



Pinnacle West Capital Corp. (PNW)

Updated August 10th, 2024 by Felix Martinez

Key Metrics

Current Price:	\$86	5 Year CAGR Estimate:	7.4%	Market Cap:	\$9.7 B
Fair Value Price:	\$82	5 Year Growth Estimate:	5.0%	Ex-Dividend Date:	08/01/24
% Fair Value:	105%	5 Year Valuation Multiple Estimate:	1.1%	Dividend Payment Date:	09/03/24
Dividend Yield:	4.1%	5 Year Price Target	\$104	Years Of Dividend Growth:	11
Dividend Risk Score:	C	Retirement Suitability Score:	NA	Rating:	Hold

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 \$8.7 billion.

On August 1st, 2024, Pinnacle West Capital reported second-quarter results for Fiscal Year (FY)2024. The company reported a significant increase in net income for the second quarter of 2024, with earnings of \$203.8 million, or \$1.76 per diluted share, compared to \$106.7 million, or \$0.94 per diluted share, for the same period in 2023. This improvement was driven by new customer rates implemented in March 2024, record-high June temperatures, and increased customer usage. However, the company also faced higher expenses related to depreciation, amortization, and interest. The extreme summer heat significantly impacted energy consumption, with the Phoenix area experiencing its hottest June on record. The average high temperature during the second quarter was 97.6 degrees Fahrenheit, leading to a substantial rise in residential cooling degree-days, a measure used by utilities to assess the impact of weather on energy use. Pinnacle West Chairman, President, and CEO Jeff Guldner highlighted the importance of reliable energy services during these challenging conditions, emphasizing the company's commitment to maintaining a stable energy supply while also preparing for a clean energy future. Pinnacle West and its subsidiary, APS, are actively working to enhance customer experience and provide support during extreme weather conditions. The company has introduced various resources, such as a mobile app for monitoring energy use, and expanded its heat-relief initiatives in partnership with local organizations. Additionally, APS offers several assistance programs to help customers manage their energy bills, including discounts for low-income households and emergency financial aid. The company remains optimistic about its financial outlook for 2024, maintaining earnings guidance in the range of \$4.60 to \$4.80 per diluted share.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$3.58	\$3.92	\$3.95	\$4.35	\$4.54	\$4.77	\$4.87	\$5.47	\$4.26	\$4.41	\$4.77	\$6.09
DPS	\$2.30	\$2.41	\$2.53	\$2.66	\$2.82	\$3.18	\$3.18	\$3.24	\$3.42	\$3.48	\$3.54	\$3.91
Shares¹	111.0	112.0	112.0	112.0	113.0	113.0	113.0	113.0	113.0	113.0	113.0	113.0

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 \$6.09 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.

¹ 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	18.0	17.1
Avg. Yld.	3.4%	3.7%	3.2%	3.1%	3.3%	3.3%	4.0%	4.7%	4.5%	4.8%	4.1%	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 18.0x, 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%	74%	64%

