



Fortis, Inc. (FTS)

Updated February 21st, 2019 by Josh Arnold

Key Metrics

Current Price:	\$46	5 Year CAGR Estimate:	11.6%	Volatility Percentile:	2.2%
Fair Value Price:	\$51	5 Year Growth Estimate:	6.0%	Momentum Percentile:	70.9%
% Fair Value:	92%	5 Year Valuation Multiple Estimate:	1.7%	Growth Percentile:	52.0%
Dividend Yield:	3.9%	5 Year Price Target	\$68	Valuation Percentile:	71.3%
Dividend Risk Score:	B	Retirement Suitability Score:	A	Total Return Percentile:	74.4%

Overview & Current Events

Fortis is Canada's largest investor-owned utility business with operations in Canada, the United States, and the Caribbean. It is cross-listed in Toronto and New York, where it trades with a market capitalization of CAD\$20 billion. Fortis has increased its dividend for 45 consecutive years and trades with a current after-tax yield of 3.3% (3.9% before the 15% withholding tax applied by the Canadian government). Canadian Dollars are used in this research report.

Fortis reported Q4 earnings on 2/15/19 and results were largely in line with expectations. Earnings-per-share for 2018 came in at \$2.59, which was a nearly 12% increase year-over-year. The increase in earnings was driven by several factors. First, the company's regulated and non-regulated businesses continued to grow, as they have for years. In addition, the company's tax rate was lower against 2017 thanks to US tax reform. Results for 2017 also contained one-time items including mark-to-market adjustments, an acquisition break fee, and transmission refunds, none of which reoccurred in 2018. The company's 2018 results also suffered a bit from a lower return on equity incentive ladder at ITC, which took effect in April of 2018. Finally, Fortis continues to issue shares as a way of life, and the higher share count tempered earnings-per-share growth for 2018 despite higher earnings on a dollar basis.

Subsequent to the end of the quarter, in late January, Fortis announced it was selling its 51% interest in the Waneta Expansion Hydroelectric Project in British Columbia to Columbia Power Corporation and Columbian Basin Trust. The deal is worth \$1 billion for Fortis so it is very significant, and should close in the second quarter of 2019. Fortis is working on its enormous, five-year, \$17.3 billion capital expenditure plan and this asset sale will help fund that plan. The plan addresses the company's gaps in capacity and reliability in its network, and we think that while it is quite expensive, it is necessary to fuel future growth.

We're out with an initial estimate of \$2.66 in earnings-per-share for 2019 as we see the company's lapping of the lower tax rate as a factor, as well as the tremendous amount of capital spending it is doing this year. The asset sale will also reduce earnings, and we expect the share count to be higher as well. We don't see the longer-term growth story for Fortis as impaired by any means, but 2019 is likely to fall short of the stated goal of ~6% growth.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$1.51	\$1.62	\$1.74	\$1.65	\$1.63	\$1.38	\$2.11	\$1.89	\$2.32	\$2.59	\$2.66	\$3.56
DPS	\$1.04	\$1.12	\$1.17	\$1.21	\$1.25	\$1.30	\$1.43	\$1.55	\$1.65	\$1.73	\$1.80	\$2.40
Shares	170	173	182	190	203	226	279	309	416	425	435	475

Fortis has compounded its earnings-per-share at 6.2% per year since 2009, and we expect 6% annually moving forward, per management's guidance and despite an ever-rising share count. Our estimates are building in a steady rise in the share count, but just how many shares are issued depends upon Fortis' future acquisitions. This is a variable in the outlook that can significantly impact results, particularly if Fortis completes a sizable acquisition funded by stock.

Fortis' future growth will be driven by a substantial capital expenditure plan that the company is currently executing, as mentioned above. 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

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been important for Fortis. We see growth in the dividend roughly keeping pace with earnings growth and the share price, so the yield should remain near 4% for the foreseeable future (before mandatory withholding).

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	16.4	18.2	18.8	20.1	20.0	24.3	18.0	21.6	16.8	16.6	17.4	19.0
Avg. Yld.	4.2%	3.8%	3.6%	3.6%	3.8%	3.9%	3.8%	3.8%	3.7%	4.0%	3.9%	3.5%

Using our 2018 earnings-per-share estimate of \$2.66, Fortis is currently trading at a price-to-earnings ratio of 17.4, which we believe is below fair value at 19. That implies a 1.7% tailwind to total returns from a rising valuation. The stock has spent the past two years trading well below its historical multiple, but we continue to believe 19 is fair value.

