Southern Company (SO)

Updated August 19th, 2022 by Aristofanis Papadatos

Key Metrics

Current Price:	$80	**5 Year CAGR Estimate:**	2.7%	**Market Cap:**	$84.7 B
Fair Value Price:	$60	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	8/12/2022
% Fair Value:	133%	**5 Year Valuation Multiple Estimate:**	-5.7%	**Dividend Payment Date:**	9/6/2022
Dividend Yield:	3.4%	**5 Year Price Target**	$76	**Years Of Dividend Growth:**	21
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Rating:**	Sell

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 $84.7 billion.

Southern is one of the most resilient companies to the pandemic. In fact, the company greatly benefited from the record-low interest rates that 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 has begun raising interest rates aggressively and thus the interest expense of Southern will increase.

In late July, Southern reported (7/28/22) financial results for the second quarter of fiscal 2022. Revenue grew 39% over last year's quarter thanks to strong rate hikes, which more than offset the increased fuel cost. Earnings-per-share grew 27%, from $0.84 to $1.07, and exceeded the analysts' consensus by $0.23 thanks to strong price hikes, higher energy usage and warmer weather. Management reiterated its guidance for the Vogtle project, expecting the two units to be delayed for at least another year due to 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' estimates only once in the last 22 quarters and reaffirmed its guidance for 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	***$2.72***	***$3.20***
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 (2% 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 has provided 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	***22.3***	***16.7***
Avg. Yld.	4.3%	4.6%	4.7%	4.8%	4.4%	4.6%	5.3%	4.0%	4.4%	4.2%	***3.4%***	***4.2%***

[1] 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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Southern has rallied 27% in just six months, as investors view the stock as a safe haven amid 40-year high inflation. As a result, the stock is currently trading at a 10-year high price-to-earnings ratio of 22.3, which is much 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 -5.7% 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%	***76.0%***	***70.0%***

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 39% 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.

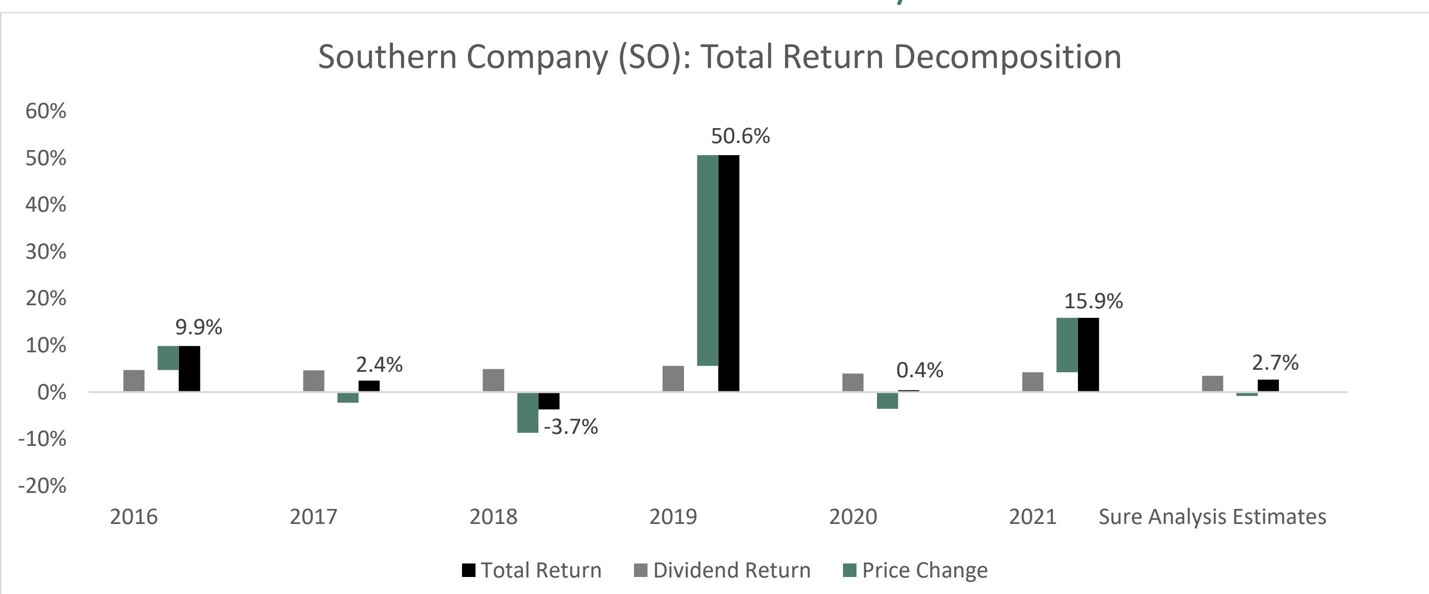
Southern has raised its dividend by 3.0% this year and thus it has raised its dividend for 21 consecutive years and has not cut it for 75 consecutive years. It currently offers a 3.4% dividend yield, which is higher than the 3.0% median yield of utilities. Due to the weak balance sheet, dividend growth 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.

