Sempra Energy (SRE)

Updated February 28th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$141	**5 Year CAGR Estimate:**	8.1%	**Market Cap:**	$40.7 B
Fair Value Price:	137	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	3/19/2020
% Fair Value:	103%	**5 Year Valuation Multiple Estimate:**	-0.6%	**Dividend Payment Date:**	4/15/2020
Dividend Yield:	3.0%	**5 Year Price Target**	$183	**Years Of Dividend Growth:**	10
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	8.0%

Overview & Current Events

Sempra Energy (SRE) was founded 20 years ago and has grown into a $40.7 billion market cap company. It serves one of the largest utility customer bases in the U.S., as it distributes natural gas and electricity in Southern California (over 20 million customers) and owns a majority stake in Texas-based Oncor, a transmission and distribution business (over 10 million customers). The company also owns and operates other utilities and merchant renewable energy projects, liquefied natural gas facilities, and gas pipes and storage in the U.S. and Latin America.

Sempra Energy benefits from two key trends, namely the transition towards cleaner energy resources and the advance of the U.S. as a global energy leader. In 2018, the company sold most of its non-core assets in order to better focus on its large core North American regulated utility, LNG export, and Mexican infrastructure (IEnova) assets as well as deleverage the balance sheet. Given the strong competitive advantages enjoyed by these core assets and the late stage in the economic cycle, we believe that these moves have made Sempra Energy more attractive.

In late February, Sempra Energy reported (2/27/20) financial results for the fourth quarter of fiscal 2019. In the year, revenues grew 7% thanks to strong performance in regulated business and adjusted earnings-per-share jumped 22%, from $5.57 to a new all-time high of $6.78. Management reaffirmed its guidance for earnings-per-share of $6.70-$7.50 this year and initiated guidance for adjusted earnings per-share of $7.50-$8.10 in 2021.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.86	$5.51	$3.48	$4.01	$4.63	$5.37	$5.46	$5.42	$5.57	$6.78	***$7.20***	***$9.64***
DPS	$1.56	$1.92	$2.40	$2.52	$2.64	$2.80	$3.02	$3.29	$3.58	$3.87	***$4.18***	***$5.59***
Shares[1]	248	242	247	249	251	251	251	252	270	289	***305***	***350***

Sempra's enormous economies of scale and regulated monopolies in California and Texas should enable it to capitalize on any economic growth in those regions to drive long term growth. Texas in particular should see strong organic growth due to the population growth in the state. The company recently initiated a 5-year capital plan of $11.9 billion, which will be a growth driver in the upcoming years. Additionally, Sempra's assets in Mexico enjoy a first mover advantage which should enable them to grow rapidly as Mexico begins to invest more seriously in its massively underdeveloped infrastructure. The LNG export portfolio should also see robust demand as the U.S. continues its transition into a global energy exporting giant. As a result, management has several expansion projects, which should contribute significantly to the company's cash flows. As this year's expected record earnings will form a high base for future comparison, we expect 6% annual growth of earnings-per-share and dividend over the next five years.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	18.4	10.1	20.7	22.3	24.1	17.3	18.5	19.8	19.4	19.8	***19.6***	***19.0***
Avg. Yld.	3.0%	3.4%	3.3%	2.8%	2.4%	3.0%	3.0%	3.1%	3.3%	2.9%	***3.0%***	***3.1%***

[1] In millions.

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Sempra Energy is currently trading at a price-to-earnings ratio of 19.6, which is slightly higher than its 10-year average of 19.0. We expect the stock to trade close to its average valuation level in five years from now. If this occurs, the stock will incur a modest -0.6% annualized contraction of its price-to-earnings ratio.

Safety, Quality, Competitive Advantage, & Recession Resiliency

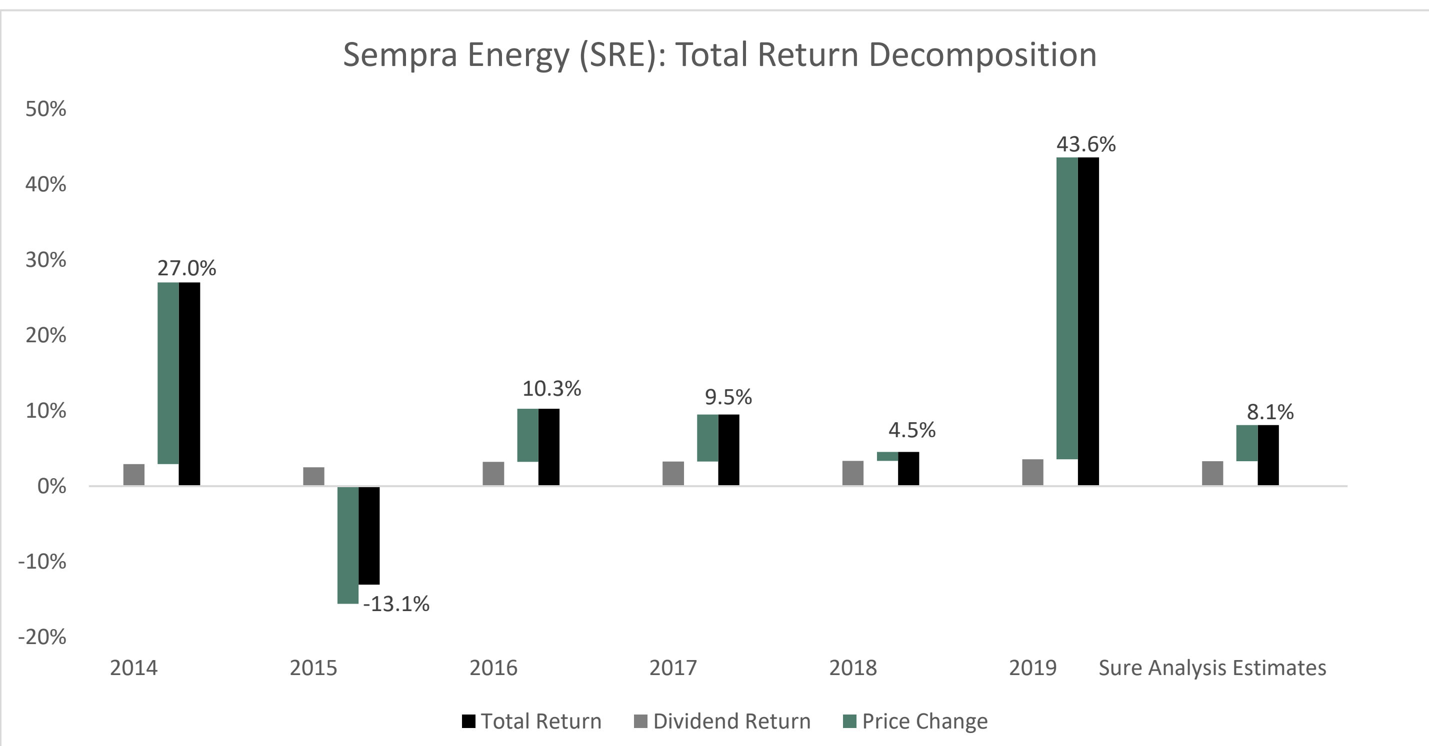
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	54.5%	34.8%	69.0%	62.8%	57.0%	52.1%	55.3%	60.7%	64.3%	57.1%	***58.1%***	***58.1%***

