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12/10/2022

CANADIAN UTILITIES (CU.TO)

Business Model

Canadian Utilities Ltd, a subsidiary of holding company Atco, offers gas and electricity services. The company's main divisions include Electricity (generation, transmission, and distribution), Pipelines & Liquid (natural gas and water), and Retail Energy. Headquartered in Calgary, Alberta, the firm mainly operates in Canada and Australia, along with some operations in the United States and Mexico. Canadian Utilities launched a large venture called Atco Energy, which provides low-cost and sustainable energy solutions for Alberta.

The Company in a Nutshell

- The company owns and operates ~$21B of energy infrastructure assets including Structures & Logistics.
- CU has had 50 consecutive years with a dividend increase.
- The company operates 105,000 kms of electric powerlines and 64,000 kms of natural gas pipelines.

Investment Thesis

Canadian Utilities exhibits a stellar dividend history. An investor can expect additional dividend growth in the future while enjoying a generous 4-5% yield today. As most of its business is regulated, it is easier for management to plan for its investments and dividend growth. The company is looking to do more business in Mexico. As this country is forecasted to have more substantial GDP growth potential than Canada, this could become an exciting growth vector in the future. CU intends to invest $3.2B in regulated utilities through to 2023. Among their current projects, we count the acquisition of Pioneer pipeline in 2020, solar projects in the Yukon (2021), in addition to expansion projects in Puerto Rico (through the creation of LUMA Energy). We would like to see additional diversification going forward.

VALUATION

Dividend Growth Rate Years 1-10: 2% **Terminal Dividend Growth Rate: 3%**

	Discount Rate (Horizontal)		
Margin of Safety	**9.00%**	**10.00%**	**11.00%**
20% Premium	$33.90	$29.14	$25.56
10% Premium	$31.08	$26.71	$23.43
Intrinsic Value	$28.25	**$24.28**	$21.30
10% Discount	$25.43	$21.86	$19.17
20% Discount	$22.60	$19.43	$17.04

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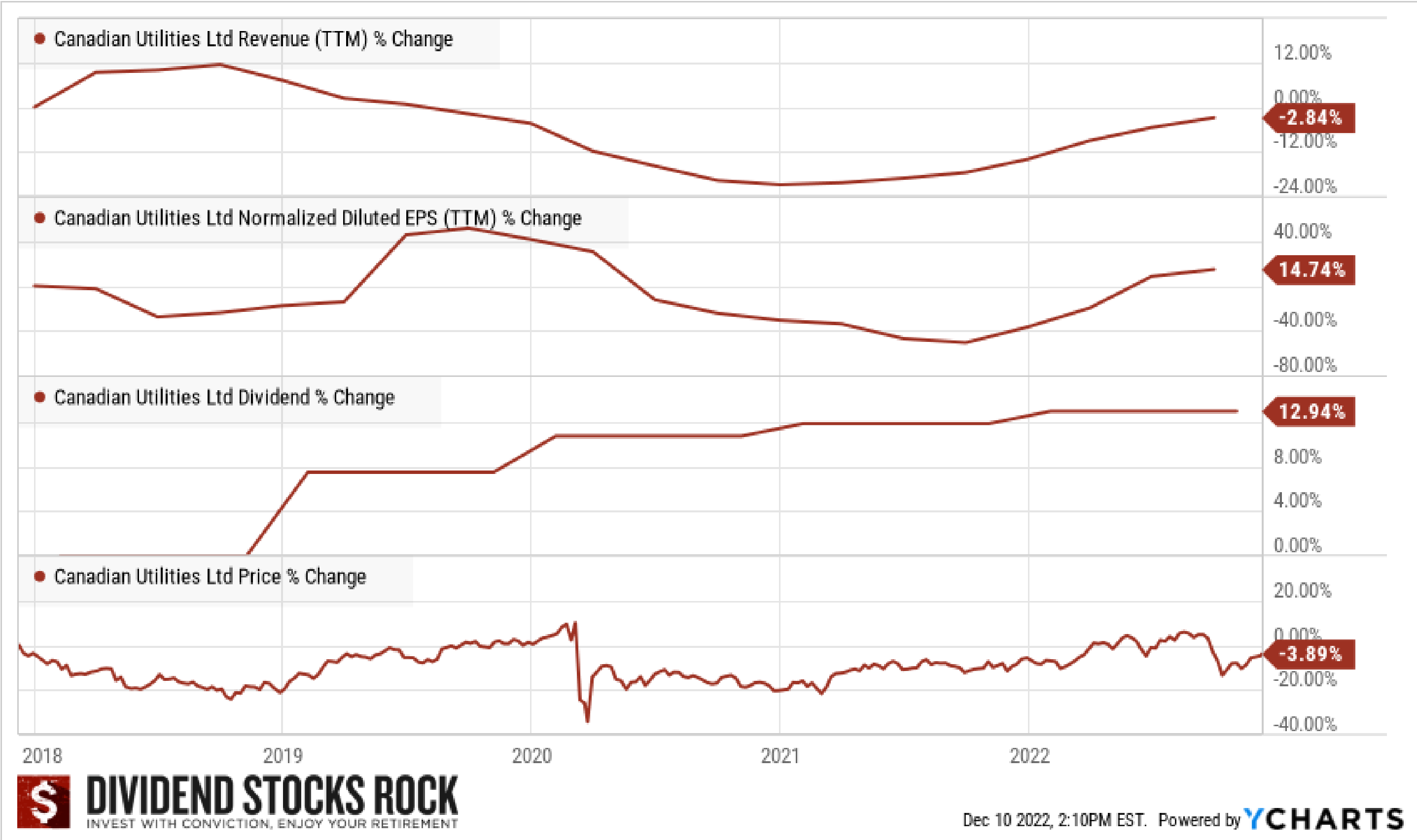

Potential Risks

CU's future growth depends on its future investments. Utilities provide substantial cash flow but are capital intensive. We saw that management was quick to cut down on CAPEX during economic downturns. The company temporarily cut its capital expenditures following the 2020 recession but increased its budget as the economy recovered. CU's CAPEX is based on its projections of profitability. If regulators disagree, some projects could be less profitable than expected. Nova Scotia recently announced it will cap rate increases. Can this happen in Alberta too? As interest rates go up, this may also have an impact on CU's debt burden. Depending on how the oilsands business evolves in the coming years, CU's revenue may face headwinds. Finally, the dividend growth rate has slowed since 2020 and this may be a sign of weakness.

Dividend Growth Perspective

CU has successfully increased its dividend each year since 1972 and has an impressive dividend payment track record. After a series of generous increases, CU revised its dividend growth policy in 2020 (+2.8%) and followed with a symbolic dividend increase (+1%) in 2021 and 0.9% in 2022. This is concerning but CU still has an attractive yield, stable business, & is an excellent candidate for income seekers. Treat it as a deluxe bond.