Southern Company (SO)

Updated February 21st, 2024 by Aristofanis Papadatos

Key Metrics

Current Price:	$67	**5 Year CAGR Estimate:**	9.1%	**Market Cap:**	$72.5 B
Fair Value Price:	$69	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	2/16/2024
% Fair Value:	97%	**5 Year Valuation Multiple Estimate:**	0.6%	**Dividend Payment Date:**	3/6/2024
Dividend Yield:	4.2%	**5 Year Price Target**	$88	**Years Of Dividend Growth:**	22
Dividend Risk Score:	B	**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 $72.5 billion.

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 eight years. As it refinances its debt on a regular basis, it greatly benefits when interest rates are low, just like during 2008-2021. On the other hand, the Fed has raised interest rates to 23-year highs and thus the interest expense of Southern has increased 30% in the last two years.

In mid-February, Southern reported (2/15/24) financial results for the full fiscal 2023. Revenue declined -14% over the prior year's quarter due to lower fuel costs but adjusted earnings-per-share grew 1%, from $3.60 to $3.65, thanks to lower costs and rate hikes. Moreover, Southern started up its Vogtle Unit 3, the first new nuclear facility built in the U.S. in a generation, in early August. This project faced so many setbacks that it became 8 years late, with a cost more than double the initial cost estimate. Furthermore, Southern has missed analysts' estimates only twice in the last 28 quarters. Management provided strong guidance for 2024, expecting 10% growth of earnings-per-share, from $3.65 to $3.90-$4.10, assuming that Vogtle Unit 4 will come in service in April. The company seems poised to grow its bottom line at a double-digit rate for the first time in more than a decade thanks to the start-up of its nuclear plant.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$2.77	$2.84	$2.83	$3.02	$3.07	$3.11	$3.25	$3.41	$3.60	$3.65	***$4.00***	***$5.11***
DPS	$2.08	$2.15	$2.22	$2.30	$2.38	$2.46	$2.54	$2.62	$2.70	$2.78	***$2.80***	***$3.28***
Shares[1]	907.8	911.7	990.4	1007.6	1034.0	1052.0	1058	1062	1090	1092	***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 2.1% average annual rate over the last decade. Management previously stated that it would need to issue only $2.0 billion of shares (2.8% 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 3.1% annual rate in the last decade and at a 5.2% 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 2029.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	16.0	15.8	17.8	15.5	14.7	17.9	17.9	18.5	19.7	19.0	***16.8***	***17.3***
Avg. Yld.	4.7%	4.8%	4.4%	4.6%	5.3%	4.0%	4.4%	4.2%	3.8%	4.0%	***4.2%***	***3.7%***

[1] In millions.

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Southern is currently trading at a price-to-earnings ratio of 16.8, which is slightly lower than the 10-year average price-to-earnings ratio of 17.3 of the stock. If the utility trades at its average valuation level in five years, it will enjoy a 0.6% annualized gain.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	75.1%	75.7%	78.4%	71.7%	77.5%	79.1%	78.2%	76.8%	75.0%	76.2%	***70.0%***	***64.2%***

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 38% 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.

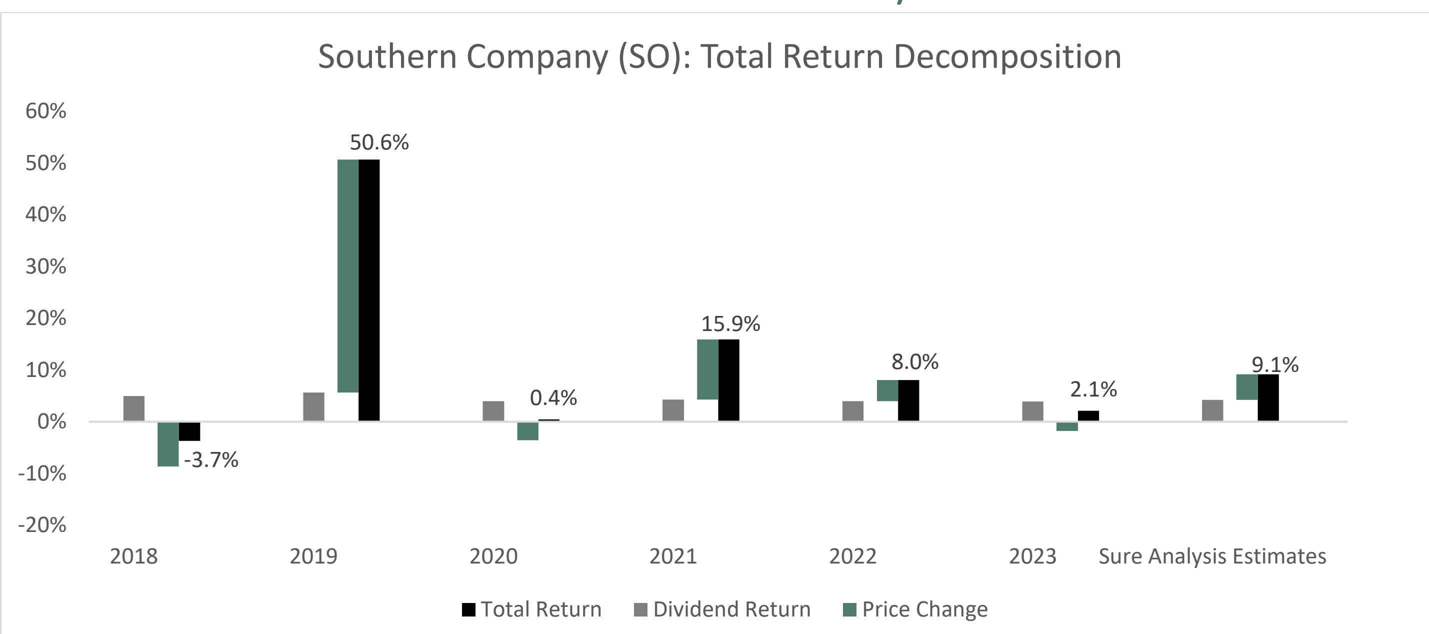
Southern has raised its dividend for 22 consecutive years and has not cut it for 76 consecutive years. It currently offers a 4.2% dividend yield, which is slightly higher than the 4.0% median yield of utilities. Due to the weak balance sheet, dividend growth is likely to remain meager (~3% annually) 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 grew its earnings thanks to its resilient business model, which involves rate hikes.

