



Fortis Inc. (FTS)

Updated February 10th, 2023 by Kay Ng

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|----------------------------------|----------|
| Current Price: | \$42 | 5 Year CAGR Estimate: | 10.4% | Market Cap: | \$20B |
| Fair Value Price: | \$44 | 5 Year Growth Estimate: | 6.0% | Ex-Dividend Date: | 02/14/23 |
| % Fair Value: | 95% | 5 Year Valuation Multiple Estimate: | 1.0% | Dividend Payment Date: | 03/01/23 |
| Dividend Yield: | 4.1% | 5 Year Price Target | \$58 | Years Of Dividend Growth: | 49 |
| Dividend Risk Score: | B | Retirement Suitability Score: | A | Rating: | 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 2022, Fortis had 99% regulated assets: 82% regulated electric and 17% regulated gas. As well, 64% were in the U.S., 33% in Canada, and 3% in the Caribbean.

Fortis reported Q4 2022 results on 2/10/23. For the quarter, it reported adjusted net earnings of C\$347 million, up 16% versus Q4 2022, while adjusted earnings-per-share (EPS) rose 14% to C\$0.72.

The full-year 2022 results provide a bigger picture. Adjusted earnings rose 9% year over year to C\$1,329 million, while adjusted EPS increased by 7% to C\$2.78 (which translates to US\$2.08). As planned, the utility invested C\$4.0 billion for its capital spending in 2022. For 2023, it plans capital investments of C\$4.3 billion. We initiate our 2023 EPS estimate at \$2.20.

Growth on a Per-Share Basis

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| EPS | \$1.60 | \$1.56 | \$1.52 | \$1.78 | \$2.02 | \$1.89 | \$1.92 | \$2.02 | \$2.04 | \$2.08 | \$2.20 | \$2.94 |
| DPS | \$1.20 | \$1.16 | \$1.09 | \$1.15 | \$1.25 | \$1.33 | \$1.38 | \$1.44 | \$1.64 | \$1.67 | \$1.69 | \$2.16 |
| Shares¹ | 213 | 276 | 282 | 401 | 421 | 429 | 447 | 465 | 471 | 479 | 485 | 518 |

Fortis compounded its EPS at 5.6% and DPS at 6.4% per year from 2013 to 2022 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. We extend those growth rates for EPS and DPS of 6% and 5%, respectively, from 2023 to 2028.

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 3.0% and 3.7% per year from 2013 to 2022.

Additionally, the utility tends to 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.

¹ 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 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | Now | 2028 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E | 16.9 | 18.2 | 17.8 | 28.1 | 40.6 | 21.2 | 19.9 | 20.0 | 21.7 | 21.7 | 18.9 | 19.8 |
| Avg. Yld. | 4.1% | 3.7% | 3.3% | 3.1% | 3.1% | 2.9% | 3.1% | 3.5% | 3.5% | 3.6% | 4.1% | 3.7% |

Fortis stock averaged a P/E of 22.6 from 2013-2022, but the average multiple drops to 20.6 when the 2017 outlier is taken out. So, we target a fair target P/E of 19.8. Using our 2023 EPS estimate, Fortis trades at a price-to-earnings ratio of 18.9, 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 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 75% | 74% | 72% | 65% | 62% | 70% | 72% | 71% | 80% | 80% | 77% | 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 and interest rates are higher than recent history.

