



# Spark Energy Inc. (SPKE)

Updated November 18<sup>th</sup>, 2020 by Aristofanis Papadatos

## Key Metrics

|                             |        |  |        |                                  |            |
|-----------------------------|--------|--|--------|----------------------------------|------------|
| <b>Current Price:</b>       | \$9.30 | <b>5 Year CAGR Estimate:</b>               | 5.9%   | <b>Market Cap:</b>               | \$330 M    |
| <b>Fair Value Price:</b>    | \$8.80 | <b>5 Year Growth Estimate:</b>             | 0.0%   | <b>Ex-Dividend Date:</b>         | 11/30/2020 |
| <b>% Fair Value:</b>        | 106%   | <b>5 Year Valuation Multiple Estimate:</b> | -1.2%  | <b>Dividend Payment Date:</b>    | 12/15/2020 |
| <b>Dividend Yield:</b>      | 7.8%   | <b>5 Year Price Target</b>                 | \$8.80 | <b>Years Of Dividend Growth:</b> | 0          |
| <b>Dividend Risk Score:</b> | F      | <b>Retirement Suitability Score:</b>       | C      | <b>Last Dividend Increase:</b>   | N/A        |

## Overview & Current Events

Spark Energy Inc. is an independent retail energy services company founded in 1999. The organization provides residential and commercial customers with alternative choices for their natural gas and electricity. Spark Energy is headquartered in Houston, Texas, and currently operates in 19 states and serves 100 utility territories. Spark Energy has a market cap of \$330 million and executed its initial public offering in 2014.

In early November, Spark Energy reported (11/3/20) financial results for the third quarter of fiscal 2020. Its earnings-per-share plunged -44% over last year's quarter, from \$0.93 to \$0.52, due to a steep decrease in the total customer count, from 772,000 to 499,000, which was partly offset by lower operating expenses. Spark Energy continued to shed low-margin commercial customers in favor of high-margin customers. However, it is facing a strong headwind due to the social distancing that has resulted from the pandemic. This headwind has led Spark Energy to reduce its door-to-door marketing efforts and thus its customer count has shrunk at a fast clip. Management expects the customer count to decrease even further in the near future. Moreover, management implied once again that the dividend will be cut if the pandemic persists for a considerable period.

Spark Energy has an opaque business model and does not provide any guidance for the year. We note the decent business momentum of the company and the fact that it has left most of its litigation issues behind, as it settled them last year. As the company has performed better than our expectations, we have raised our earnings-per-share forecast for the year from \$0.25 to \$0.70.

## Growth on a Per-Share Basis

| Year                      | 2010 | 2011 | 2012 | 2013 | 2014    | 2015   | 2016   | 2017   | 2018    | 2019   | 2020          | 2025          |
|---------------------------|------|------|------|------|---------|--------|--------|--------|---------|--------|---------------|---------------|
| <b>EPS</b>                | ---  | ---  | ---  | ---  | -\$0.01 | \$0.53 | \$1.11 | \$1.21 | -\$0.69 | \$0.02 | <b>\$0.70</b> | <b>\$0.70</b> |
| <b>DPS</b>                | ---  | ---  | ---  | ---  | \$0.30  | \$0.73 | \$0.73 | \$0.73 | \$0.73  | \$0.73 | <b>\$0.73</b> | <b>\$0.73</b> |
| <b>Shares<sup>1</sup></b> | ---  | ---  | ---  | ---  | 6.00    | 6.24   | 33.44  | 34.62  | 34.99   | 35.0   | <b>35.0</b>   | <b>40.0</b>   |

Since its IPO, Spark Energy has made 14 acquisitions and has grown its customer base at a fast pace. However, this strategy has hardly borne fruit so far. The company has a remarkably volatile performance record and hence it is essentially impossible to forecast its future results with any degree of accuracy. Its fragile business model is also evident from the markedly high monthly attrition rate, which averaged 5.0% in 2019 and 4.0% this year. Spark Energy posted a loss in 2018 and a marginal profit last year while it has not provided any material guidance for this year. It is also worth noting that Spark Energy offers very little information in its earnings reports and is not followed by analysts. It is also concerning that its management remains focused on EBITDA instead of earnings. We prefer to be conservative and expect earnings-per-share around \$0.70 in 2025.

<sup>1</sup> In millions.

