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Research on Evaluation of Utility Companies in the United States of America

Ivan Hristov
Professor of Mathematics and Statistics
Valencia College, Orlando, Florida, United States of America
ihristov@valenciacollege.edu

Abstract

In this paper some of the utility companies in the United States of America have been examined in terms of dividend payouts, current financial evaluation and future growth potential. The utility companies in the United States of America and all over the world have been one of the biggest dividend payers. They provide services that are basic necessities which is why, these companies are being regulated by the local governments. That oversight has prevented that sector from growing, compared to other sectors of the economy. However, historically utility companies have been the biggest dividend payer over time. Utility companies are among the lowest-risk securities available, commonly having more-than-adequate cash flows and excellent credit ratings. They are conservative, low-volatility, non-cyclical investments. The utilities sector's primary appeal to investors is its resistance to economic ups and downs. Their dividend payouts, current financial evaluation and potential for future growth will be used to draw some conclusions about investing in that sector. Duke Energy Corporation (DUK), PPL Corporation (PPL), The Southern Company (SO) and American Electric Power Company, Inc. (AEP) are examined by a side by side comparison to select the one with the highest potential.

Keywords: *dividend, growth of utility companies, utilities, utilities dividends*

1 Introduction:

The utility companies have always been stable dividend payers and with their high yield have been an attractive buy for investors [4]. These companies are usually monopolies in the regions they do business in, or there is a very limited competition. Customers will not move to another provider just because they do not like the services, or the price is too high. Utility companies provide basic necessities services, which there is always a need for. That "stability" of these companies makes them an attractive choice for investors [10].

At a certain point, investors do not want any unknowns, and would prefer a stable return on their capital investments. With that being said, there are some disadvantages to investing in utility companies. First, as we mentioned earlier, they are very heavily regulated. They have to get their rates approved by the state government so that will reduce profits. The state government's main goal is to make these services affordable for consumers. The government monitors the rates and will only allow an increase if it is justified. A natural disaster that damaged the grid, higher prices of ore, or investment in renewable energy sources, are examples of such justifications. Another justification would be that the utility company needs an extra capital to stay in business.

Because regulation hinders growth, companies have hard time increasing revenue. Mergers and acquisitions have to be approved so are rate increases. That leaves fewer areas to work on in terms of increasing profits. The utility companies also grow if the state is expanding its commercial or residential infrastructure. Expansion provides more customers since the expanded infrastructure will need services.

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Another way to increase profit is to reduce cost by investing in renewable sources of energy [1]. That will reduce cost and increase profits in the future for the company.

The balance sheet, the statement of cash flow and Stockholders' Equity will give an inside view of the financial position the companies as well. Based on how the utility companies manage their funds, there will be a potential for improved earnings. List of liabilities and payout ratio is also a barometer of the overall financial position of the company. Past performance will also be considered as an indicator for future performance.

With all that being said we will compare the following utility companies and determine which one has the highest evaluation based on these factors. We will consider the following companies: **Duke Energy Corporation (DUK), PPL Corporation (PPL), The Southern Company (SO) and American Electric Power Company, Inc. (AEP).** In this next section, all the four companies are examined by a side by side comparison to select the one with the highest potential. The data were collected on May 9th of 2018. The company selected at the end as a result of this examination will be evaluated again after 1 year to see if the optimal choice was made.

2 Current dividend yield, payout ratio, and dividend history

A. Review Stage

In this section we evaluate each one of the given utility companies based on current dividend yield, payout ratio and dividend history.