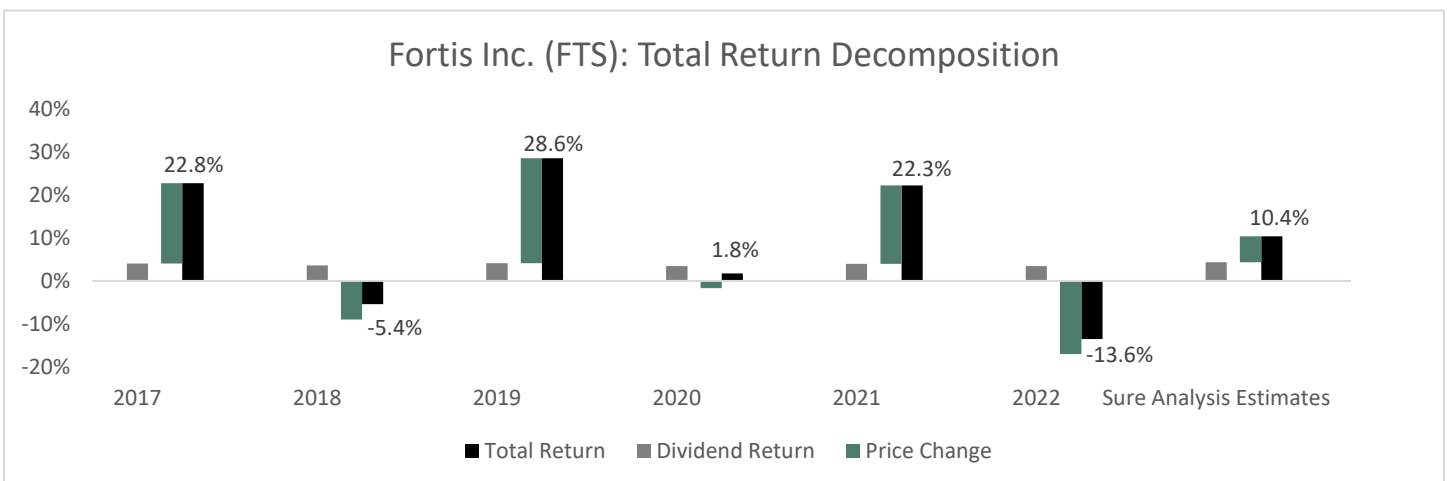
Fortis's liquidity position is strong, including C\$3.8 billion of undrawn liquidity available from \$5.9-billion credit facilities at the end of Q4 2022. Fortis' payout ratio had been about 70% of earnings, which is where it's heading. The dividend is important to management and we believe it is safe 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 10.4% through 2028 from 6% earnings growth, a 4.1% yield, and a P/E expansion of 1.0%. We rate FTS stock as a buy, especially for conservative investors.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 3,930 | 4,892 | 5,294 | 5,164 | 6,405 | 6,474 | 6,618 | 6,669 | 7,536 | 8,488 |
| Gross Profit | 2,360 | 2,902 | 3,264 | 3,396 | 4,583 | 4,549 | 4,719 | 4,757 | 5,182 | 5,450 |
| Gross Margin | 60.0% | 59.3% | 61.7% | 65.8% | 71.6% | 70.3% | 71.3% | 71.3% | 68.8% | 64.2% |
| D&A Exp. | 525 | 623 | 684 | 742 | 910 | 959 | 1,017 | 1,066 | 1,200 | 1,282 |
| Operating Profit | 827 | 927 | 1,112 | 1,120 | 1,938 | 1,825 | 1,854 | 1,872 | 1,969 | 2,106 |
| Operating Margin | 21.1% | 18.9% | 21.0% | 21.7% | 30.2% | 28.2% | 28.0% | 28.1% | 26.1% | 24.8% |
| Net Profit | 398 | 343 | 631 | 498 | 793 | 900 | 1,297 | 951 | 1,032 | 1,071 |
| Net Margin | 10.1% | 7.0% | 11.9% | 9.7% | 12.4% | 13.9% | 19.6% | 14.3% | 13.7% | 12.6% |
| Free Cash Flow | -268 | -673 | -447 | -134 | -207 | -474 | -796 | -999 | -382 | -608 |
| Income Tax | 31 | 60 | 175 | 109 | 454 | 127 | 218 | 172 | 187 | 222 |

Balance Sheet Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Total Assets | 16,819 | 22,598 | 20,757 | 35,530 | 38,029 | 38,950 | 40,883 | 43,509 | 45,222 | 47,342 |
| Cash & Equivalents | 68 | 198 | 174 | 200 | 260 | 244 | 283 | 195 | 103 | 154 |
| Accounts Receivable | 331 | 413 | 373 | 376 | 366 | 395 | 386 | 467 | 487 | 685 |
| Inventories | 134 | 277 | 243 | 276 | 292 | 292 | 302 | 331 | 375 | 487 |
| Goodwill & Int. Ass. | 2,273 | 3612 | 3,397 | 9,920 | 10,119 | 10,081 | 10,154 | 10,260 | 10,245 | 10,324 |
| Total Liabilities | 10,831 | 14,749 | 13,296 | 23,329 | 24,710 | 25,400 | 25,486 | 27,602 | 28,818 | 30,511 |
| Accounts Payable | 397 | 527 | 298 | 411 | 553 | 499 | 577 | 554 | 607 | 653 |
| Long-Term Debt | 6,963 | 9,320 | 8,456 | 16,527 | 17,231 | 17,727 | 17,380 | 19,212 | 20,064 | 21,121 |
| Shareholder's Equity | 4,482 | 5,919 | 5,808 | 9,623 | 10,640 | 10,947 | 12,944 | 13,390 | 13,855 | 14,299 |
| LTD/E Ratio | 1.24 | 1.24 | 1.19 | 1.53 | 1.44 | 1.46 | 1.23 | 1.31 | 1.33 | 1.36 |

Profitability & Per Share Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 2.5% | 1.7% | 2.9% | 1.8% | 2.2% | 2.3% | 3.3% | 2.3% | 2.3% | 2.3% |
| Return on Equity | 9.4% | 6.6% | 10.8% | 6.5% | 7.8% | 8.3% | 10.9% | 7.2% | 7.6% | 7.6% |
| ROIC | 3.2% | 2.3% | 3.8% | 2.2% | 2.7% | 2.9% | 4.1% | 2.8% | 2.9% | 2.9% |
| Shares Out. | 213 | 276 | 282 | 401 | 421 | 429 | 447 | 465 | 471 | 479 |
| Revenue/Share | 18.78 | 21.64 | 18.60 | 16.48 | 15.39 | 15.23 | 15.13 | 14.33 | 15.99 | 17.72 |
| FCF/Share | -1.28 | -2.98 | -1.57 | -0.43 | -0.50 | -1.11 | -1.82 | -2.15 | -0.81 | -1.27 |

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

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