



Southern Company (SO)

Updated November 4th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	\$62	5 Year CAGR Estimate:	2.1%	Volatility Percentile:	9.5%
Fair Value Price:	\$49	5 Year Growth Estimate:	2.5%	Momentum Percentile:	89.8%
% Fair Value:	127%	5 Year Valuation Multiple Estimate:	-4.7%	Growth Percentile:	15.3%
Dividend Yield:	4.0%	5 Year Price Target	\$55	Valuation Percentile:	31.1%
Dividend Risk Score:	D	Retirement Suitability Score:	C	Total Return Percentile:	19.3%

Overview & Current Events

Southern Company is a major energy utility that serves ~9 million customers in the U.S. via its subsidiaries. It has a market capitalization of \$65 billion.

Southern has greatly benefited from the shift of the Fed to a dovish stance this year. Lower interest rates render the dividends of utilities more attractive. Moreover, they benefit Southern in another way as well. Due to its poor execution and its acquisition of AGL Resources for \$12 billion in 2016, Southern has almost doubled its net debt in the last five years. In addition, it has a heavy debt maturity schedule, with \$7.3 billion of its debt maturing by the end of 2021. As it will not be able to pay off this debt load, it will have to roll it over so it greatly benefits from lower rates. Thanks to this tailwind, Southern has rallied 44% off its bottom at the end of last year, to an all-time high. The rally has also resulted from the progress in the construction of Vogtle, which has markedly improved in the last four quarters.

In late October, Southern reported (10/30/19) financial results for the third quarter of fiscal 2019. Revenue decreased 3% due to the sale of Gulf Power and other assets but earnings-per-share smashed analysts' estimates (\$1.34 vs. \$1.14) thanks to rate hikes and warmer than normal weather. As a result, the stock rallied to a new all-time high on the day of its earnings release. Management now expects this year's earnings-per-share at or above the top end of its guidance of \$2.98-\$3.10 and stated that it still expects to meet its targets for cost and commission date of the Vogtle Plant. Thanks to the impressive results in the quarter, we have raised this year's earnings-per-share estimate from \$3.05 to \$3.11.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$2.32	\$2.36	\$2.55	\$2.67	\$2.70	\$2.77	\$2.84	\$2.83	\$3.02	\$3.07	\$3.11	\$3.52
DPS	\$1.73	\$1.80	\$1.87	\$1.94	\$2.01	\$2.08	\$2.15	\$2.22	\$2.30	\$2.38	\$2.46	\$2.86
Shares¹	819.7	843.3	865.1	867.8	887.1	907.8	911.7	990.4	1007.6	1034.0	1050.0	1140.0

Due to its huge capital expenses and its debt pile, the company issues new shares on a regular basis. Southern has increased its share count at a 3.1% average annual rate in the last five years and management has stated that it will need to issue about \$2.0 billion of shares (3% of the current market cap) in the next five years.

Southern has grown its earnings-per-share at a 3.2% annual rate in the last decade and at a 2.6% annual rate in the last five years. Although management targets 4%-6% long-term earnings-per-share growth, we expect approximately 2.5% earnings-per-share growth over the next five years due to the debt burden and the tendency of the company to dilute its shareholders more than its guidance.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	13.5	14.9	15.8	17.0	16.2	16.0	15.8	17.8	15.5	14.7	19.9	15.7
Avg. Yld.	5.5%	5.1%	4.6%	4.3%	4.6%	4.7%	4.8%	4.4%	4.6%	5.3%	4.0%	5.2%

¹ In millions.

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Thanks to its relentless rally, Southern is trading at a price-to-earnings ratio of 19.9, which is much higher than its 10-year average price-to-earnings of 15.7. If the stock reverts to its average valuation level over the next five years, it will incur a 4.7% annualized drag from the contraction of its earnings multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2023
Payout	74.6%	76.3%	73.3%	72.7%	74.4%	75.1%	75.7%	78.4%	71.7%	77.5%	79.1%	81.2%

The competitive advantage of Southern is its state-regulated business, which requires excessive capital expenses for infrastructure and poses high barriers to entry to potential competitors. Southern has stretched its balance sheet in recent years. Its debt/assets and its payout ratio have climbed near decade-high levels while its interest expense currently consumes almost one-third of its operating income. On the bright side, these metrics have somewhat improved lately thanks to asset sales, whose proceeds have been used for debt reduction.

