



# Pinnacle West Capital Corp. (PNW)

Updated March 3<sup>rd</sup>, 2024 by Felix Martinez

## Key Metrics

<b>Current Price:</b>	\$68	<b>5 Year CAGR Estimate:</b>	12.4%	<b>Market Cap:</b>	\$7.7 B
<b>Fair Value Price:</b>	\$81	<b>5 Year Growth Estimate:</b>	5.0%	<b>Ex-Dividend Date:</b>	04/28/24
<b>% Fair Value:</b>	84%	<b>5 Year Valuation Multiple Estimate:</b>	3.5%	<b>Dividend Payment Date:</b>	06/01/24
<b>Dividend Yield:</b>	5.2%	<b>5 Year Price Target</b>	\$103	<b>Years Of Dividend Growth:</b>	11
<b>Dividend Risk Score:</b>	C	<b>Retirement Suitability Score:</b>	B	<b>Rating:</b>	Buy

## 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 \$7.7 billion.

On February 27<sup>th</sup>, 2024, Pinnacle West Capital reported fourth-quarter results for Fiscal Year (FY)2023. The company reported solid financial results for 2023, with consolidated net income of \$501.6 million or \$4.41 per diluted share. The positive performance was driven by favorable weather, customer growth, and operational success. Despite a net loss of \$23,000 for Q4 2023, the full-year improvement of \$18 million was attributed to various factors, including increased revenue and transmission revenue. The CEO, Jeff Guldner, highlighted the company's progress in overcoming financial challenges and the positive outcome of the 2022 rate case, supporting investments in energy infrastructure. The company acknowledged employees for their efforts during extreme weather conditions and emphasized its position to provide top-level service in 2024. Arizona's growing economy and population were noted, with APS, the principal subsidiary, experiencing 2% customer growth in 2023. A Transmission System Plan was filed to address energy needs and enhance reliability. The commitment to customer service was underscored, with APS ranking in the second quartile for both business and residential customers according to J.D. Power. Various initiatives were outlined to improve the digital experience and provide assistance programs, contributing to over \$69 million in funding and discounts in 2023.

Looking ahead, Pinnacle West provided a 2024 financial outlook, estimating consolidated earnings guidance in the range of \$4.60 to \$4.80 per diluted share on a weather-normalized basis, following the conclusion of APS's rate case. Detailed factors and assumptions underlying the 2024 outlook were made available on [pinnaclewest.com/investors](https://pinnaclewest.com/investors).

## Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
<b>EPS</b>	\$3.58	\$3.92	\$3.95	\$4.35	\$4.54	\$4.77	\$4.87	\$5.47	\$4.26	\$4.41	<b>\$4.73</b>	<b>\$6.04</b>
<b>DPS</b>	\$2.30	\$2.41	\$2.53	\$2.66	\$2.82	\$3.18	\$3.18	\$3.24	\$3.42	\$3.48	<b>\$3.54</b>	<b>\$3.91</b>
<b>Shares<sup>1</sup></b>	111.0	112.0	112.0	112.0	113.0	113.0	113.0	113.0	113.0	113.0	<b>113.0</b>	<b>113.0</b>

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 5% rate for the next five years. This would give us \$6.04 per share in earnings for 2029. Our expected 5% growth rate is higher than the 10-year average growth rate of 2.3%.

PNW's net margin has been improving over the past decade, growing from a low of 10.5% in 2011 to 10.7% last year. This could continue to be a growth driver as well.

<sup>1</sup> Share count is in millions.

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The company has increased its dividend each year for the past eleven years. The dividend growth rate has been 4.7% for the past ten years and 2.2% for the past five years. We expect PNW to grow its dividend at a 2% yearly rate, which would be lower than its expected earnings growth. Still, the company has a reasonable payout ratio to cover its dividend.

## Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	19.1	16.5	19.8	19.6	18.8	18.9	16.4	12.9	17.8	16.3	14.9	17.1
Avg. Yld.	3.4%	3.7%	3.2%	3.1%	3.3%	3.3%	4.0%	4.7%	4.5%	4.8%	5.0%	3.8%

In the preceding decade, PNW has exhibited an average price-to-earnings (P/E) ratio of 17.6x, which we deem an equitable valuation for a utility firm of PNW's caliber. Presently, PNW is trading at a P/E ratio of 14.9x, a valuation that appears reasonable for investors seeking enduring value in high-yield utility enterprises. An analysis of the dividend yield further reveals that the current yield surpasses the company's decade-long average. Over the course of the last ten years, PNW has sustained an average dividend yield of 3.8%.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	64.2%	61.5%	64.1%	61.1%	62.1%	66.7%	65.3%	59.2%	80.3%	78.9%	75%	65%

