\$439	\$455
Operating Profit	\$942	\$943	\$1,033	\$922	\$639	\$898	\$917	\$835	\$963	\$702
Operating Margin	31.0%	31.0%	31.5%	28.3%	25.0%	35.0%	29.1%	24.7%	32.7%	29.1%
Net Profit	\$521	\$553	\$570	\$644	\$276	\$468	\$397	\$489	\$717	\$319
Net Margin	17.2%	18.2%	17.4%	19.8%	10.8%	18.2%	12.6%	14.5%	24.4%	13.2%
Free Cash Flow	-\$14	-\$870	-\$517	-\$596	-\$43	\$248	\$73	-\$205	\$185	\$553
Income Tax	\$189	\$156	\$182	\$187	\$161	\$178	\$133	\$174	\$40	\$113

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	11,248	13,287	14,135	14,388	13,021	13,945	16,572	16,020	15,344	15,920
Cash & Equivalents	\$574	\$351	\$468	\$302	\$350	\$256	\$304	\$400	\$745	\$609
Accounts Receivable	\$399	\$533	\$448	\$418	\$312	\$384	\$469	\$496	\$389	\$426
Inventories	\$77	\$79	\$85	\$73	\$32	\$28	\$32	\$23	\$23	\$22
Goodwill & Int. Ass.	\$285	\$331	\$347	\$341	\$349	\$390	\$448	\$463	\$482	\$514
Total Liabilities	\$7,148	\$8,890	\$9,070	\$9,558	\$8,558	\$9,294	\$11,530	\$11,202	\$10,046	\$10,580
Long-Term Debt	\$4,468	\$5,502	\$5,910	\$6,305	\$5,759	\$6,214	\$7,890	\$7,694	\$6,864	\$7,102
Shareholder's Equity	\$3,391	\$3,670	\$4,019	\$3,870	\$3,259	\$3,401	\$3,714	\$3,592	\$4,020	\$4,029
D/E Ratio	1.09	1.25	1.17	1.31	1.33	1.38	1.61	1.64	1.33	1.37

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	5.1%	4.5%	4.2%	4.5%	2.0%	3.5%	2.6%	3.0%	4.6%	2.0%
Return on Equity	15.7%	15.7%	14.8%	16.3%	7.7%	14.1%	11.1%	13.4%	18.8%	7.9%
ROIC	6.6%	6.0%	5.5%	5.8%	2.6%	4.4%	3.3%	3.8%	5.8%	2.6%
Shares Out.	255.4	256.0	259.3	262.8	265.3	267.8	270.1	272.1	273.2	273
Revenue/Share	\$11.88	\$11.87	\$12.66	\$12.41	\$9.64	\$9.59	\$11.67	\$12.41	\$10.77	\$8.83
FCF/Share	-\$0.06	-\$3.40	-\$1.99	-\$2.27	-\$0.16	\$0.93	\$0.27	-\$0.75	\$0.68	\$2.02

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

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