



Pinnacle West Capital Corp. (PNW)

Updated November 26th, 2022 by Felix Martinez

Key Metrics

Current Price:	\$77	5 Year CAGR Estimate:	5.3%	Market Cap:	\$8.66 B
Fair Value Price:	\$73	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	01/31/23 ¹
% Fair Value:	105%	5 Year Valuation Multiple Estimate:	~0.9%	Dividend Payment Date:	03/01/23
Dividend Yield:	4.5%	5 Year Price Target	\$81	Years Of Dividend Growth:	11
Dividend Risk Score:	C	Retirement Suitability Score:	B	Rating:	Hold

Overview & Current Events

Pinnacle West Capital is a holding company based in Phoenix, Arizona. The company was initially known as Arizona Public Service Company, then later reorganized as a holding company, AZP Group Inc., in February 1985. In 1987, it changed its name to what is now known as Pinnacle West Capital, which trades under the ticker symbol PNW. Its principal subsidiary, Arizona Public Service (APS), provides electricity service to more than 1.3 million Arizona homes and businesses. The company has the generating capacity to produce 6,300 megawatts, and it employs more than 6,000 in Arizona and New Mexico. PNW has been paying a dividend for 27 years and growing the dividend consecutively for the past eleven years. Pinnacle West Capital has a market capitalization of \$8.66 billion.

On November 3rd, 2022, Pinnacle West Capital reported third-quarter and nine months results for Fiscal Year (FY)2022. Because of the recent general rate case outcome results, this year's results are lower. The unfavorable rate case decision was the primary driver for the lower quarter-over-quarter results. Revenue for the quarter was up 12.3% compared to the third quarter of 2021. However, operating expenses were up 19.7% year-over-year. This was driven by higher fuel and purchased power. Thus, operating income was lower by (2.7)% year-over-year. As for net income, the company reported consolidated net income attributable to common shareholders for the 2022 third quarter of \$326.3 million, or \$2.88 per diluted share. This result compares with net income of \$339.8 million, or \$3.00 per share, for the same period a year ago. On October 21st, 2022, the company announced a dividend increase of 1.8%. This marks the eleven consecutive year of a dividend increase.

We expect PNW to generate earnings-per-share of \$4.28 per share for 2022. This would represent a (21.8)% decrease compared to 2021. This decrease is caused by recent rate changes by Arizona Public Service Co. (APS).

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$3.50	\$3.66	\$3.58	\$3.92	\$3.95	\$4.35	\$4.54	\$4.77	\$4.87	\$5.47	\$4.28	\$4.73
DPS	\$2.12	\$2.20	\$2.30	\$2.41	\$2.53	\$2.66	\$2.82	\$3.18	\$3.18	\$3.24	\$3.42	\$3.78
Shares²	111.0	111.0	111.0	112.0	112.0	112.0	113.0	113.0	113.0	113.0	113.0	113.0

We expect continued growth for PNW to be primarily driven by more people coming to Arizona. We predict that Pinnacle West Capital will continue to grow earnings at a 2% rate for the next five years. This would give us \$4.73 per share in earnings for 2027. Our expected 2% growth rate is lower than the 10-year average growth rate of 5.1%.

PNW's net margin has been improving over the past decade, growing from a low of 10.5% in 2011 to 15.4% last year. This could continue to be a growth driver as well.

The company has increased its dividend each year for the past eleven years. The dividend growth rate has been 4.8% for the past ten years and 5.2% for the past five years. We expect PNW to grow its dividend at a 2% yearly rate, which would align with its expected earnings growth. Still, the company has a reasonable payout ratio to cover its dividend.

¹ Ex-Dividend and Dividend Payment Dates are estimates.

² Share count is 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	14.6	14.5	19.1	16.5	19.8	19.6	18.8	18.9	16.4	12.9	17.9	17.1
Avg. Yld.	4.2%	4.2%	3.4%	3.7%	3.2%	3.1%	3.3%	3.3%	4.0%	4.7%	4.5%	4.7%

Over the past decade, PNW has traded with an average P/E ratio of 17.1. We think this is a fair P/E for a high-quality utility company like PNW. Currently, PNW trades hands with a P/E of 17.9. This is not a reasonable valuation for long-term investors who like high-yield utility companies. Looking at the dividend yield, we see that the current yield is also higher than the company's ten-year average yield. For the past 10-years, PNW has had an average dividend yield of 3.7% over the past ten years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	60.6%	60.1%	64.2%	61.5%	64.1%	61.1%	62.1%	66.7%	65.3%	59.2%	80%	80%

