



Southern Company (SO)

Updated October 31st, 2022 by Aristofanis Papadatos

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|----------------------------------|------------|
| Current Price: | \$66 | 5 Year CAGR Estimate: | 6.7% | Market Cap: | \$72.2 B |
| Fair Value Price: | \$60 | 5 Year Growth Estimate: | 5.0% | Ex-Dividend Date: | 11/18/2022 |
| % Fair Value: | 110% | 5 Year Valuation Multiple Estimate: | -2.0% | Dividend Payment Date: | 12/6/2022 |
| Dividend Yield: | 4.1% | 5 Year Price Target | \$76 | Years Of Dividend Growth: | 21 |
| Dividend Risk Score: | C | Retirement Suitability Score: | B | Rating: | Hold |

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 \$72.2 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 October, Southern reported (10/27/22) financial results for the third quarter of fiscal 2022. Revenue grew 34% over last year's quarter thanks to strong rate hikes and increased consumption, which more than offset the increased fuel cost. Earnings-per-share grew 7%, from \$1.23 to \$1.31, but missed the analysts' consensus by \$0.02. On the bright side, Southern completed initial fuel load at Vogtle Unit 3 and thus there is limited delay potential from now on. 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. Southern has missed analysts' estimates only twice in the last 23 quarters and slightly improved its guidance for annual earnings-per-share, now expecting them to be near the top of its previous guidance of \$3.50-\$3.60.

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 |
| Shares¹ | 867.8 | 887.1 | 907.8 | 911.7 | 990.4 | 1007.6 | 1034.0 | 1052.0 | 1058 | 1062 | 1082 | 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. Management previously stated that it would need to issue only \$2.0 billion of shares (3% of the current market cap) in the next five years but it has already issued this number of shares and hence it is likely to exceed its dilution guidance once again.

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. It has provided guidance for annual earnings-per-share growth of 5%-7% in the upcoming years. Given 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 5.0% earnings-per-share growth until 2027.

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 | 18.4 | 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% | 4.2% |

¹ In millions.

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Since our last research report, in August, when the valuation of Southern had reached a 10-year high, the stock has corrected -21%. Nevertheless, it is still trading at a price-to-earnings ratio of 18.4, 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 -2.0% 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 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.

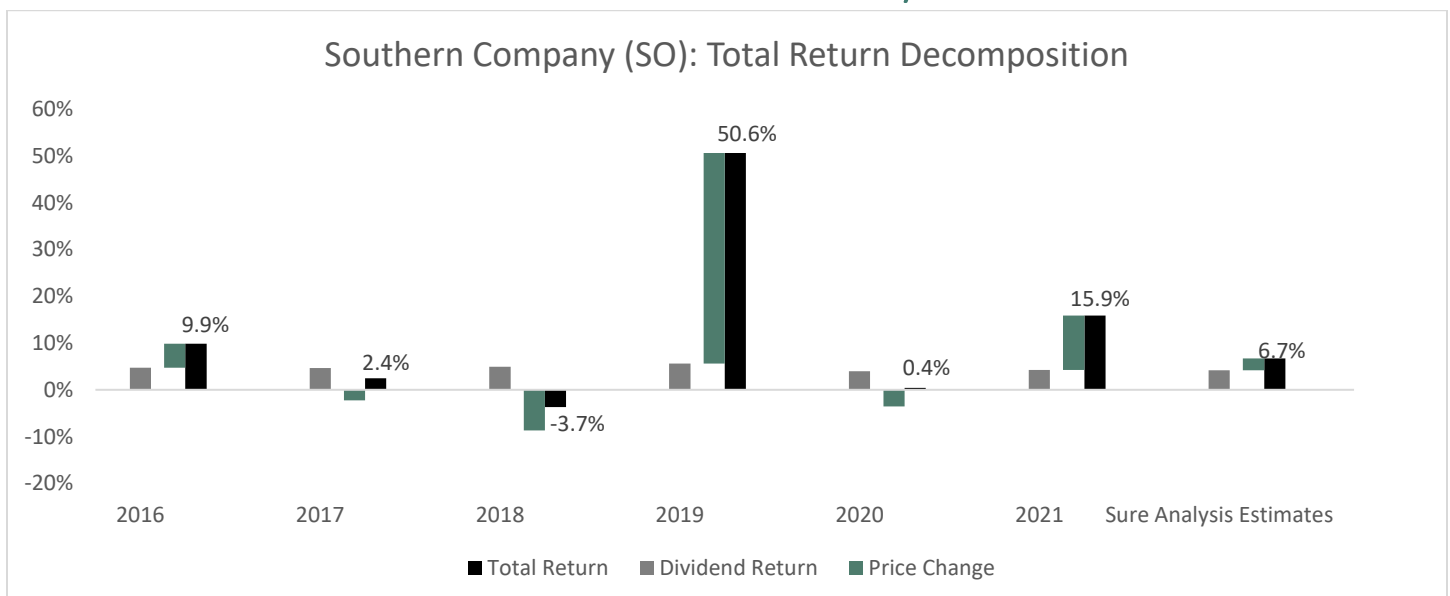
Southern has raised its dividend by 3.0% this year and thus it has raised its dividend for 21 consecutive years and has not cut it for 75 consecutive years. It currently offers a 4.1% dividend yield, which is higher than the 3.6% median yield of utilities. Due to the weak balance sheet, dividend growth 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 outperformed the S&P 500 by a wide margin this year (-3% vs. -19%), 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 and we note that the stock has become more attractive after its recent correction. We expect Southern to offer a 6.7% average annual return over the next five years, as its 5.0% earnings growth and its 4.1% dividend may be partly offset by a -2.0% valuation headwind. We rate the stock as a hold.

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.

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