



Spark Energy Inc. (SPKE)

Updated April 15th, 2019 by Aristofanis Papadatos

Key Metrics

| | | | | | |
|-----------------------------|--------|--------------------------------------------|---------|---------------------------------|-------|
| Current Price: | \$9.52 | 5 Year CAGR Estimate: | 16.9% | Volatility Percentile: | 97.9% |
| Fair Value Price: | \$3.13 | 5 Year Growth Estimate: | 29.2% | Momentum Percentile: | 14.0% |
| % Fair Value: | 95% | 5 Year Valuation Multiple Estimate: | -20.0% | Growth Percentile: | 99.6% |
| Dividend Yield: | 7.7% | 5 Year Price Target | \$11.25 | Valuation Percentile: | 0.3% |
| Dividend Risk Score: | F | Retirement Suitability Score: | C | Total Return Percentile: | 96.1% |

Overview & Current Events

Spark Energy Inc. is an independent retail energy services company founded in 1999. The organization provides residential and commercial customers with alternative choices for their natural gas and electricity. Spark Energy is headquartered in Houston, Texas and currently operates in 19 states and serves 94 utility territories. Spark Energy has a market cap of \$333 million and executed its initial public offering in 2014.

In early March, Spark Energy reported (3/4/19) financial results for the fourth quarter of fiscal 2018. In the quarter, its adjusted EBITDA fell 30%, from \$28.9 million in prior year's quarter to \$20.1 million, due to a lower retail gross margin. The latter resulted from lower electricity unit margins and lower natural gas volumes. The company switched from a profit of \$46.3 million in prior year's quarter to a loss of \$15.3 million, mostly due to the above decrease in retail gross margin and non-cash losses in the hedging derivatives of the company. While these are non-cash losses, they are correctly included in earnings, as they essentially offset the benefit from higher realized commodity prices.

While management did not provide specific guidance for this year, it stated that it expected improved margins, particularly at the second half of the year.

Growth on a Per-Share Basis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|---------------|------|------|------|------|------|---------|--------|--------|--------|---------|---------------|---------------|
| EPS | --- | --- | --- | --- | --- | -\$0.01 | \$0.53 | \$1.11 | \$1.21 | -\$0.69 | \$0.25 | \$0.90 |
| DPS | --- | --- | --- | --- | --- | \$0.30 | \$0.73 | \$0.73 | \$0.73 | \$0.73 | \$0.73 | \$0.73 |
| Shares | --- | --- | --- | --- | --- | 6.00 | 6.24 | 33.44 | 34.62 | 34.99 | 35.5 | 40.0 |

Since its IPO, Spark Energy has made 14 acquisitions and has thus grown its customer base at a fast pace. However, this strategy has not born fruit yet. The company has a remarkably volatile performance record and hence it is essentially impossible to forecast its future results with any degree of accuracy. Spark Energy posted a loss last year while it did not provide any material guidance for this year. It is also worth noting that Spark Energy offers very little information in its earnings reports and is hardly followed by analysts. It is also concerning that its management remains focused on EBITDA instead of earnings. We prefer to be conservative and assume earnings-per-share around \$0.90 by 2024.

The company's expansion into the country of Japan is likely to be an important growth driver in the upcoming years. Spark Energy operates a profitable Japan business that currently has 107,000 customers acquired through a diverse set of sales channels. In a previous conference call, management noted that *"We continue to see development of the wholesale markets and corresponding new product alternatives over there. The business continues to outperform our business case, and we expect to begin taking distributions from 2019."*

Valuation Analysis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Now | 2024 |
|------------------|------|------|------|------|------|------|------|------|------|------|-------------|-------------|
| Avg. P/E | --- | --- | --- | --- | --- | --- | 14.7 | 12.0 | 13.5 | --- | 38.1 | 12.5 |
| Avg. Yld. | --- | --- | --- | --- | --- | --- | 9.3% | 5.5% | 4.5% | 7.6% | 7.7% | 8.0% |

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Spark Energy has consistently traded at a price-to-earnings ratio in the low double-digits since its initial public offering. Accordingly, we estimate that the firm's fair value is somewhere near a price-to-earnings ratio of 12.5. Due to our expectations for poor earnings this year, the stock is trading at a price-to-earnings ratio of 38.1 today. If Spark Energy's price-to-earnings ratio contracts to 12.5 over the next five years, the stock will incur a 20.0% annualized drag in its returns during this time period.

