



DSR STOCK CARD

10/14/2022

ALGONQUIN POWER (AQN.TO) (AQN)

Business Model

Algonquin Power & Utilities Corp, a parent company of Liberty, is a diversified international generation, transmission, and distribution utility with over \$16 billion of total assets. Through its two business groups, the Regulated Services Group and the Renewable Energy Group, AQN is committed to providing safe, secure, reliable, cost-effective, and sustainable energy and water solutions through its portfolio of electric generation, transmission, and distribution utility investments to over one million customer connections, largely in the United States and Canada. AQN provides renewable energy through its portfolio of long-term contracted wind, solar, and hydroelectric generating facilities.

The Company in a Nutshell

- The company is an interesting play in the utility business as it serves both the US and Canada.
- AQN expects to invest about \$12.4B through to 2026.
- AQN's focus on clean and renewable energy is a great utility alternative for conscientious investors.

Investment Thesis

Like many utilities in North America, solid growth is to be found outside of the company. AQN had approximately 120K customers in 2013 and now serves over 1M customers and achieved this impressive growth through acquisitions. The company "did it again" with the recent acquisition of Kentucky Power, for which the company just negotiated a rebate and will pay \$200M less. With a budget of \$12.4B in CAPEX, AQN has several projects pending through to 2026. These include more acquisitions, pipeline replacements, and organic CAPEX. The utility counts on its regulated businesses to grow its revenue once those projects are funded. AQN has double-digit earnings growth potential for the foreseeable future but expect a short-term slowdown due to an aggressive leverage strategy and more common shares being issued.

VALUATION*

*We used a 1.25 currency conversion rate.

Dividend Growth Rate Years 1-10: 8%

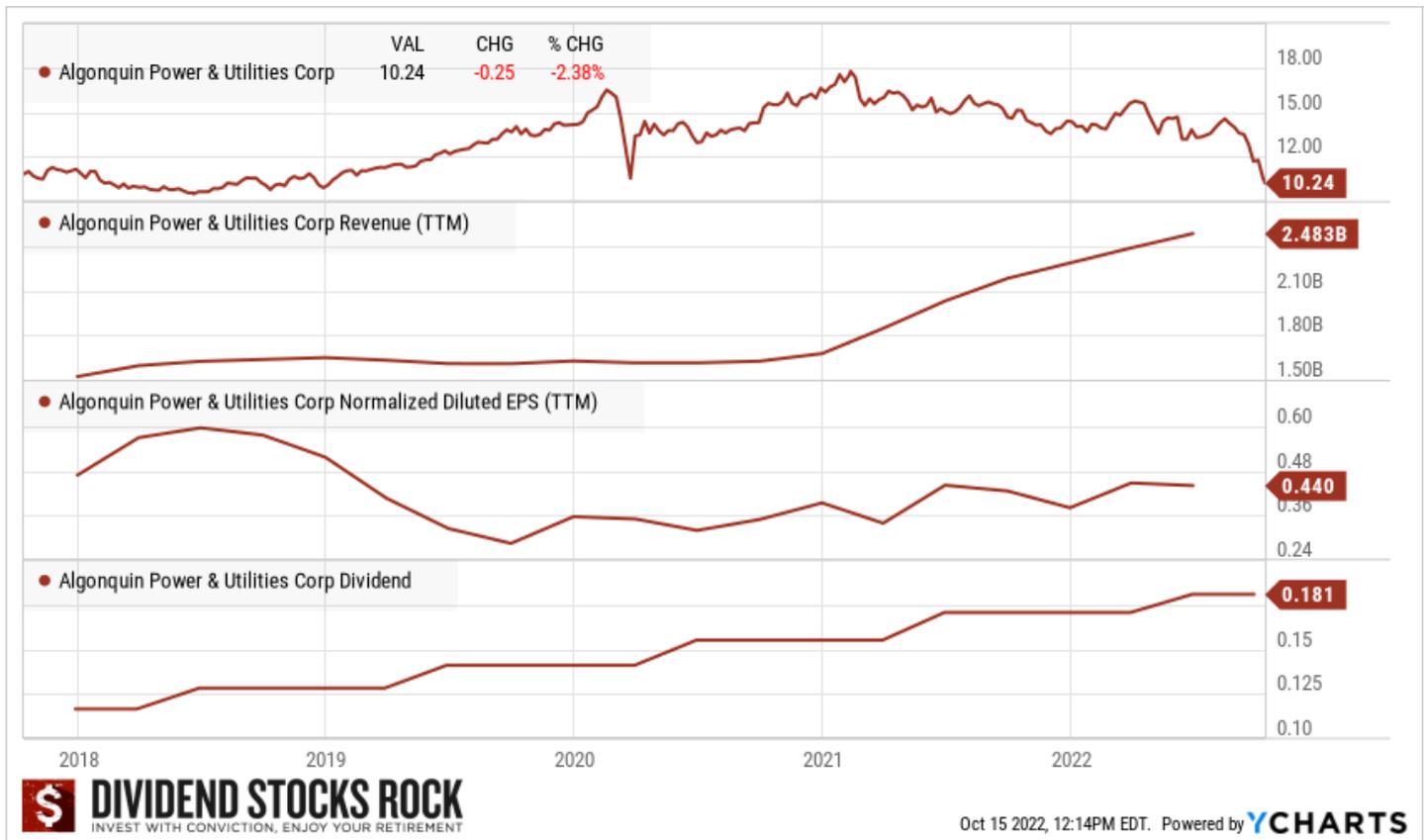
Terminal Dividend Growth Rate: 5%

	Discount Rate (Horizontal)		
	9.00%	10.00%	11.00%
Margin of Safety			
20% Premium	\$36.28	\$28.78	\$23.79
10% Premium	\$33.26	\$26.38	\$21.81
Intrinsic Value	\$30.24	\$23.99	\$19.83
10% Discount	\$27.21	\$21.59	\$17.85
20% Discount	\$24.19	\$19.19	\$15.86



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Potential Risks

Like most utility companies, AQN uses leverage to finance its growth. 42% of its capital asset structure is comprised of long-term debt, and the rest comes from the equity markets. The company has posted solid growth since 2012, but this may plateau after the next round of projects is completed in 2025. If regulators are less generous than anticipated, revenue growth may fall short of expectations. We saw what happened with PNW in Arizona. AQN recently acquired Kentucky Power & Kentucky Transco. The company wants to use its “greening the fleet” strategy (e.g., replace coal with renewable energy generation). This looks good on paper but will require more capital going forward. While the acquisition should keep AQN within the same credit rating, there could be a time where there is too much debt on its balance sheet. In addition, higher interest rates could weigh on AQN’s future dividend growth.

Dividend Growth Perspective

The dividend fluctuations are due to currency conversion as the company once paid its dividend in CAD, and now does so in USD. As a Canadian company, 90%+ of AQN’s EBITDA comes from the U.S. There is therefore no reason to worry about the company’s cash distribution. AQN exhibits an ambitious capital expenditure (CAPEX) budget; these investments will drive earnings growth and shareholders will be rewarded accordingly. Shareholders can expect a high single-digit dividend growth rate for the next decade.