



Fortis Inc. (FTS)

Updated February 26th, 2021 by Kay Ng

Key Metrics

Current Price:	\$39	5 Year CAGR Estimate:	10.8%	Market Cap:	\$18.4B
Fair Value Price:	\$41	5 Year Growth Estimate:	6.0%	Ex-Dividend Date:	05/14/21
% Fair Value:	94%	5 Year Valuation Multiple Estimate:	1.2%	Dividend Payment Date:	06/01/21
Dividend Yield:	4.1%	5 Year Price Target	\$55	Years Of Dividend Growth¹:	47
Dividend Risk Score:	B	Retirement Suitability Score:	A	Last Dividend Increase¹:	5.9%

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 3.5% (about 4.1% before the 15% withholding tax applied by the Canadian government). Unless otherwise noted, US\$ is used in this research report. At the end of 2020, 63% of Fortis's assets are in the U.S., 34% are in Canada, and 3% are in the Caribbean; 82% of assets are regulated electric utility assets, 17% are regulated gas, and only 1% are non-regulated.

Fortis reported Q4 and full-year 2020 results on 02/12/21. For the quarter, it reported adjusted net earnings of C\$320 million, up 16% compared to prior year's period of C\$277 million. Adjusted earnings-per-share (EPS) climbed by 11% to C\$0.69. For 2020, adjusted net earnings increased by 7% to C\$1.2 billion, while adjusted EPS increased marginally by less than 1% to C\$2.57.

Barry Perry, President and CEO of Fortis, retired at the end of 2020. David Hutchens, who was previously Fortis's COO and CEO of UNS Energy, a Fortis subsidiary, succeeded Perry in the roles. The company will continue to grow steadily as a regulated utility with the goal of reducing 75% of carbon emissions by 2035 compared to 2019. A key part of the plan is to exit all coal-fired generation by 2032. We give an initial 2021 EPS estimate of \$2.14.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$1.65	\$1.71	\$1.60	\$1.56	\$1.52	\$1.78	\$2.02	\$1.89	\$1.92	\$2.02	\$2.14	\$2.86
DPS	\$1.17	\$1.20	\$1.20	\$1.16	\$1.09	\$1.15	\$1.25	\$1.33	\$1.38	\$1.44	\$1.59	\$2.13
Shares¹	189	192	213	276	282	401	421	429	447	465	474	549

Fortis compounded its EPS at 4.8% per year and DPS at 5.9% per year from 2011 to 2020 in C\$. Fortis's five-year capital plan of C\$19.6 billion through 2025 and expects its mid-year rate base to grow at a compound annual growth rate of 6.0% from C\$30.2 billion in 2020 to C\$40.3 billion in 2025. These supports management's dividend growth guidance of 6% per year through 2025. From 2021 to 2026, we use estimated EPS and DPS growth rates of 6%.

The capital plan includes investing in areas, such as a greener and improved grid and a shift from fossil fuel to solar and wind generation. 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 and DPS at only 2.3% per year from 2011 to 2021.

Although US\$ has mostly declined against C\$ in the last 12 months, it's still relatively 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 impact results, particularly if Fortis completes a sizable acquisition funded by stock.

1. Years of Dividend Growth and Last Dividend Increase based in C\$. Shares in millions.

Disclosure: Kay Ng owns Fortis shares.



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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	12.2	14.1	16.9	18.2	17.8	28.1	40.6	21.2	19.9	20.0	18.0	19.1
Avg. Yld.	4.3%	4.1%	4.1%	3.7%	3.3%	3.1%	3.1%	2.9%	3.1%	3.5%	4.1%	3.9%

Using our 2021 EPS estimate, Fortis trades at a price-to-earnings ratio of 18, which we think is a fair value for a defensive, decent-yield dividend stock. 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 3.5% (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.

