



# Fortis Inc. (FTS)

Updated February 17<sup>th</sup>, 2020 by Kay Ng

## Key Metrics

<b>Current Price:</b>	\$44	<b>5 Year CAGR Estimate:</b>	5.7%	<b>Market Cap:</b>	\$20.4B
<b>Fair Value Price:</b>	\$39	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	02/14/20
<b>% Fair Value:</b>	114%	<b>5 Year Valuation Multiple Estimate:</b>	-2.6%	<b>Dividend Payment Date:</b>	03/01/20
<b>Dividend Yield:</b>	3.3%	<b>5 Year Price Target</b>	\$49	<b>Years Of Dividend Growth<sup>1</sup>:</b>	46
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	B	<b>Last Dividend Increase<sup>1</sup>:</b>	6.1%

## 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. Fortis has increased its dividend for 46 consecutive years and trades with a current after-tax yield of 2.8% (3.3% before the 15% withholding tax applied by the Canadian government). Unless otherwise noted, US\$ is used in this research report.

Fortis reported Q4 and 2019 results on 02/13/20. For the quarter, it reported adjusted earnings-per-share (EPS) growth of 10.7% to C\$0.62. For 2019, it reported adjusted EPS growth of 1.6% to C\$2.55. In Q2, Fortis sold its Waneta hydroelectric generation facility for C\$1 billion of proceeds, which resulted in a one-time after-tax gain on sale of C\$484 million or C\$1.12 per common share. This, along with the C\$1.2 billion equity raise in December for C\$52.15 per share, which was about 20.5 times its 2019 earnings and a very good price, allowed Fortis to pay down debt. During 2019, Fortis invested C\$3.8 billion across its utilities, as a part of its ongoing capital investments. Our 2020 EPS and DPS estimates are based on a 5% and 6% growth rate, respectively, in C\$ converted into US\$.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$1.63	\$1.65	\$1.71	\$1.60	\$1.56	\$1.52	\$1.78	\$2.02	\$1.89	\$1.92	<b>\$2.02</b>	<b>\$2.58</b>
<b>DPS</b>	\$1.09	\$1.17	\$1.20	\$1.20	\$1.16	\$1.09	\$1.15	\$1.25	\$1.33	\$1.38	<b>\$1.46</b>	<b>\$1.95</b>
<b>Shares<sup>1</sup></b>	174	189	192	213	276	282	401	421	429	447	<b>460</b>	<b>534</b>

Fortis compounded its EPS at 5.2% per year and DPS at 5.6% per year from 2010 to 2019 in C\$. Additionally, management expects dividend growth of about 6% annually through 2024, supported by organic growth and its five-year capital plan of C\$18.8 billion between 2020 and 2024. The capital plan includes investing in areas, such as a greener and improved grid, a shift from fossil fuel to solar and wind generation, and electric vehicle penetration. Importantly, this growth rate is *before* the impact of acquisitions, which have historically been important for Fortis. Notably, the picture doesn't look as rosy from a US\$ perspective. In US\$, Fortis compounded its EPS at only 1.8% per year and dividend per share at 2.7% per year from 2010 to 2019. US\$ is quite high against C\$ compared to historic levels. Therefore, should C\$ improve against the US\$, it should be a tailwind on US investors who buy the stock now.

The utility will use equity offerings as a source of capital to pay down debt or make acquisitions, resulting in a greater number of common shares. 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 forecasts a rate-base growth rate of about 6% through 2024 to reach a rate base of C\$38.4 billion (vs. C\$28 billion in 2019). We see an EPS growth of 5% and DPS growth of 6% per year through 2025.

1. Years of Dividend Growth and Last Dividend Increase based in C\$. Shares in millions.

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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## Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	18.7	20.3	19.6	19.7	19.9	19.8	16.2	16.7	18.5	19.5	<b>21.8</b>	<b>19.1</b>
Avg. Yld.	3.6%	3.5%	3.6%	3.8%	3.7%	3.6%	4.0%	3.7%	3.8%	3.7%	<b>3.3%</b>	<b>4.0%</b>

Using our 2020 EPS estimate, Fortis trades at a price-to-earnings ratio of 21.8, which we believe is a little pricey. The stock spent 2016 and 2017 trading at well below its historic multiple, but the P/E multiple expansion has occurred already. We continue to believe a P/E of about 19 is fair for the highly predictable utility. Fortis is currently trading with a dividend yield of 3.3% (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