As a regulated utility in possession of dominant businesses in their respective regions, Sempra Energy possesses a clear moat around a significant portion of its earnings. At the same time, however, the regulated nature of its pricing prevents it from earning surplus profits. These businesses, as well as the stable, mission-critical nature of its infrastructure business in Mexico make it quite recession resistant. As proof of this, Sempra's earnings-per-share increased during the Great recession (2008 and 2009). However, its LNG export business and international exposure make it susceptible to commodity price, geopolitical, and currency exchange risks. Nevertheless, its high-quality assets, low payout ratio, stable cash flows and strong growth prospects make it a fairly low-risk investment. Moreover, while the company has a weak balance sheet and interest coverage ratio of only 2.5, it has reduced its leverage thanks to the sale of non-core assets.

Final Thoughts & Recommendation

Sempra Energy owns quality assets, many of which are in recession-resistant businesses. Its utilities businesses are dominant players in their fields and its LNG export and infrastructure businesses have strong growth prospects. Combined, they create a business that has both stable and defensive characteristics. Thanks to its recent correction off its all-time high, the stock can offer an 8.1% average annual return over the next five years. The security could be attractive for growth and income-oriented investors but we rate it as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	9003	10036	9647	10557	11035	10231	10183	11207	11687	10829
Gross Profit	2721	3065	3001	3371	3346	3592	3353	4277	4414	4692
Gross Margin	30.2%	30.5%	31.1%	31.9%	30.3%	35.1%	32.9%	38.2%	37.8%	43.3%
D&A Exp.	866	976	1090	1113	1156	1250	1312	1490	1549	1569
Operating Profit	1585	1845	1648	1959	1888	2026	1731	2519	2491	2627
Operating Margin	17.6%	18.4%	17.1%	18.6%	17.1%	19.8%	17.0%	22.5%	21.3%	24.3%
Net Profit	719	1339	865	1009	1162	1350	1371	257	1050	2198
Net Margin	8.0%	13.3%	9.0%	9.6%	10.5%	13.2%	13.5%	2.3%	9.0%	20.3%
Free Cash Flow	92	-977	-938	-788	-962	-258	-1903	-324	-337	-620
Income Tax	133	394	59	366	300	341	389	1276	96	315

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	30283	33249	36499	37244	39651	41150	47786	50454	60638	65665
Cash & Equivalents	912	252	475	904	570	403	349	288	190	108
Acc. Receivable	891	1198	1146	1308	1242	1283	1390	1307	1488	1261
Inventories	258	346	408	287	396	298	258	307	296	277
Goodwill & Int.	540	1484	1547	1450	1346	1223	2912	2993	2645	1815
Total Liabilities	21045	23071	25816	25394	27551	28571	32545	35314	41390	43860
Accounts Payable	755	983	976	1088	1198	1133	1346	1350	1324	1234
Long-Term Debt	9487	10863	12892	12945	14288	14663	17121	19412	25363	25816
Total Equity	9027	9795	10302	11028	11346	11829	12971	12690	14900	17691
D/E Ratio	1.05	1.11	1.25	1.17	1.26	1.24	1.32	1.53	1.48	1.29

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.4%	4.2%	2.5%	2.7%	3.0%	3.3%	3.1%	0.5%	1.9%	3.5%
Return on Equity	8.0%	14.2%	8.6%	9.5%	10.4%	11.7%	11.1%	2.0%	7.6%	13.5%
ROIC	3.9%	6.7%	3.9%	4.2%	4.5%	5.0%	4.6%	0.8%	2.7%	4.8%
Shares Out.	248	242	247	249	251	251	251	252	270	289
Revenue/Share	36.31	41.55	39.11	42.34	44.02	40.77	40.54	44.42	43.31	38.40
FCF/Share	0.37	-4.05	-3.80	-3.16	-3.84	-1.03	-7.58	-1.28	-1.25	-2.20

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