



Fortis Inc. (FTS)

Updated May 1st, 2019 by Kay Ng

Key Metrics

Current Price:	\$49	5 Year CAGR Estimate:	10.2%	Volatility Percentile:	2.9%
Fair Value Price:	\$51	5 Year Growth Estimate:	6.0%	Momentum Percentile:	71.9%
% Fair Value:	97%	5 Year Valuation Multiple Estimate:	0.6%	Growth Percentile:	53.0%
Dividend Yield:	3.6%	5 Year Price Target	\$68	Valuation Percentile:	60.5%
Dividend Risk Score:	B	Retirement Suitability Score:	A	Total Return Percentile:	60.9%

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\$21 billion. Fortis has increased its dividend for 45 consecutive years and trades with a current after-tax yield of 3.1% (3.6% before the 15% withholding tax applied by the Canadian government). Canadian Dollars are used in this research report.

Fortis reported Q1 earnings on 5/1/19 and results were largely in line with expectations. Adjusted earnings-per-share increased 5.7% to \$0.74 over the comparable quarter in 2018. The increase in earnings was driven by the company's largely regulated business (99% regulated), which continued to grow, as it has for years.

In April, Fortis sold its 51% interest in the Waneta Expansion Hydroelectric Project, in British Columbia to Columbia Power Corporation and Columbian Basin Trust, for about \$1 billion, which is meaningful given Fortis' size. The company plans to redeploy the proceeds to help fund growth in its regulated utility businesses as a part of its five-year, \$17.3 billion capital expenditure plan through 2023.

We're maintaining our estimate of \$2.66 in earnings-per-share for 2019 due to the tremendous amount of capital spending of \$3.7 billion being done this year. Moreover, the asset sale will reduce earnings. 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	\$2.66	\$2.52	\$2.66	\$3.56
DPS	\$1.04	\$1.12	\$1.17	\$1.21	\$1.25	\$1.30	\$1.43	\$1.55	\$1.65	\$1.75	\$1.85	\$2.40
Shares	171	174	189	192	213	276	282	401	421	429	435	475

Fortis has compounded its earnings-per-share at 5.9% per year since 2009, and we expect growth of about 6% annually moving forward, per management's guidance and despite an ever-rising share count. Our estimates account for 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 been important for Fortis. We see growth in the dividend roughly keeping pace with earnings growth and the share price. We also expect the yield to 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	18.5	19.1
Avg. Yld.	4.2%	3.8%	3.6%	3.6%	3.8%	3.9%	3.8%	3.8%	3.7%	4.1%	3.6%	3.8%

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Using our 2019 earnings-per-share estimate of \$2.66, Fortis is currently trading at a price-to-earnings ratio of 18.5, which we believe is roughly fairly valued. The stock has spent the past two years trading well below its historical multiple, but we continue to believe a price-to-earnings ratio of 19 is fair value for the highly predictable utility.

Fortis is currently trading with a dividend yield of 3.6% (gross of the withholding tax paid to the Canadian government), providing investors with a decent opportunity to generate safe portfolio income in the international markets.

