Southern Company (SO)

Updated February 16th, 2022 by Aristofanis Papadatos

Key Metrics

Current Price:	$65	**5 Year CAGR Estimate:**	6.9%	**Market Cap:**	$68.8 B
Fair Value Price:	$60	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	2/18/2022
% Fair Value:	108%	**5 Year Valuation Multiple Estimate:**	-1.7%	**Dividend Payment Date:**	3/7/2022
Dividend Yield:	4.1%	**5 Year Price Target**	$76	**Years Of Dividend Growth:**	20
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	3.1%

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 $68.8 billion.

Southern is one of the most resilient companies to the pandemic. In fact, the company has greatly benefited from the record-low interest rates that have resulted from the pandemic. 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 six years. In addition, it has a heavy debt maturity schedule. As it refinances its debt on a regular basis, it greatly benefits from low rates. On the other hand, the Fed is about to begin raising interest rates and thus the interest expense of Southern will increase.

In mid-February, Southern reported (2/17/22) financial results for the fourth quarter of fiscal 2021. Revenue grew 13% over the prior year's quarter thanks to strong customer consumption, customer growth and price hikes. However, earnings-per-share decreased -23%, from $0.47 to $0.36, due to a sharp increase in the expected cost of its Vogtle Plant. Management now expects the two units to be delayed for at least another year due to recently found lapses. This project has faced so many setbacks that it is now 7 years late, with an expected cost that is more than double the initial cost estimate. On the bright side, Southern has missed analysts' earnings-per-share estimates only once in the last 20 quarters and provided guidance for adjusted earnings-per-share of $3.50-$3.60 in 2022.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$2.67	$2.70	$2.77	$2.84	$2.83	$3.02	$3.07	$3.11	$3.25	$3.41	***$3.58***	***$4.57***
DPS	$1.94	$2.01	$2.08	$2.15	$2.22	$2.30	$2.38	$2.46	$2.54	$2.62	***$2.64***	***$3.12***
Shares[1]	867.8	887.1	907.8	911.7	990.4	1007.6	1034.0	1052.0	1058	1062	***1066***	***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 2.3% average annual rate over the last decade. 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 2.8% annual rate in the last decade and at a 3.8% annual rate in the last five years. Management recently reiterated its guidance for annual earnings-per-share growth of 5%-7% in the upcoming years. Given this guidance, the decent business momentum of Southern, the expected contribution from the Vogtle Plant in the upcoming years but also the lackluster performance record of Southern, we expect approximately 5.0% earnings-per-share growth over the next five years.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	17.0	16.2	16.0	15.8	17.8	15.5	14.7	17.9	17.9	18.5	***18.2***	***16.7***
Avg. Yld.	4.3%	4.6%	4.7%	4.8%	4.4%	4.6%	5.3%	4.0%	4.4%	4.2%	***4.1%***	***4.1%***

[1] In millions.

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Southern is trading at a price-to-earnings ratio of 18.2, which is higher than its 10-year average price-to-earnings ratio of 16.7. If the stock reverts to its average valuation level over the next five years, it will incur a -1.7% annualized drag due to the contraction of its earnings multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	72.7%	74.4%	75.1%	75.7%	78.4%	71.7%	77.5%	79.1%	78.2%	76.8%	***73.7%***	***68.3%***

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 36% 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.

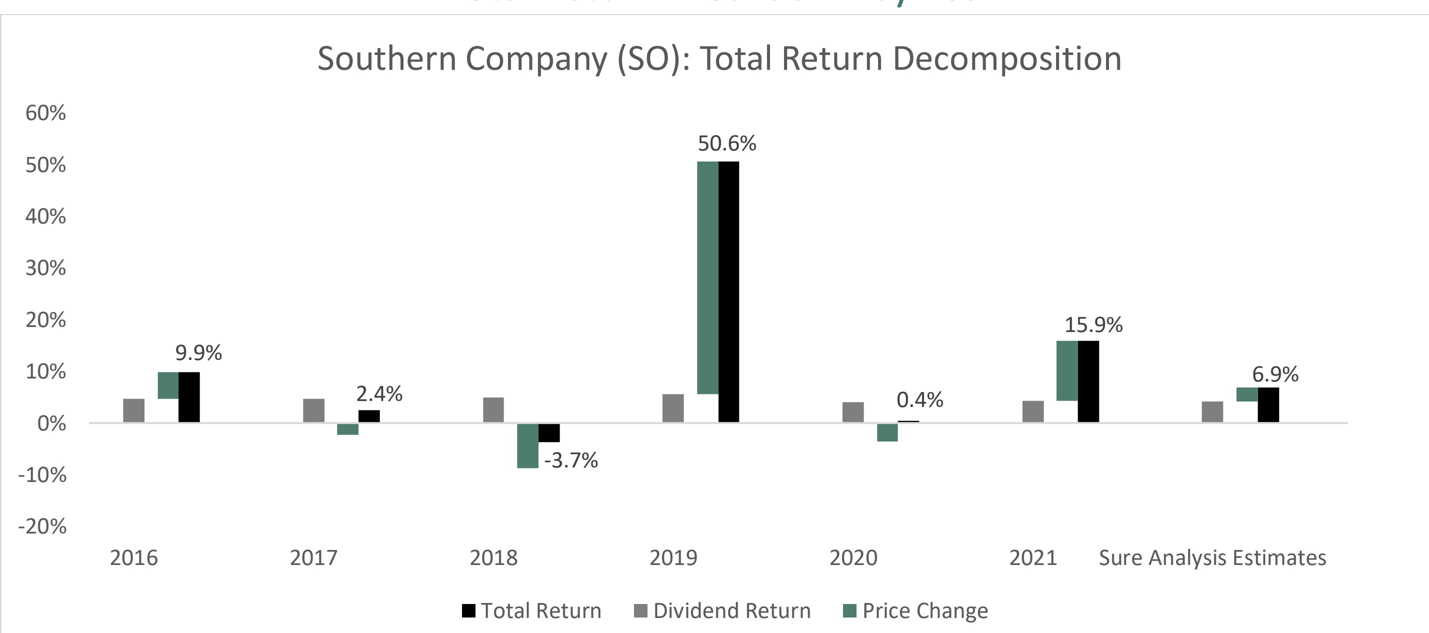
Southern has raised its dividend for 20 consecutive years and has not cut it for 74 consecutive years. Moreover, it currently offers a 4.1% dividend yield, which is higher than that of most utilities. Due to the weak balance sheet, dividend growth is likely to remain meager (~3% annually) going forward.

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 downturn caused by the pandemic, Southern has grown its earnings thanks to its resilient business model, which involves rate hikes, and the boost from lower interest rates.

Final Thoughts & Recommendation

Just like most utilities, the stock of Southern is facing a strong headwind due to the surge in inflation, which has resulted from the immense fiscal stimulus packages offered by the government in response to the pandemic. Fortunately for the stock, inflation could normalize from next year, though this remains to be confirmed. We expect Southern to offer a 6.9% average annual return over the next five years and thus maintain our hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

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

Balance Sheet Metrics

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

Profitability & Per Share Metrics

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