



Fortis Inc. (FTS)

Updated February 19th, 2022 by Kay Ng

Key Metrics

Current Price:	\$45	5 Year CAGR Estimate:	8.8%	Market Cap:	\$21.6B
Fair Value Price:	\$44	5 Year Growth Estimate:	6.0%	Ex-Dividend Date:	05/16/22
% Fair Value:	103%	5 Year Valuation Multiple Estimate:	-0.6%	Dividend Payment Date:	06/01/22
Dividend Yield:	3.7%	5 Year Price Target	\$59	Years Of Dividend Growth¹:	49
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 3.1% (about 3.7% before the 15% withholding tax applied by the Canadian government). Unless otherwise noted, US\$ is used in this research report. At the end of 2021, Fortis had C\$58-billion of assets. 63% were in the U.S., 34% in Canada, and 3% in the Caribbean; 82% of assets were regulated electric utility assets, 17% were regulated gas, and only 1% were non-regulated.

Fortis reported Q4 and full-year 2021 results on 02/11/22. For the quarter, it reported adjusted net earnings of C\$300 million, down 6% versus Q4 2020. Adjusted earnings-per-share (EPS) fell 9% to C\$0.63. The lower EPS was primarily due to a number of factors, including unfavorable weather impacts in Arizona and Belize, higher non-recoverable costs from performance targets at Central Hudson and stock-based compensation, particularly at ITC, higher number of outstanding shares, and more.

For the full year, adjusted net earnings was C\$1,219 million, up 2% versus 2020. Adjusted EPS was C\$2.59, up <1%. The utility completed C\$3.6 billion of capital plan for 2021, which roughly aligned with its target of C\$3.8 billion.

We initiate our 2022 EPS estimate at \$2.20.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$1.71	\$1.60	\$1.56	\$1.52	\$1.78	\$2.02	\$1.89	\$1.92	\$2.02	\$2.04	\$2.20	\$2.94
DPS	\$1.20	\$1.20	\$1.16	\$1.09	\$1.15	\$1.25	\$1.33	\$1.38	\$1.44	\$1.64	\$1.68	\$2.25
Shares¹	192	213	276	282	401	421	429	447	465	471	477	509

Fortis compounded its EPS at 4.8% and DPS at 6.1% per year from 2012 to 2021 in C\$. Fortis has a five-year capital plan of C\$20 billion for 2022 to 2026 and expects its mid-year rate base to grow at a compound annual growth rate of approximately 6% from C\$31.2 billion in 2021 to C\$41.6 billion in 2026. These support management's dividend growth guidance of 6% per year through 2025. From 2022 to 2027, 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, respectively, at only 2.0% and 3.5% per year from 2012 to 2021.

Additionally, 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.

The company will continue to grow steadily as the regulated utility aims to reduce 75% of carbon emissions by 2035 compared to 2019. A key part of the plan is to exit all coal-fired generation by 2032.

¹ Years of Dividend Growth and Last Dividend Increase based in C\$. Shares 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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	14.1	16.9	18.2	17.8	28.1	40.6	21.2	19.9	20.0	21.7	20.6	20.0
Avg. Yld.	4.1%	4.1%	3.7%	3.3%	3.1%	3.1%	2.9%	3.1%	3.5%	3.5%	3.7%	3.8%

Fortis stock averaged a P/E of 21.9 from 2012-2021, but the average multiple drops to 19.8 when the 2017 outlier is taken out. So, we target a fair target P/E of 20.0. Using our 2022 EPS estimate, Fortis trades at a price-to-earnings ratio of 20.6, which we think is fairly valued for the predictable dividend stock. Fortis is currently trading with a dividend yield of 3.7% (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