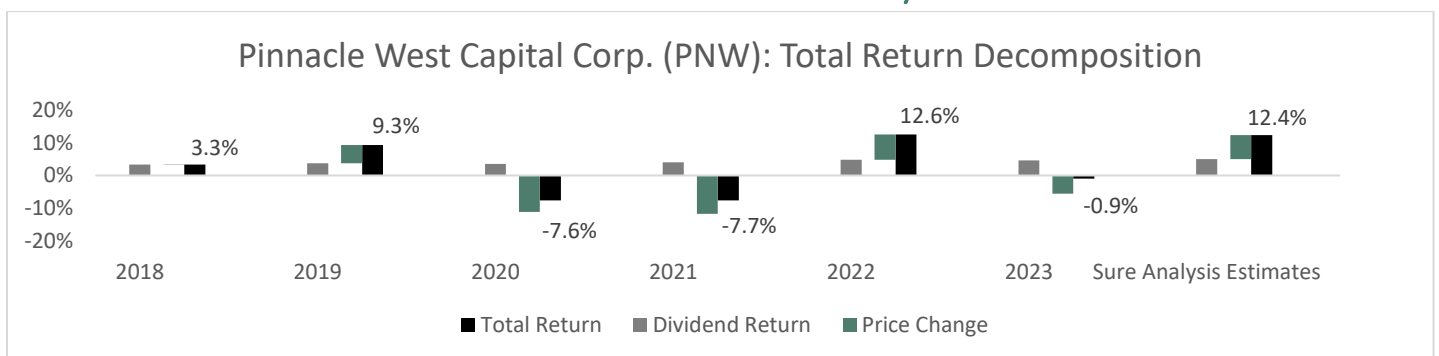
Pinnacle West Capital's advantage is its utility, which tends to be monopoly-like. Investors often hold utility stocks for their defensive nature. People will always need to power their homes and businesses. However, PNW shows that earnings can decrease during a recession. For example, during the Great 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 1.7 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 2.8. 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 under our fair value estimate. We forecast total shareholder returns of 12.4% per year for the next five years. Thus, this stock earns a buy rating because of the expected total return.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Revenue</b>	3,492	3,495	3,499	3,565	3,691	3,471	3,587	3,804	4324	4696
<b>Gross Profit</b>	1,404	1,526	1,491	1,635	1,578	1,487	1,635	1,697	1708	1845
<b>Gross Margin</b>	40.2%	43.7%	42.6%	45.9%	42.8%	42.8%	45.6%	44.6%	39.5%	39.3%
<b>D&amp;A Exp.</b>	496	572	565	611	651	664	686	719	818	854
<b>Operating Profit</b>	811	855	836	910	774	672	788	805	732	825
<b>Operating Margin</b>	23.2%	24.4%	23.9%	25.5%	21.0%	19.4%	22.0%	21.2%	16.9%	17.6%
<b>Net Profit</b>	398	437	442	488	511	538	551	619	484	502
<b>Net Margin</b>	11.4%	12.5%	12.6%	13.7%	13.8%	15.5%	15.3%	16.3%	11.2%	10.7%
<b>Free Cash Flow</b>	189	18	(252)	(291)	99	(235)	(360)	-613	-466	-639
<b>Income Tax</b>	221	238	236	258	134	(16)	78	110	75	77

## Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Total Assets</b>	14,289	15,028	16,004	17,019	17,664	18,479	20,020	22,003	22723	24660
<b>Cash &amp; Equivalents</b>	8	39	9	14	6	10	60	10	5	5
<b>Accounts Receivable</b>	298	275	250	305	268	266	314	392	453	514
<b>Inventories</b>	256	280	283	289	294	346	334	367	451	494
<b>Goodwill &amp; Int. Ass.</b>	120	124	90	257	263	291	283	274	259	267
<b>Total Liabilities</b>	9,770	10,309	11,068	11,883	12,315	12,926	14,268	15,982	16564	18380
<b>Accounts Payable</b>	295	297	265	256	277	346	319	393	430	442
<b>Long-Term Debt</b>	3,538	3,820	4,324	4,967	5,215	5,747	6,483	7,356	8133	9025
<b>Shareholder's Equity</b>	4,367	4,584	4,804	5,007	5,223	5,431	5,634	5,906	6049	6178
<b>LTD/E Ratio</b>	0.81	0.83	0.90	0.99	1.00	1.06	1.15	1.25	1.34	1.46

## Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Return on Assets</b>	2.9%	3.0%	2.8%	3.0%	2.9%	3.0%	2.9%	2.9%	2.2%	2.1%
<b>Return on Equity</b>	9.3%	9.8%	9.4%	10.0%	10.0%	10.1%	10.0%	10.7%	8.1%	8.1%
<b>ROIC</b>	5.0%	5.3%	5.0%	5.0%	4.9%	4.9%	4.7%	4.8%	3.5%	3.4%
<b>Shares Out.</b>	111.0	112.0	112.0	112.0	113.0	113.0	113.0	113.0	113.4	113.8
<b>Revenue/Share</b>	31.41	31.33	31.23	31.73	32.80	30.78	31.76	33.61	38.1	41.3
<b>FCF/Share</b>	1.70	0.16	(2.25)	(2.59)	0.88	(2.08)	(3.19)	-5.42	-4.1	-5.6

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

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