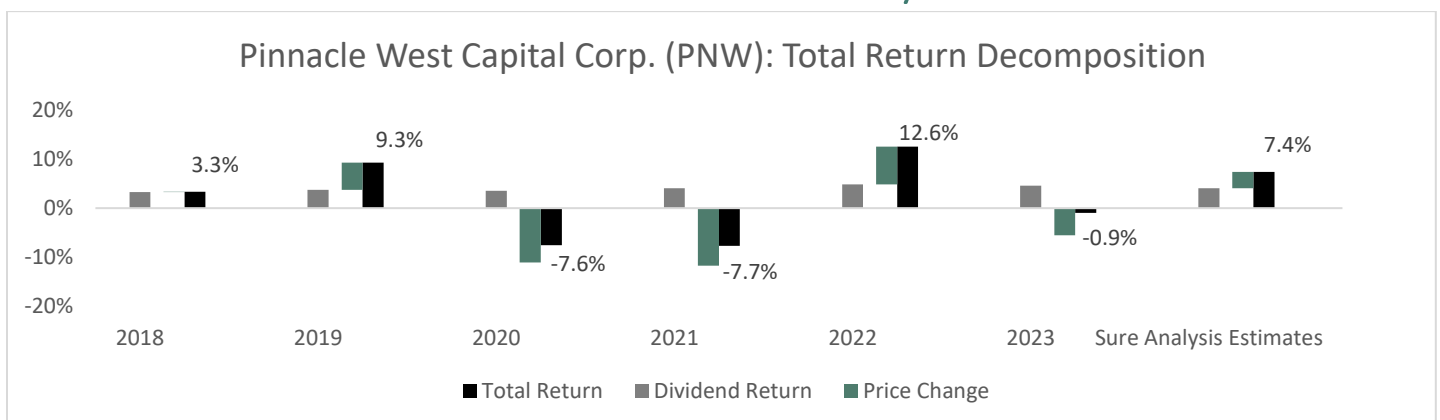
Pinnacle West Capital's advantage is its utility, which tends to be monopoly-like. Investors often hold utility stocks for their defensive nature. People will always need to power their homes and businesses. However, PNW shows that earnings can decrease during a recession. For example, during the Great 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 1.8 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 3.0. 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 7.4% per year for the next five years. Thus, this stock earns a hold 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
Revenue	3,492	3,495	3,499	3,565	3,691	3,471	3,587	3,804	4324	4696
Gross Profit	1,404	1,526	1,491	1,635	1,578	1,487	1,635	1,697	1708	1845
Gross Margin	40.2%	43.7%	42.6%	45.9%	42.8%	42.8%	45.6%	44.6%	39.5%	39.3%
D&A Exp.	496	572	565	611	651	664	686	719	818	854
Operating Profit	811	855	836	910	774	672	788	805	732	825
Operating Margin	23.2%	24.4%	23.9%	25.5%	21.0%	19.4%	22.0%	21.2%	16.9%	17.6%
Net Profit	398	437	442	488	511	538	551	619	484	502
Net Margin	11.4%	12.5%	12.6%	13.7%	13.8%	15.5%	15.3%	16.3%	11.2%	10.7%
Free Cash Flow	189	18	(252)	(291)	99	(235)	(360)	-613	-466	-639
Income Tax	221	238	236	258	134	(16)	78	110	75	77

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	14,289	15,028	16,004	17,019	17,664	18,479	20,020	22,003	22723	24660
Cash & Equivalents	8	39	9	14	6	10	60	10	5	5
Accounts Receivable	298	275	250	305	268	266	314	392	453	514
Inventories	256	280	283	289	294	346	334	367	451	494
Goodwill & Int. Ass.	120	124	90	257	263	291	283	274	259	267
Total Liabilities	9,770	10,309	11,068	11,883	12,315	12,926	14,268	15,982	16564	18380
Accounts Payable	295	297	265	256	277	346	319	393	430	442
Long-Term Debt	3,538	3,820	4,324	4,967	5,215	5,747	6,483	7,356	8133	9025
Shareholder's Equity	4,367	4,584	4,804	5,007	5,223	5,431	5,634	5,906	6049	6178
LTD/E Ratio	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
Return on Assets	2.9%	3.0%	2.8%	3.0%	2.9%	3.0%	2.9%	2.9%	2.2%	2.1%
Return on Equity	9.3%	9.8%	9.4%	10.0%	10.0%	10.1%	10.0%	10.7%	8.1%	8.1%
ROIC	5.0%	5.3%	5.0%	5.0%	4.9%	4.9%	4.7%	4.8%	3.5%	3.4%
Shares Out.	111.0	112.0	112.0	112.0	113.0	113.0	113.0	113.0	113.4	113.8
Revenue/Share	31.41	31.33	31.23	31.73	32.80	30.78	31.76	33.61	38.1	41.3
FCF/Share	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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