Fortis is currently trading with a dividend yield of 3.9% (gross of the withholding tax paid to the Canadian government), providing investors with a compelling opportunity to generate meaningful portfolio income in the international markets. Should the valuation rise over time, the yield will drift lower, but that would be a favorable net result for shareholders.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	69%	69%	67%	73%	77%	94%	68%	82%	71%	67%	68%	67%

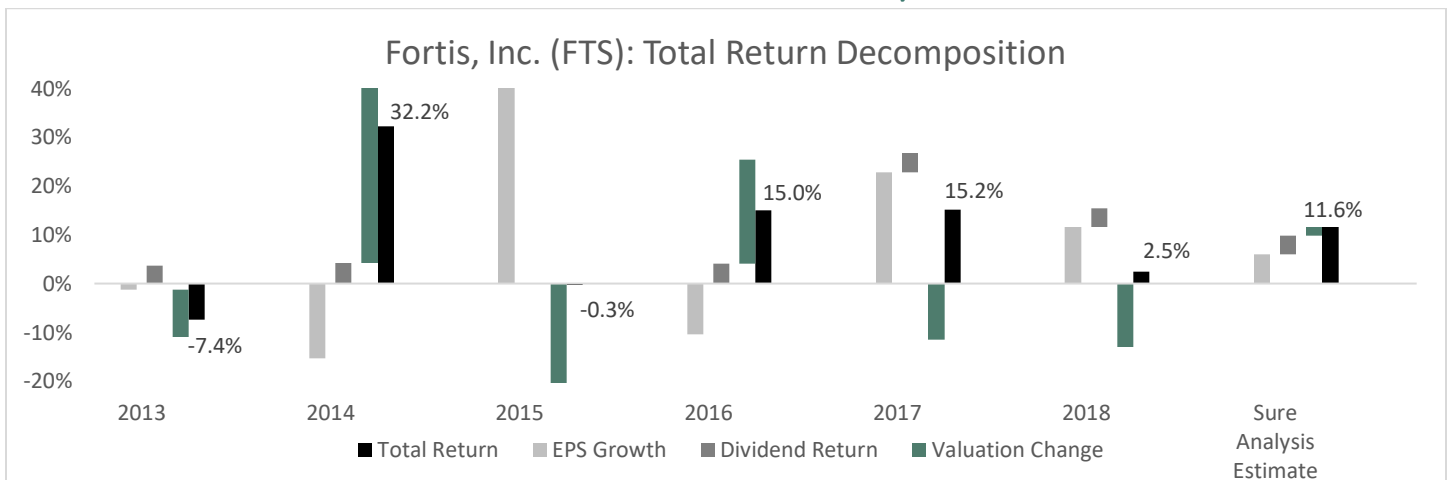
Fortis' payout ratio has spent the last couple of years around two-thirds of earnings, and we believe it will stay there. That implies mid-single digit dividend increases annually, which would keep pace with earnings. The dividend is important to management and we believe it is very safe and should continue to rise for years to come.

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 allowed Fortis to now generate more than half of its revenue from the United States.

Final Thoughts & Recommendation

Even under conservative assumptions, Fortis appears positioned to deliver 11.6% total returns over time. These returns will accrue from 6% earnings growth, the 3.9% yield and a 1.7% tailwind from a rising valuation. 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 averse to portfolio volatility.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	3207	3546	3780	3655	3930	4892	5294	5164	6405	6474
Gross Profit	1623	1911	2064	2133	2360	2902	3264	3396	4583	4549
Gross Margin	50.6%	53.9%	54.6%	58.3%	60.0%	59.3%	61.7%	65.8%	71.6%	70.3%
D&A Exp.	317	396	421	470	525	623	684	742	910	959
Operating Profit	617	716	784	794	827	927	1112	1120	1938	1825
Operating Margin	19.2%	20.2%	20.7%	21.7%	21.1%	18.9%	21.0%	21.7%	30.2%	28.2%
Net Profit	247	303	361	362	398	343	631	498	793	900
Net Margin	7.7%	8.6%	9.6%	9.9%	10.1%	7.0%	11.9%	9.7%	12.4%	13.9%
Free Cash Flow	-302	-331	-259	-154	-268	-673	-447	-134	-207	-474
Income Tax	43	65	85	61	31	60	175	109	454	127

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	11520	12907	13923	15028	16819	22598	20757	35530	38029	38950
Cash & Equivalents	81	109	85	155	68	198	174	200	260	244
Acc. Receivable	565	655	592	528	331	413	373	376	366	395
Inventories	169	168	131	134	134	277	243	276	292	292
Goodwill & Int.	1752	1877	1851	1903	2273	3612	3397	9920	10119	10081
Total Liabilities	8044	8849	9081	9590	10831	14749	13296	23329	24710	25400
Accounts Payable	809	953	448	501	397	527	298	411	553	499
Long-Term Debt	5401	5966	5869	6115	6963	9320	8456	16527	17231	17727
Total Equity	3030	3304	3745	4013	4482	5919	5808	9623	10640	10947
D/E Ratio	1.61	1.53	1.27	1.19	1.24	1.24	1.19	1.53	1.44	1.46

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	2.4%	2.5%	2.7%	2.5%	2.5%	1.7%	2.9%	1.8%	2.2%	2.3%
Return on Equity	9.0%	9.6%	10.2%	9.3%	9.4%	6.6%	10.8%	6.5%	7.8%	8.3%
ROIC	3.1%	3.2%	3.5%	3.3%	3.2%	2.3%	3.8%	2.2%	2.7%	2.9%
Shares Out.	170	173	182	190	203	226	279	309	416	425
Revenue/Share	17.35	18.95	19.90	18.53	18.78	21.64	18.60	16.48	15.39	15.23
FCF/Share	-1.63	-1.77	-1.36	-0.78	-1.28	-2.98	-1.57	-0.43	-0.50	-1.11

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

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