



# Fortis Inc. (FTS)

Updated November 10<sup>th</sup>, 2022 by Kay Ng

## Key Metrics

<b>Current Price:</b>	\$40	<b>5 Year CAGR Estimate:</b>	10.6%	<b>Market Cap:</b>	\$20B
<b>Fair Value Price:</b>	\$43	<b>5 Year Growth Estimate:</b>	6.0%	<b>Ex-Dividend Date:</b>	11/16/22
<b>% Fair Value:</b>	94%	<b>5 Year Valuation Multiple Estimate:</b>	1.2%	<b>Dividend Payment Date:</b>	12/01/22
<b>Dividend Yield:</b>	4.1%	<b>5 Year Price Target</b>	\$57	<b>Years Of Dividend Growth:</b>	49
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	A	<b>Rating:</b>	Buy

## 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 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 stable Q3 2022 results on 10/28/22. For the quarter, it reported adjusted net earnings of C\$341 million, up 14% versus Q3 2021, while adjusted earnings-per-share (EPS) rose 11% to C\$0.71.

The year-to-date results provide a bigger picture. Adjusted earnings rose 7% year over year to C\$982 million, while adjusted EPS increased by 5% to C\$2.06. The utility invested C\$2.9 billion for its capital spending year to date, which is on track for this year's capital spending plan of C\$4.0 billion. Additionally, Fortis increased its quarterly dividend by 5.6% in September in C\$. This marks its 49<sup>th</sup> consecutive year of dividend growth. As well, it updated its five-year C\$22.3-billion capital plan through 2027 that represents a rate base growth of 6.2%. We updated our 2022 EPS estimate to \$2.16.

## Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
<b>EPS</b>	\$1.71	\$1.60	\$1.56	\$1.52	\$1.78	\$2.02	\$1.89	\$1.92	\$2.02	\$2.04	<b>\$2.16</b>	<b>\$2.89</b>
<b>DPS</b>	\$1.20	\$1.20	\$1.16	\$1.09	\$1.15	\$1.25	\$1.33	\$1.38	\$1.44	\$1.64	<b>\$1.65</b>	<b>\$2.11</b>
<b>Shares<sup>1</sup></b>	192	213	276	282	401	421	429	447	465	471	<b>477</b>	<b>509</b>

Fortis compounded its EPS at 4.8% and DPS at 6.1% per year from 2012 to 2021 in C\$. After releasing its five-year capital plan of C\$22.3 billion for 2023 to 2027, which suggests a mid-year rate base growth at a compound annual growth rate of ~6.2% from C\$34.0 billion in 2022 to C\$46.1 billion in 2027, the company also revealed its dividend growth guidance of 4-6% through 2027. Consequently, from 2023 to 2027, we use EPS and DPS growth rates of 6% and 5%, respectively.

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.

<sup>1</sup> 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	18.7	19.8
Avg. Yld.	4.1%	4.1%	3.7%	3.3%	3.1%	3.1%	2.9%	3.1%	3.5%	3.5%	4.1%	3.7%

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 19.8. The stock has dipped ~13% since our last coverage in August. Using our 2022 EPS estimate, Fortis trades at a price-to-earnings ratio of 18.7, which makes it a fairly-valued stock. Fortis is currently trading with a dividend yield of 4.1% (gross of the withholding tax paid to the Canadian government). This is 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%	73%

Because demand for Fortis's utility services doesn't change much in various economic environments, Fortis's results have been quite resilient through economic uncertainties, including the one we're experiencing in which inflation is high and interest rates are rising to aim to curb inflation.

