NorthWestern Corp. (NWE)

Updated May 23rd, 2023, by Ian Bezek

Key Metrics

Current Price:	$58	**5 Year CAGR Estimate:**	8.4%	**Market Cap:**	$3.5 B
Fair Value Price:	$59	**5 Year Growth Estimate:**	4.5%	**Ex-Dividend Date:**	06/14/23
% Fair Value:	99%	**5 Year Valuation Multiple Estimate:**	0.2%	**Dividend Payment Date:**	06/30/23
Dividend Yield:	4.4%	**5 Year Price Target**	$73	**Years Of Dividend Growth:**	18
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Rating:**	Hold

Overview & Current Events

NorthWestern Corp. is a Sioux Falls, South Dakota based electricity and gas utility. It has 1,500 employees, and primarily serves the states of South Dakota and Montana. The company's largest source of power generation is currently coal. However, it does produce 27% of its power from hydro and another 6% from wind in addition to contracting additional renewable electricity from other suppliers. In recent times, the company had 35% of its electricity from power purchases rather than its own generation capacity. However, reliance on contracted power will decline in future years because Northwestern has invested in new power plants. One, the 58-megawatt Huron plant in South Dakota, opened on time and under budget in May 2022. Another larger 175-megawatt plant is supposed to come online in Montana in 2024, and the company has begun work for that facility.

On April 18th, 2023, NorthWestern announced its Q1 2023 earnings. Revenue jumped 15% from the same period of 2022 to $454 million as the company's increased production capacity had a beneficial impact on operating results. Earnings per share of $1.05 fell slightly from the $1.08 reported in the same quarter of 2022 however and fell short of analyst expectations. On a net income basis, NorthWestern's profits rose slightly, but share dilution associated with the construction of new power plants caused the EPS figure to decline year-over-year.

NorthWestern's Q1 results were not especially impressive. However, the firm is advancing with its Montana regulatory rate review. If concluded favorably, this rate adjustment should help Northwestern to post increasing earnings per share for full-year 2023. More broadly, NorthWestern's profitability figures should tick upward as inflationary pressures have started to moderate. NorthWestern has chosen not to provide 2023 earnings guidance until the currently pending Montana general rate review is completed.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$2.46	$2.99	$2.90	$3.39	$3.34	$3.40	$3.53	$3.06	$3.60	$3.18	***$3.45***	***$4.30***
DPS	$1.52	$1.60	$1.92	$2.00	$2.10	$2.20	$2.30	$2.40	$2.48	$2.52	***$2.56***	***$2.83***
Shares[1]	39	47	48	48	49	50	50	51	54	56	***60***	***63***

Since 2013, NorthWestern Corp. has grown its earnings-per-share by an average compound rate of 2.9%. Meanwhile, it has grown its dividend by 5.8% per year on average over the same period. NorthWestern's earnings growth has slowed significantly in recent years, with current earnings falling short of where NorthWestern was in 2019. The company's dividend hikes have also slowed down, with the latest increase being by just one cent per quarter.

Following 2022's decline in earnings, we are forecasting 4.5% intermediate-term earnings growth, which falls in the middle part of management's range for longer-term earnings growth. The company is in a heavy investment cycle with its two new power facilities. This came unfortunately timed with a surge in interest rates, which increases the cost of the firm's debt service. In light of that, it's understandable why NorthWestern has moved to smaller dividend increases than it has historically achieved. As part of its balance sheet management, the company has engaged in some share dilution recently, which further limits the potential pace of earnings and dividend growth.

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[1] 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	16.2	18.4	17.2	17.8	16.8	19.9	19.5	16.9	18.2	***16.8***	***17.0***
Avg. Yld.	3.7%	3.3%	3.6%	3.4%	3.5%	3.9%	3.3%	4.0%	4.1%	4.3%	***4.4%***	***3.9%***

NorthWestern has historically had a stable P/E ratio with its average not going above 20 or below 15 over the past decade. Shares are currently right around their long-term median valuation. We see the company's long-term P/E multiple remaining within this range and settling at 17.

The company's dividend yield has generally run between the mid-3% to low 4% range. The current 4.4% dividend yield is a higher than usual entry point for NorthWestern stock. Offsetting the higher starting dividend yield, however, is the fact that dividend growth has significantly decelerated over the past couple of years. And dividend growth may remain muted thanks to the company's current investment cycle and related share dilution.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	62%	54%	66%	59%	63%	65%	65%	78%	69%	79%	***74%***	***66%***

