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For patient investors, this utility stock offers steady growth

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Back in January, I used some of the cash in my Strategy Lab model dividend portfolio to purchase an additional 10 shares of Canadian Utilities Ltd.

My reasoning was simple: As bad as things are in Alberta, the vast majority of Canadian Utilities' earnings come from regulated operations – including electricity and natural gas transmission and distribution – that are insulated from commodity prices, throw off stable cash flows and account for most of the company's growth.

What's more, the Calgary-based company had recently raised its dividend by 10 per cent. The increase sent a strong signal that the company remained confident about the future of its business, which also includes unregulated power generation, natural gas processing and storage, industrial water-related infrastructure and work force housing and logistics.

Buying good companies whose shares are suffering a setback can be a profitable investing strategy, and in this case, adding to my position turned out to be a good call. Since I bought those 10 additional shares at $32.25 each, Canadian Utilities has risen 13.7 per cent, closing Tuesday at $36.67. For patient investors, I believe there are more gains to come. While it's anyone's guess what the stock will do in the short run, I'm confident that over the long run investors will be rewarded with share price gains and a dividend – currently yielding about 3.6 per cent – that continues to grow, having increased annually for 44 consecutive years.

Even with the weakness in Alberta, Canadian Utilities managed to put up solid first-quarter results. Adjusted earnings of $197-million or 74 cents a share were up from $130-million or 49 cents a year earlier, topping the average analyst estimate of about 69 cents.

The gain in adjusted earnings was driven largely by continued capital investment and growth in the company's regulated electric and gas utilities, which had been hit by several negative regulatory decisions in the year-earlier period. Company-wide cost-cutting efforts also contributed to the improved results, Canadian Utilities said.

"The core engine for growth remains the electric and gas utilities with continued capex [capital expenditures] driving rate base growth," RBC Dominion Securities analyst Robert Kwan said in a note. (The rate base is the value of assets on which a regulated utility is permitted to earn a specified return.) However, he added that headwinds in Alberta – including the recession and depressed power prices – "will continue to cap the share price."

Mr. Kwan rates the stock "sector perform" with a price target of $37. His target price was derived by applying a price-to-earnings multiple of about 16 to projected 2017 adjusted earnings of $2.30 a share. This represents a discount to the average P/E of about 20 for other regulated utilities, reflecting the company's higher exposure to Alberta.

Even as he sees little room for share price growth, Mr. Kwan projects that the dividend will rise by 10 per cent again next year, to $1.43 a share annually from $1.30 currently.

Other analysts also expect the stock to trade in a narrow range. According to Bloomberg, of the seven analysts who follow the company, five rate it a "hold" or equivalent, with one "buy" and one "sell." The average 12-month price target is $36.79.

Looking further out, however, the stock could benefit from significant investments in the company's utilities and contracted assets. From 2016 through 2018, Canadian Utilities plans to spend about $5.3-billion – including $2.1-billion on regulated electric assets, $1.1-billion on the contracted Fort McMurray electric transmission project, and $2-billion on regulated gas assets in Alberta and Australia. It also plans to invest $100-million on a gas pipeline in Mexico and hydrocarbon storage projects.

Canadian Utilities' "premium regulated utility expansion plans remain on track, despite fears of slower Alberta growth," Ben Pham, an analyst with BMO Nesbitt Burns, said in a note. Given the stock's current valuation, "one could argue that investors are getting the unregulated assets [accounting for about 10 per cent of earnings] for free," he said.

Darryl McCoubrey of ***Veritas Investment Research*** – the only analyst with a "buy" on the shares – also likes the fact that 90 per cent of the company's value "is attributable to low-risk, regulated assets, which are currently valued at a discount to peers such as Emera Inc., Fortis Inc. and Hydro One Ltd."

"In addition, Canadian Utilities' low payout ratio [63 per cent of trailing 12-month adjusted earnings] and robust growth plan suggest its dividend will grow at a faster pace," ***Mr. McCoubrey*** said in an interview.

As a dividend investor, I'm content to hold the stock through the current soft patch as I wait for my income to increase.