Sempra Energy (SRE)

Updated March 7th, 2019 by Samuel Smith

Key Metrics

Current Price:	$121	**5 Year CAGR Estimate:**	11.4%	**Volatility Percentile:**	8.2%
Fair Value Price:	$123	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	76.0%
% Fair Value:	98%	**5 Year Valuation Multiple Estimate:**	0.2%	**Growth Percentile:**	75.6%
Dividend Yield:	3.2%	**5 Year Price Target**	$180	**Valuation Percentile:**	46.5%
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**Total Return Percentile:**	63.4%

Overview & Current Events

Sempra Energy (SRE) was founded 20 years ago and has grown into a $33.25 billion market cap company. SRE serves one of the largest utility customer bases in the U.S. as it distributes natural gas and electricity in Southern California (over 20 million customers) and owns a majority stake in Texas-based Oncor, a transmission and distribution business (over 10 million customers). The company also owns and operates other utilities and merchant renewable energy projects, liquefied natural gas facilities, and gas pipes and storage in the U.S. and Latin America.

SRE reported solid quarterly results, 2018 results, and 2019 guidance on 2/26/19. The company forecasts 7.7% EPS growth for 2019, in-line with its 8% dividend increase. 2018 saw SRE sell off most of its non-core assets in order to better focus on its large core North American regulated utility, LNG export, and Mexican infrastructure (IEnova) assets as well as deleverage the balance sheet. Given the strong competitive advantages enjoyed by these core assets and the late stage in the economic cycle, we believe that these moves de-risk SRE and make it more attractive as an investment.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$4.52	$2.86	$5.51	$3.48	$4.01	$4.63	$5.37	$5.46	$5.42	$5.57	***$6.00***	***$8.82***
DPS	$1.56	$1.56	$1.92	$2.40	$2.52	$2.64	$2.80	$3.02	$3.29	$3.58	***$3.87***	***$5.69***
Shares	247	248	242	247	249	251	251	251	252	270	***273***	***285***

Sempra's enormous economies of scale and regulated monopolies in California and Texas should enable it to capitalize on any economic growth in those regions to drive long term growth. Texas in particular should see strong organic growth due to the population growth in the state. Additionally, SRE's assets in Mexico enjoy a first mover advantage which should enable them to grow rapidly as Mexico begins to invest more seriously in its massively underdeveloped infrastructure. The LNG export portfolio should also see robust demand as the U.S. continues its transition into a global energy exporting giant. As a result, management has several expansion projects (in particular Cameron phase 2) which should contribute significantly to company cash flows. We believe that management's guidance for strong growth in 2019 is just the beginning of several years of rapid growth. We therefore assign an annual EPS growth estimate of 8% to shares over the next five years and expect the dividend to grow at the same pace.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	12.5	18.4	10.1	20.7	22.3	24.1	17.3	18.5	19.8	19.4	***20.3***	***20.5***
Avg. Yld.	2.8%	3.0%	3.4%	3.3%	2.8%	2.4%	3.0%	3.0%	3.1%	3.3%	***3.2%***	***3.2%***

SRE's growth is accelerating due to increased focus on its competitively-advantaged core assets and the accelerating infrastructure and energy export booms in Mexico and the United States, respectively. As a result, the company's 8% projected EPS and dividend growth rate over the next half decade warrants the fairly high current valuation multiple relative to SRE's recent history. In fact, the compelling total return potential combined with the moated business model warrants a slight valuation multiple expansion in the near term, in our opinion, as we believe the 3.2% dividend yield is pretty typical for the company throughout its history.

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Safety, Quality, Competitive Advantage, & Recession Resiliency

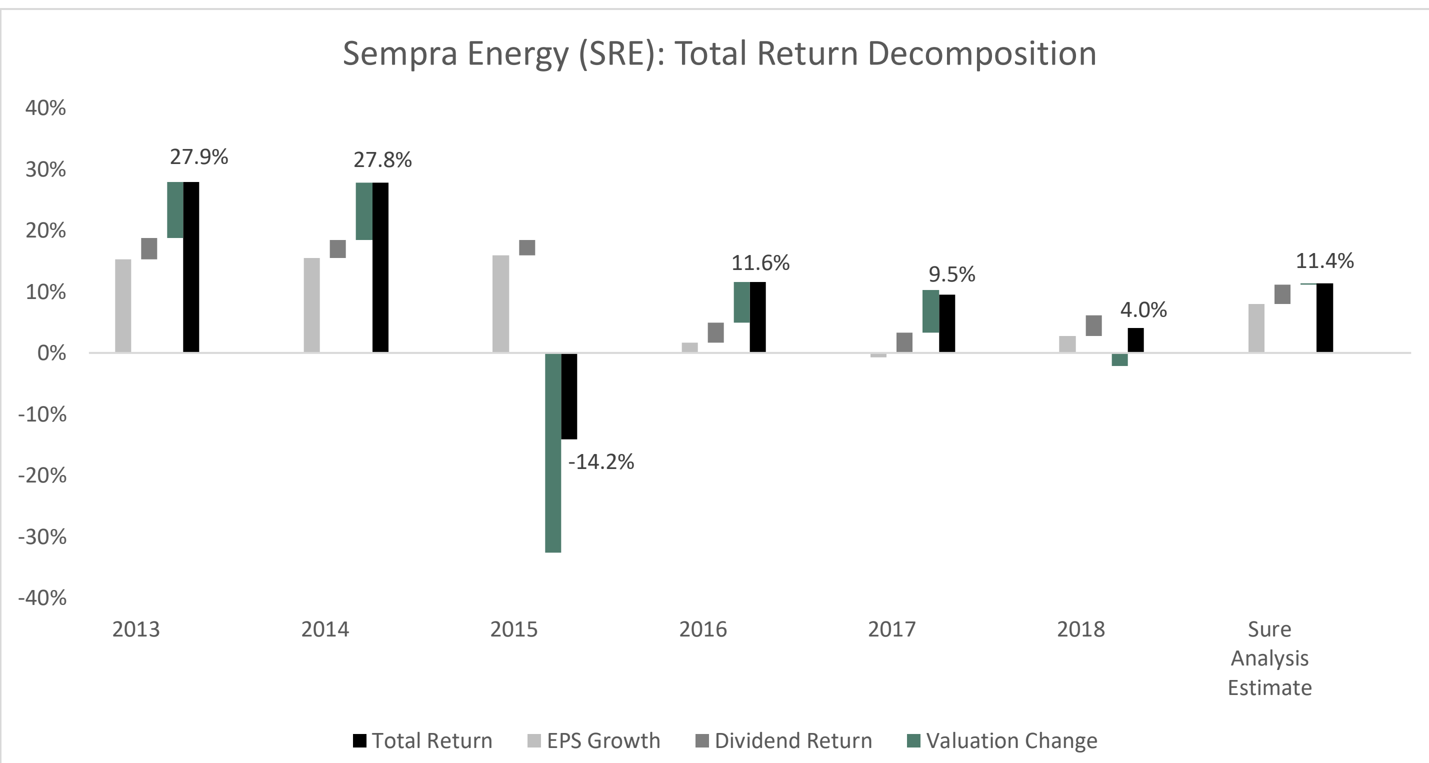
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	34.5%	54.5%	34.8%	69.0%	62.8%	57.0%	52.1%	55.3%	60.7%	64.3%	***64.5%***	***64.5%***

