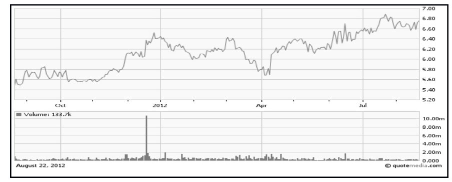
Algonquin Power & Utilities Corp (AQN: TSX)

Recommendation: BUY

Current Price (August 22, 2012)..*$6.76*

Fair Value..*$7.82*



Algonquin Power and Utilities Q2 Results – Dividend Increased 11%; Results Slightly Below Expectations but Mid to Long-Term Outlook Remains Solid with Development and Acquisition Pipeline Strong and Growing

Industry: Renewable Power Generation and Regulated Utilities
Recommended: February 2012
Recommendation Price: $6.15
Current Price: $6.76

INVESTMENT RECOMMENDATION

We are maintaining coverage on Algonquin Power & Utilities Corp (AQN: TSX) with a rating of BUY and a fair value assessment of $7.82 per share. Algonquin Power & Utilities will remain in our Moderate-Risk and Hybrid portfolios.

COMPANY DESCRIPTION

Algonquin Power & Utilities Corp (formally Algonquin Power & Utilities Income Fund) owns and operates a diverse portfolio of renewable power generation, clean thermal power generation, and regulated electricity, water and natural gas distribution assets throughout North America. As at September 30, 2011, the company owns or has interests in hydroelectric facilities operating in Ontario, Québec, Newfoundland, Alberta, New Brunswick, New York State, New Hampshire, Vermont, Maine, and New Jersey with a combined generating capacity of approximately 165 MW. The company also owns a 104 MW wind powered generating station in Manitoba and holds exchangeable debt securities in a 26 MW wind powered generating station recently completed in Saskatchewan. Approximately 92% of the electrical output from the renewable energy facilities is sold pursuant to long-term power purchase agreements (PPAs) with a weighted average remaining contract life of 13 years. Algonquin also maintains ownership interests in thermal energy facilities representing approximately 210 MW of installed generating capacity with approximately 72% of the electrical output sold through long-term PPAs with a weighted average remaining contract life of 8 years. In the United States, Algonquin's subsidiary, Liberty Utilities, provides rate regulated electricity, natural gas and water distribution, and wastewater collection utility services to 75,000 customers in the States of Arizona, Texas, Missouri and Illinois, and to 47,000 customers located in the Lake Tahoe region of California. The company's strategy is to maximize shareholder value by delivering a total return comprised of dividends and dividend growth supported by increasing cash flows and earnings. Through an emphasis on sustainable, long-view renewable power and utility investments, the company has targeted annualized per share earnings growth of greater than 5% over a medium-term time horizon.

DISCUSSION OF Q1 2012 FINANCIAL RESULTS

Consolidated: For the second quarter of 2012, revenue was $65.4 million compared to $66.8 million in the second quarter of 2011. Adjusted EBITDA was $24.9 million compared to $28.2 million in the second quarter of 2011. Lower revenue and EBITDA relative to last year was primarily the result of lower hydrology at the companies hydro facilities, lower power sales and prices at the Windsor Locks co-generation facility, lower electricity sales from Liberty Utilities (West), and the Sanger co-generation facility being off-line for planned major maintenance. Partially offsetting these items was increased demand for retail sales at Tinker Hydro/AES, the impact of a stronger U.S. dollar, and higher wind resource relative to last year. For Q3, the company expects the Windsor Locks and Sanger facilities to operate at levels comparable to 2011. For the first 6 months of the year, AQN generated funds from operations of $29.7 million and declared total dividends of $20.6 million for a payout ratio of 69%. Adjusted for acquisition costs and litigation accruals (associated with Quebec water lease) funds from operations were $34.9 million (payout ratio: 59%).

Balance Sheet: AQN ended the quarter with $461.8 million in total debt and $160.8 million in cash and equivalents. Based on expected 2012 EBITDA of approximately $105 million, the net debt to EBITDA ratio is 2.9 times. We consider this to be a very healthy leverage ratio considering the relatively stable nature of AQN's cash flow.

Dividend and Ongoing Policy: In conjunction with the Q2 results, AQN announced that it would be increasing its quarterly dividend 11% to $0.078 per share ($0.31 annualized). This is the third dividend increase declared in 2 years. At the current price, AQN provides an annualized income yield of 4.58%. We believe that the company increased the dividend in anticipation of contributions from new assets added at the end or subsequent to Q2. We also anticipate that the company will elect to continue to increase the dividend over the next few years as new development projects and acquisitions start contributing to cash flow.

