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A dividend-growing utility that rewards patience

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With investing, patience is often a virtue.

Today's exhibit: Canadian Utilities Ltd.

One of the original stocks in my Strategy Lab model dividend portfolio, Canadian Utilities has had a choppy ride since the portfolio was launched in September, 2012. Last year was particularly challenging, as the shares plunged amid worries about slowing growth in the company's home province of Alberta.

When a stock doesn't work out as expected, some investors believe the solution is to sell it and move on. But for a company as solid as Calgary-based Canadian Utilities, throwing in the towel would have been a mistake.

Instead, I bought more.

In three separate transactions – in 2014, '15 and '16 – I used the cash that had accumulated in my model portfolio to pick up a total of 45 additional shares at an average cost of $35.57, bringing my position to 165 shares. I was following one of my favourite investing rules: Acquire good stocks when they are experiencing short-term problems.

Well, I'm pleased to report that, after a dismal 2015, Canadian Utilities' shares have regained their form. The stock, which closed on Tuesday at $38.51, has posted a total return of about 24 per cent in 2016, compared with a total return of about 16 per cent for the S&P/TSX composite index. (Total return is a theoretical measure that assumes all dividends were reinvested in additional shares.)

What's more, while Canadian Utilities' share-price performance still lags most of the other stocks in my model portfolio, its dividend growth has been exemplary. Since Strategy Lab was launched nearly four years ago, the company has raised its dividend every January by an average of more than 10 per cent (its record of annual increases goes back 44 years, according to the company). The shares now pay a dividend of $1.30 annually and yield an attractive 3.4 per cent.

And I believe there is more good news to come.

As a conservative, income-focused investor, one of the things I like about Canadian Utilities is that most of its operations – which include electricity and natural-gas transmission and distribution – are either regulated or contracted on a long-term basis. This makes for predictable earnings and insulates the company from swings in commodity prices.

And because its operations are growing, its earnings are poised to rise. In a report in June, analyst **Darryl McCoubrey** of **Veritas Investment Research** named Canadian Utilities as his top pick, citing the company's "best-in-class growth prospects for its core rate base." (Rate base is the value of assets on which a regulated utility is permitted to earn a specified return.) Specifically, **Mr. McCoubrey** said the company's electric and gas utilities in Canada and Australia are expected to grow about 8 per cent annually from 2015 through 2017 – higher than the 5-per-cent average growth rate for its peers.

He also likes the fact that Canadian Utilities has a very strong balance sheet (including a single-A credit rating), faces little near-term uncertainty from regulatory decisions and has an attractive valuation of between 1.3 and 1.4 times its 2017 core regulated rate base, compared with 1.6 to 1.7 times for other utilities in Canada.

Adding to Canadian Utilities' appeal, its 24.5-per-cent-owned structures and logistics division – which provides work-force housing – is showing "early evidence of a recovery" thanks to cost reductions, higher occupancy levels and increased activity, **Mr. McCoubrey** said in a July note in which he reiterated his "buy" rating and $42.50 price target on the shares.

Some analysts are slightly more cautious on the shares. After the company released modestly better-than-expected second-quarter results in late July – helped by company-wide cost reductions – RBC Dominion Securities analyst Robert Kwan raised his price target to $42 from $37 but maintained a "sector perform" rating.

Among the factors that could weigh on the shares are negative sentiment toward the Alberta economy and the potential for Alberta power prices to remain depressed, he said. That would exert a drag on the company's unregulated power-production operations. Another risk is a potential rise in interest rates, which would likely hurt shares of utilities and other interest-sensitive stocks.

For his part, **Mr. McCoubrey** said low Alberta power prices are already baked into the stock price and that investors are effectively getting Canadian Utilities' power-production operations for free. An uptick in electricity prices could potentially be a catalyst for the shares, he said in an interview.

For investors who can accept the risks and who are looking for a stock that will almost certainly continue to raise its dividend, Canadian Utilities may be worth investigating further. I'm willing to be patient and collect my dividends while I wait for the share price to recover further. Remember to do your own research before investing in any security.

Disclosure: The author also owns shares of Canadian Utilities personally