Note: As the current price-to-earnings ratio is more than triple our assumed fair price-to-earnings ratio, we cannot calculate the fair value of the stock as usual. Instead we have left the fair value unchanged, based on an expectation of normalized earnings power.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|--------|------|------|------|------|------|------|------|-------|-------|------|------|-------|
| Payout | --- | --- | --- | --- | --- | --- | 138% | 65.8% | 61.3% | --- | 292% | 81.1% |

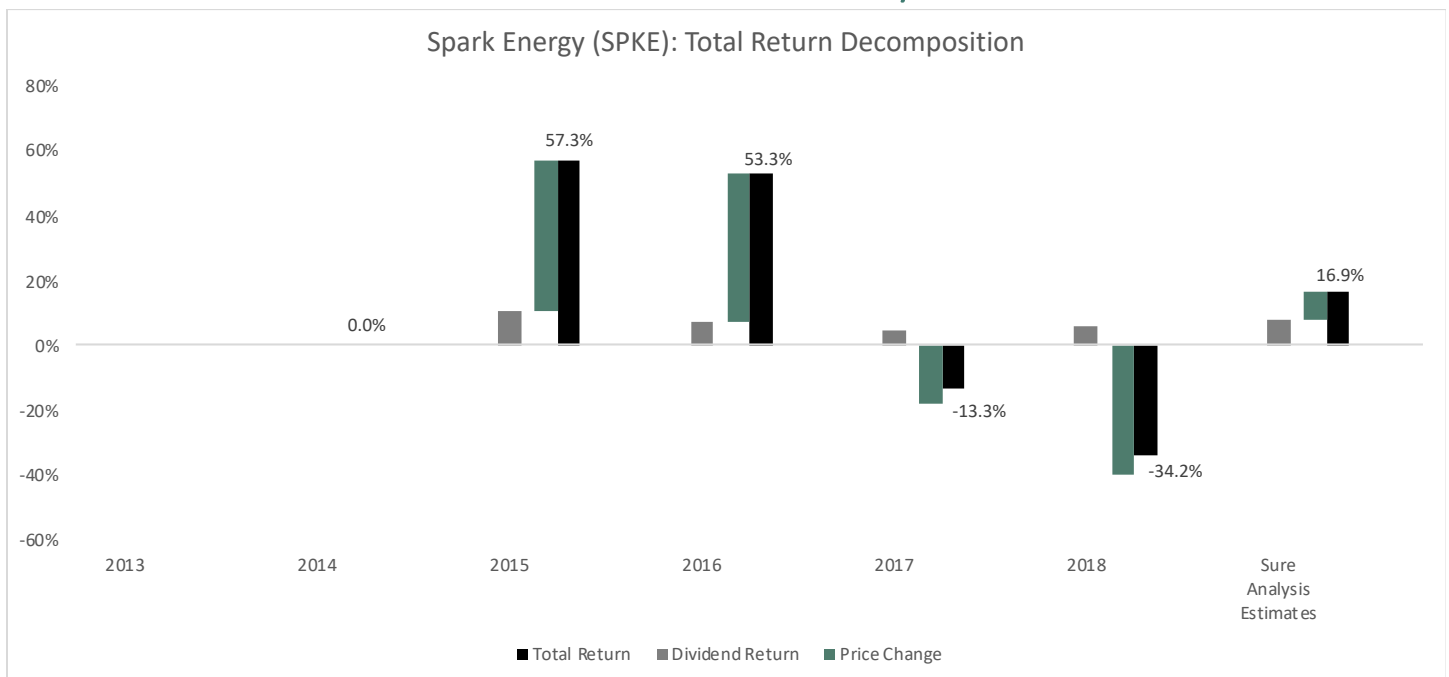
As a small-cap energy business, Spark Energy tends to be more volatile than most large cap stocks. While the stock has rallied 30% off its bottom in the Christmas sell-off, it is still 60% off its peak, in 2017. In addition, it is hardly followed by analysts and provides little information in its reports.

Final Thoughts & Recommendation

In our previous research reports, we recommended buying Spark Energy thanks to its rapid growth rate, its high dividend yield and the potential for modest valuation expansion. Since then, the stock has advanced 13% whereas S&P has remained flat. The stock can still offer a double-digit average annual return over the next five years, assisted by its 7.7% dividend yield. As a result, it maintains its buy rating.