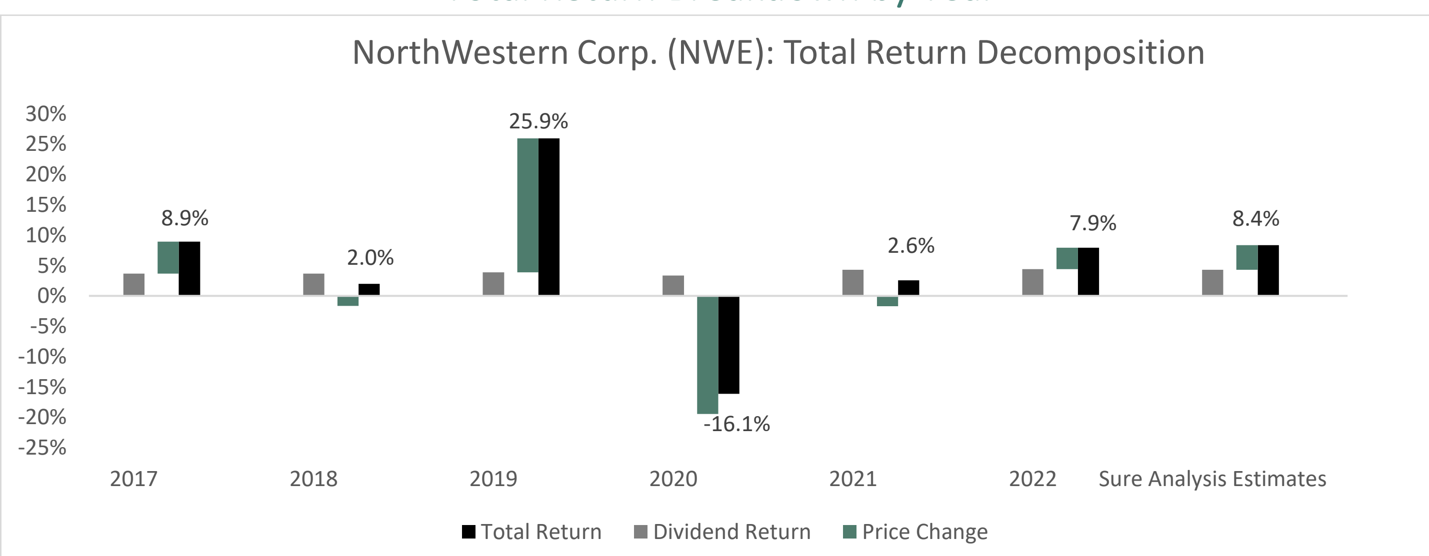
NorthWestern is somewhat on the small side as far as publicly traded utilities go and could face some geographical risk if anything happens to curb power demand in key states such as South Dakota and Montana. However, utilities, as an industry, are highly resilient and tend to fare relatively well during economic duress.

NorthWestern aims to have its dividend payout ratio be between 60% and 70%. However, it has now crept up to 74% based on this year's projected earnings. We expect that earnings will grow more quickly than dividends through 2028 as NorthWestern seeks to get its payout ratio back down to something below 70%.

Final Thoughts & Recommendation

NorthWestern shares are now in line with our fair value estimate. As such, we now estimate 8.4% per year total return potential, driven by a 4.5% earnings growth rate and the generous starting dividend yield. There is some execution risk around the company's new power plants, and dividend hikes will likely be subdued. However, the starting 4.4% dividend yield helps counterbalance those points. Shares earn a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	1,155	1,205	1,214	1,257	1,306	1,192	1,258	1,199	1,372	1,478
Gross Profit	675	722	841	856	895	919	940	892	947	986
Gross Margin	58.5%	59.9%	69.3%	68.1%	68.6%	77.1%	74.7%	74.5%	69.0%	66.7%
SG&A Exp.	286	306	297	294	295	307	109	94	102	114
Operating Profit	171	178	266	255	272	266	277	236	276	263
Operating Margin	14.8%	14.8%	21.9%	20.3%	20.8%	22.3%	22.0%	19.7%	20.1%	17.8%
Net Profit	94	121	151	164	163	197	202	155	187	183
Net Margin	8.1%	10.0%	12.5%	13.1%	12.5%	16.5%	16.1%	12.9%	13.6%	12.4%
Free Cash Flow	(37)	(20)	56	(1)	46	98	(19)	(54)	(214)	(208)
Income Tax	14	(10)	30	(8)	13	(19)	(20)	(11)	3	(0.6)

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	3,715	4,974	5,265	5,499	5,421	5,644	6,083	6,389	6,780	7,318
Cash & Equivalents	17	20	12	5	8	8	5	6	3	8,489
Acc. Receivable	175	163	154	160	182	162	167	168	199	245
Inventories	56	55	53	49	52	51	54	61	81	107
Total Liabilities	355	355	358	358	358	358	358	358	358	4,653
Accounts Payable	2,685	3,496	3,665	3,823	3,622	3,702	4,044	4,310	4,441	202
Long-Term Debt	93	82	75	79	85	87	97	100	115	2,619
Total Equity	1,296	1,930	1,998	2,094	2,113	2,102	2,233	2,415	2,541	2,665
LTD/E Ratio	1,031	1,478	1,600	1,676	1,799	1,942	2,039	2,079	2,340	0.98

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	2.6%	2.8%	3.0%	3.1%	3.0%	3.6%	3.4%	2.5%	2.8%	2.6%
Return on Equity	9.6%	9.6%	9.8%	10.0%	9.4%	10.5%	10.2%	7.5%	8.5%	7.3%
ROIC	4.2%	4.2%	4.3%	4.5%	4.2%	5.0%	4.9%	3.5%	4.0%	3.6%
Shares Out.	38.7	46.9	48.2	48.3	49.4	50.3	50.4	50.6	54.1	56.3
Revenue/Share	30.27	29.85	25.46	25.94	26.83	23.73	24.94	23.71	26.54	26.25
FCF/Share	(0.96)	(0.50)	1.18	(0.02)	0.95	1.95	(0.38)	(1.06)	(4.15)	(3.69)

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