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%	62%	69%	70%	67%

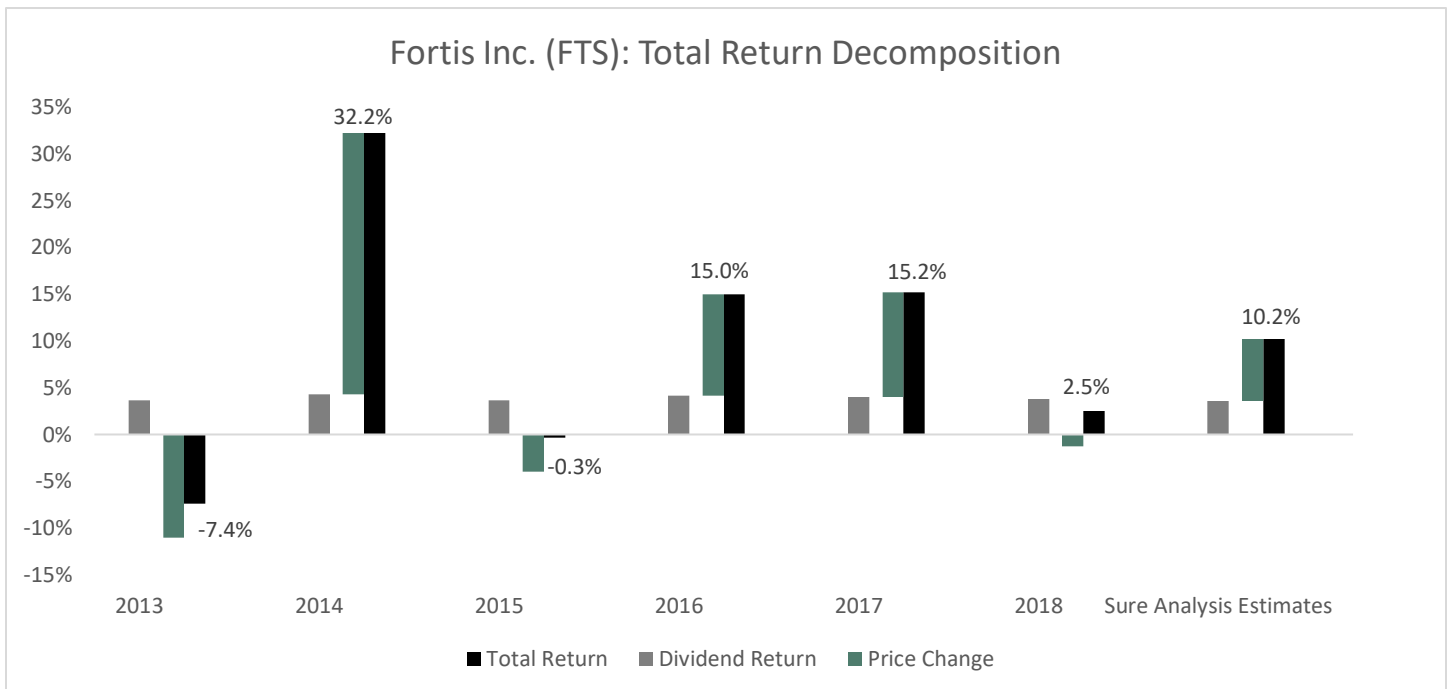
Fortis' payout ratio has spent the last couple of years around two-thirds of earnings, and we believe it will stay there. That implies mid-single digit dividend increases annually, which would keep pace with earnings. The dividend is important to management and we believe it is very safe and should continue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

Fortis appears positioned to deliver 10.2% total returns over time. These returns will largely accrue from 6% earnings growth and the 3.6% yield from the fairly-valued stock. 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, and especially if it dips meaningfully.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	3643	3657	3738	3654	4047	5401	6757	6838	8301	8390
Gross Profit	1844	1971	2041	2132	2430	3204	4166	4497	5940	5895
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.	360	408	416	470	541	688	873	983	1179	1243
Operating Profit	701	739	775	794	852	1023	1419	1483	2511	2365
Operating Margin	19.2%	20.2%	20.7%	21.7%	21.1%	18.9%	21.0%	21.7%	30.2%	28.2%
Net Profit	280	313	357	362	410	379	805	660	1028	1166
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	-343	-341	-256	-154	-276	-743	-570	-177	-268	-614
Income Tax	49	67	84	61	32	66	223	145	588	165

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	12139	12909	14214	14950	17908	26233	28804	47904	47822	53051
Cash & Equivalents	85	109	87	154	72	230	242	269	327	332
Acc. Receivable	595	655	604	525	352	479	517	507	460	538
Inventories	178	168	134	133	143	321	337	372	367	398
Goodwill & Int.	1846	1877	1890	1893	2420	4193	4714	13375	12725	13730
Total Liabilities	8476	8850	9271	9540	11532	17121	18451	31454	31073	34595
Accounts Payable	852	953	457	498	423	612	414	554	696	679
Long-Term Debt	5691	5967	5992	6083	7414	10819	11735	22282	21668	24145
Total Equity	3193	3305	3823	3992	4772	6871	8060	12974	13380	14910
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%	2.6%	2.5%	2.5%	1.7%	2.9%	1.7%	2.1%	2.3%
Return on Equity	9.0%	9.6%	10.0%	9.3%	9.4%	6.5%	10.8%	6.3%	7.8%	8.2%
ROIC	3.1%	3.2%	3.4%	3.2%	3.2%	2.2%	3.8%	2.2%	2.7%	2.9%
Shares Out.	171	174	189	192	213	276	282	401	421	429
Revenue/Share	19.71	19.55	19.67	18.53	19.34	23.89	23.73	21.82	19.94	19.73
FCF/Share	-1.86	-1.82	-1.35	-0.78	-1.32	-3.29	-2.00	-0.56	-0.64	-1.44

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

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