



Algonquin Power & Utilities Corp. (AQN)

Updated November 11th, 2022 by Kay Ng

Key Metrics

Current Price:	\$9	5 Year CAGR Estimate:	16.4%	Market Cap:	\$6.3B
Fair Value Price:	\$11	5 Year Growth Estimate:	6.5%	Ex-Dividend Date:	12/29/22
% Fair Value:	81%	5 Year Valuation Multiple Estimate:	4.3%	Dividend Payment Date:	01/13/23
Dividend Yield:	7.8%	5 Year Price Target	\$16	Years Of Dividend Growth:	10
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating:	Buy

Overview & Current Events

Algonquin Power & Utilities Corp. trades on both the Toronto Stock Exchange and New York Stock Exchange under the ticker, AQN. The renewable power and utility company was founded in 1988. All the figures in this report are in U.S. dollars unless otherwise noted.

The company has increased its dividend every year since 2011. It has two business segments: regulated utilities (natural gas, electric, and water) and non-regulated renewable energy (wind, solar, hydro, and thermal). Combined, its entire portfolio has 4.3 GW of generating capacity that it aims to achieve 75% renewable energy generation by 2023.

Algonquin serves more than 1 million connections primarily in the U.S. and Canada. It also has renewable and clean energy facilities that are largely (about 82%) under long-term contracts of ~12 years with inflation escalations.

Algonquin reported its Q3 2022 results on 11/11/22. For the quarter, revenue rose 26% to \$666.7 million, adjusted net earnings fell 25% to \$73.5 million, adjusted earnings-per-share (“EPS”) fell 27% to \$0.11, but adjusted EBITDA, a cash flow proxy, increased by 10% to \$276.1 million, against Q3 2021. Management noted that the quarterly results were impacted by higher interest rates and delays in the construction and completion of certain renewable projects due to the timing of tax incentives.

The pending Kentucky Power acquisition would add to the rate base of its regulated utilities fleet with an expected close in the second half of 2022. In October, AQN announced that it was performing capital recycling on four wind projects that would raise cash proceeds of \$278 million and C\$107 million. AQN reduced its 2022 EPS estimate to \$0.66-\$0.69. Therefore, we updated our 2022 EPS estimate to \$0.68.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$0.14	\$0.26	\$0.37	\$0.46	\$0.42	\$0.57	\$0.66	\$0.63	\$0.64	\$0.71	\$0.68	\$0.92
DPS	\$0.29	\$0.33	\$0.37	\$0.49	\$0.55	\$0.60	\$0.51	\$0.55	\$0.61	\$0.67	\$0.72	\$0.90
Shares¹	189	207	238	256	274	432	489	526	599	654	678	786

Investors should note that Algonquin previously paid Canadian dollar-denominated dividends and only started paying a U.S. dollar-denominated dividend in 2014. It also began reporting in US\$ in 2018. So, in the table above, the EPS from 2012 to 2017 are in CAD\$. To match the dividends with the earnings, the dividend-per-share is also displayed in CAD\$ from 2012 to 2017. From 2018 and onwards, the data is in US\$. Historically, Algonquin’s EPS has been volatile. However, they have become more stable in the past few years, as the company has increased its scale with a more diversified asset base that is largely regulated utilities with predictable returns or renewable facilities that generate stable cash flow long-term. Specifically, its 2016 to 2021 EPS growth rate was 11.6% based on USD. It’s common for Algonquin to use equity financing to make acquisitions – its share count is more than three times what it was from 2012. Going forward, it will likely issue new shares for growth, which is fine only when its stock’s long-term upward trend is intact.

For example, in late October 2021, Algonquin announced that it agreed to acquire Kentucky Power for just under \$2.85 billion. Kentucky Power is a state rate-regulated electricity generation, distribution and transmission utility that serves

¹ Shares in millions.

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~228k customer connections regulated by the FERC. The utility is funding \$646 (C\$800) million of the acquisition with bought deal equity financing at C\$18.15 per share. The company's five-year capital program from 2022 through 2026 consists of \$12.4 billion of investments across its businesses – about 70% in regulated opportunities and 30% in its renewable energy segment. In the near term, it shouldn't need to make equity offerings because it's digesting the Kentucky Power acquisition. We forecast an EPS growth rate of 6.5% through 2027. Our DPS estimate through the period is 4.5%, as AQN's payout ratio is at the high end.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	47.4	27.3	22.9	22.4	27.5	22.3	15.7	19.0	22.5	22.6	13.8	17.0
Avg. Yld.	4.4%	4.6%	4.4%	4.8%	4.8%	4.7%	4.9%	4.6%	4.2%	4.4%	7.8%	5.7%

Taking out the outlier in 2012, from 2013-2021, the average price-to-earnings ratio was 22.5 and the average yield was 4.6%. Algonquin is a very different and much larger utility versus a decade ago. We think a reasonable price-to-earnings of 17 makes sense for today's macro environment and a long-term growth rate of ~6.5%. The stock is undervalued. We believe Algonquin would not stray far away from a yield of about 6% in this higher interest rate environment.

