Southern Company (SO)

Updated February 22nd, 2021 by Aristofanis Papadatos

Key Metrics

Current Price:	$59	**5 Year CAGR Estimate:**	7.4%	**Market Cap:**	$62.4 B
Fair Value Price:	$55	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	2/12/2021
% Fair Value:	107%	**5 Year Valuation Multiple Estimate:**	-1.4%	**Dividend Payment Date:**	3/8/2021
Dividend Yield:	4.4%	**5 Year Price Target**	$70	**Years Of Dividend Growth:**	19
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	3.2%

Overview & Current Events

Southern Company is a major energy utility that serves ~9 million customers in the U.S. via its subsidiaries. It has a market capitalization of $62.4 billion.

Southern is one of the most resilient companies to the downturn that has been caused by the coronavirus pandemic. In fact, the company greatly benefits from the record-low interest rates that have resulted from the recession. Due to cost overruns and its acquisition of AGL Resources for $12 billion in 2016, Southern has almost doubled its net debt in the last five years. In addition, it has a heavy debt maturity schedule, with $8.5 billion of its debt maturing by the end of 2023. As it will not be able to pay off this debt load, it will have to roll it over so it greatly benefits from lower rates.

In mid-February, Southern reported (2/18/21) financial results for the fourth quarter of fiscal 2020. In the full year, revenue decreased -5% due to the effect of the pandemic on the demand for energy and milder weather. However, thanks to rate hikes and reduced expenses, Southern grew its adjusted earnings-per-share 4.5% over the prior year. Management provided guidance for earnings-per-share of $3.25-$3.35 this year. Notably, Southern has missed analysts' earnings-per-share estimates only once in the last 16 quarters. It has also greatly improved its execution in the Vogtle Plant in the last two years.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$2.55	$2.67	$2.70	$2.77	$2.84	$2.83	$3.02	$3.07	$3.11	$3.25	***$3.33***	***$4.25***
DPS	$1.87	$1.94	$2.01	$2.08	$2.15	$2.22	$2.30	$2.38	$2.46	$2.54	***$2.62***	***$3.04***
Shares[1]	865.1	867.8	887.1	907.8	911.7	990.4	1007.6	1034.0	1052.0	1058	***1065***	***1170***

Due to its huge capital expenses and its debt pile, the company issues new shares on a regular basis. Southern has increased its share count at a 3.0% average annual rate in the last five years. On the bright side, management has stated that it will need to issue only $2.0 billion of shares (3% of the current market cap) in the next five years.

Southern has grown its earnings-per-share at a 2.7% annual rate both in the last decade and in the last five years. Management has repeatedly stated that it targets 4%-6% long-term earnings-per-share growth. Given the decent business momentum of Southern, the expected contribution from the Vogtle Plant in the upcoming years and the less pronounced dilution of shareholders going forward, we expect approximately 5.0% earnings-per-share growth over the next five years.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	15.8	17.0	16.2	16.0	15.8	17.8	15.5	14.7	17.9	17.9	***17.7***	***16.5***
Avg. Yld.	4.6%	4.3%	4.6%	4.7%	4.8%	4.4%	4.6%	5.3%	4.0%	4.4%	***4.4%***	***4.3%***

[1] In millions.

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Southern is trading at a price-to-earnings ratio of 17.7, which is higher than its 10-year average price-to-earnings ratio of 16.5. If the stock reverts to its average valuation level over the next five years, it will incur a -1.4% annualized drag due to the contraction of its earnings multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	73.3%	72.7%	74.4%	75.1%	75.7%	78.4%	71.7%	77.5%	79.1%	78.2%	***78.7%***	***71.5%***

The competitive advantage of Southern is its state-regulated business, which requires excessive capital expenses for infrastructure and poses high barriers to entry to potential competitors. Southern has stretched its balance sheet in recent years. Its debt/assets and its payout ratio have climbed near decade-high levels while its interest expense currently consumes 35% of its operating income. On the bright side, these metrics have somewhat improved lately thanks to asset sales, whose proceeds have been used for debt reduction.