Safety, Quality, Competitive Advantage, & Recession Resiliency

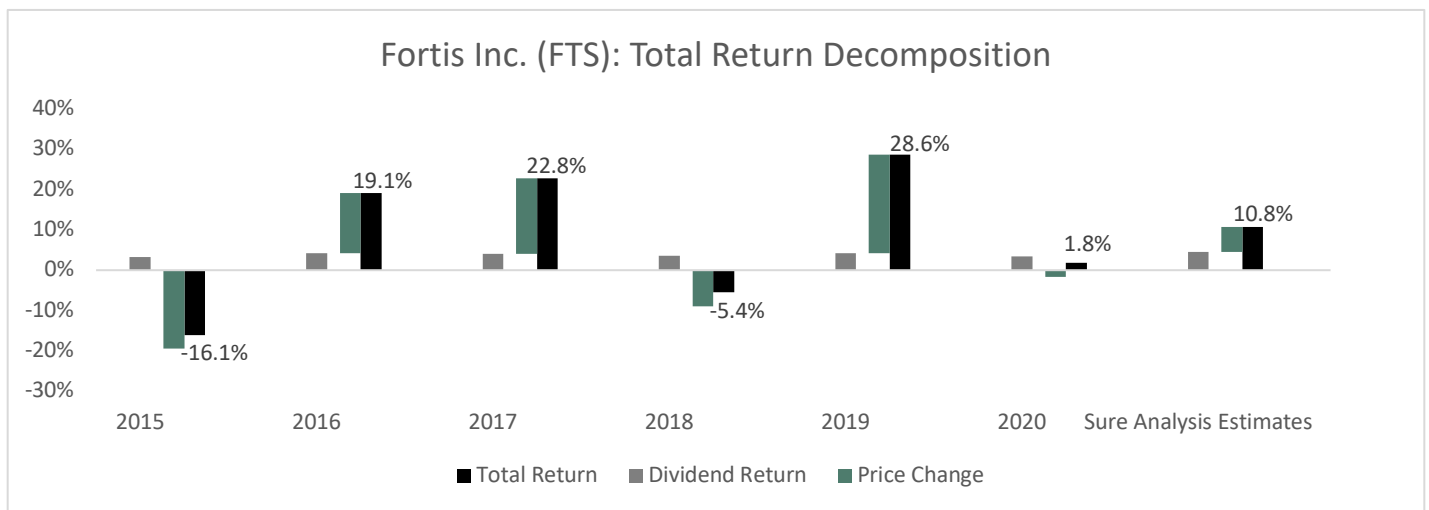
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	71%	70%	75%	74%	72%	65%	62%	70%	72%	71%	74%	74%

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. Therefore, Fortis's results will be quite resilient against economic downturns including the one we're experiencing during the pandemic, in which it had higher operating costs. Its liquidity position is strong, including C\$4.3 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 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. As vaccine programs are rolled out, some investors are taking money out of Fortis stock into other areas. The recent dip in Fortis stock brings it to fair valuation. We estimate FTS will deliver a total rate of return of 10.8% through 2026 from 6% earnings growth, a 4% yield, and a P/E expansion of 1.2%. Conservative & income-oriented investors should consider buying Fortis at current levels.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	3780	3655	3930	4892	5294	5164	6405	6474	6618	6669
Gross Profit	2064	2133	2360	2902	3264	3396	4583	4549	4719	4757
Gross Margin	54.6%	58.3%	60.0%	59.3%	61.7%	65.8%	71.6%	70.3%	71.3%	71.3%
D&A Exp.	421	470	525	623	684	742	910	959	1017	1066
Operating Profit	784	794	827	927	1112	1120	1938	1825	1854	1872
Operating Margin	20.7%	21.7%	21.1%	18.9%	21.0%	0.2	0.3	0.3	0.3	0.3
Net Profit	361	362	398	343	631	498	793	900	1297	951
Net Margin	9.6%	9.9%	10.1%	7.0%	11.9%	9.7%	12.4%	13.9%	19.6%	14.3%
Free Cash Flow	-259	-154	-268	-673	-447	-134	-207	-474	-796	-999
Income Tax	85	61	31	60	175	109	454	127	218	172

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	13923	15028	16819	22598	20757	35530	38029	38950	40883	43509
Cash & Equivalents	85	155	68	198	174	200	260	244	283	195
Accounts Receivable	592	528	331	413	373	376	366	395	386	467
Inventories	131	134	134	277	243	276	292	292	302	331
Goodwill & Int. Ass.	1851	1903	2273	3612	3397	9920	10119	10081	10154	10260
Total Liabilities	9081	9590	10831	14749	13296	23329	24710	25400	25486	27602
Accounts Payable	448	501	397	527	298	411	553	499	577	554
Long-Term Debt	5869	6115	6963	9320	8456	16527	17231	17727	17380	19212
Shareholder's Equity	3745	4013	4482	5919	5808	9623	10640	10947	12944	13390
D/E Ratio	1.27	1.19	1.24	1.24	1.19	1.53	1.44	1.46	1.23	1.31

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	2.7%	2.5%	2.5%	1.7%	2.9%	1.8%	2.2%	2.3%	3.3%	2.3%
Return on Equity	10.2%	9.3%	9.4%	6.6%	10.8%	6.5%	7.8%	8.3%	10.9%	7.2%
ROIC	3.5%	3.3%	3.2%	2.3%	3.8%	2.2%	2.7%	2.9%	4.1%	2.8%
Shares Out.	189	192	213	276	282	401	421	429	447	465
Revenue/Share	19.90	18.53	18.78	21.64	18.60	16.48	15.39	15.23	15.13	14.33
FCF/Share	-1.36	-0.78	-1.28	-2.98	-1.57	-0.43	-0.50	-1.11	-1.82	-2.15

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

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