



Southern Company (SO)

Updated February 20th, 2023 by Aristofanis Papadatos

Key Metrics

Current Price:	\$67	5 Year CAGR Estimate:	6.9%	Market Cap:	\$72.6 B
Fair Value Price:	\$62	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	2/17/2023
% Fair Value:	109%	5 Year Valuation Multiple Estimate:	-1.7%	Dividend Payment Date:	3/6/2023
Dividend Yield:	4.1%	5 Year Price Target	\$79	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 \$72.6 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 seven 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 has begun to increase.

In mid-February, Southern reported (2/16/23) financial results for the fourth quarter of fiscal 2022. Revenue grew 22% over the prior year's quarter, primarily due to higher fuel costs. Earnings-per-share decreased -28%, from \$0.36 to \$0.26, as high non-fuel operational and maintenance costs more than offset the effect of rate hikes and customer growth.

Moreover, Southern postponed the start-up at Vogtle Unit 3 to May or June. This project has faced so many setbacks that it is now 8 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 twice in the last 24 quarters. Management provided guidance for earnings-per-share of \$3.55-\$3.65 in 2023 and \$3.95-\$4.10 in 2024. We expect earnings-per-share of \$3.62 this year.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$2.70	\$2.77	\$2.84	\$2.83	\$3.02	\$3.07	\$3.11	\$3.25	\$3.41	\$3.60	\$3.62	\$4.62
DPS	\$2.01	\$2.08	\$2.15	\$2.22	\$2.30	\$2.38	\$2.46	\$2.54	\$2.62	\$2.70	\$2.72	\$3.20
Shares¹	887.1	907.8	911.7	990.4	1007.6	1034.0	1052.0	1058	1062	1090	1100	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 3.2% annual rate in the last decade and at a 3.6% 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 2028.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	16.2	16.0	15.8	17.8	15.5	14.7	17.9	17.9	18.5	19.7	18.5	17.0
Avg. Yld.	4.6%	4.7%	4.8%	4.4%	4.6%	5.3%	4.0%	4.4%	4.2%	3.8%	4.1%	4.1%

¹ In millions.

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Southern is trading at a price-to-earnings ratio of 18.5, which is higher than its 10-year average price-to-earnings ratio of 17.0. If the stock reverts to its average valuation level over the next five years, it will incur a -1.7% annualized drag due to the contraction of its earnings multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	74.4%	75.1%	75.7%	78.4%	71.7%	77.5%	79.1%	78.2%	76.8%	75.0%	75.1%	69.2%

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 to 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.