	Dividend yield	Annualized payout	Payout Ratio	Dividend growth (years)	Dividend growth last 3 years	Annual growth 2017	Consecutive years of increases (years)
Duke Energy Corporation (DUK)	4.59%	3.56	75.60%	11	3.50%	3.40%	11
PPL Corporation (PPL)	5.88%	1.64	71.30%	6	1.80%	3.10%	6
The Southern Company (SO)	5.48%	2.4	83%	16	3.40%	3.50%	16
American Electric Power Company, Inc. (AEP)	3.74%	2.48	63.90%	4	5.60%	5.30%	4

Table I Current dividend yield, payout ratio, and dividend history

B. Dividend yield

The first of the fundamentals is the dividend yield. Based on current yield PPL Corporation (PPL) has the highest return followed by the Southern Company (SO). All utility companies pay a high dividend in general, however, we look at couple of other reasons why the current yield will be considered. Utility companies have similar tendency, as a result when they go up the whole utility index goes up all together. It is possible for one to occasionally deviate a little bit from the others, however, the long-term assumption is that they will stay together (without a significant difference a year from now).

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Based on the assumptions that all companies have similar fundamentals we can assume that there will be no significant change in price per share in the future. In that case a higher yield is providing a better return [3] [7].

C. Payout ratio

Payout ratio – ideally the lower the better. If the payout is lower, there will be more earning left for the company to improve its financial standing. American Electric Power Company, Inc. (AEP) has the lowest payout ratio followed by PPL Corporation (PPL) [5].

D. Dividend growth (annual and last 3 years) and consecutive years of increase

The dividend growth (annual and last 3 years) and consecutive years of increase are another fundamental that will be considered [6]. All of the companies have different statistics, so it is important to see the big picture. DUK and SO have a long history of increases with moderate growth. PPL has a relatively short history of increases with a small growth. AEP has the highest growth based on the shortest consecutive years of increase.

To recap, DUK and SO will provide a moderate growth, PPL – small and AEP highest growth.

The impact of that will be considered when the growth is superimposed to the current yield. PPL has the smallest growth but based on the current yield of 5.88 % will still be ahead of the other three utility companies. AEP has the highest growth, however that is based on a current dividend of 3.74 %.

Should all fundamentals stay the same, it will take number of years for AEP to even reach the yield of PPL. SO has a 5.48% yield with moderate growth, however the payout ratio is very high [8]. That might prevent the company from continually growing at the same rates as recorded in the past. DUK is very well position, however, based on the current dividend yield of 4.59 % it will be placed second after PPL.

3 Comparison based on current price, 52-week history and percent off 52-week high

In this section we evaluate each one of the given utility companies based on current price, 52-week history and percent off 52-week high.

	Current price	52 week low	52 week high	Percent off 52 week high
Duke Energy Corporation (DUK)	77.83	72.93	91.8	-15.22%
PPL Corporation (PPL)	27.31	27.08	40.2	-30.82%
The Southern Company (SO)	43.85	42.38	53.51	-18.05%
American Electric Power Company, Inc. (AEP)	66.63	63.32	78.07	-14.65%

Table II Comparison based on current price, 52-week history and percent off 52-week high

Percent off 52-week high will be considered as an indication of performance. If the assumption is made that all of the given four companies can achieve their 52-week high price per share, then PPL has the highest return potential with 30.82 % of upside. SO is second with 18.05%.

The utility industry has proven to be very cyclic with peaks being attainted during winter period. For that reason, we look at past performance, and make a conjecture that it can be repeated based on the nature of their business. During winter months the whole utility index goes up and price per share of these companies matches that performance.

4 Comparison Based On Valuation Measure And Financial Highlights

In this section we evaluate each one of the given utility companies based on P/E ratio (ttm), EPS ratio (ttm), Profit margin and Operating margin [9].

	P/E ratio (ttm)	EPS ratio (ttm)	Profit margin	Operating margin
Duke Energy Corporation (DUK)	17.98	4.36	13.19%	26.30%
PPL Corporation (PPL)	16.3	2.86	15.15%	41.20%
The Southern Company (SO)	52.76	0.84	3.66%	11.22%
American Electric Power Company, Inc. (AEP)	17.16	3.88	12.44%	21.25%

Table III Comparison based on valuation measure and financial highlights

A. The price-earning ration ratio (P/E ratio)

The P/E will be considered. If a company has a high P/E, investors are paying a higher price for the stock compared to its earnings. Investors are willing to drive up the price for the stock because they believe the company has good growth prospects, meaning it will make more profit in the future. If a company has a lower P/E, you get more earnings for your investment. This makes a low-P/E stock a good value, but it can also simply indicate that investors aren't very confident about the company's prospects. In terms of utility companies there is nothing unknown and uncertain about their business model, therefore we will just look at the numbers. The lower the P/E, the higher return. PPL has the lowest P/E of 16.3 and AEP is second with 17.16.