Outlook: Our investment thesis on AQN is primarily based on development projects and acquisitions that we expect to contribute to cash flow from Q3 2012 to 2016. Q3 results will include contributions from the acquisition of Sandy Ridge, which was acquired on July 1, 2012, the acquisition of Granite State and EnergyNorth on July 3, 2012, and the acquisition of the Midwest Gas Utilities on August 1, 2012.

TABLE 1: MARKET DATA

Symbol	AQN: TSX
Yield	4.58 %
Market Capitalization	$1.06 Billion
Shares Outstanding (basic)	153,414,269
Shares Outstanding (diluted)	153,962,584
Average Daily Trading Volume	252,806

TABLE 2: QUARTERLY FINANCIAL DATA

	Q2 2012	Q2 2011	Change
Revenues	$65,384,000	$66,827,000	-2.2%
Net Income	$6,900,000	$8,200,000	-15.8%
EPS (Diluted)	$0.05	$0.07	-28.6%
FFO	$18,993,000	$19,685,000	-3.5%
FFO Per Share	$0.12	$0.17	-29.4%

TABLE 3: ANNUAL FINANCIAL DATA

	6 Months - 2012	6 Months - 2012	Change
Revenues	$129,821,000	$138,535,000	-6.3%
Net Income	$12,400,000	$13,500,000	-8.1%
EPS (Diluted)	$0.09	$0.13	-30.7%
FFO	$29,809,000	$36,446,000	-18.1%
FFO Per Share	$0.20	$0.33	-39.4%

TABLE 4: FINANCIAL RATIOS

	2012e	Target Range
Price/Earnings	n/a	n/a
Price/Cash Flow	14.1	Less than 12.0
Debt/Cash Flow	2.9	Less than 4.5
Payout Ratio	70.0%	Less than 75.0%

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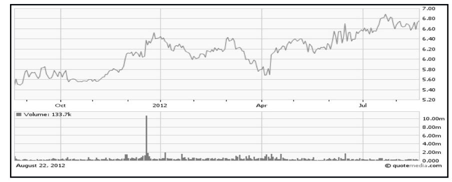

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Combined, these acquisitions are expected to add approximately $3.3 million in EBITDA in Q3. Looking out further, AQN's acquisition and development pipeline remain very full from 2013 to 2016. Specific information on the pipeline is provided below. We anticipate that these projects will continue to provide incremental step-ups in cash flow which will allow the company to increase the dividend consistently over the next several years. We also anticipate that AQN will continue to identify new projects that will add to the pipeline as existing projects are completed.

DEVELOPMENT PIPELINE – RENEWABLE POWER GENERATION				
Project	**Size (MW)**	**Capital Cost (M)**	**Operation Date**	**PPA Term**
Chaplin Wind	177	$355	2016	25
Amherst Island	75	$230	2014	20
Val Eo	24	$70	2015	20
Morse Wind	25	$70	2014	20
St. Damase	24	$70	2014	20
Cornwall Solar	10	$45	2012	20
St. Leon II	17	$30	2012	25
TOTAL	**352**	**$870**		

ACQUISITION PIPELINE – POWER AND UTILITIES
In June, AQN Liberty received approval for the transaction to acquire Emera's remaining 49.999% ownership interest in Liberty Energy (California). Total consideration is 8.211 million AQN shares and the transaction is expected to close in the second half of 2012.
On July 20, AQN entered into an agreement to acquire all issued and outstanding shares of United Water Arkansas Inc. a regulated water distribution utility located in Arkansas serving approximately 17,300 customers. The total purchase price is approximately US $28.6 million and the transaction is expected to close in mid-2013.
On August 8, 2012, the company entered into an agreement to acquire regulated natural gas distribution utility assets serving approximately 64,000 customers in the State of Georgia for total consideration of US $140.7 million.
On March 9, AQN entered into an agreement to acquire a 51% majority interest in a 480 MW portfolio of four wind power projects in the United States from Gamesa, consisting of Minonk (200MW), Senate (150MW), Pocahontas Prairie (80MW) and Sandy Ridge (50MW). Sandy Ridge was acquired on July 1st. Senate and Minonk are expected to achieve COD in Q4. AQN has elected to defer the acquisition of Pocahontas Prairie pending satisfactory contracting of the output of the facility.

