



Northwest Natural Holding Company (NWN)

Updated April 16th, 2020 by Samuel Smith

Key Metrics

Current Price:	\$62	5 Year CAGR Estimate:	0.8%	Market Cap:	\$1.9B
Fair Value Price:	\$47	5 Year Growth Estimate:	2.9%	Ex-Dividend Date:	1/30/20
% Fair Value:	132%	5 Year Valuation Multiple Estimate:	-5.4%	Dividend Payment Date:	2/14/20
Dividend Yield:	3.1%	5 Year Price Target	\$54	Years Of Dividend Growth:	64
Dividend Risk Score:	B	Retirement Suitability Score:	B	Last Dividend Increase:	0.5%

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 64 consecutive years. NW Natural trades with a market capitalization of \$1.9 billion. NW Natural reported full year results on 3/2/20. Adjusted earnings per share came in at \$2.41, up from \$2.24 in 2018. The company's growth was fueled in part by the addition of nearly 12,500 natural gas meters over the last 12 months, equating to a 1.7% growth rate. The company also invested nearly \$240 million into natural gas infrastructure and began service at its North Mist facility, while scoring first in the nation among large gas utilities in the 2019 J.D. Power Gas Utility Residential Customer Satisfaction Study. They also closed four water and wastewater utility transactions during the year, bringing the company's total connections to nearly 21,000. The strong growth enabled them to increase their dividend for the 64th consecutive year. They expect 2020 earnings per share to come in between \$2.25 and \$2.45, or a midpoint of \$2.35.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$2.73	\$2.39	\$2.22	\$2.24	\$2.16	\$1.96	\$2.12	\$2.24	\$2.24	\$2.41	\$2.35	\$2.71
DPS	\$1.68	\$1.75	\$1.79	\$1.83	\$1.85	\$1.86	\$1.87	\$1.88	\$1.90	\$1.91	\$1.91	\$2.14
Shares¹	27	27	27	27	27	27	29	29	30	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 in the low-single-digits 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 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.

The company's dividend has been raised for 64 consecutive years, 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 dividend growth going forward to continue that trend. The payout ratio has gotten too high to allow for higher rates of growth.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	17.0	19.0	21.1	19.4	20.7	23.7	26.9	31.9	26.5	30.2	26.4	20.0
Avg. Yld.	3.6%	3.9%	3.8%	4.2%	4.1%	4.0%	3.3%	3.0%	3.0%	2.7%	3.1%	4.0%

¹ In millions

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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 26.4 today. With interest rates at historical lows and dividend stocks losing their luster when it comes to high valuations, we are forecasting a major headwind to total returns from a price-to-earnings multiple that should contract towards 20 from today's levels. We believe the yield will rise from today's 3.1% 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	61%	73%	80%	81%	85%	92%	87%	84%	85%	83%	81%	79%