Final Thoughts & Recommendation

The stock of Southern is a safe haven amid high inflation thanks to its reliable rate hikes year after year. We expect Southern to offer a 9.1% average annual return over the next five years thanks to 5.0% earnings growth, its 4.2% dividend and a 0.6% valuation tailwind. We maintain our hold rating but the stock is on the verge of earning a buy rating. We view it as highly attractive at its current price thanks to its high expected return, its reliable growth and its resilience to downturns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	18,467	17,489	19,896	23,031	23,495	21,419	20,375	23,113	29,279	25,253
Gross Profit	7,436	7,678	8,530	9,915	9,616	9,603	9,897	10,061	10,821	11,708
Gross Margin	40.3%	43.9%	42.9%	43.1%	40.9%	44.8%	48.6%	43.5%	37.0%	46.4%
D&A Exp.	2293	2395	2923	3457	3549	3331	3,905	3,973	4,064	4,986
Operating Profit	3642	4282	4487	2293	4110	5335	4,820	3,514	5,564	5,826
Op. Margin	19.7%	24.5%	22.6%	10.0%	17.5%	24.9%	23.7%	15.2%	19.0%	23.1%
Net Profit	2031	2421	2493	880	2242	4754	3,134	2,408	3,535	3,976
Net Margin	11.0%	13.8%	12.5%	3.8%	9.5%	22.2%	15.4%	10.4%	12.1%	15.7%
Free Cash Flow	569	600	-2416	-1029	-1056	-1774	-745	-1,071	-1,621	-1,542
Income Tax	977	1194	951	142	449	1798	393	267	795	496

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets ($B)	70.2	78.3	109.7	111.0	116.9	118.7	122.9	127.5	134.9	139.3
Cash & Equivalents	710	1404	1975	2130	1396	1975	1,065	1,798	1,917	748
Acc. Receivable	1090	1058	2206	2413	2527	2042	2,269	1,806	2,138	2,030
Inventories	1969	1929	2782	2627	2394	2388	2,488	2,355	2,677	3,352
Goodwill & Int.	N/A	319	7221	7141	5928	5816	5,767	5,725	5,567	5,529
Total Liabilities	48932	56218	82967	85153	87584	86650	90,410	94,968	100,359	104,106
Accounts Payable	1593	1905	2825	3076	3436	2557	2,806	2,169	3,525	2,898
Long-Term Debt	24745	28706	47425	50762	46825	46842	49,189	53,717	57,550	62,000
Total Equity	19949	20592	24758	24167	24723	27505	27,972	27,873	30,408	31,444
LTD/E Ratio	1.22	1.39	1.91	2.07	1.87	1.69	1.74	1.91	1.90	1.97

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	3.0%	3.3%	2.7%	0.8%	2.0%	4.0%	2.6%	1.9%	2.7%	2.9%
Return on Equity	10.4%	11.9%	11.0%	3.6%	9.2%	18.2%	11.3%	8.6%	12.1%	11.4%
ROIC	4.5%	5.0%	4.0%	1.2%	2.9%	6.1%	3.9%	2.9%	4.0%	4.2%
Shares Out.	907.8	911.7	990.4	1007.6	1034.0	1052.0	1058	1062	1081	1098
Revenue/Share	20.50	19.13	20.77	22.85	22.92	20.32	19.13	21.64	27.09	23.00
FCF/Share	0.63	0.66	-2.52	-1.02	-1.03	-1.68	-0.70	-1.00	-1.50	-1.40

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