



Fortis Inc. (FTS)

Updated May 28th, 2018 by Nick McCullum

Key Metrics

Current Price¹: \$42	5 Year CAGR Estimate: 13.4%	Quality Percentile: N/A
Fair Value Price¹: \$50	5 Year Growth Estimate: 6.0%	Momentum Percentile: N/A
% Fair Value: 84%	5 Year Valuation Multiple Estimate: 3.3%	Total Return Percentile: N/A
Dividend Yield: 4.1%	5 Year Price Target \$67	Valuation Percentile: N/A

Overview & Current Events

Fortis is Canada's largest investor-owned utility business with operations in Canada, the United States, and the Caribbean. The company is cross-listed on the Toronto Stock Exchange and the New York Stock Exchange, where it trades with a market capitalization of US\$13.7 billion. Fortis has increased its dividend for 44 consecutive years, trades with a current after-tax yield of 3.5% (4.1% before the 15% withholding tax applied by the Canadian government) and has "6% average growth planned through 2022."

In early May, Fortis reported (5/1/18) financial results for the first quarter of 2018. Results were in-line with the market's expectations. Fortis saw sales decline by 3.4% (largely due to foreign exchange fluctuations) but managed to offset this top-line erosion through prudent cost management. Adjusted earnings-per-share declined by 2.8% due entirely to a significant, one-time increase in the number of shares outstanding (Fortis issued \$500 million of common equity in March of 2017). On a company-wide basis, performance figures were far better. Adjusted net earnings increased by 2.1%. Looking ahead, we expect Fortis' performance to improve, particularly if the USD/CAD exchange rate moves in a favorable direction in the near future.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS¹	\$1.52	\$1.51	\$1.62	\$1.74	\$1.65	\$1.63	\$1.38	\$2.11	\$1.89	\$2.66	\$2.60	\$3.48
DPS¹	\$1.00	\$1.04	\$1.12	\$1.17	\$1.21	\$1.25	\$1.30	\$1.43	\$1.55	\$1.65	\$1.85	\$2.50

Fortis has compounded its earnings-per-share at 6.4% per year since 2008. Looking ahead, we believe that continued ~6% annualized earnings-per-share growth is feasible for this Canadian utility corporation. This year is expected to be a flat or slightly down year for Fortis' earnings. The company is likely to print earnings-per-share of about \$2.60 for the current fiscal year. Applying a 6% growth rate to this earnings estimate allows us to calculate a 2023 bottom line projection of \$3.48.

Fortis' future growth will be driven by a substantial capital expenditure plan that the company is currently executing. More specifically, Fortis is working through a \$15.1 billion capital investment program that is expected to increase its rate base to \$33 billion by 2022, which implies a five-year compound annual growth rate of 5.4%. The capital expenditure plan is focused on areas like grid improvement, natural gas distribution, cyber protection, and clean energy. Importantly, this growth rate is *before* the impact of acquisitions, which have historically been important for Fortis; for example, Fortis closed the \$11.3 billion acquisition of Michigan-based ITC Holdings Corporation in late 2016. Fortis' market capitalization is *only* ~\$14 billion. Continued acquisition-based growth is likely.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	17.5	16.4	18.2	18.8	20.1	20.0	24.3	18.0	21.6	16.8	16.2	19.2
Avg. Yld.	3.8%	4.2%	3.8%	3.6%	3.6%	3.8%	3.9%	3.8%	3.8%	3.7%	4.1%	3.8%

¹ All figures in Canadian dollars.

Using our 2018 earnings-per-share estimate of \$2.80, Fortis is currently trading at a price-to-earnings ratio of 16.2. For context, the utility has traded at an average price-to-earnings ratio of 19.2 over the last 10 years. Fortis appears to be meaningfully undervalued at current prices. If its price-to-earnings multiple can revert to its 10-year average over a period of 5 years, this will add 3.3% to the company's annualized returns during this time period.

Fortis' current valuation multiple – well below its normal levels – is also beneficial for income-oriented investors. Fortis is currently trading with a dividend yield of 4.1%, providing dividend investors with a compelling opportunity to generate meaningful portfolio income in the international markets.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	16.0%	15.2%	15.3%	14.4%	14.3%	13.6%	12.2%	14.5%	9.4%	12.4%	13.0%	13.0%
Debt/A	68.3%	69.8%	68.6%	65.2%	63.8%	64.4%	65.3%	64.1%	65.7%	65.0%	65.0%	65.0%
Int. Cov.	1.9	1.9	2.1	2.3	2.2	2.2	1.9	3.0	2.3	2.9	2.5	2.5
Payout	65.8%	68.9%	69.1%	67.2%	73.3%	76.7%	94.2%	67.8%	82.0%	62.0%	66.1%	66.7%
Std. Dev.	22.9%	14.8%	14.6%	12.3%	8.0%	10.6%	10.5%	15.1%	13.7%	9.4%	13.0%	13.0%

Fortis' gross profits expressed as a percentage of total assets have declined over time while its leverage ratios and interest coverage has improved. More importantly, what truly stands out about Fortis' quality metrics is the company's remarkably low stock price volatility. The company has posted single-digit price standard deviation in 2 of the last 10 years. Accordingly, Fortis appeals for investors who recognize that they may have trouble stomaching prolonged levels of heightened volatility in their investment portfolios.

Qualitatively, Fortis' competitive advantage is its size and scale in the fragmented Canadian utility industry. In addition, Fortis is unique because of its cross-border exposure. Three multi-billion acquisitions in the last five years have caused Fortis to now generate more than half of its revenue from the United States.

Final Thoughts & Recommendation

Even when using very conservative assumptions, Fortis appears positioned to deliver double-digit total returns over long holding periods. Moreover, the company is likely to do so with far less volatility than the stock market averages. Accordingly, we are recommending Fortis as a buy for conservative, income-oriented investors who are adverse to portfolio volatility.

Total Return Breakdown by Year

