



Pinnacle West Capital Corp. (PNW)

Updated March 17th, 2021 by Felix Martinez

Key Metrics

Current Price:	\$80	5 Year CAGR Estimate:	10.2%	Market Cap:	\$9 B
Fair Value Price:	\$87	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	05/01/21 ¹
% Fair Value:	92%	5 Year Valuation Multiple Estimate:	1.6%	Dividend Payment Date:	06/01/21 ¹
Dividend Yield:	4.2%	5 Year Price Target	\$111	Years Of Dividend Growth:	9
Dividend Risk Score:	C	Retirement Suitability Score:	B	Last Dividend Increase:	6.1%

Overview & Current Events

Pinnacle West Capital is a holding company based in Phoenix, Arizona. The Company was initially known as Arizona Public Service Company, then later reorganized as a holding company, AZP Group Inc., in February 1985. In 1987, it changed its name to what is now known as, Pinnacle West Capital, which trades under the ticker symbol PNW. Through its principal subsidiary, Arizona Public Service (APS), the Company provides electricity service to more than 1.3 million Arizona homes and businesses. The company has the generating capacity to produce 6,300 megawatts, and it employs more than 6,000 in Arizona and New Mexico. PNW has been paying a dividend for 27 years and growing the dividend consecutively for the past nine years. Pinnacle West Capital has a market capitalization of \$9 billion.

On February 24th, 2021, Pinnacle West Capital reported fourth-quarter and full-year earnings. For the quarter, operating revenue grew 10.5% year over year, from \$670.4 million to \$741 million. Revenue growth was driven by customer growth of 2.3% as people and businesses continued to move to Arizona. The influx of people is making the company's service territory among the fastest growing in the nation. However, for the quarter, PNW had a net loss of -\$19.4 million, or -\$0.17 per share. The main drivers for the loss were a settlement with the Arizona Attorney General's Office and the decision to pull forward near-term operations and maintenance expenses into the year's final quarter.

For the year, PNW saw a 3.3% increase in revenue compared to 2019. Net income also grew but by a slightly slower pace of 2.2% for the year. Overall, PNW earned \$4.87 per share for the year, which is 2.1% higher than what it earned in 2019. We expect PNW to generate earnings-per-share of \$4.98 per share for 2021. This would represent a 2.3% increase compared to 2020.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$2.99	\$3.50	\$3.66	\$3.58	\$3.92	\$3.95	\$4.35	\$4.54	\$4.77	\$4.87	\$4.98	\$6.36
DPS	\$2.10	\$2.12	\$2.20	\$2.30	\$2.41	\$2.53	\$2.66	\$2.82	\$3.00	\$3.18	\$3.37	\$4.30
Shares²	110.0	111.0	111.0	111.0	112.0	112.0	112.0	113.0	113.0	113.0	113.0	113.0

We expect continued growth for PNW to be primarily driven by more people coming to Arizona. We predict that Pinnacle West Capital will continue to grow earnings at a 5% rate for the next five years. This would give us \$6.36 per share in earnings for 2026. Our expected 5% growth rate is slightly lower than the 10-year average growth rate of 5.6%, but it is higher than the 5-year average growth rate of 4.7%. PNW's net margin has been improving over the past decade, growing from a low of 10.5% in 2011 to 15.4% last year. This could continue to be a growth driver as well.

The company has increased its dividend each year for the past nine years. The dividend growth rate is 4.7% for the past nine years and 5.9% for the past five years. We expect PNW to grow its dividend at a 5% yearly rate, which would be in line with its expected earnings growth.

¹ Ex-Dividend and Dividend payment dates are estimates.

² Share count is 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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	16.1	14.6	14.5	19.1	16.5	19.8	19.6	18.8	18.9	16.4	16.1	17.4
Avg. Yld.	4.4%	4.2%	4.2%	3.4%	3.7%	3.2%	3.1%	3.3%	3.3%	4.0%	4.2%	3.9%

Over the past decade, PNW has traded with an average P/E ratio of 17.4. We think this is a fair P/E for a high-quality utility company like PNW. Currently, PNW trades hands with a P/E of 16.1. This is a reasonable valuation for a long-term investor who likes high-yield utility companies. Looking at the dividend yield, we see that the current yield is also higher than the company's historical yield. For the past 10-years, PNW has an average dividend yield of 3.7%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	70.2%	60.6%	60.1%	64.2%	61.5%	64.1%	61.1%	62.1%	62.9%	65.3%	68%	68%