As a regulated utility in possession of dominant businesses in their respective regions, SRE possesses a clear moat around a significant portion of its earnings. At the same time, however, the regulated nature of its pricing prevents it from earning surplus profits. These businesses, as well as the stable, mission-critical nature of its infrastructure business in Mexico make it quite recession resistant. As proof of this, SRE's EPS and book value per share both actually increased during the last recession (2008 and 2009). However, its LNG export business and international exposure make it susceptible to commodity price, geopolitical, and currency exchange risks. Nevertheless, its high-quality assets, low payout ratio, stable cash flows, and strong growth prospects make it a fairly low risk investment. Additionally, SRE's balance sheet has been considerably strengthened thanks to their dispositions of non-core assets.

Final Thoughts & Recommendation

SRE owns quality assets, many of which are in recession resistant businesses. Its utilities businesses are dominant players in their fields and its LNG export and infrastructure businesses have strong growth prospects. Combined, they create a business that has both stable, defensive characteristics as well as strong growth prospects. As a result, SRE offers investors compelling total return potential (11.4% coming from its 3.2% dividend yield, 8% annual EPS growth forecast, and 0.2% annualized multiple expansion forecast) without taking on too much risk. As a result, we rate it a buy for value, growth, and dividend investors.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	8106	9003	10036	9647	10557	11035	10231	10183	11207	11687
Gross Profit	4848	2721	3065	3001	3371	3346	3592	3353	4277	4414
Gross Margin	59.8%	30.2%	30.5%	31.1%	31.9%	30.3%	35.1%	32.9%	38.2%	37.8%
D&A Exp.	775	866	976	1090	1113	1156	1250	1312	1490	1549
Operating Profit	1307	1585	1845	1648	1959	1888	2026	1731	2519	2491
Operating Margin	16.1%	17.6%	18.4%	17.1%	18.6%	17.1%	19.8%	17.0%	22.5%	21.3%
Net Profit	1119	719	1339	865	1009	1162	1350	1371	257	1050
Net Margin	13.8%	8.0%	13.3%	9.0%	9.6%	10.5%	13.2%	13.5%	2.3%	9.0%
Free Cash Flow	-37	92	-977	-938	-788	-962	-258	-1903	-324	-337
Income Tax	422	133	394	59	366	300	341	389	1276	96

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	28512	30283	33249	36499	37244	39651	41150	47786	50454	60638
Cash & Equivalents	110	912	252	475	904	570	403	349	288	190
Acc. Receivable	971	891	1198	1146	1308	1242	1283	1390	1307	1488
Inventories	197	258	346	408	287	396	298	258	307	296
Goodwill & Int.	524	540	1484	1547	1450	1346	1223	2912	2993	2645
Total Liabilities	19261	21045	23071	25816	25394	27551	28571	32545	35314	41390
Accounts Payable	522	755	983	976	1088	1198	1133	1346	1350	1324
Long-Term Debt	8651	9487	10863	12892	12945	14288	14663	17121	19412	25363
Total Equity	9007	9027	9795	10302	11028	11346	11829	12971	12690	14900
D/E Ratio	0.96	1.05	1.11	1.25	1.17	1.26	1.24	1.32	1.53	1.48

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	4.1%	2.4%	4.2%	2.5%	2.7%	3.0%	3.3%	3.1%	0.5%	1.9%
Return on Equity	13.2%	8.0%	14.2%	8.6%	9.5%	10.4%	11.7%	11.1%	2.0%	7.6%
ROIC	6.6%	3.9%	6.7%	3.9%	4.2%	4.5%	5.0%	4.6%	0.8%	2.7%
Shares Out.	247	248	242	247	249	251	251	251	252	270
Revenue/Share	32.77	36.31	41.55	39.11	42.34	44.02	40.77	40.54	44.42	43.31
FCF/Share	-0.15	0.37	-4.05	-3.80	-3.16	-3.84	-1.03	-7.58	-1.28	-1.25

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