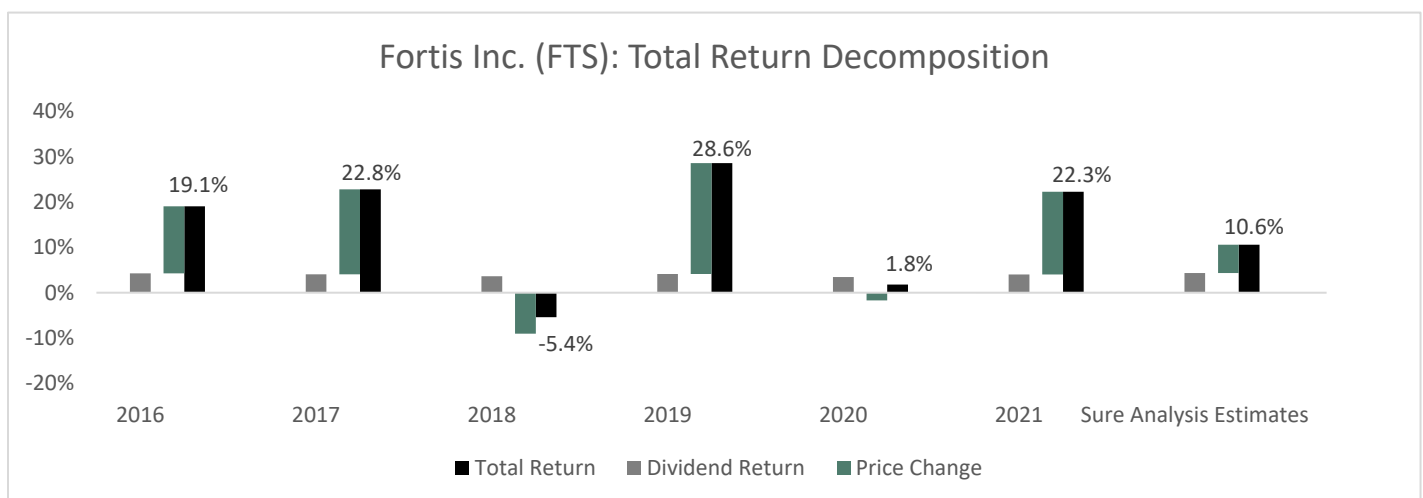
Its liquidity position is strong, including C\$3.6 billion of undrawn liquidity available from \$5.8-billion credit facilities at the end of Q3 2022. Fortis' payout ratio had been about 70% of earnings, which is where it's headed this year. The dividend is important to management and we believe it is 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 10.6% through 2027 from 6% earnings growth, a 4.1% yield, and a P/E expansion of 1.2%. We rate FTS stock as a buy, especially for conservative investors.

## Total Return Breakdown by Year



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## Income Statement Metrics

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

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total Assets</b>	15,028	16,819	22,598	20,757	35,530	38,029	38,950	40,883	43,509	45,222
<b>Cash &amp; Equivalents</b>	155	68	198	174	200	260	244	283	195	103
<b>Accounts Receivable</b>	528	331	413	373	376	366	395	386	467	487
<b>Inventories</b>	134	134	277	243	276	292	292	302	331	375
<b>Goodwill &amp; Int. Ass.</b>	1,903	2,273	3,612	3,397	9,920	10,119	10,081	10,154	10,260	10,245
<b>Total Liabilities</b>	9,590	10,831	14,749	13,296	23,329	24,710	25,400	25,486	27,602	28,818
<b>Accounts Payable</b>	501	397	527	298	411	553	499	577	554	607
<b>Long-Term Debt</b>	6,115	6,963	9,320	8,456	16,527	17,231	17,727	17,380	19,212	20,064
<b>Shareholder's Equity</b>	4,013	4,482	5,919	5,808	9,623	10,640	10,947	12,944	13,390	13,855
<b>LTD/E Ratio</b>	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
<b>Return on Assets</b>	2.5%	2.5%	1.7%	2.9%	1.8%	2.2%	2.3%	3.3%	2.3%	2.3%
<b>Return on Equity</b>	9.3%	9.4%	6.6%	10.8%	6.5%	7.8%	8.3%	10.9%	7.2%	7.6%
<b>ROIC</b>	3.3%	3.2%	2.3%	3.8%	2.2%	2.7%	2.9%	4.1%	2.8%	2.9%
<b>Shares Out.</b>	192	213	276	282	401	421	429	447	465	471
<b>Revenue/Share</b>	18.53	18.78	21.64	18.60	16.48	15.39	15.23	15.13	14.33	15.99
<b>FCF/Share</b>	-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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