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## Valuation Analysis

| Year      | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Now         | 2025        |
|-----------|------|------|------|------|------|------|------|------|------|------|-------------|-------------|
| Avg. P/E  | ---  | ---  | ---  | ---  | ---  | 14.7 | 12.0 | 13.5 | ---  | ---  | <b>13.3</b> | <b>12.5</b> |
| Avg. Yld. | ---  | ---  | ---  | ---  | ---  | 9.3% | 5.5% | 4.5% | 7.6% | 7.4% | <b>7.8%</b> | <b>8.3%</b> |

Spark Energy has traded at a price-to-earnings ratio in the low double-digits since its initial public offering. Accordingly, we estimate that the firm's fair value is somewhere near a price-to-earnings ratio of 12.5. The stock is currently trading at a price-to-earnings ratio of 13.3. If the price-to-earnings ratio contracts to 12.5 over the next five years, the stock will incur a -1.2% annualized drag in its returns.

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

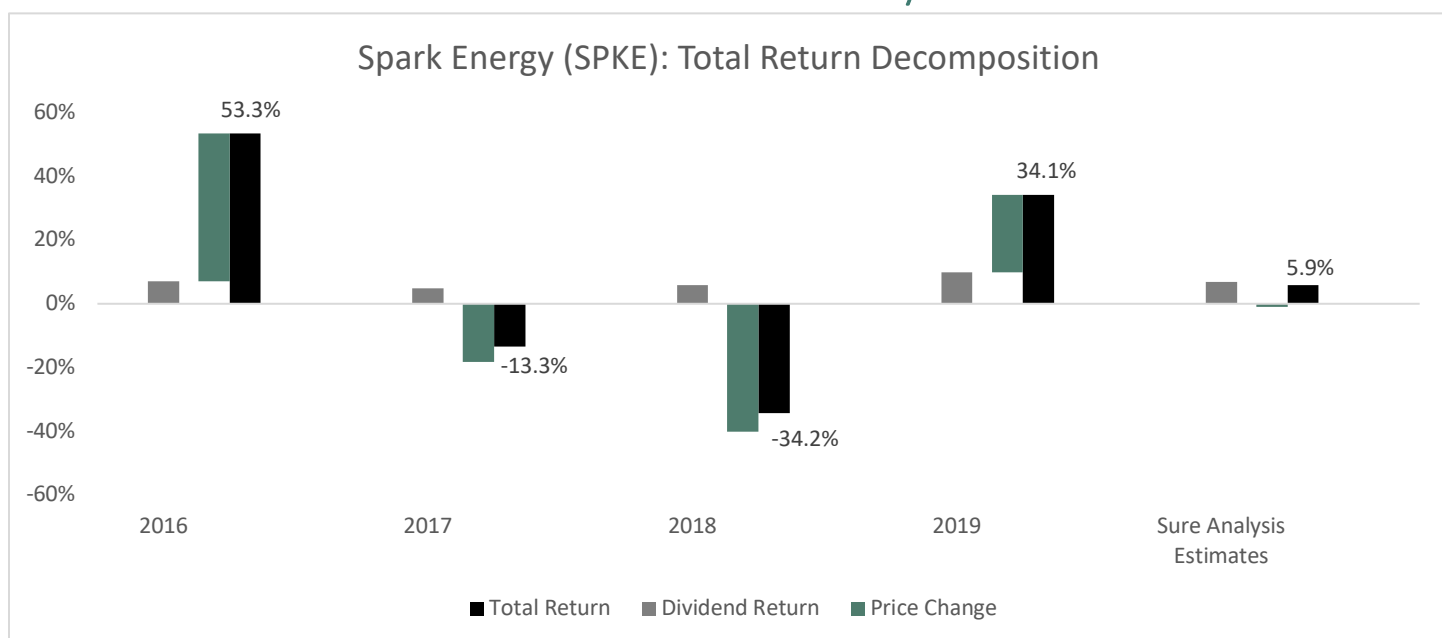
| Year   | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016  | 2017  | 2018 | 2019  | 2020        | 2025        |
|--------|------|------|------|------|------|------|-------|-------|------|-------|-------------|-------------|
| Payout | ---  | ---  | ---  | ---  | ---  | 138% | 65.8% | 61.3% | ---  | 3650% | <b>104%</b> | <b>104%</b> |

As a small-cap energy business, Spark Energy tends to be more volatile than most large cap stocks. To provide a perspective, the stock is -60% off its peak posted about three years ago. Moreover, the stock could underperform the market during sell-off periods. In the sell-off triggered by the pandemic, the stock plunged -50% whereas the S&P 500 fell -35%. Furthermore, Spark Energy is not followed by analysts and provides little information in its reports.