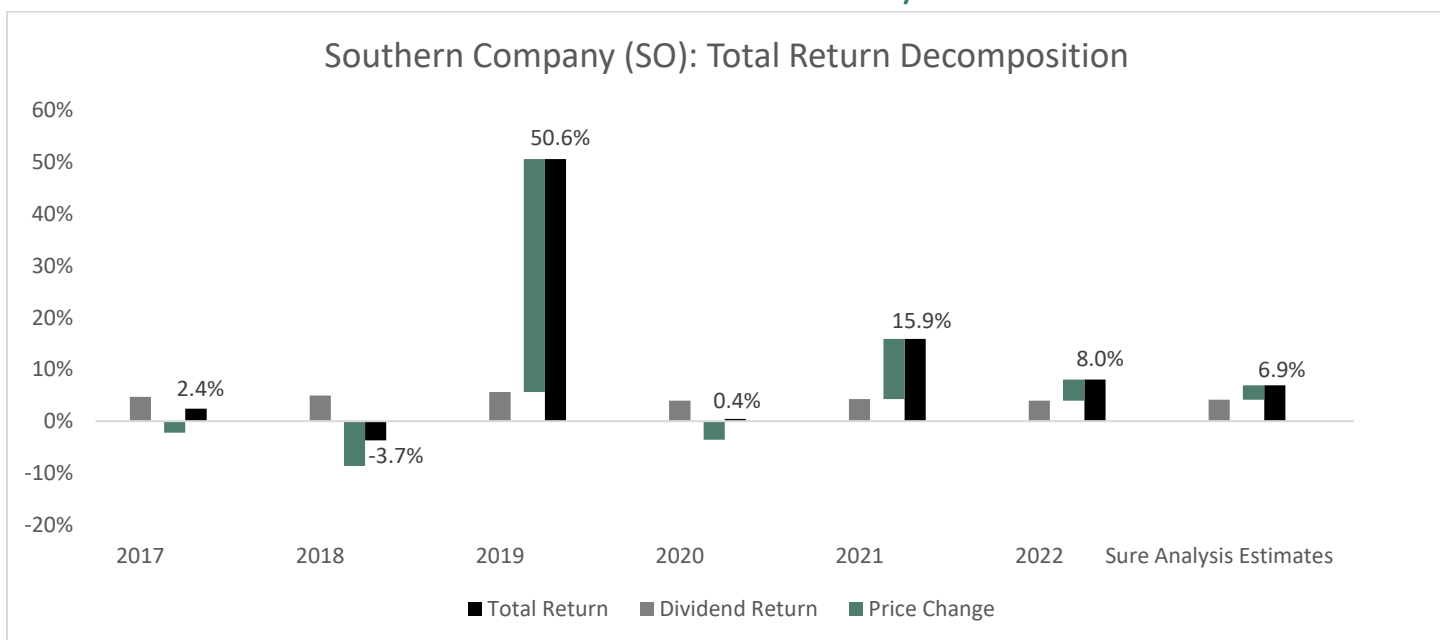
Southern raised its dividend by 3.0% last year and thus it has raised its dividend for 21 consecutive years and has not cut it for 75 consecutive years. It currently offers a 4.1% dividend yield, which is higher than the 3.3% median yield of utilities. Due to the weak balance sheet, dividend growth is 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 in the last 12 months (+3% vs. -7%), as investors consider the stock a safe haven amid 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 6.9% 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 -1.7% valuation headwind. We rate the stock as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	17,087	18,467	17,489	19,896	23,031	23,495	21,419	20,375	23,113	29,279
Gross Profit	7,270	7,436	7,678	8,530	9,915	9,616	9,603	9,897	10,061	10,821
Gross Margin	42.5%	40.3%	43.9%	42.9%	43.1%	40.9%	44.8%	48.6%	43.5%	37.0%
D&A Exp.	2298	2293	2395	2923	3457	3549	3331	3,905	3,973	4,064
Operating Profit	3255	3642	4282	4487	2293	4110	5335	4,820	3,514	5,564
Op. Margin	19.0%	19.7%	24.5%	22.6%	10.0%	17.5%	24.9%	23.7%	15.2%	19.0%
Net Profit	1710	2031	2421	2493	880	2242	4754	3,134	2,408	3,535
Net Margin	10.0%	11.0%	13.8%	12.5%	3.8%	9.5%	22.2%	15.4%	10.4%	12.1%
Free Cash Flow	634	569	600	-2416	-1029	-1056	-1774	-745	-1,071	-1,621
Income Tax	849	977	1194	951	142	449	1798	393	267	795

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets (\$B)	64.5	70.2	78.3	109.7	111.0	116.9	118.7	122.9	127.5	134.9
Cash & Equivalents	659	710	1404	1975	2130	1396	1975	1,065	1,798	1,917
Acc. Receivable	1027	1090	1058	2206	2413	2527	2042	2,269	1,806	2,138
Inventories	2298	1969	1929	2782	2627	2394	2388	2,488	2,355	2,677
Goodwill & Int.	N/A	N/A	319	7221	7141	5928	5816	5,767	5,725	5,567
Total Liabilities	44407	48932	56218	82967	85153	87584	86650	90,410	94,968	100,359
Accounts Payable	1376	1593	1905	2825	3076	3436	2557	2,806	2,169	3,525
Long-Term Debt	23266	24745	28706	47425	50762	46825	46842	49,189	53,717	57,550
Total Equity	19008	19949	20592	24758	24167	24723	27505	27,972	27,873	30,408
LTD/E Ratio	1.20	1.22	1.39	1.91	2.07	1.87	1.69	1.74	1.91	1.90

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	2.7%	3.0%	3.3%	2.7%	0.8%	2.0%	4.0%	2.6%	1.9%	2.7%
Return on Equity	9.2%	10.4%	11.9%	11.0%	3.6%	9.2%	18.2%	11.3%	8.6%	12.1%
ROIC	4.0%	4.5%	5.0%	4.0%	1.2%	2.9%	6.1%	3.9%	2.9%	4.0%
Shares Out.	887.1	907.8	911.7	990.4	1007.6	1034.0	1052.0	1058	1062	1081
Revenue/Share	19.40	20.50	19.13	20.77	22.85	22.92	20.32	19.13	21.64	27.09
FCF/Share	0.72	0.63	0.66	-2.52	-1.02	-1.03	-1.68	-0.70	-1.00	-1.50

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

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