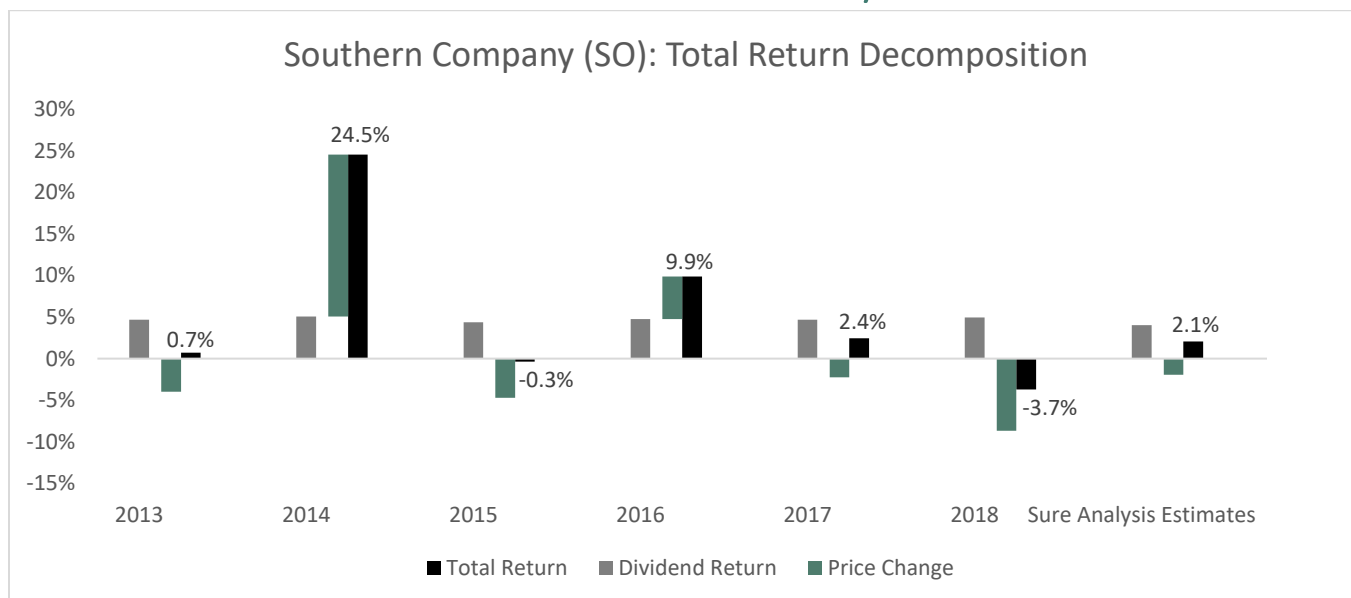
Southern has raised its dividend for 18 consecutive years and has not cut it for 71 consecutive years. Moreover, it currently offers a 4.0% dividend yield, which is higher than that of most utilities. Due to the weak balance sheet, dividend growth is likely to be meager (~3% annually) going forward.

Southern is also attractive because of its resilience during recessions. In the Great Recession, when most companies saw their earnings collapse, the earnings-per-share of Southern fell just 1.3%. Whenever the next recession shows up, Southern will likely outperform the market thanks to its resilient and predictable earnings and the double boost it will receive from likely lower interest rates in such an event.

Final Thoughts & Recommendation

The prospects of the stock of Southern have greatly improved this year thanks to the reduced execution risk at its Vogtle Plant and the shift of the Fed to a more dovish stance. With that said, Southern has rallied 44% off its bottom in the Christmas sell-off. This is an unusually rapid move Southern. As a result, Southern is likely to offer just a 2.1% average annual return over the next five years. As it will have great downside risk in the event of higher interest rates, it receives a sell rating. It is also riskier than one would expect from a 'boring' utility due to its debt load.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	15743	17456	17657	16537	17087	18467	17489	19896	23031	23495
Gross Profit	9317	10194	6849	7164	7270	7436	7678	8530	9915	9653
Gross Margin	59.2%	58.4%	38.8%	43.3%	42.5%	40.3%	43.9%	42.9%	43.1%	41.1%
D&A Exp.	1788	1831	2048	2145	2298	2293	2395	2923	3457	3549
Operating Profit	3470	3802	4231	4463	3255	3642	4282	4487	2293	4110
Op. Margin	22.0%	21.8%	24.0%	27.0%	19.0%	19.7%	24.5%	22.6%	10.0%	17.5%
Net Profit	1708	2040	2268	2415	1710	2031	2421	2493	880	2242
Net Margin	10.8%	11.7%	12.8%	14.6%	10.0%	11.0%	13.8%	12.5%	3.8%	9.5%
Free Cash Flow	-1407	-95	1378	89	634	569	600	-2416	-1029	-1056
Income Tax	896	1026	1219	1334	849	977	1194	951	142	449

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets (\$B)	52.0	55.0	59.3	63.1	64.5	70.2	78.3	109.7	111.0	116.9
Cash & Equivalents	690	447	1315	628	659	710	1404	1975	2130	1396
Acc. Receivable	953	1140	1074	961	1027	1090	1058	2206	2413	2527
Inventories	2241	2135	2270	2819	2298	1969	1929	2782	2627	2394
Goodwill & Int.	N/A	N/A	N/A	N/A	N/A	N/A	319	7221	7141	5928
Total Liabilities	36461	38123	40607	43770	44407	48932	56218	82967	85153	87584
Accounts Payable	1329	1275	1553	1387	1376	1593	1905	2825	3076	3436
Long-Term Debt	19883	20752	21199	22411	23266	24745	28706	47425	50762	46825
Total Equity	14878	16202	17578	18297	19008	19949	20592	24758	24167	24723
D/E Ratio	1.28	1.23	1.18	1.20	1.20	1.22	1.39	1.91	2.07	1.87

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	3.4%	3.8%	4.0%	3.9%	2.7%	3.0%	3.3%	2.7%	0.8%	2.0%
Return on Equity	12.1%	13.1%	13.4%	13.5%	9.2%	10.4%	11.9%	11.0%	3.6%	9.2%
ROIC	5.0%	5.6%	5.9%	5.9%	4.0%	4.5%	5.0%	4.0%	1.2%	2.9%
Shares Out.	819.7	843.3	865.1	867.8	887.1	907.8	911.7	990.4	1007.6	1034.0
Revenue/Share	19.78	20.86	20.44	18.81	19.40	20.50	19.13	20.77	22.85	22.92
FCF/Share	-1.77	-0.11	1.59	0.10	0.72	0.63	0.66	-2.52	-1.02	-1.03

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

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