## Final Thoughts & Recommendation

Spark Energy is facing a setback in its growth efforts due to the coronavirus. If the pandemic does not extend much into next year, we expect the stock to offer a 5.9% average annual return over the next five years, thanks to its 7.8% dividend yield. The stock may offer higher returns but management provides too little information on the results and no guidance. Also, given the markedly volatile performance record of Spark Energy, the stock is highly speculative. Moreover, retirees should note that Spark Energy earns a poor rating for Retirement Suitability, largely due to its short dividend history and its excessive payout ratio. We also note that the dividend is at risk of being cut. We rate shares 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  |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>Revenue</b>          | 5,591 | 6,091 | 379   | 317   | 323   | 358   | 547   | 798   | 1,006 | 814   |
| <b>Gross Profit</b>     | 2,007 | 2,108 | 100   | 84    | 64    | 117   | 202   | 246   | 160   | 199   |
| <b>Gross Margin</b>     | 35.9% | 34.6% | 26.3% | 26.5% | 19.9% | 32.7% | 36.9% | 30.8% | 15.9% | 24.4% |
| <b>SG&amp;A Exp.</b>    | ---   | 1,267 | 47    | 35    | 46    | 62    | 85    | 101   | 111   | 134   |
| <b>D&amp;A Exp.</b>     | 210   | 228   | 23    | 16    | 22    | 25    | 49    | 43    | 51    | 41    |
| <b>Operating Profit</b> | 656   | 622   | 29    | 33    | (4)   | 30    | 84    | 102   | (4)   | 24    |
| <b>Operating Margin</b> | 11.7% | 10.2% | 7.8%  | 10.4% | -1.2% | 8.3%  | 15.4% | 12.8% | -0.4% | 2.9%  |
| <b>Net Profit</b>       | 261   | 245   | 26    | 31    | (0)   | 4     | 14    | 19    | (1)   | 8     |
| <b>Net Margin</b>       | 4.7%  | 4.0%  | 6.9%  | 9.9%  | 0.0%  | 1.1%  | 2.6%  | 2.4%  | -0.1% | 1.0%  |
| <b>Free Cash Flow</b>   | 252   | 194   | 42    | 43    | 3     | 44    | 65    | 60    | 58    | 85    |
| <b>Income Tax</b>       | 168   | 145   | 0     | 0     | (1)   | 2     | 10    | 39    | 2     | 7     |

## Balance Sheet Metrics

| Year                            | 2010  | 2011  | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---------------------------------|-------|-------|------|------|------|------|------|------|------|------|
| <b>Total Assets</b>             | 6,374 | 6,663 | 129  | 109  | 138  | 162  | 375  | 504  | 489  | 423  |
| <b>Cash &amp; Equivalents</b>   | 261   | 239   | 7    | 7    | 4    | 4    | 19   | 29   | 41   | 57   |
| <b>Accounts Receivable</b>      | 468   | 547   | 78   | 69   | 65   | 62   | 115  | 162  | 153  | 116  |
| <b>Inventories</b>              | 314   | 363   | 4    | 4    | 8    | 4    | 4    | 4    | 4    | 3    |
| <b>Goodwill &amp; Int. Ass.</b> | 1,713 | 1,710 | ---  | ---  | 1    | 26   | 107  | 155  | 147  | 138  |
| <b>Total Liabilities</b>        | 4,313 | 4,472 | 68   | 73   | 114  | 129  | 251  | 303  | 308  | 266  |
| <b>Accounts Payable</b>         | 373   | 400   | 44   | 37   | 39   | 32   | 56   | 82   | 71   | 49   |
| <b>Long-Term Debt</b>           | 2,206 | 2,296 | 10   | 28   | 33   | 49   | 78   | 146  | 146  | 123  |
| <b>Shareholder's Equity</b>     | 1,825 | 1,978 | 61   | 36   | 9    | 11   | 30   | 58   | 46   | 51   |
| <b>D/E Ratio</b>                | 1.21  | 1.16  | 0.16 | 0.77 | 3.81 | 4.30 | 2.58 | 1.48 | 1.07 | 0.87 |

## Profitability & Per Share Metrics

| Year                    | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>Return on Assets</b> | 4.2%  | 3.8%  | ---   | 26.4% | 0.0%  | 2.6%  | 5.4%  | 4.4%  | -0.2% | 1.9%  |
| <b>Return on Equity</b> | 15.3% | 12.9% | ---   | 64.6% | -0.2% | 38.7% | 69.3% | 43.8% | -2.3% | 17.4% |
| <b>ROIC</b>             | 6.2%  | 5.6%  | ---   | 46.6% | -0.1% | 5.6%  | 10.2% | 7.0%  | -0.4% | 2.8%  |
| <b>Shares Out.</b>      | ---   | ---   | ---   | ---   | 6.00  | 6.24  | 33.44 | 34.62 | 34.99 | 35.0  |
| <b>Revenue/Share</b>    | 33.73 | 35.95 | 63.18 | 52.85 | 53.81 | 53.82 | 43.08 | 59.80 | 75.13 | 55.86 |
| <b>FCF/Share</b>        | 1.52  | 1.15  | 6.98  | 7.17  | 0.47  | 6.64  | 5.10  | 4.53  | 4.36  | 5.81  |

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

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