Safety, Quality, Competitive Advantage, & Recession Resiliency

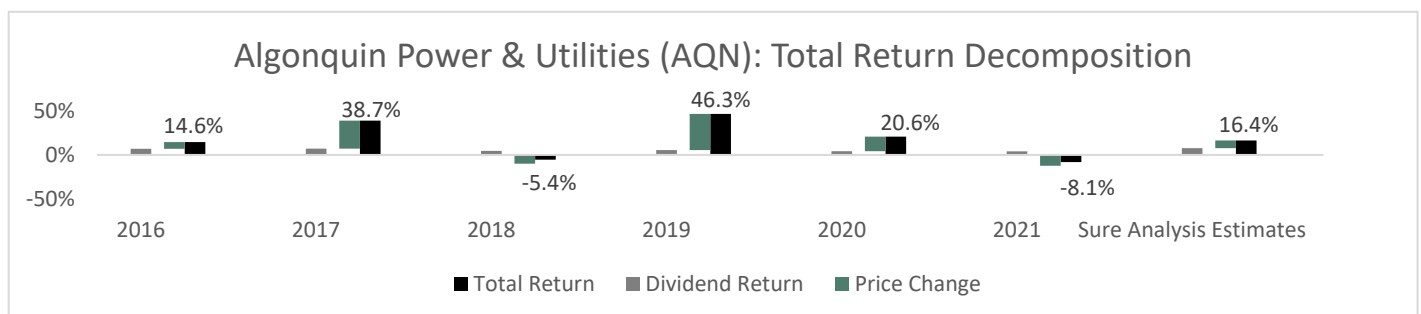
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	207%	127%	100%	107%	131%	105%	77%	87%	95%	94%	107%	97%

Algonquin cut its dividend in 2011 around the previous recession as earnings fell drastically. Most of the decade displayed payout ratios that were extended. That said, its earnings have been much more stable since 2018 after switching to reporting in US\$ and primarily building operations that are either regulated or have long-term contracts. After aligning the company's U.S. dollar reporting to its U.S. dollar-denominated dividend, its payout ratio has been more telling since 2018. A rising interest rates and the timing of the execution of its renewable projects is cutting into its 2022 earnings and propping up its payout ratio to uncomfortable levels. But management still announced the same dividend for the coming quarter. Going forward, it'd be more prudent for the company to further lower its payout ratio by growing its dividend at a slower pace than its earnings growth. Therefore, we estimate a 4.5% dividend growth rate versus an estimated EPS growth rate of 6.5%. Algonquin has an investment-grade S&P credit rating of BBB.

Final Thoughts & Recommendation

Algonquin is a higher-risk utility due to its higher payout ratio and higher debt levels. The stock is undervalued. Over the next five years, we estimate total returns of 16.4%, coming from a yield of 7.8%, growth of 4.3% from P/E expansion, and earnings growth of 6.5% per year. We rate the stock as a buy for high-risk investors.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	351	634	811	741	815	1,522	1,648	1,626	1,677	2,285
Gross Profit	230	379	449	469	596	1,129	1,164	1,183	1,276	1,566
Gross Margin	65.5%	59.7%	55.3%	63.3%	73.1%	74.2%	70.6%	72.7%	76.1%	68.5%
SG&A Exp.	20	22	30	29	34	59	53	74	90	83
D&A Exp.	52	93	99	109	146	257	261	284	314	403
Operating Profit	42	97	119	131	174	368	378	353	343	378
Operating Margin	12.0%	15.3%	14.7%	17.7%	21.4%	24.2%	23.0%	21.7%	20.5%	16.6%
Net Profit	15	19	65	85	97	149	185	531	782	265
Net Margin	4.2%	3.0%	8.0%	11.4%	11.9%	9.8%	11.2%	32.6%	46.7%	11.6%
Free Cash Flow	-15	-56	-206	42	-88	-239	64	30	-281	-1,188
Income Tax	-14	9	14	32	28	73	53	70	65	-43

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	2,793	3,265	3,534	3,597	6,138	8,396	9,399	10,921	13,224	16,786
Cash & Equivalents	53	13	8	90	82	43	47	62	102	125
Accounts Receivable	89	151	162	135	141	245	246	259	233	301
Inventories	24	31	27	21	28	89	96	91	135	178
Goodwill & Int. Ass.	119	131	126	133	276	1,005	1,009	1,079	1,323	1,306
Total Liabilities	1,384	1,888	1,952	1,946	4,288	5,075	5,701	6,514	7,235	9,084
Accounts Payable	34	14	59	36	67	120	90	150	192	185
Long-Term Debt	776	1,179	1,095	1,071	3,178	3,080	3,337	3,932	4,538	6,211
Shareholder's Equity	805	788	1,125	1,240	1,272	2,533	2,993	3,691	5,019	5,675
LTD/E Ratio	0.84	1.31	0.84	0.77	2.22	1.13	1.05	1.01	0.87	1.06

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	0.7%	0.6%	1.9%	2.4%	2.0%	2.1%	2.1%	5.2%	6.5%	1.8%
Return on Equity	2.2%	2.4%	6.8%	7.2%	7.8%	7.9%	6.7%	15.9%	18.0%	5.0%
ROIC	0.9%	0.8%	2.5%	3.1%	2.5%	2.6%	2.8%	6.9%	8.3%	2.2%
Shares Out.	189	207	238	256	274	432	489	526	599	654
Revenue/Share	2.21	3.08	3.75	2.89	2.98	3.94	3.54	3.22	2.97	3.63
FCF/Share	-0.09	-0.27	-0.95	0.16	-0.32	-0.62	0.14	0.06	-0.50	-1.89

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

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