NextEra Energy

Calgary Portfolio Management Trust

Utilities
NYSE: NEE
Market Outperform | Buy

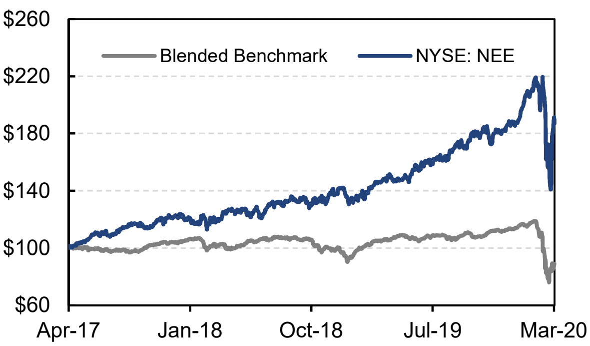
March 31, 2020
Colton Borle, Portfolio Manager
Lucas Peters, Portfolio Manager

Return on Investment	
Current Share Price	$240.62
Target Price	$282.00
Dividend Yield	2.40%
Holding Period Return	20%
Company Quality (CQ) Score	3.9
Conviction Rating	2

Market Profile	
52-Week Range	$235.38 - $283.87
Market Capitalization (US$B)	$117.8
Net Debt (US$B)	$46.9
Enterprise Value (US$B)	$164.6
Beta (5-Year Monthly)	0.31

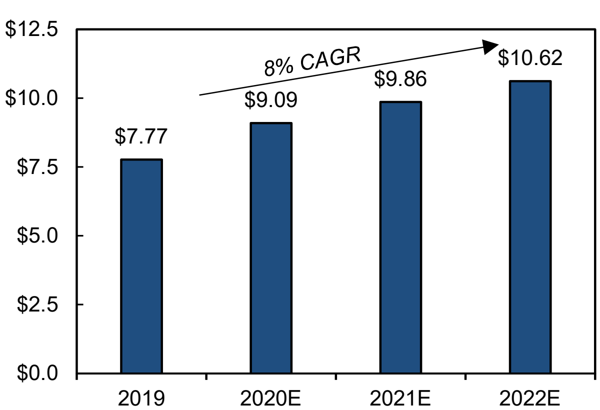
Metrics	2020E	2021E	2022E
Revenue (US$B)	$19.56	$20.27	$21.74
EPS	$9.09	$9.86	$10.62
P/E	29.0x	26.7x	24.8x
EV/EBITDA	17.7x	16.7x	15.7x

Historical Trading Performance (Indexed to $100)



Source: S&P Capital IQ

Figure 1: NEE EPS Growth



Source: Broker Research, CPMT Estimates

Company Overview

NextEra Energy (NYSE: NEE) is one of the largest electric power and energy infrastructure companies in North America as well as a market leader in the renewable energy space. NEE has two principal business segments, Florida Power & Light (FPL) and NextEra Energy Resources (NEER). FPL is a rate-regulated electric utility engaged primarily in the generation, transmission, distribution, and sale of energy in the state of Florida. It is the largest electric utility in the state with 27,400 MW of net generating capacity and 75,400 circuit miles of T&D lines. NEER is a diversified clean energy business that develops, constructs, and operates long-term contracted assets with an emphasis on renewable projects. NEER, with approximately 24,700 MW of total generating capacity, is one of the largest wholesale generators of electric power in the U.S., and is the world's largest generator of wind and solar power. In January 2019, NEE acquired Gulf Power (GP) from Southern Co. (NYSE: SO) for ~$6.5B. GP is an integrated rate-regulated electric utility that operates in NW Florida that is expected to file as a single entity with FPL in its 2021 rate case. NEE's complete corporate structure can be found in Figure 4.

Industry Update

Despite growing concerns over the COVID-19 pandemic, utility companies are broadly well-positioned in terms of liquidity and access to capital markets. In March, U.S. utilities raised $13.5B with several rotating from commercial paper markets to term loans/revolvers. With all considered, utilities dividends should be safe moving forward and capex plans look to remain intact through 2020. Among the most financially stable companies is NEE with industry-best FFO/Debt (20% vs median 15%), Net Debt/LTM EBITDA (4.5x vs median 5.6x), and a well-positioned DPO for the time being (62% vs median 67%). Even though the market sell-off is not sparing any sectors, we believe that concerns over liquidity and EPS growth in the space are overdone.

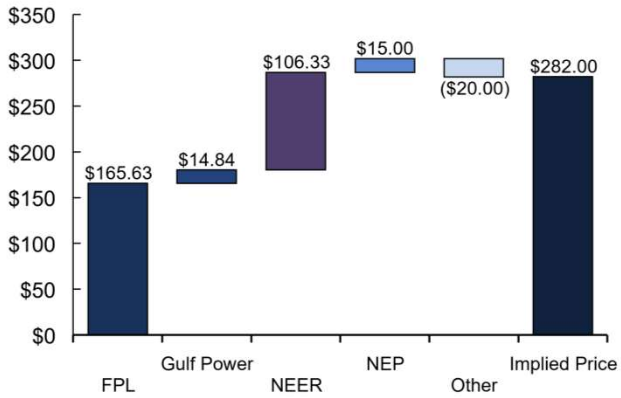
Valuation

The CPMT arrived at a target price of $282 through a sum-of-the-parts valuation of NEE's regulated businesses, energy resources, investment in NEP, and other operations. For FPL and Gulf Power, the CPMT applied a 25.0x exit multiple to the 2022E EPS implied by each segment's rate base growth, approved equity ratio, and ROE guidance to arrive at implied share prices of ~$166 and ~$15, respectively. NEER was valued at ~$106 per share using various EBITDA exit multiples for its constituted segments. The value of NEP and drag from NEE's Corporate and Other segment were valued at $15 and ($20) using consensus estimates. The CPMT believes NEE is currently valued attractively and is poised to outperform the utilities sector over the forecasted period.