Nevertheless, retirees should note that Spark Energy earns a poor rating for Retirement Suitability, largely due to its short dividend history. Moreover, the stock is highly volatile and speculative and hence it is suitable only for investors who have strong confidence in its business model and can stomach wild swings in its stock price.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|------------------|------|------|------|------|-------|-------|-------|-------|-------|-------|
| Revenue | N/A | N/A | N/A | N/A | 317 | 323 | 358 | 547 | 798 | 1006 |
| Gross Profit | N/A | N/A | N/A | N/A | 84 | 64 | 117 | 202 | 246 | 160 |
| Gross Margin | N/A | N/A | N/A | N/A | 26.5% | 19.9% | 32.7% | 36.9% | 30.8% | 15.9% |
| SG&A Exp. | N/A | N/A | N/A | N/A | 35 | 46 | 62 | 85 | 101 | 111 |
| D&A Exp. | N/A | N/A | N/A | N/A | 16 | 22 | 25 | 49 | 43 | 51 |
| Operating Profit | N/A | N/A | N/A | N/A | 33 | -4 | 30 | 84 | 102 | -4 |
| Operating Margin | N/A | N/A | N/A | N/A | 10.4% | -1.2% | 8.3% | 15.4% | 12.8% | -0.4% |
| Net Profit | N/A | N/A | N/A | N/A | 31 | 0 | 4 | 14 | 19 | -1 |
| Net Margin | N/A | N/A | N/A | N/A | 9.9% | 0.0% | 1.1% | 2.6% | 2.4% | -0.1% |
| Free Cash Flow | N/A | N/A | N/A | N/A | 43 | 3 | 44 | 65 | 60 | 58 |
| Income Tax | N/A | N/A | N/A | N/A | 0 | -1 | 2 | 10 | 39 | 2 |

Balance Sheet Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|----------------------|------|------|------|------|------|------|------|------|------|------|
| Total Assets | N/A | N/A | N/A | N/A | 109 | 138 | 162 | 375 | 504 | 489 |
| Cash & Equivalents | N/A | N/A | N/A | N/A | 11 | 4 | 4 | 19 | 29 | 41 |
| Accounts Receivable | N/A | N/A | N/A | N/A | 63 | 65 | 62 | 112 | 162 | 153 |
| Inventories | N/A | N/A | N/A | N/A | 4 | 8 | 4 | 4 | 4 | 4 |
| Goodwill & Int. Ass. | N/A | N/A | N/A | N/A | 0 | 4 | 29 | 101 | 155 | 147 |
| Total Liabilities | N/A | N/A | N/A | N/A | 73 | 114 | 129 | 251 | 303 | 308 |
| Accounts Payable | N/A | N/A | N/A | N/A | 37 | 39 | 30 | 52 | 82 | 72 |
| Long-Term Debt | N/A | N/A | N/A | N/A | 28 | 33 | 49 | 78 | 146 | 146 |
| Shareholder's Equity | N/A | N/A | N/A | N/A | 36 | 9 | 11 | 30 | 58 | 46 |
| D/E Ratio | N/A | N/A | N/A | N/A | 0.77 | 3.81 | 4.30 | 2.58 | 1.48 | 1.07 |

Profitability & Per Share Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|------------------|------|------|------|------|-------|-------|-------|-------|-------|-------|
| Return on Assets | N/A | N/A | N/A | N/A | 26.4% | 0.0% | 2.6% | 5.4% | 4.4% | -0.2% |
| Return on Equity | N/A | N/A | N/A | N/A | 64.6% | -0.2% | 38.7% | 69.3% | 43.8% | -2.3% |
| ROIC | N/A | N/A | N/A | N/A | 46.6% | -0.1% | 5.6% | 10.2% | 7.0% | -0.4% |
| Shares Out. | N/A | N/A | N/A | N/A | 6.00 | 6.24 | 33.44 | 34.62 | 34.99 | 6.00 |
| Revenue/Share | N/A | N/A | N/A | N/A | 18.93 | 53.81 | 53.82 | 43.08 | 59.80 | 75.13 |
| FCF/Share | N/A | N/A | N/A | N/A | 2.57 | 0.47 | 6.64 | 5.10 | 4.53 | 4.36 |

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

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