B. Earnings per share (EPS)

Earnings per share (**EPS**) is the portion of a company's profit allocated to each outstanding share of common stock. Earnings per share serve as an indicator of a company's profitability.

The higher, the better. DUK has the highest - 4.36, followed by AEP – 3.88.

C. Profit margin and Operating margin

Profit margin and Operating margin are both measure of profitability. The higher the margin, the higher the profit. If the profits are higher, then the company will be able to provide a better return to shareholders. [2] PPL has the highest- 15.15 % and 41.20%, followed by DUK – 13.19 % and 26.30%.

5 Comparison based on effectiveness and balance sheet

In this section we evaluate each one of the given utility companies based on Return on Assets (ttm), Return on Equity (ttm), Quarterly revenue growth (yoy) and Current ratio (mrq).

	Return on Assets (ttm)	Return on Equity (ttm)	Quarterly revenue growth (yoy)	Current ratio (mrq)
Duke Energy Corporation (DUK)	2.82%	7.42%	3.90%	0.68
PPL Corporation (PPL)	4.81%	10.92%	5.10%	0.57
The Southern Company (SO)	1.46%	3.37%	8.60%	0.74
American Electric Power Company, Inc. (AEP)	3.23%	9.87%	2.90%	0.44

Table IV Comparison based on effectiveness and balance sheet

A. Return on Assets (ttm)

Return on assets (ROA) is an indicator of how profitable a company is, relative to its total assets. The higher the ROA number, the better, because the company is earning more money on less investment. [3] PPL has the highest – 4.81%, followed by AEP with 3.23%.

B. Return on Equity (ttm)

The higher the number, the more effective a company is at turning its assets and employees into piles of money for investors. PPL has the highest – 10.92%, followed by AEP with 9.87%.

C. Quarterly revenue growth (yoy)

For Quarterly revenue growth (yoy) SO has the highest – 8.60%, PPL has the second highest -5.10% and DUK is third with 3.90%.

Going back to table I we note that the payout ratio of SO was much higher than PPL's payout ratio (83 % compared to 71.3 %). This will make the growth unsustainable since the company would like to stay at a safe percentage for the payout ratio. Considering this additional information, SO's high quarterly revenue growth should not be considered since it is unattainable, based on the current fundamentals [8].

D. Current ratio

The current ratio is a liquidity ratio that measures a company's ability to pay short-term and long-term obligations. The higher the current ratio, the more capable the company is of paying its obligations as it has a larger proportion of asset value relative to the value of its liabilities. Utility companies usually have values bellow 1. SO has the highest of 0.74 and DUK is second with 0.68.

6 Conclusion

The following companies - Duke Energy Corporation (DUK), PPL Corporation (PPL), The Southern Company (SO) and American Electric Power Company, Inc. (AEP) were compared side by side.

Based on dividend payouts, current financial evaluation and future growth potential, we would select one that has the highest potential for future returns [2]. PPL was the leading choice for most of the comparisons. PPL has a high yield, good fundaments and upside potential. DUK is also a solid choice, placing second, based on the scores of the fundaments used for the evaluation.

Placing low in our evaluation are SO and AEP. SO has a high payout ratio, high P/E and low EPS. AEP has a small current dividend and the current price is high (close to 52-week high). We are very cautious about these results since that will prevent future growth.

In conclusion, PPL is the company expected to perform better than the remaining three. All four utility companies will be evaluated again after one year. The new evaluation on May 9th, 2019 will compare percent increase based on the values used the previous year.

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