Pinnacle West Capital Corp. (PNW)

Updated November 13th, 2021 by Felix Martinez

Key Metrics

Current Price:	$66	**5 Year CAGR Estimate:**	11.8%	**Market Cap:**	$7.36 B
Fair Value Price:	$88	**5 Year Growth Estimate:**	2.0%	**Ex-Dividend Date:**	11/15/21
% Fair Value:	75%	**5 Year Valuation Multiple Estimate:**	5.9%	**Dividend Payment Date:**	12/01/21
Dividend Yield:	5.1%	**5 Year Price Target**	$97	**Years Of Dividend Growth:**	10
Dividend Risk Score:	C	**Retirement Suitability Score:**	A	**Last Dividend Increase:**	2.4%

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 ten years. Pinnacle West Capital has a market capitalization of $7.36billion.

On November 5th, 2021, Pinnacle West Capital reported third-quarter results for Fiscal Year (FY)2021. Operating revenue grew 4.2% year over year, from $1,254 million to $1,308 million. Revenue growth was driven by customer growth of 2.3% as people and businesses moved to Arizona. The influx of people is making the Company's territory among the fastest growing in the nation. For the nine months of the year, revenue is up 5.6% compared to the first nine months of FY2020. Operating expenses increased by $79 million, which was driven by Fuel and purchased power. Net income saw a decrease year over year. Net income is lower by (2.0)% from $351 million to $344million. For the first nine months of the year, net income is up 3.3% compared to the first nine months of last year.

On a per-share basis, The Company made $3.00 per share for the quarter and only earned $3.07 per share in 3Q20, a decrease of (2.3)%. However, for the nine months of the year, earnings are up 3.4% compared to the same period of last year.

On November 4th, 2021, the Company announced a dividend increase of 2.4%. The Company will pay out $0.85 per share per quarter.

In our last report, we expected PNW to generate earnings-per-share of $5.00 per share for 2021. However, The Company had a decent quarter, and we are now increasing our FY2021 expected EPS to $5.06 per share. This would represent a 3.9% 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	***$5.06***	***$5.59***
DPS	$2.10	$2.12	$2.20	$2.30	$2.41	$2.53	$2.66	$2.82	$3.00	$3.18	***$3.42***	***$3.78***
Shares[1]	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 2% rate for the next five years. This would give us $5.59 per share in earnings for 2026. Our expected 2% growth rate is lower than the 10-year average growth rate of 5.6%.

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.

[1] Share count is in millions.

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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 2% yearly rate, which would be lower than its expected earnings growth. Still, the Company has a reasonable payout ratio to cover its dividend.

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	***13.1***	***17.4***
Avg. Yld.	4.4%	4.2%	4.2%	3.4%	3.7%	3.2%	3.1%	3.3%	3.3%	4.0%	***5.1%***	***3.8%***

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 13.1. 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 ten-year average yield. For the past 10-years, PNW has had 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%***

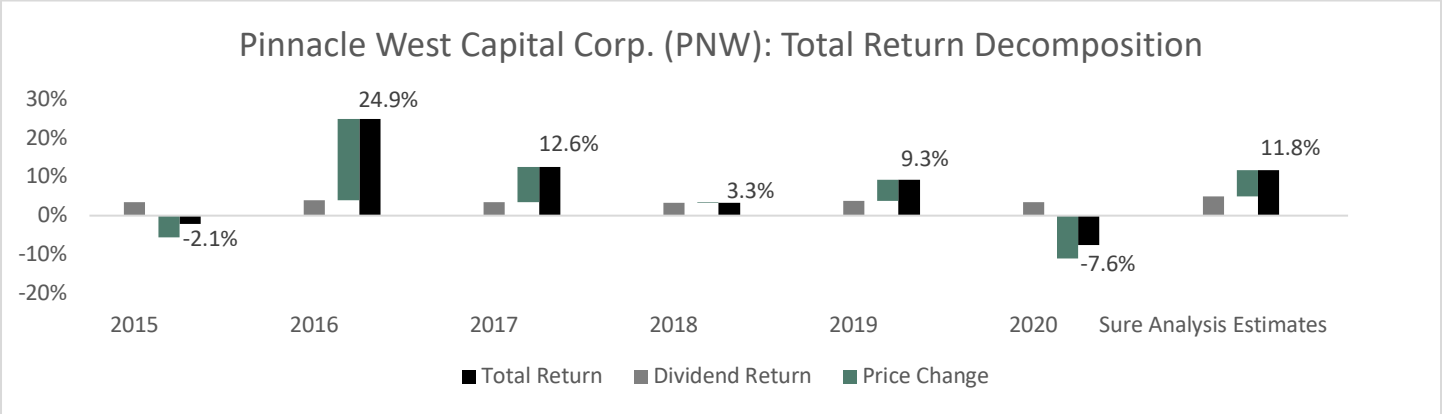
Pinnacle West Capital's advantage is its utility, which tends to be monopoly-like. Investors often hold utility stocks for their defensive nature. People will always need to power their homes and businesses. However, PNW shows that earnings can decrease during a recession. For example, during the Great Recession from 2008-2009, PNW's earning 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 1.3 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 3.9. 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 under our fair value estimate. We forecast total shareholder returns of 11.8% per year for the next five years. Thus, this stock earns a Buy rating as the Company stock price has decreased since our previous report.

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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