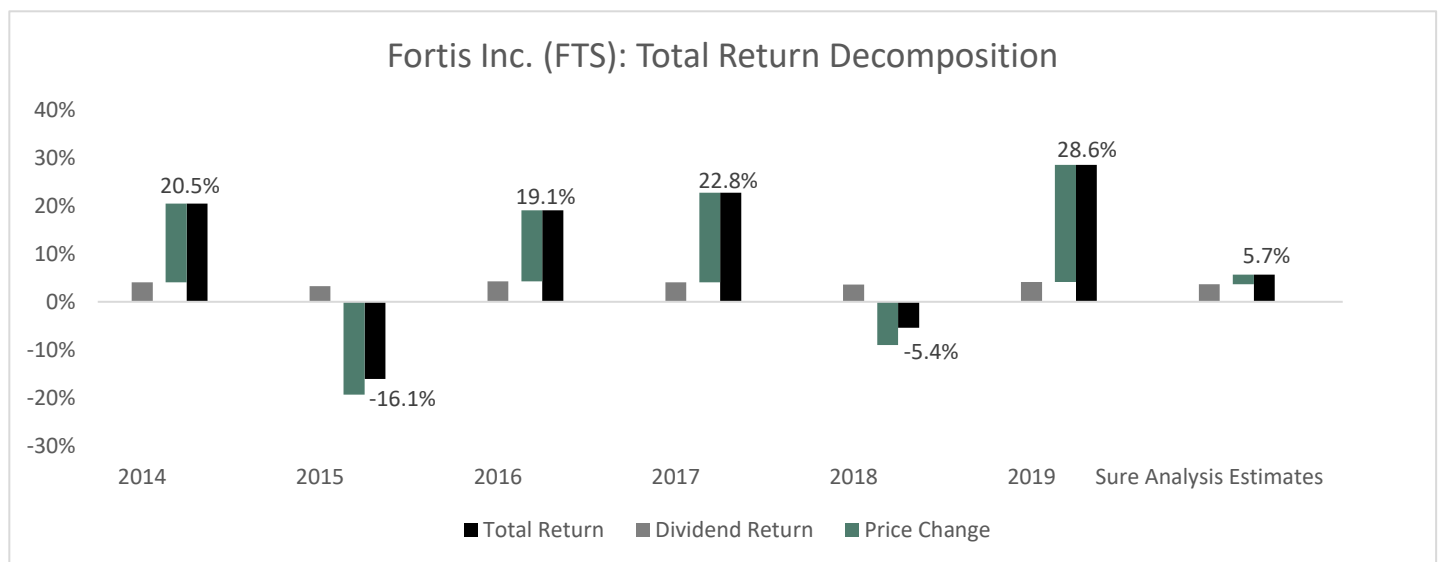
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	67%	71%	70%	75%	74%	72%	65%	62%	70%	72%	<b>72%</b>	<b>76%</b>

Fortis' payout ratio had been about 70% of earnings, and we believe it's healthy in the 70% range. The dividend is important to management and we believe it is 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. Its timely U.S. acquisitions of regulated utilities since 2013 have allowed Fortis to now generate more than half of its revenue from the country.

## Final Thoughts & Recommendation

Fortis is a quality North American regulated utility that has a leading position. The utility is a low-risk business, but the stock is getting expensive. However, we estimate it will deliver a total rate of return of 5.7% through 2025 from 5% earnings growth, a 3.3% yield, and a P/E contraction of 2.6%. We think there are better income and total-return ideas in the Sure Dividend coverage universe. Conservative & income-oriented investors should look to buying Fortis on meaningful dips when it trades at or below a P/E of 19.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Revenue</b>	3546	3780	3655	3930	4892	5294	5164	6405	6474	6618
<b>Gross Profit</b>	1911	2064	2133	2360	2902	3264	3396	4583	4549	4719
<b>Gross Margin</b>	53.9%	54.6%	58.3%	60.0%	59.3%	61.7%	65.8%	71.6%	70.3%	71.3%
<b>SG&amp;A Exp.</b>										
<b>D&amp;A Exp.</b>	396	421	470	525	623	684	742	910	959	1,017
<b>Operating Profit</b>	716	784	794	827	927	1112	1120	1938	1825	1854
<b>Operating Margin</b>	20.2%	20.7%	21.7%	21.1%	18.9%	21.0%	21.7%	30.2%	28.2%	28.0%
<b>Net Profit</b>	303	361	362	398	343	631	498	793	900	1297
<b>Net Margin</b>	8.6%	9.6%	9.9%	10.1%	7.0%	11.9%	9.7%	12.4%	13.9%	19.6%
<b>Free Cash Flow</b>	(331)	(259)	(154)	(268)	(673)	(447)	(134)	(207)	(474)	(796)
<b>Income Tax</b>	65	85	61	31	60	175	109	454	127	218

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total Assets</b>	12907	13923	15028	16819	22598	20757	35530	38029	38950	40883
<b>Cash &amp; Equivalents</b>	109	85	155	68	198	174	200	260	244	283
<b>Accounts Receivable</b>	655	592	528	331	413	373	376	366	395	386
<b>Inventories</b>	168	131	134	134	277	243	276	292	292	302
<b>Goodwill &amp; Int. Ass.</b>	1877	1851	1903	2273	3612	3397	9920	10119	10081	10154
<b>Total Liabilities</b>	8849	9081	9590	10831	14749	13296	23329	24710	25400	25486
<b>Accounts Payable</b>	953	448	501	397	527	298	411	553	499	577
<b>Long-Term Debt</b>	5966	5869	6115	6963	9320	8456	16527	17231	17727	17380
<b>Shareholder's Equity</b>	3304	3745	4013	4482	5919	5808	9623	10640	10947	12944
<b>D/E Ratio</b>	1.53	1.27	1.19	1.24	1.24	1.19	1.53	1.44	1.46	1.23

## Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Return on Assets</b>	2.5%	2.7%	2.5%	2.5%	1.7%	2.9%	1.8%	2.2%	2.3%	3.3%
<b>Return on Equity</b>	9.6%	10.2%	9.3%	9.4%	6.6%	10.8%	6.5%	7.8%	8.3%	10.9%
<b>ROIC</b>	3.2%	3.5%	3.3%	3.2%	2.3%	3.8%	2.2%	2.7%	2.9%	4.1%
<b>Shares Out.</b>	174	189	192	213	276	282	401	421	429	447
<b>Revenue/Share</b>	18.95	19.90	18.53	18.78	21.64	18.60	16.48	15.39	15.23	15.13
<b>FCF/Share</b>	(1.77)	(1.36)	(0.78)	(1.28)	(2.98)	(1.57)	(0.43)	(0.50)	(1.11)	(1.82)

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

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