



Northwest Natural Holding Company (NWN)

Updated November 11th, 2018 by Josh Arnold

Key Metrics

Current Price:	\$69	5 Year CAGR Estimate:	-2.8%	Volatility Percentile:	28.3%
Fair Value Price:	\$44	5 Year Growth Estimate:	2.9%	Momentum Percentile:	52.9%
% Fair Value:	156%	5 Year Valuation Multiple Estimate:	-8.5%	Growth Percentile:	10.4%
Dividend Yield:	2.8%	5 Year Price Target	\$51	Valuation Percentile:	3.1%
Dividend Risk Score:	B	Retirement Suitability Score:	B	Total Return Percentile:	1.7%

Overview & Current Events

NW Natural was founded in 1859 and has grown from just a handful of customers to serving more than 740,000 today. The utility's mission is to deliver natural gas to its customers in the Pacific Northwest and it has done that well, affording it the ability to raise its dividend for 63 consecutive years. NW Natural trades with a market capitalization of \$2 billion.

NW Natural reported Q3 earnings on 11/6/18 and results were good enough for management to reiterate earnings guidance for this year. The company's net loss per share worsened to 41 cents against 30 cents last year as Q3 is typically the weakest for the business during the year. Q3's heating demand is very weak due to weather conditions and losses are expected each year during this time. Higher margins from the utility business were more than offset by higher maintenance costs, as well as a lower tax benefit against the year-ago quarter. We've lowered our earnings-per-share estimate for this year after Q3 results towards the middle of the guided range. However, NW Natural made some important steps towards its long-term goals in Q3.

The company has seen its gas utility business continue to add customers at an annualized rate of 1.7%, which is quite high for a gas utility. Indeed, NW Natural calls out that its utility business continues to have one of the highest growth rates in its customer base in the nation. In addition to the gas utility, NW Natural has a burgeoning water utility business and in Q3, it signed a purchase agreement for another water utility and wastewater business, while closing four others. NW Natural has only been in the water business for a few quarters, but it is investing heavily as it sees water not only as a diversifier away from the core utility business, but also a source of long-term growth.

The company's key Oregon rate case went into effect on 11/1/18 after the Public Utility Commission of Oregon provided an order on the matter in late October. The order allows for a 3.72% increase in annual revenue over current rates and annual earnings benefit of \$14.2 million. NW Natural believes this will boost cash flow by \$15 million annually as well. In other words, NW Natural received a favorable ruling from Oregon, as expected, and this will fuel the next few years of revenue growth for the utility business. Simultaneously, it will provide additional cash flow for the company to go after additional water utility customers.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$2.57	\$2.83	\$2.73	\$2.39	\$2.22	\$2.24	\$2.16	\$1.96	\$2.12	\$1.94	\$2.20	\$2.54
DPS	\$1.52	\$1.60	\$1.68	\$1.75	\$1.79	\$1.83	\$1.85	\$1.86	\$1.87	\$1.88	\$1.90	\$2.10
Shares	27	27	27	27	27	27	27	27	29	29	30	32

Earnings-per-share have declined rather steadily in the past decade or so as NW Natural has been unable to push through any pricing increases. It is obviously highly regulated and as such, is not in control over its pricing and margins. Revenue has fallen as well, providing another headwind to earnings growth. We are forecasting an average growth rate of 2.9% for the next five years as NW Natural pushes through approved pricing increases and continues to acquire customers at low single digit rates, as it did in Q3 and with the new Oregon rate case. NW Natural also has its water utilities business that will provide a small amount of growth, but higher earnings will primarily come from customer and pricing growth while the company invests in its fledgling water business for longer-term growth.

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The company's dividend has been raised for 63 consecutive years and the stock yields a respectable 2.8%, so the payout is of great importance to shareholders. The dividend has grown very slowly in recent years as a lack of earnings growth has capped the amount of cash NW Natural can return to shareholders; we are forecasting ~2% dividend growth going forward in a continuation of that trend. The payout ratio has grown too much to allow for higher rates of growth.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	18.1	15.2	17.0	19.0	21.1	19.4	20.7	23.7	26.9	31.9	31.2	20.0
Avg. Yld.	3.3%	3.7%	3.6%	3.9%	3.8%	4.2%	4.1%	4.0%	3.3%	3.0%	2.8%	4.1%

NW Natural's price-to-earnings multiple has risen substantially during the past decade. This has seen the stock's multiple rise from 15.2 in 2009 to 31.9 in 2017, and it is 31.2 today. With interest rates rising and dividend stocks losing their luster when it comes to high valuations, we are forecasting an 8.5% headwind to total returns from a price-to-earnings multiple that should fall back towards 20 from today's levels. We believe the yield will rise from today's 2.8% to a more normalized 4.1% in the next five years as the dividend grows but the stock's valuation falls.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	34.3%	37.2%	45.3%	43.5%	51.4%	50.8%	51.5%	54.8%	61.4%	57.4%	60.0%	60.0%
Debt/A	52%	72%	74%	74%	74%	75%	75%	75%	72%	76%	76%	75%
Int. Cov.	3.9	4.0	3.9	3.4	3.3	3.2	3.2	2.9	3.6	3.6	3.6	3.7
Payout	59%	56%	61%	73%	80%	81%	85%	92%	87%	97%	86%	83%
Std. Dev.	37.8%	22.0%	20.1%	21.8%	14.4%	14.3%	15.8%	18.9%	21.3%	15.7%	18.0%	20.0%