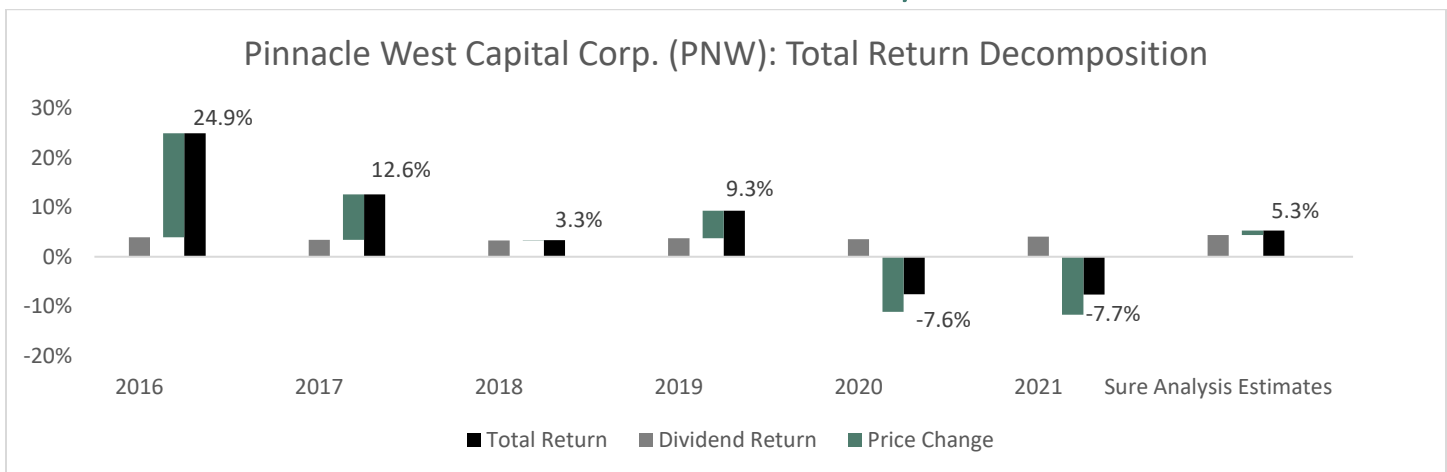
Pinnacle West Capital's advantage is its utility, which tends to be monopoly-like. Investors often hold utility stocks for their defensive nature. People will always need to power their homes and businesses. However, PNW shows that earnings can decrease during a recession. For example, during the Great Recession from 2008 to 2009, PNW's earning per share fell from \$2.96 in 2007 to \$2.12 in 2008. Earnings did bounce back in 2009 and further in 2010 to \$3.08. During the COVID-19 pandemic, PNW has so far fared even better.

Even though earnings fell significantly during the Great Recession, the dividend was not cut. This shows that PNW is committed to paying its dividends. The Debt-to-Equity ratio (D/E) is 1.5 for the year, which is fair. The company currently has an S&P credit rating of A-, which is investment-grade quality. Also, PNW has an interest coverage ratio of 3.8. Thus, the company has a very healthy balance sheet.

Final Thoughts & Recommendation

Pinnacle West Capital Corp is a high-quality utility company at a reasonable price. The company continues to produce a very reliable and growing dividend. At the current price, PNW is over our fair value estimate. We forecast total shareholder returns of 5.3% per year for the next five years. Thus, this stock earns a hold rating because of the low expected total return.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	3,302	3,455	3,492	3,495	3,499	3,565	3,691	3,471	3,587	3,804
Gross Profit	1,422	1,434	1,404	1,526	1,491	1,635	1,578	1,487	1,635	1,697
Gross Margin	43.1%	41.5%	40.2%	43.7%	42.6%	45.9%	42.8%	42.8%	45.6%	44.6%
D&A Exp.	481	492	496	572	565	611	651	664	686	719
Operating Profit	852	846	811	855	836	910	774	672	788	805
Operating Margin	25.8%	24.5%	23.2%	24.4%	23.9%	25.5%	21.0%	19.4%	22.0%	21.2%
Net Profit	382	406	398	437	442	488	511	538	551	619
Net Margin	11.6%	11.8%	11.4%	12.5%	12.6%	13.7%	13.8%	15.5%	15.3%	16.3%
Free Cash Flow	282	137	189	18	(252)	(291)	99	(235)	(360)	-613
Income Tax	237	231	221	238	236	258	134	(16)	78	110

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	13,380	13,509	14,289	15,028	16,004	17,019	17,664	18,479	20,020	22,003
Cash & Equivalents	26	10	8	39	9	14	6	10	60	10
Accounts Receivable	277	300	298	275	250	305	268	266	314	392
Inventories	249	260	256	280	283	289	294	346	334	367
Goodwill & Int. Ass.	162	158	120	124	90	257	263	291	283	274
Total Liabilities	9,277	9,168	9,770	10,309	11,068	11,883	12,315	12,926	14,268	15,982
Accounts Payable	221	285	295	297	265	256	277	346	319	393
Long-Term Debt	3,414	3,490	3,538	3,820	4,324	4,967	5,215	5,747	6,483	7,356
Shareholder's Equity	3,973	4,194	4,367	4,584	4,804	5,007	5,223	5,431	5,634	5,906
LTD/E Ratio	0.86	0.83	0.81	0.83	0.90	0.99	1.00	1.06	1.15	1.25

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	2.9%	3.0%	2.9%	3.0%	2.8%	3.0%	2.9%	3.0%	2.9%	2.9%
Return on Equity	9.8%	9.9%	9.3%	9.8%	9.4%	10.0%	10.0%	10.1%	10.0%	10.7%
ROIC	5.1%	5.3%	5.0%	5.3%	5.0%	5.0%	4.9%	4.9%	4.7%	4.8%
Shares Out.	111.0	111.0	111.0	112.0	112.0	112.0	113.0	113.0	113.0	113.0
Revenue/Share	29.87	31.18	31.41	31.33	31.23	31.73	32.80	30.78	31.76	33.61
FCF/Share	2.55	1.24	1.70	0.16	(2.25)	(2.59)	0.88	(2.08)	(3.19)	-5.42

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

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