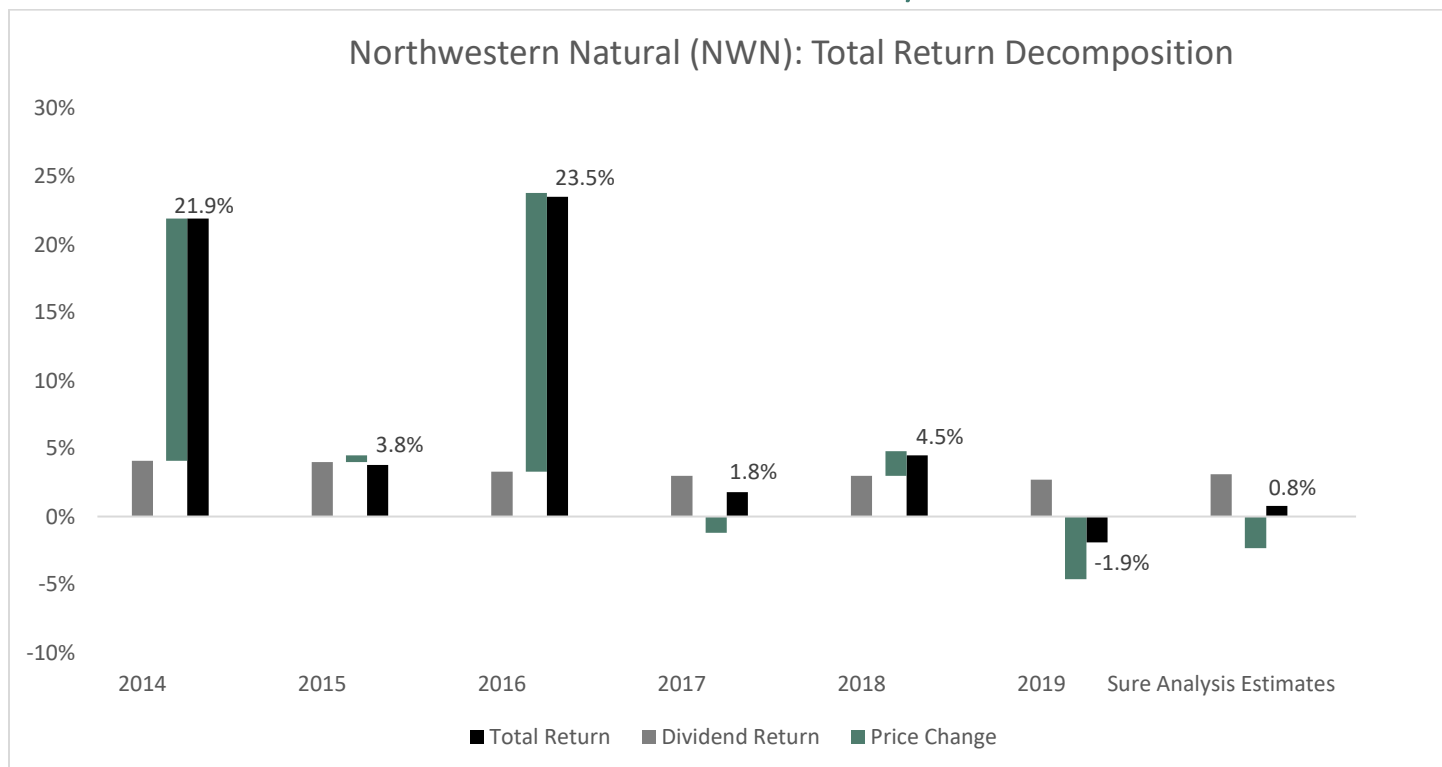
NW Natural's quality metrics have been very steady in the past decade. Seventy-six percent of its total assets are encumbered by debt, which is completely acceptable for a utility. Its interest coverage is fairly strong at 3.6, so there are certainly no financing concerns moving forward. The dividend 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 priced well in excess of fair value. The combination of the 3.1% yield, 5.4% headwind from expected multiple compression, and 2.9% expected earnings growth should lead to annualized total returns of just 0.8% for investors over the next half decade 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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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	792	828	731	759	754	724	668	755	706	746
Gross Profit	247	244	246	249	252	239	271	278	264	283
Gross Margin	31.1%	29.5%	33.6%	32.8%	33.4%	33.0%	40.5%	36.8%	37.4%	37.9%
D&A Exp.	65	70	73	76	79	81	78	81	85	91
Operating Profit	158	145	142	143	143	124	151	151	132	143
Operating Margin	19.9%	17.5%	19.5%	18.8%	19.0%	17.2%	22.6%	20.0%	18.7%	19.2%
Net Profit	73	63	59	61	59	54	59	(56)	65	62
Net Margin	9.2%	7.6%	8.0%	8.0%	7.8%	7.4%	8.8%	-7.4%	9.1%	8.3%
Free Cash Flow	(122)	133	37	37	96	66	84	(7)	(50)	(57)
Income Tax	49	43	43	42	42	36	43	41	24	13

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	2,617	2,747	2,813	2,971	3,065	3,069	3,080	3,040	3,193	3,321
Cash & Equivalents	3	6	9	9	10	4	4	3	8	6
Accounts Receivable	68	77	61	82	70	68	67	66	67	67
Inventories	80	74	68	61	78	71	54	48	44	44
Total Liabilities	1,924	2,032	2,083	2,219	2,298	2,288	2,229	2,297	2,477	2,499
Accounts Payable	93	86	86	96	91	73	86	111	115	112
Long-Term Debt	859	823	882	930	896	864	773	834	952	969
Shareholder's Equity	693	714	730	752	767	781	850	743	716	822
D/E Ratio	1.24	1.15	1.21	1.24	1.17	1.11	0.91	1.12	1.33	1.18

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.9%	2.4%	2.1%	2.1%	1.9%	1.8%	1.9%	-1.8%	2.1%	1.9%
Return on Equity	10.7%	9.0%	8.1%	8.2%	7.7%	6.9%	7.2%	-7.0%	8.9%	8.0%
ROIC	4.9%	4.1%	3.7%	3.7%	3.5%	3.2%	3.6%	-3.5%	4.0%	3.6%
Shares Out.	27	27	27	27	27	27	29	29	30	30
Revenue/Share	29.72	30.96	27.15	28.07	27.70	26.40	24.05	26.26	24.46	25.00
FCF/Share	(4.58)	4.97	1.37	1.39	3.51	2.42	3.02	(0.23)	(1.74)	(1.91)

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

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