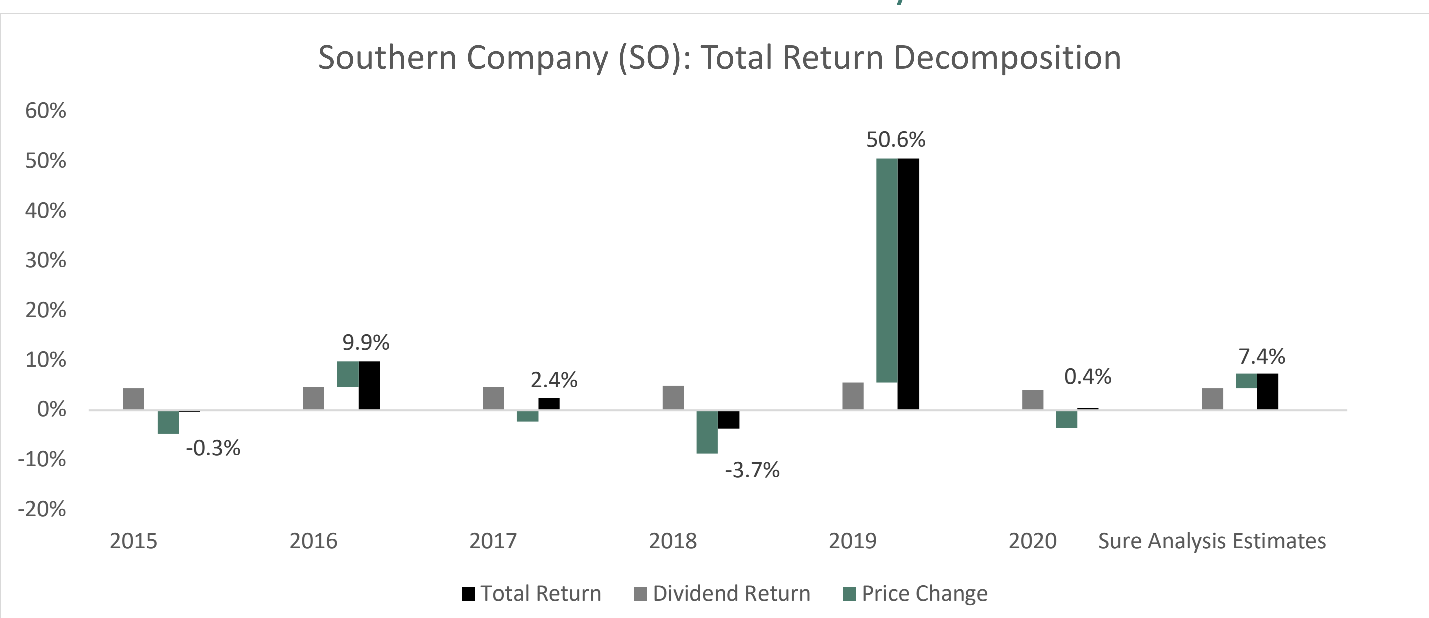
Southern has raised its dividend for 19 consecutive years and has not cut it for 73 consecutive years. Moreover, it currently offers a 4.4% dividend yield, which is higher than that of most utilities. Due to the weak balance sheet, dividend growth is likely to be meager (~3% annually) going forward.

Southern is attractive for its resilience during recessions. In the Great Recession, when most companies saw their earnings collapse, the earnings-per-share of Southern fell just -1.3%. In the current recession, which has been caused by the coronavirus, Southern has grown its earnings thanks to its resilient business model, which involves rate hikes, and the boost from lower interest rates. The -16% correction of its stock price in about a year has resulted merely from overvalued status before the pandemic, in our view.

Final Thoughts & Recommendation

The prospects of Southern have greatly improved in recent quarters thanks to the reduced execution risk at its Vogtle Plant and the record-low interest rates. Southern is also resilient to the ongoing recession, it is reasonably valued and could offer a 7.4% average annual return over the next five years. We thus rate the stock as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	17,657	16,537	17,087	18,467	17,489	19,896	23,031	23,495	21,419	20,375
Gross Profit	6,849	7,164	7,270	7,436	7,678	8,530	9,915	9,616	9,603	9,897
Gross Margin	38.8%	43.3%	42.5%	40.3%	43.9%	42.9%	43.1%	40.9%	44.8%	48.6%
D&A Exp.	2048	2145	2298	2293	2395	2923	3457	3549	3331	3,905
Operating Profit	4231	4463	3255	3642	4282	4487	2293	4110	5335	4,820
Op. Margin	24.0%	27.0%	19.0%	19.7%	24.5%	22.6%	10.0%	17.5%	24.9%	23.7%
Net Profit	2268	2415	1710	2031	2421	2493	880	2242	4754	3,134
Net Margin	12.8%	14.6%	10.0%	11.0%	13.8%	12.5%	3.8%	9.5%	22.2%	15.4%
Free Cash Flow	1378	89	634	569	600	-2416	-1029	-1056	-1774	-745
Income Tax	1219	1334	849	977	1194	951	142	449	1798	393

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets ($B)	59.3	63.1	64.5	70.2	78.3	109.7	111.0	116.9	118.7	122.9
Cash & Equivalents	1315	628	659	710	1404	1975	2130	1396	1975	1,065
Acc. Receivable	1074	961	1027	1090	1058	2206	2413	2527	2042	2,269
Inventories	2270	2819	2298	1969	1929	2782	2627	2394	2388	2,488
Goodwill & Int.	N/A	N/A	N/A	N/A	319	7221	7141	5928	5816	5,767
Total Liabilities	40607	43770	44407	48932	56218	82967	85153	87584	86650	90,410
Accounts Payable	1553	1387	1376	1593	1905	2825	3076	3436	2557	2,806
Long-Term Debt	21199	22411	23266	24745	28706	47425	50762	46825	46842	49,189
Total Equity	17578	18297	19008	19949	20592	24758	24167	24723	27505	27,972
D/E Ratio	1.18	1.20	1.20	1.22	1.39	1.91	2.07	1.87	1.69	1.74

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	4.0%	3.9%	2.7%	3.0%	3.3%	2.7%	0.8%	2.0%	4.0%	2.6%
Return on Equity	13.4%	13.5%	9.2%	10.4%	11.9%	11.0%	3.6%	9.2%	18.2%	11.3%
ROIC	5.9%	5.9%	4.0%	4.5%	5.0%	4.0%	1.2%	2.9%	6.1%	3.9%
Shares Out.	865.1	867.8	887.1	907.8	911.7	990.4	1007.6	1034.0	1052.0	1058
Revenue/Share	20.44	18.81	19.40	20.50	19.13	20.77	22.85	22.92	20.32	19.13
FCF/Share	1.59	0.10	0.72	0.63	0.66	-2.52	-1.02	-1.03	-1.68	-0.70

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