



Northwest Natural Holding Company (NWN)

Updated May 30th, 2019 by Samuel Smith

Key Metrics

Current Price:	\$67	5 Year CAGR Estimate:	-1.1%	Volatility Percentile:	26.0%
Fair Value Price:	\$47	5 Year Growth Estimate:	2.9%	Momentum Percentile:	70.4%
% Fair Value:	144%	5 Year Valuation Multiple Estimate:	-6.8%	Growth Percentile:	12.3%
Dividend Yield:	2.8%	5 Year Price Target	\$54	Valuation Percentile:	8.0%
Dividend Risk Score:	B	Retirement Suitability Score:	B	Total Return Percentile:	3.8%

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 Q1 results on 5/7/19 and the consolidated earnings-per-share of \$1.73 crushed consensus estimates by \$0.36. Revenue also beat estimates handily, coming in at \$285.35 million and growing 7.8% year-over-year. These results reflected solid progress in the business as the company earned \$1.50 from continuing operations as opposed to \$1.46 a year ago, added more than 12,500 natural gas meters over the past 12 months (1.7% growth rate), finished construction of the North Mist gas storage expansion with the commissioning phase nearly complete, and received the final Oregon general rate case order.

Overall, the business is off to a good start to the year as results were boosted by customer growth and higher natural gas rates. Operationally, the distribution system performed well in the face of abnormally cold weather and pipeline constraints in the Pacific Northwest. Furthermore, the company continued to make solid progress on its long-term growth strategy as the company prepares to complete several acquisitions in the coming months.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$2.83	\$2.73	\$2.39	\$2.22	\$2.24	\$2.16	\$1.96	\$2.12	\$2.24	\$2.24	\$2.35	\$2.71
DPS	\$1.60	\$1.68	\$1.75	\$1.79	\$1.83	\$1.85	\$1.86	\$1.87	\$1.88	\$1.90	\$1.94	\$2.14
Shares	27	27	27	27	27	27	27	29	29	30	30	32

Earnings-per-share are still down over the past decade as NWN 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 2018 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. 2019 should see it begin to embark on our long-term growth forecasts as management expects earnings growth of 4.9% at the midpoint of its guidance.

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 gotten too high to allow for higher rates of growth.



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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	15.2	17.0	19.0	21.1	19.4	20.7	23.7	26.9	31.9	26.5	28.5	20.0
Avg. Yld.	3.7%	3.6%	3.9%	3.8%	4.2%	4.1%	4.0%	3.3%	3.0%	3.0%	2.8%	4.0%

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 28.5 today. With interest rates expected to remain stable and/or rise, and dividend stocks losing their luster when it comes to high valuations, we are forecasting a 6.8% 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% in the next five years as the dividend grows but the stock's multiple declines.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	56%	61%	73%	80%	81%	85%	92%	87%	84%	85%	83%	79%

