

# Fortis Inc. (FTS)

Updated August 18<sup>th</sup>, 2020 by Kay Ng

## Key Metrics

<b>Current Price:</b>	\$40	<b>5 Year CAGR Estimate:</b>	6.0%	<b>Market Cap:</b>	\$18.7B
<b>Fair Value Price:</b>	\$36	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	08/18/20
<b>% Fair Value:</b>	113%	<b>5 Year Valuation Multiple Estimate:</b>	-2.4%	<b>Dividend Payment Date:</b>	09/01/20
<b>Dividend Yield:</b>	3.4%	<b>5 Year Price Target</b>	\$45	<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 trades with a current after-tax yield of 2.9% (3.4% before the 15% withholding tax applied by the Canadian government). Unless otherwise noted, US\$ is used in this research report.

Fortis reported Q2 2020 results on 07/30/20. For the quarter, it reported net earnings of C\$274 million, compared to prior year's period of C\$720 million. This was due to one-time items, including primarily the C\$484 million gain in the sale of the Waneta Expansion hydroelectric generating facility in April 2019. On an adjusted basis, earnings-per-share (EPS) increased by 3.7% to C\$0.56, as the regulated utility enjoyed rate base growth led by ITC and increased retail sales at UNS Energy thanks to cooperating weather. Results were dampened by lower Caribbean earnings due to COVID-19 disrupted tourism-related activities, higher COVID-related costs, and a higher number of common shares. Management also pointed to lower earnings at Tucson Electric Power (TEP) from higher costs related to ~C\$1 billion utility infrastructure investments spent over the past few years. It expects new rates at TEP will be approved later this year to recover these investment costs. We estimate a mild drop in 2020's EPS against last year that's dragged slightly down by COVID-19 impacts but should be helped by a stronger US\$ against the C\$.

## 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>\$1.86</b>	<b>\$2.37</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>\$1.37</b>	<b>\$1.83</b>
<b>Shares<sup>1</sup></b>	174	189	192	213	276	282	401	421	429	447	<b>465</b>	<b>538</b>

Fortis compounded its EPS at 5.2% per year and DPS at 5.6% per year from 2010 to 2019 in C\$. In the first half of 2020, Fortis completed 47% of its C\$4.3 billion capital plan for 2020. It might make non-material changes to it in light of COVID-19. However, it's keeping its five-year capital plan intact. Specifically, Fortis has a C\$18.8 billion five-year capital plan and expects its mid-year rate base to grow at a CAGR of 6.5% from C\$28.0 billion in 2019 to C\$38.4 billion in 2024. These supports management's dividend growth guidance of 6% per year through 2024. From 2020 to 2025, we use estimated EPS and DPS growth rates of 5% and 6%, respectively.

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 still high against C\$ compared to long-term historic levels. Therefore, should C\$ continue to improve against the US\$, it should be a tailwind for U.S. 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 on 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.

1. Estimated dividend dates; 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	21.5	19.1
Avg. Yld.	3.6%	3.5%	3.6%	3.8%	3.7%	3.6%	4.0%	3.7%	3.8%	3.7%	3.4%	4.0%

Using our 2020 EPS estimate, Fortis trades at a price-to-earnings ratio of 21.5, which we think is slightly expensive. The stock spent 2016 and 2017 trading at well below its historic multiple, but the P/E multiple has expanded 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 3.4% (gross of the withholding tax paid to the Canadian government). This is a solid dividend for safe income generation from a blue-chip North American utility. However, total returns over the next five years will be dampened from a fully-valued stock.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

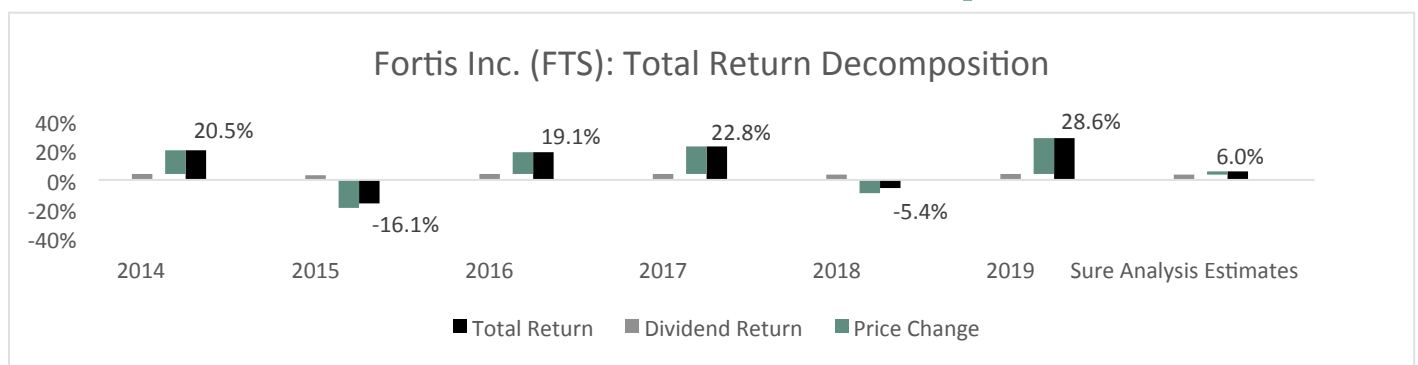
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	67%	71%	70%	75%	74%	72%	65%	62%	70%	72%	74%	77%

Although some of Fortis's business clients are running at lower capacities or are closed temporarily during the COVID-19 period, its residential clients are using more energy at home. As a result, Fortis estimates that 82% of its revenues will be essentially intact in the face of the virus. In short, Fortis is quite resilient against economic downturns including the one we're experiencing today. Its liquidity position is strong, including C\$4.8 billion of undrawn liquidity available from credit facilities. 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 high economic uncertainty that COVID-19 brings has driven up the valuation of highly predictable Fortis. We estimate FTS will deliver a total rate of return of 6.0% through 2025 from 5% earnings growth, a 3.4% yield, and a P/E contraction of -2.4%. There are better income and total-return ideas in the Sure Dividend coverage universe. Conservative & income-oriented investors can consider buying Fortis on meaningful dips.

## Total Return Breakdown by Year



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## Income Statement Metrics

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

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	12907	13923	15028	16819	22598	20757	35530	38029	38950	40883
Cash & Equivalents	109	85	155	68	198	174	200	260	244	283
Accounts Receivable	655	592	528	331	413	373	376	366	395	386
Inventories	168	131	134	134	277	243	276	292	292	302
Goodwill & Int. Ass.	1877	1851	1903	2273	3612	3397	9920	10119	10081	10154
Total Liabilities	8849	9081	9590	10831	14749	13296	23329	24710	25400	25486
Accounts Payable	953	448	501	397	527	298	411	553	499	577
Long-Term Debt	5966	5869	6115	6963	9320	8456	16527	17231	17727	17380
Shareholder's Equity	3304	3745	4013	4482	5919	5808	9623	10640	10947	12944
D/E Ratio	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
Return on Assets	2.5%	2.7%	2.5%	2.5%	1.7%	2.9%	1.8%	2.2%	2.3%	3.3%
Return on Equity	9.6%	10.2%	9.3%	9.4%	6.6%	10.8%	6.5%	7.8%	8.3%	10.9%
ROIC	3.2%	3.5%	3.3%	3.2%	2.3%	3.8%	2.2%	2.7%	2.9%	4.1%
Shares Out.	174	189	192	213	276	282	401	421	429	447
Revenue/Share	18.95	19.90	18.53	18.78	21.64	18.60	16.48	15.39	15.23	15.13
FCF/Share	(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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