



Sempra Energy®

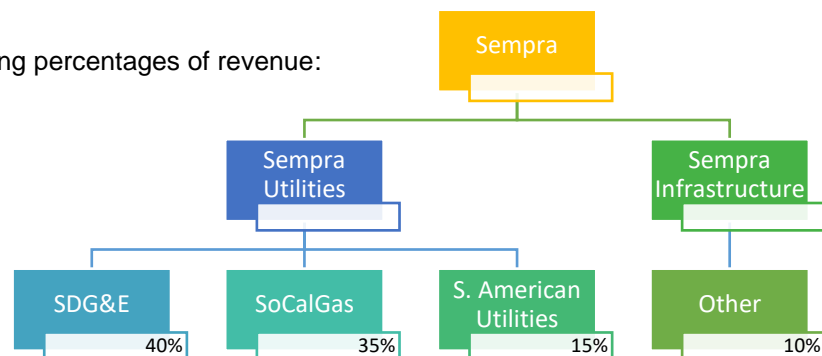
Maren Madsen & Grant Gresens  
Senior Analysts: Tanner Thompson & Joel Yang

## Sempra Energy (SRE)

### Overview and Corporate Structure

Sempra Energy is an energy infrastructure and energy-services holding company. Their business strategy is to increase shareholder value through operating in U.S. and South American regulated utilities and U.S. and Mexican energy infrastructure. Sempra can be divided into two principle operations: Sempra Utilities and Sempra Infrastructure. Sempra Utilities includes San Diego Gas & Energy (SDG&E), SoCalGas, and Sempra South American Utilities. Sempra Infrastructure includes Sempra Mexico, Sempra Renewables, and Sempra LNG & Midstream. The recent acquisition of Oncor, an electric distribution and transmission business in Texas, adds a new segment within the Sempra Utilities operating unit.

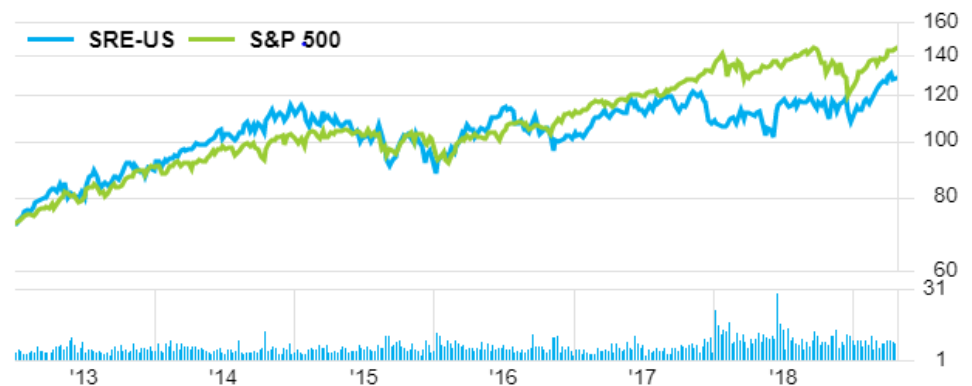
Sempra can be broken down into the following percentages of revenue:



### Recommendation

For this stock we recommend a **BUY** with their investment plans, locational advantages and resistance we see this as a strong stock in any market. They have set initiatives to be the leading energy infrastructure company in North America and have unmatched growth opportunities among other utilities companies

#### Performance



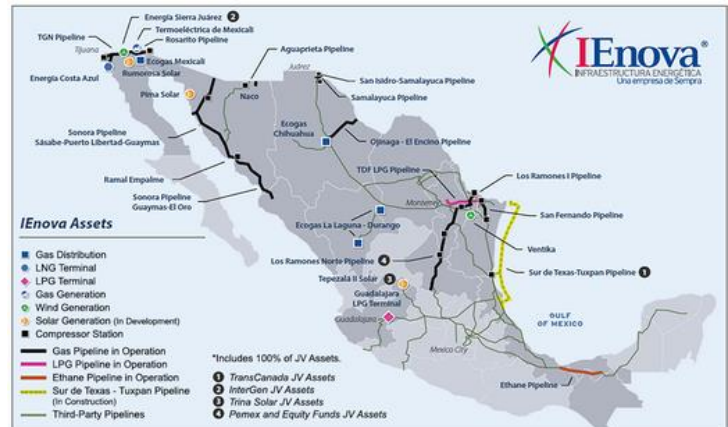
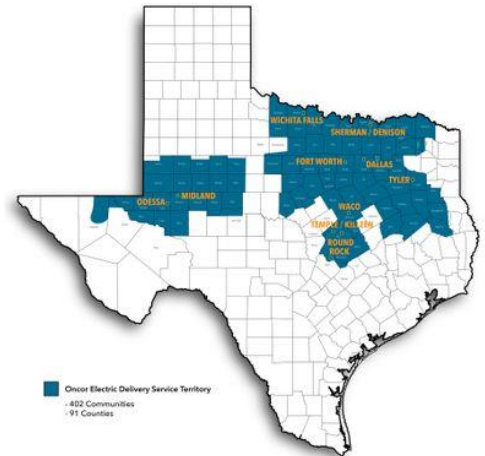
### Investment Thesis

#### 1. Locational Advantages

- Currently, the main operating points of Sempra are in San Diego and in the Southern California and Dallas/Ft. Worth area. These locations are strong for their current economic conditions and population inflow. Both San Diego and the Dallas/Fort Worth areas have placed on CNBC as a top 15 city for economic growth, population inflow, and best places to start a small business. Growth in the utilities industry depends on population for the residential sector, economic health, and energy culture. Renewables make up nearly 50% of their energy, making them a popular decision amongst consumers. These locations are also some of the fastest growing in terms of economic and population growth.

