



Fortis Inc. (FTS)

Updated May 2nd, 2024 by Kay Ng

Key Metrics

Current Price:	\$40	5 Year CAGR Estimate:	11.5%	Market Cap:	\$19.6B
Fair Value Price:	\$45	5 Year Growth Estimate:	5.5%	Ex-Dividend Date:	05/16/24
% Fair Value:	89%	5 Year Valuation Multiple Estimate:	2.4%	Dividend Payment Date:	06/01/24
Dividend Yield:	4.4%	5 Year Price Target	\$59	Years Of Dividend Growth¹:	50
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 3.7% (about 4.4% before the 15% withholding tax applied by the Canadian government). Unless otherwise noted, US\$ is used in this report. Fortis is virtually 100% regulated with ~82% regulated electric and ~17% regulated gas. As well, ~64% of its assets are in the U.S., ~33% in Canada, and ~3% in the Caribbean. ~93% of its assets are for transmission and distribution of electricity or gas, which provide essential services, leading to resilient earnings through the economic cycle.

Fortis reported Q1 2024 results on 05/01/24. For the quarter, it reported adjusted net earnings of CAD\$459 million, up 5.0% versus Q1 2023, while adjusted earnings-per-share (EPS) came in at C\$0.93, up 2.2%. The utility's 2024 capital plan of CAD\$4.8 billion is on track with CAD\$1.1 billion invested in Q1.

In March, the transmission operator in the U.S. Midwest region, the Midcontinent Independent System Operator ("MISO"), identified \$17-23 billion of transmission investments in the second tranche of its long-range transmission plan that were within ITC's footprint. ITC, a subsidiary of Fortis, should be able to take part in a good portion of this investment opportunity, which would contribute to long-term growth. The MISO board approval is expected to occur in the second half of this year. We update our 2024 EPS estimate to \$2.36 as there has been a bit of share dilution.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$1.56	\$1.52	\$1.78	\$2.02	\$1.89	\$1.92	\$2.02	\$2.04	\$2.08	\$2.30	\$2.36	\$3.08
DPS	\$1.16	\$1.09	\$1.15	\$1.25	\$1.33	\$1.38	\$1.44	\$1.64	\$1.67	\$1.69	\$1.75	\$2.18
Shares¹	276	282	401	421	429	447	465	471	479	489	496	529

Fortis compounded its EPS at 6.1% and DPS at 6.6% per year from 2014 to 2023 as measured in CAD\$. After releasing its five-year capital plan of CAD\$25 billion for 2024 to 2028, which suggests a mid-year rate base growth at a compound annual growth rate of ~6.3% from C\$36.8 billion in 2023 to C\$49.4 billion in 2028, the company also maintained its dividend growth guidance of 4-6% through 2028. In a higher interest rate environment, we use for our EPS and DPS estimates – 5.5% and 4.5%, respectively, from 2024 to 2029.

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 does not include 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 at only 4.4% and 4.3% per year from 2014 to 2023, respectively.

Additionally, the utility tends to use equity offerings (including its dividend reinvestment plan) as a source of capital to pay down debt or make acquisitions, resulting in a steadily rising number of outstanding 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. The company will continue to grow its green investments steadily, as the regulated utility aims to reduce its carbon emissions 50% by 2030 and 75% by 2035 as compared to 2019.

¹ Years of dividend growth based on CAD\$; Shares in millions.

Disclosure: Kay Ng owns shares in Fortis.



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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	18.2	17.8	28.1	40.6	21.2	19.9	20.0	21.7	21.7	18.8	16.9	19.0
Avg. Yld.	3.7%	3.3%	3.1%	3.1%	2.9%	3.1%	3.5%	3.5%	3.6%	4.1%	4.4%	3.7%

Fortis stock averaged a P/E of 22.8 from 2014-2023, but the average multiple drops to 20.8 when the 2017 outlier is taken out. We think a P/E of 19 is fair. Using our 2024 EPS estimate, Fortis trades at a price-to-earnings ratio of 16.9, which makes it slightly discounted. Fortis is currently trading with a dividend yield of 4.4% (excluding the withholding tax paid to the Canadian government). This North American utility offers a reliable dividend stream.