CONCLUSION

AQN is what we consider a transitional story. Our investment thesis is based on the growth profile inherent in their acquisition and development project pipeline as opposed to the current financials. During the second quarter, financial performance was reasonably stable with some weakness attributable to lower hydrology in their renewable power portfolio and lower results at two of their power generation facilities and one of their utilities. However, the company has 3 recently acquired projects which will be contributing to cash flow in the latter half of the year and has a number of projects that are expected to come online between 2013 and 2016. In total, we have calculated that the pipeline is valued at over $1.3 billion, which would nearly double their total assets from the current level. We also expect that the company will likely continue to add to this pipeline aggressively as they have over the past few years. AQN announced that they will be increasing their quarter dividend by 11%, which is the third increase we have seen in the last two years. Over the upcoming several years, we expect the robust pipeline of projects to continue to provide the company with the opportunity of dividend growth. We will reiterate that AQN's valuation based on current cash flow is not the underlying motivation behind our BUY recommendation. The company is well situated in what we consider to be a growth industry in renewable power generation; however, we believe that investors should be looking at the company with a minimum time horizon of 18 to 24 months. Over this period, we see a very strong likelihood that investors will be rewarded with total returns of 12% to 15% per year or higher which includes an attractive and growing income yield.

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2008a; 2009e
The term (a) refers to the actually results that a company has posted on its financial statements. The term (e) refers to analyst estimates of future results.

Book value (BV)
The total value of a company's assets, on its Balance Sheet, less any liabilities. Also referred to as Shareholder Equity. (The value of a companies assets, on its Balance Sheet, does not necessarily reflect the true value of assets).

Cash Flow from Operations (CFO; Operating Cash Flow)
The cash inflow that a company recieves during a period, resulting from operating activities (does not include Cash Flow from Investing or Financing).

Current ratio
One of many ratios designed to evaluate short-term liquidity of a company. Calculated as current assets divided by current liabilities, this ratio gauges the level of cash resources relative to current liabilities as a measure of cash obligations (the ratio should be greater than 1).

D/E: Debt-to-equity ratio
A measure of a company's financial leverage calculated by dividing long term debt by shareholders equity. It indicates what proportion of equity and debt the company is using to finance its assets (a lower ratio indicates lower relative debt ratios).

EBITDA
Earnings before interest, taxes, depreciation, and amortization. EBITDA is calculated as revenue minus expenses (excluding tax, interest, depreciation, and amortization).

EPS: Earnings per share
A company's earnings available to common shareholders, also known as net income or net profit, divided by the number of shares outstanding.

Fair Value
The price at which an analyst believes a companies stock should be priced. Although this value is based on intelligent analysis, it in no way is a representation of what the companies share price will be trading at given any period of time. The analysis used to determine Fair Value is based on numerous assumptions and uncertainties. Fair Value should be used only as a general guide to investing and should not be depended upon.

FCFE: Free cash flow to equity
Cash flow from operations less working capital requirements, sustaining capital expenditures and scheduled debt repayments. FCFE consists of cash inflows that are available to the shareholders of the company.

Net working capital surplus (deficiency)
A measure of the company's ability to carry on its normal business comfortably and without financial stringency, to expand its operations without the need of new financing, and to meet emergencies and losses. Calculated by deducting current liabilities from the current assets (as positive figure is a surplus, whereas a negative figure is a deficiency).

P/B: Price-to-book ratio
Calculated as a stock's market value (current closing price) divided by its latest quarter's book value. While a lower P/B ratio could mean that the stock is undervalued, it could also serve as a sign of weak fundamentals, and as with most ratios, this varies a fair amount by industry.

P/CF: Price-to-cash flow ratio
Calculated as a company's current share price divided by its cash flow per share (i.e., free cash flow divided by the number of company's shares outstanding) over the last four quarters (called "TTM," or "trailing 12 months" calculation). It is a measure of the market's expectations regarding a firm's future financial health.

P/S: Price-to-sales ratio
It is calculated as a stock's current market price divided by its sales (revenue) per share. When calculating this ratio, we use the company's revenue from its latest four quarters, or on a TTM basis.

ROE: Return on equity
A measure of a corporation's profitability, calculated as net income divided by shareholder's equity. ROE is often useful in comparing the profitability of a company to other firms in the same industry.

Tangible Book Value (TBV)
The total value of a company's assets, on its Balance Sheet, less any liabilities and intangible assets such as goodwill. Also referred to as Shareholder Equity. (Also true asset values likely differ from Balance Sheet Values, Tangible Book Value is generally considered a more accurate representation of value).

Times Interest Earned
The multiple of Net Income (before interest and taxes) to interest payments during the period. This assesses a companies ability and margin of safety, with respect to meeting its interest obligations (a higher number is more attractive).

Yield
The investment return resulting from income distributions. Calculated as the annual or annualized interest or dividend distribution, divided by the cost of the original investment.

Disclosure

Stock Holding				Other	
Companies	KeyStone	KeyStone Employees	Related Companies	Investment Banking Client	Related Company Business Relationship
Algonquin Power & Utilities Corp	NO	YES	NO	NO	NO