Final Thoughts & Recommendation

The stock of Southern has rallied 27% in six months, as investors consider the stock a safe haven amid 40-year high inflation thanks to its reliable rate hikes year after year. We agree on the resilience of Southern in an inflationary environment but we find its current valuation as too rich. We expect Southern to offer a 2.7% average annual return over the next five years, as its 5.0% earnings growth and its 3.4% dividend may be partly offset by a -5.7% valuation headwind. We rate the stock as a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	16,537	17,087	18,467	17,489	19,896	23,031	23,495	21,419	20,375	23,113
Gross Profit	7,164	7,270	7,436	7,678	8,530	9,915	9,616	9,603	9,897	10,061
Gross Margin	43.3%	42.5%	40.3%	43.9%	42.9%	43.1%	40.9%	44.8%	48.6%	43.5%
D&A Exp.	2145	2298	2293	2395	2923	3457	3549	3331	3,905	3,973
Operating Profit	4463	3255	3642	4282	4487	2293	4110	5335	4,820	3,514
Op. Margin	27.0%	19.0%	19.7%	24.5%	22.6%	10.0%	17.5%	24.9%	23.7%	15.2%
Net Profit	2415	1710	2031	2421	2493	880	2242	4754	3,134	2,408
Net Margin	14.6%	10.0%	11.0%	13.8%	12.5%	3.8%	9.5%	22.2%	15.4%	10.4%
Free Cash Flow	89	634	569	600	-2416	-1029	-1056	-1774	-745	-1,071
Income Tax	1334	849	977	1194	951	142	449	1798	393	267

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets ($B)	63.1	64.5	70.2	78.3	109.7	111.0	116.9	118.7	122.9	127.5
Cash & Equivalents	628	659	710	1404	1975	2130	1396	1975	1,065	1,798
Acc. Receivable	961	1027	1090	1058	2206	2413	2527	2042	2,269	1,806
Inventories	2819	2298	1969	1929	2782	2627	2394	2388	2,488	2,355
Goodwill & Int.	N/A	N/A	N/A	319	7221	7141	5928	5816	5,767	5,725
Total Liabilities	43770	44407	48932	56218	82967	85153	87584	86650	90,410	94,968
Accounts Payable	1387	1376	1593	1905	2825	3076	3436	2557	2,806	2,169
Long-Term Debt	22411	23266	24745	28706	47425	50762	46825	46842	49,189	53,717
Total Equity	18297	19008	19949	20592	24758	24167	24723	27505	27,972	27,873
LTD/E Ratio	1.20	1.20	1.22	1.39	1.91	2.07	1.87	1.69	1.74	1.91

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	3.9%	2.7%	3.0%	3.3%	2.7%	0.8%	2.0%	4.0%	2.6%	1.9%
Return on Equity	13.5%	9.2%	10.4%	11.9%	11.0%	3.6%	9.2%	18.2%	11.3%	8.6%
ROIC	5.9%	4.0%	4.5%	5.0%	4.0%	1.2%	2.9%	6.1%	3.9%	2.9%
Shares Out.	867.8	887.1	907.8	911.7	990.4	1007.6	1034.0	1052.0	1058	1062
Revenue/Share	18.81	19.40	20.50	19.13	20.77	22.85	22.92	20.32	19.13	21.64
FCF/Share	0.10	0.72	0.63	0.66	-2.52	-1.02	-1.03	-1.68	-0.70	-1.00

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