Safety, Quality, Competitive Advantage, & Recession Resiliency

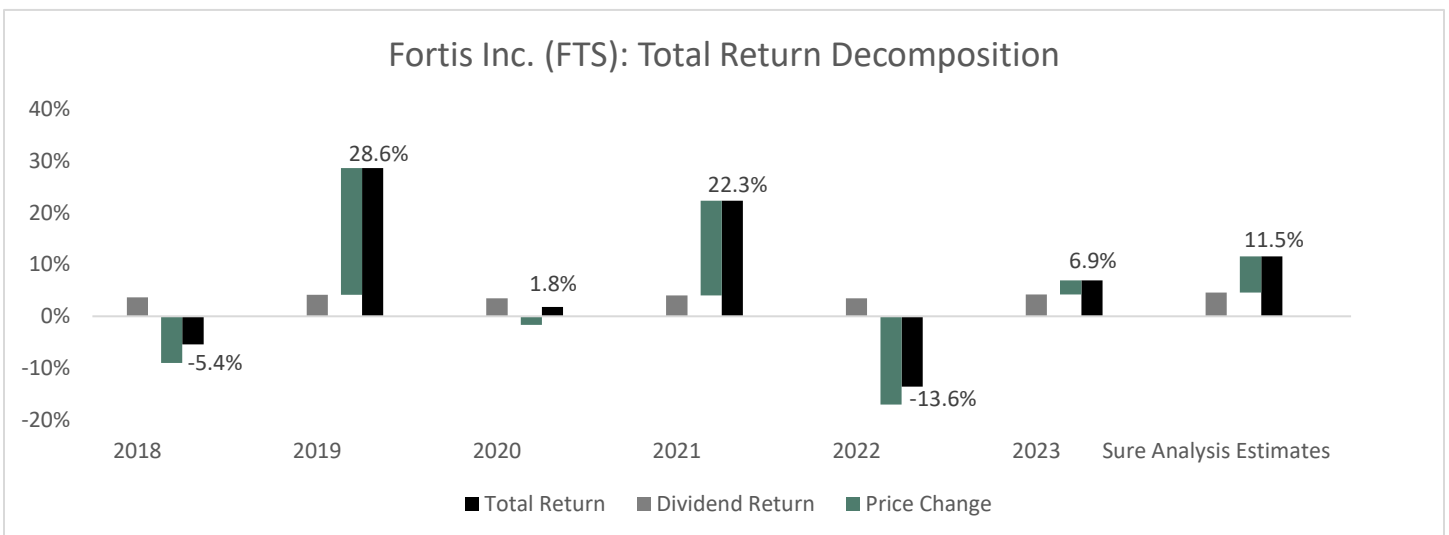
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	74%	72%	65%	62%	70%	72%	71%	80%	80%	73%	74%	71%

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 maintains an investment-grade credit rating. Its S&P credit rating stands at A- currently. Fortis' payout ratio had been about 70% of earnings, with it set to come in around 74% in 2024. 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, scale, and diversity. 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 revenues from that country.

Final Thoughts & Recommendation

Fortis is a quality North American regulated utility that has a leading position. But like its peers, it's being weighed down by higher interest rates leading to a higher cost of capital, making investments less attractive. Nonetheless, we estimate FTS will deliver a total rate of return of 11.5% through 2029 from 5.5% earnings growth, a 4.4% yield, and a multiple expansion of 2.4%. We rate FTS stock as a buy.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	4,892	5,294	5,164	6,405	6,474	6,618	6,669	7,536	8,488	8,529
Gross Profit	2,902	3,264	3,396	4,583	4,549	4,719	4,757	5,182	5,450	5,737
Gross Margin	59.3%	61.7%	65.8%	71.6%	70.3%	71.3%	71.3%	68.8%	64.2%	67.3%
D&A Exp.	623	684	742	910	959	1,017	1,066	1,200	1,282	1,313
Operating Profit	927	1,112	1,120	1,938	1,825	1,854	1,872	1,969	2,106	2,284
Operating Margin	18.9%	21.0%	21.7%	30.2%	28.2%	28.0%	28.1%	26.1%	24.8%	26.8%
Net Profit	343	631	498	793	900	1,297	951	1,032	1,071	1,165
Net Margin	7.0%	11.9%	9.7%	12.4%	13.9%	19.6%	14.3%	13.7%	12.6%	13.7%
Free Cash Flow	-673	-447	-134	-207	-474	-796	-999	-382	-608	-462
Income Tax	60	175	109	454	127	218	172	187	222	267

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	22,598	20,757	35,530	38,029	38,950	40,883	43,509	45,222	47,342	49,690
Cash & Equivalents	198	174	200	260	244	283	195	103	154	471
Accounts Receivable	413	373	376	366	395	386	467	487	685	671
Inventories	277	243	276	292	292	302	331	375	487	427
Goodwill & Int.	3612	3,397	9,920	10,119	10,081	10,154	10,260	10,245	10,324	10,320
Total Liabilities	14,749	13,296	23,329	24,710	25,400	25,486	27,602	28,818	30,511	32,100
Accounts Payable	527	298	411	553	499	577	554	607	653	746
Long-Term Debt	9,320	8,456	16,527	17,231	17,727	17,380	19,212	20,064	21,121	22,350
Shareholder's Equity	5,919	5,808	9,623	10,640	10,947	12,944	13,390	13,855	14,299	14,990
LTD/E Ratio	1.24	1.19	1.53	1.44	1.46	1.23	1.31	1.33	1.36	1.38

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	1.7%	2.9%	1.8%	2.2%	2.3%	3.3%	2.3%	2.3%	2.3%	2.4%
Return on Equity	6.6%	10.8%	6.5%	7.8%	8.3%	10.9%	7.2%	7.6%	7.6%	6.8%
ROIC	2.3%	3.8%	2.2%	2.7%	2.9%	4.1%	2.8%	2.9%	2.9%	3.0%
Shares Out.	276	282	401	421	429	447	465	471	479	486
Revenue/Share	21.64	18.60	16.48	15.39	15.23	15.13	14.33	15.99	17.72	17.53
FCF/Share	-2.98	-1.57	-0.43	-0.50	-1.11	-1.82	-2.15	-0.81	-1.27	-0.95

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

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