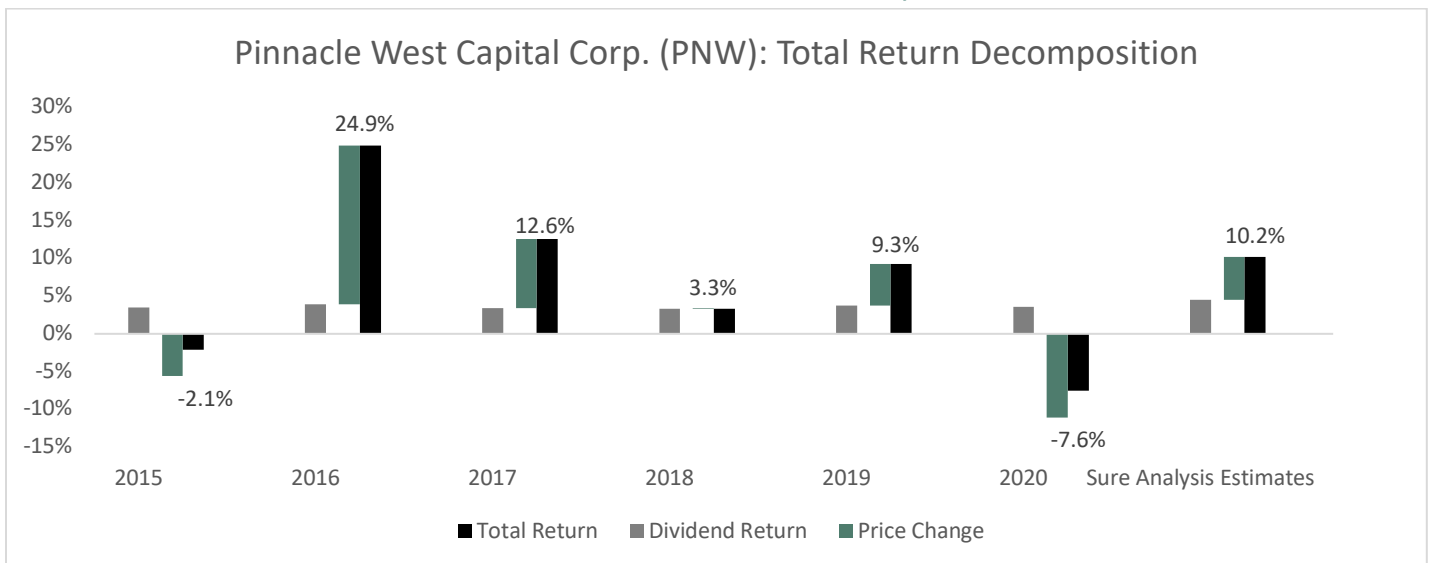
Pinnacle West Capital's competitive advantage is that it is a utility, which tend to be monopoly like in nature. Utility stocks are often held by investors for their defensive nature. People will always need to power their homes and businesses. However, PNW shows that earnings can decrease during a recession. For example, during the Great Recession from 2008-2009, PNW's earnings-per-share fell from \$2.96 in 2007 to \$2.12 in 2008. Earnings did bounce back in 2009 and further in 2010 to \$3.08. During the COVID-19 pandemic PNW has so far fared even better.

Even though earnings fell significantly during the Great Recession, the dividend was not cut during that time. This shows that PNW is committed to paying its dividends. The Debt-to-Equity ratio (D/E) is 1.2 for the year, which is fair. The company currently has an S&P credit rating of A-, which is investment-grade quality. Also, PNW has an interest coverage ratio of 4. Thus, the company has a very healthy balance sheet.

Final Thoughts & Recommendation

Pinnacle West Capital Corp is a high-quality utility company at a reasonable price. The company continues to produce a very reliable and growing dividend. At the current price, PNW is below our fair value estimate. We forecast total shareholder returns of 10.2% per year for the next five years. Thus, shares earn a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	3,241	3,302	3,455	3,492	3,495	3,499	3,565	3,691	3,471	3,587
Gross Profit	1,328	1,422	1,434	1,404	1,526	1,491	1,635	1,578	1,487	1,635
Gross Margin	41.0%	43.1%	41.5%	40.2%	43.7%	42.6%	45.9%	42.8%	42.8%	45.6%
D&A Exp.	494	481	492	496	572	565	611	651	664	686
Operating Profit	747	852	846	811	855	836	910	774	672	788
Operating Margin	23.0%	25.8%	24.5%	23.2%	24.4%	23.9%	25.5%	21.0%	19.4%	22.0%
Net Profit	339	382	406	398	437	442	488	511	538	551
Net Margin	10.5%	11.6%	11.8%	11.4%	12.5%	12.6%	13.7%	13.8%	15.5%	15.3%
Free Cash Flow	241	282	137	189	18	(252)	(291)	99	(235)	(360)
Income Tax	184	237	231	221	238	236	258	134	(16)	78

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	13,111	13,380	13,509	14,289	15,028	16,004	17,019	17,664	18,479	20,020
Cash & Equivalents	34	26	10	8	39	9	14	6	10	60
Accounts Receivable	284	277	300	298	275	250	305	268	266	314
Inventories	226	249	260	256	280	283	289	294	346	334
Goodwill & Int. Ass.	171	162	158	120	124	90	257	263	291	283
Total Liabilities	9,180	9,277	9,168	9,770	10,309	11,068	11,883	12,315	12,926	14,268
Accounts Payable	327	221	285	295	297	265	256	277	346	319
Long-Term Debt	3,496	3,414	3,490	3,538	3,820	4,324	4,967	5,215	5,747	6,483
Shareholder's Equity	3,822	3,973	4,194	4,367	4,584	4,804	5,007	5,223	5,431	5,634
D/E Ratio	0.91	0.86	0.83	0.81	0.83	0.90	0.99	1.00	1.06	1.15

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	2.7%	2.9%	3.0%	2.9%	3.0%	2.8%	3.0%	2.9%	3.0%	2.9%
Return on Equity	9.0%	9.8%	9.9%	9.3%	9.8%	9.4%	10.0%	10.0%	10.1%	10.0%
ROIC	4.6%	5.1%	5.3%	5.0%	5.3%	5.0%	5.0%	4.9%	4.9%	4.7%
Shares Out.	110.0	111.0	111.0	111.0	112.0	112.0	112.0	113.0	113.0	113.0
Revenue/Share	29.50	29.87	31.18	31.41	31.33	31.23	31.73	32.80	30.78	31.76
FCF/Share	2.20	2.55	1.24	1.70	0.16	(2.25)	(2.59)	0.88	(2.08)	(3.19)

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

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