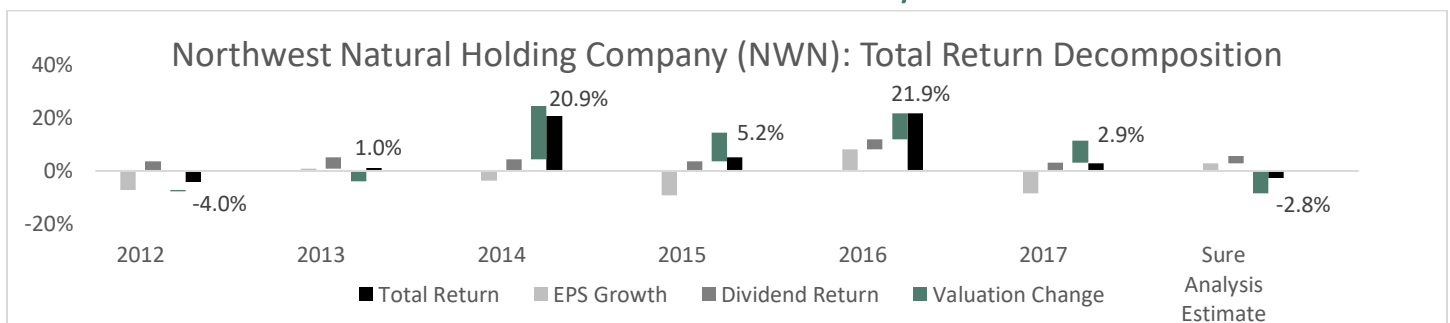
NW Natural's quality metrics have been very steady in the past decade. Seventy-six percent of its total assets are encumbered by debt, which is completely acceptable for a utility. Its interest coverage is fairly strong at 3.6, so there are certainly no financing concerns moving forward. The dividend is consuming almost all of NW Natural's earnings currently, but that situation should improve as earnings growth picks up this year and beyond.

Its obvious competitive advantage is in its monopoly in its service areas. That allowed it to perform extremely well during the Great Recession as discretionary use of natural gas and water is very low.

Final Thoughts & Recommendation

Overall, NW Natural is still well in excess of fair value. The combination of the 2.8% yield, 8.5% headwind from the valuation decline and 2.9% earnings growth should keep total returns at -2.8% annually. Given these factors, we rate the stock a sell despite the decent yield.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	1038	1013	792	828	731	759	754	724	676	762
Gross Profit	356	377	247	244	246	249	252	235	252	257
Gross Margin	34.3%	37.2%	31.1%	29.5%	33.6%	32.8%	33.4%	32.5%	37.3%	33.7%
D&A Exp.	72	63	65	70	73	76	79	81	82	86
Operating Profit	169	159	158	145	142	143	143	124	139	139
Operating Margin	16.3%	15.7%	19.9%	17.5%	19.5%	18.8%	19.0%	17.2%	20.6%	18.3%
Net Profit	70	75	73	63	59	61	59	54	59	-56
Net Margin	6.7%	7.4%	9.2%	7.6%	8.0%	8.0%	7.8%	7.4%	8.7%	-7.3%
Free Cash Flow	-69	105	-122	133	37	37	96	66	83	-7
Income Tax	41	47	49	43	43	42	42	36	41	-31

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	2378	2399	2617	2747	2813	2971	3065	3069	3080	3040
Cash & Equivalents	7	8	3	6	9	9	10	4	4	3
Accounts Receivable	81	77	68	77	61	82	70	68	67	68
Inventories	10	81	80	74	68	61	78	71	54	48
Total Liabilities	1238	1739	1924	2032	2083	2219	2298	2288	2229	2297
Accounts Payable	94	124	93	86	86	96	91	73	86	112
Long-Term Debt	248	739	859	823	882	930	896	864	773	834
Shareholder's Equity	1140	660	693	714	730	752	767	781	850	743
D/E Ratio	0.22	1.12	1.24	1.15	1.21	1.24	1.17	1.11	0.91	1.12

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	3.2%	3.1%	2.9%	2.4%	2.1%	2.1%	1.9%	1.8%	1.9%	-1.8%
Return on Equity	8.0%	8.3%	10.7%	9.0%	8.1%	8.2%	7.7%	6.9%	7.2%	-7.0%
ROIC	5.3%	5.4%	4.9%	4.1%	3.7%	3.7%	3.5%	3.2%	3.6%	-3.5%
Shares Out.	27	27	27	27	27	27	27	27	29	29
Revenue/Share	39.03	38.11	29.72	30.96	27.15	28.07	27.70	26.40	24.33	26.59
FCF/Share	-2.61	3.96	-4.58	4.97	1.37	1.39	3.51	2.42	2.97	-0.24

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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