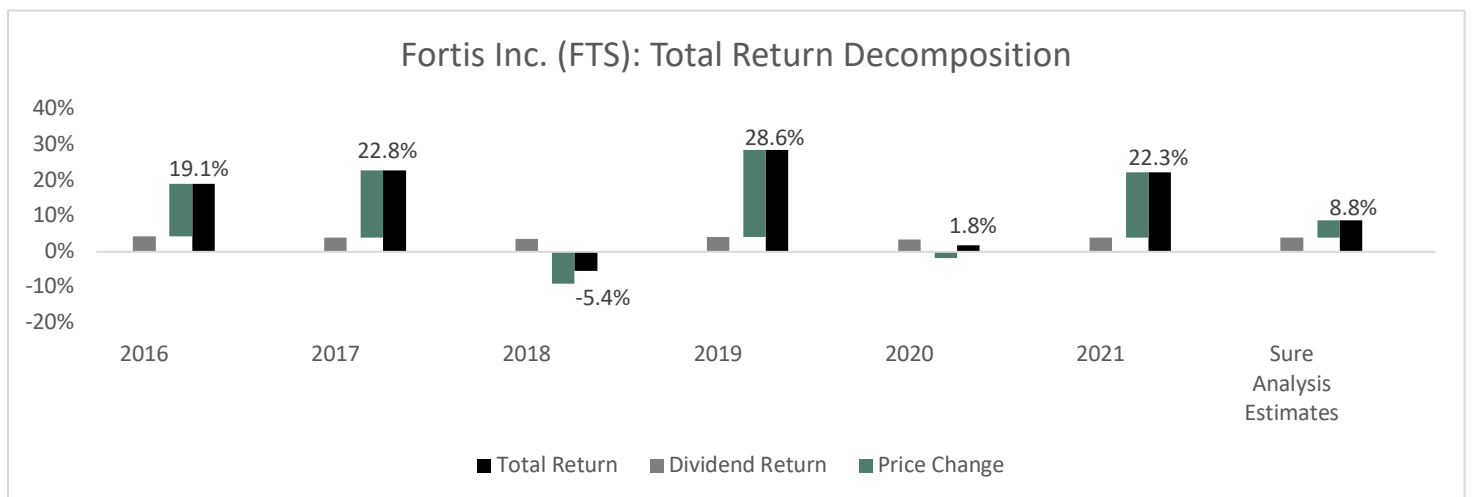
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	70%	75%	74%	72%	65%	62%	70%	72%	71%	80%	76%	76%

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 uncertainties, including the one we're experiencing during the pandemic, in which it had higher operating costs. Its liquidity position is strong, including almost C\$3.2 billion of undrawn liquidity available from credit facilities at the end of 2021. Fortis' payout ratio had been about 70% of earnings, and we believe it'll come back down to the healthier range of 70% as soon as this year. 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. We estimate FTS will deliver a total rate of return of 8.8% through 2027 from 6% earnings growth, a 3.7% yield, and a P/E compression of 0.6%. Conservative & income-oriented investors can buy Fortis on dips.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	3,655	3,930	4,892	5,294	5,164	6,405	6,474	6,618	6,669	7,536
Gross Profit	2,133	2,360	2,902	3,264	3,396	4,583	4,549	4,719	4,757	5,182
Gross Margin	58.3%	60.0%	59.3%	61.7%	65.8%	71.6%	70.3%	71.3%	71.3%	68.8%
D&A Exp.	470	525	623	684	742	910	959	1,017	1,066	1,200
Operating Profit	794	827	927	1,112	1,120	1,938	1,825	1,854	1,872	1,969
Operating Margin	21.7%	21.1%	18.9%	21.0%	21.7%	30.2%	28.2%	28.0%	28.1%	26.1%
Net Profit	362	398	343	631	498	793	900	1,297	951	1,032
Net Margin	9.9%	10.1%	7.0%	11.9%	9.7%	12.4%	13.9%	19.6%	14.3%	13.7%
Free Cash Flow	-154	-268	-673	-447	-134	-207	-474	-796	-999	-382
Income Tax	61	31	60	175	109	454	127	218	172	187

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	15,028	16,819	22,598	20,757	35,530	38,029	38,950	40,883	43,509	45,222
Cash & Equivalents	155	68	198	174	200	260	244	283	195	103
Accounts Receivable	528	331	413	373	376	366	395	386	467	487
Inventories	134	134	277	243	276	292	292	302	331	375
Goodwill & Int. Ass.	1,903	2,273	3612	3,397	9,920	10,119	10,081	10,154	10,260	10,245
Total Liabilities	9,590	10,831	14,749	13,296	23,329	24,710	25,400	25,486	27,602	28,818
Accounts Payable	501	397	527	298	411	553	499	577	554	607
Long-Term Debt	6,115	6,963	9,320	8,456	16,527	17,231	17,727	17,380	19,212	20,064
Shareholder's Equity	4,013	4,482	5,919	5,808	9,623	10,640	10,947	12,944	13,390	13,855
LTD/E Ratio	1.19	1.24	1.24	1.19	1.53	1.44	1.46	1.23	1.31	1.33

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	2.5%	2.5%	1.7%	2.9%	1.8%	2.2%	2.3%	3.3%	2.3%	2.3%
Return on Equity	9.3%	9.4%	6.6%	10.8%	6.5%	7.8%	8.3%	10.9%	7.2%	7.6%
ROIC	3.3%	3.2%	2.3%	3.8%	2.2%	2.7%	2.9%	4.1%	2.8%	2.9%
Shares Out.	192	213	276	282	401	421	429	447	465	471
Revenue/Share	18.53	18.78	21.64	18.60	16.48	15.39	15.23	15.13	14.33	15.99
FCF/Share	-0.78	-1.28	-2.98	-1.57	-0.43	-0.50	-1.11	-1.82	-2.15	-0.81

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

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