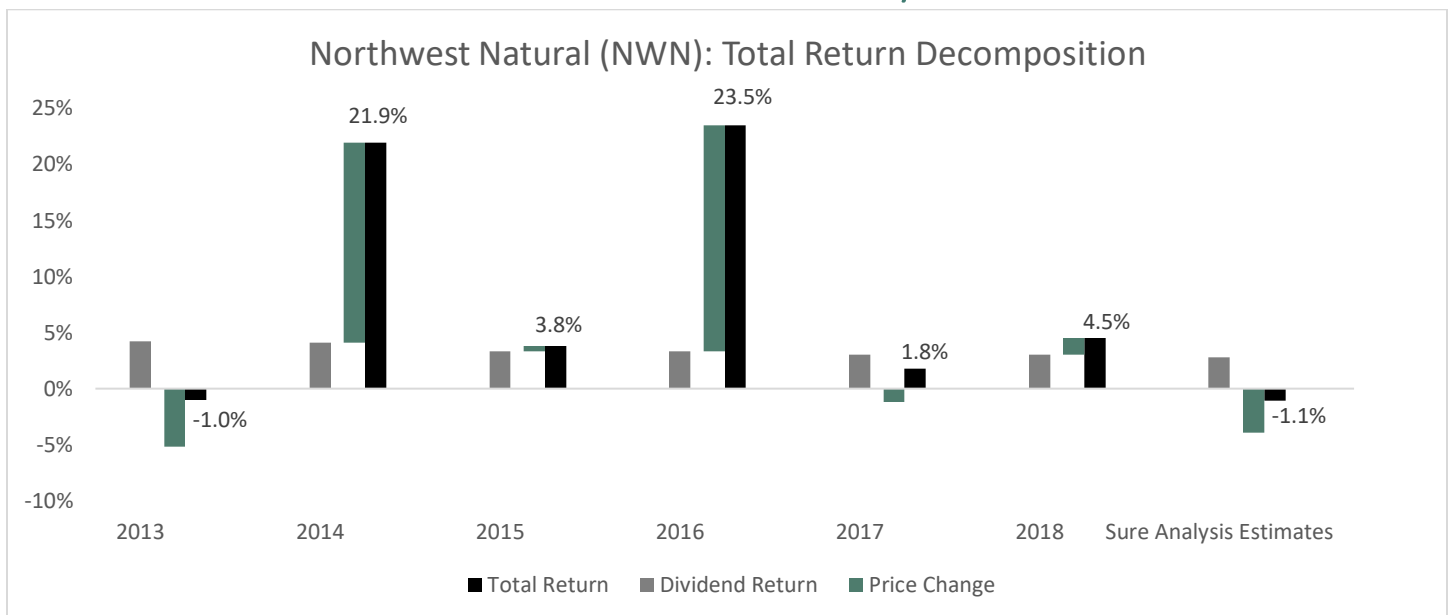
NW Natural's quality metrics have been very steady in the past decade. Seventy-six percent of its total assets are encumbered by debt, which is completely acceptable for a utility. Its interest coverage is fairly strong at 3.6, so there are certainly no financing concerns moving forward. The dividend 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. This allowed it to perform extremely well during the Great Recession as discretionary use of natural gas and water is very low. At the same time, the regulatory nature of it prevents it from driving strong profitability growth during economic booms.

Final Thoughts & Recommendation

Overall, NW Natural is still well in excess of fair value. The combination of the 2.8% yield, 6.8% headwind from the valuation decline and 2.9% earnings growth should lead to annual total losses of 1.1% for investors at today's prices. Given these factors, we rate the stock a sell despite the decent yield and stable business model.

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	1013	792	828	731	759	754	724	668	755	706
Gross Profit	377	181	174	173	173	172	158	193	197	209
Gross Margin	37.2%	22.9%	21.0%	23.6%	22.8%	22.9%	21.8%	28.9%	26.1%	29.6%
D&A Exp.										
Operating Profit	63	65	70	73	76	79	81	78	81	85
Operating Margin	159	158	145	142	143	143	124	151	151	132
Net Profit	15.7%	19.9%	17.5%	19.5%	18.8%	19.0%	17.2%	22.6%	20.0%	18.7%
Net Margin	75	73	63	59	61	59	54	59	-56	65
Free Cash Flow	7.4%	9.2%	7.6%	8.0%	8.0%	7.8%	7.4%	8.8%	-7.4%	9.1%
Income Tax	105	-122	133	37	37	96	66	84	-7	-46

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	2399	2617	2747	2813	2971	3065	3069	3080	3040	3243
Cash & Equivalents	8	3	6	9	9	10	4	4	3	13
Accounts Receivable	77	68	77	61	82	70	68	67	66	67
Inventories	81	80	74	68	61	78	71	54	48	44
Total Liabilities	1739	1924	2032	2083	2219	2298	2288	2229	2297	2480
Accounts Payable	124	93	86	86	96	91	73	86	111	116
Long-Term Debt	739	859	823	882	930	896	864	773	834	954
Shareholder's Equity	660	693	714	730	752	767	781	850	743	763
D/E Ratio	1.12	1.24	1.15	1.21	1.24	1.17	1.11	0.91	1.12	1.25

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	3.1%	2.9%	2.4%	2.1%	2.1%	1.9%	1.8%	1.9%	-1.8%	2.1%
Return on Equity	8.3%	10.7%	9.0%	8.1%	8.2%	7.7%	6.9%	7.2%	-7.0%	8.6%
ROIC	5.4%	4.9%	4.1%	3.7%	3.7%	3.5%	3.2%	3.6%	-3.5%	3.9%
Shares Out.	27	27	27	27	27	27	27	29	29	30
Revenue/Share	38.11	29.72	30.96	27.15	28.07	27.70	26.40	24.05	26.26	24.46
FCF/Share	3.96	-4.58	4.97	1.37	1.39	3.51	2.42	3.02	-0.23	-1.59

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

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