Mandate Fit

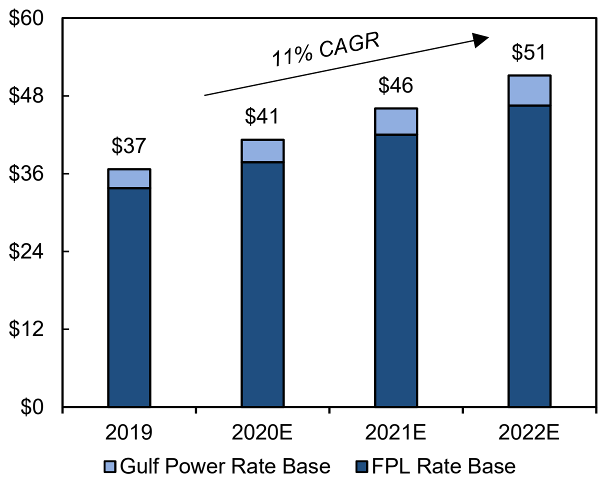
Management: NEE's management prides themselves on shareholder alignment and the TSR profile it offers investors. NEE has grown its DPS at a 9.4% CAGR over the last 15 years which has led to TSR of 43%, 119%, 162%, and 530% over a one, three, five, and ten-year period, respectively. Its management is also one of the most proficient amongst companies in the industry with respect to capital allocation; its combined rate base CAGR through 2022 is expected to be 11%, driven by its ~$25bn capex program in clean energy, T&D, and grid hardening. This capital allocation regime has brought customer bills down ~6% over the last ten years which may lead to higher future allowed ROE given the substantial benefit to customers NEE provides.

Figure 2: Valuation Waterfall



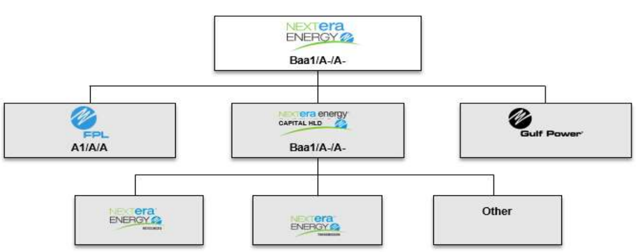
Source: Broker Research, CPMT Estimates

Figure 3: Regulated Operations Rate Base Growth (US$B)



Source: Company Fillings, CPMT Estimates

Figure 4: NEE Organizational Structure



Source: Company Filings

Competitive Advantage: NEE built its competitive advantage on being first to the game with renewables generation years ago, and is now doing a similar action with respect to battery storage. More than 50% of the solar megawatts that were added to NEE's backlog in 2019 included a battery storage component, making storage an increasingly important stand-alone business in its own right. NEE's competitive advantages and scale position it well to capitalize on the enormous disruption that is occurring to the nation's generation fleet. Going into the middle of the decade, near-firm wind is expected to be $20-30/MWh and near-firm solar will be $30-40/MWh which means new near-firm renewables will be cheaper than the operating costs of most existing coal, nuclear and less fuel efficient oil and gas-fired generation units.

Strong Balance Sheet: NEE (Baa1, Moody's) achieves a strong balance sheet due to its large scale, prominent competitive positioning, focus on reducing all merchant exposure, and FPL's strong credit quality. FPL (A1 stable, Moody's) underpins NEE's balance sheet strength through being one of the strongest utilities financially in the U.S. and accounts for ~65% of NEE's EBITDA. Although NEER has higher risk than FPL and Gulf Power, it has mitigated its credit exposures by heavily focusing on obtaining long-term contracts with investment grade counterparties. NEE's main credit risk is its proclivity for larger-scale M&A, shown by its recently completed ~$6.5B acquisition of Gulf Power and ~$9.5B proposed acquisition of Santee Cooper. Although important for growth, we will continue to monitor the balance sheet impacts of NEE's M&A activities to ensure it maintains its strong balance sheet positioning.

Growing Free Cash Flow: Although not valued on an FCF basis, NEE boasts a strong ~28% EBIT margin and is guided to grow adjusted EPS by 6-8% through 2022. Future EPS and FCF growth will be driven from high regulatory capital deployment at FPL and Gulf Power as well as by the 12 GW of renewables in NEER's backlog. The CPMT is moderately concerned about the risk posed by new rate cases for FPL and Gulf Power 2021; however, this is mitigated by the segments likely filing together and the fact that FPL provides rates well below the Florida and national average.

Investment Thesis

The CPMT is recommending a buy for NEE based on the Company's strong satisfaction of our mandate points paired with its leading positioning in the renewable energy and regulated utility industries. NEE's regulated operations offer a financially strong foundational base from which it can pursue aggressive energy resources and renewables growth. FPL alone is highly attractive given its strong credit profile, above industry average ROEs, and history of lowering customer bills. The Company's regulated operations will be further strengthened by a likely combined 2021 rate case and from further transformational M&A, such as the ongoing Santee Cooper acquisition. In addition to the Company's strong regulated business, NEER offers valuable exposure to the enormous and growing U.S. renewables market. The U.S. market is expected at grow at 15% annually through 2030 driven by electrification efforts and a societal shift to clean energy. NEE is positioned to capture the future growth through its 12GW renewables backlog and positioning as the world's largest producer of energy from the wind and sun. To complement the pure growth in renewables and energy, NEER principally pursues assets underpinned by long-term contracts in both the renewable and energy infrastructure industries. Overall, NEE achieves our mandate points and is comprised of highly attractive businesses that offer both growth and financial stability, which is why we are highly convicted on the Company.