## 2. Acquisitions & Investments

- Sempra is selling all of their South American utilities, which is about \$7 billion of assets as well as \$2.5 billion of their renewables. This was meant to pay for new acquisitions and to balance out their liquidity ratios. Sempra wanted to consolidate their business to growing markets and to focus strictly on North America. They also said they planned to invest \$25 billion into their subsidiaries and various investments over the next five years. Oncor was the first purchase.
- Oncor is the main electric provider of the Dallas/Ft. Worth area. Dallas/Ft. Worth is a top-ten place in the US to start a small business. Where electric usage is largely dependent on economic health and industry in the area, Oncor is the largest electric retailer in the area and has established their infrastructure in the most reliable, fast-growing utilities market in the country. No other utilities company is located in an area with the same economic strength as Sempra's subsidiaries. This continues into IEnova.
- Sempra has also recently taken almost a 90% ownership in IEnova. This capital investment was made because of the massive total available market (TAM) in Mexico. Mexico imports most of their natural gas as well as much of their energy. Mexico is also one of the largest countries by population in the world and over half of its natural gas supply is imported. According to the IEA, electricity demand will over double in the next twenty years. IEnova is one of the largest and first public energy infrastructure company to produce the energy right in Mexico. A very large percentage of Sempra's investments will go into capitalizing on their TAM.



## 3. Recovery Ability and Defensiveness

- The utilities sector has historically been defensive against recessions. The past recession the utilities sector decreased by only half of what the rest of the S&P did. And during the last market correction in December, Sempra stock price increased. Our portfolio still is not heavily weighted enough in Utilities, with it being one of the most defensive sectors. Sempra also holds many of the qualities needed to survive a recession. Making huge capital investments now, before it hits.

## Management

### 1. CEO & Chairman – Jeffery Martin

- Martin has served as Sempra Energy's CEO since May 2018 and, as chairman, since December 2018. He served as the executive vice president and CFO for Sempra from 2017 to 2018, and before that CEO of SDE&G from 2014 to 2016. From 2010 to 2013, Martin was president and CEO of Sempra U.S. Gas & Power and Sempra Generation; subsidiary companies of Sempra's renewable energy and midstream businesses. Martin previously also served as the president of investor relations of Sempra. He first joined Sempra Energy in 2004 as a principle working in Sempra Energy's mergers and acquisitions group. Before Sempra, he was the CFO of NewEnergy, Inc. He also was an attorney that specialized in corporate and commercial finance and real estate. He holds a bachelor's degree from the United States Military Academy at West Point, a master's degree in public administration from the University of Texas, El Paso, and a law degree from the University of Miami.

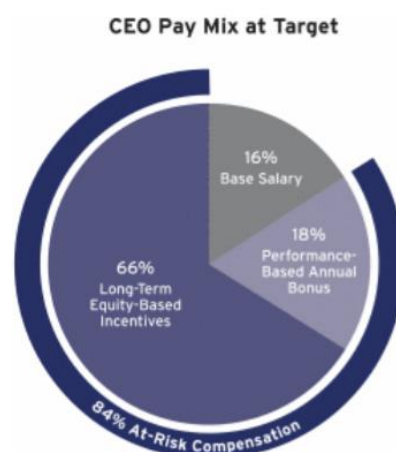


## 2. Senior Leadership Loyalty

- All of Sempra's leadership team has proven substantial knowledge of the energy and utilities industry. Majority of management has worked their way up within Sempra which demonstrates loyalty and commitment to the company. For example, President and COO, Joseph Householder, began working for Sempra Energy in 2001. Trevor Mihalik, Executive VP and CFO joined Sempra Energy in 2012. Patricia Wagner, Group President of U.S. Utilities, joined Sempra in 1995.

## 3. Compensation

- The executive compensation program places emphasis on variable performance-based pay, which incentivizes management to make strategic decisions that will maximize shareholder value. Compensation is broken down into three categories.
  - Long-Term Equity-Based Incentives
  - Performance Based Annual Bonus
  - Base Salary



## Risks

### 1. Growing Usage of Individual Electric Production

- In California people have been increasingly using their own solar panels on their homes. Currently it has been factored into their pricing, but it may not be an outstanding issue. California's culture, subsidies and rebates has generally supported building their own solar panels. It is not much of a current issue, but it may affect the long term. The solar panels however have seen a temporary decrease in purchases due to tariffs and may be seen into the future during a potential recessionary period.

### 2. Weather and Fire Risk

- Energy news has been captivated by competitors who have suffered immense expenses to wildfire restoration. PG&E has declared bankruptcy and had an 80% stock dip. As well as close competitor Edison International who had a 20% dip in less than a month. This may however be productive toward the overall risk of Sempra. The utilities industry has been entirely consumed by the thought of fire safety and avoiding these sorts of charges after one of the largest wildfires in California history. Electric users are more educated than ever, and providers are more educated than ever. This past year, Sempra also received the Edison award. The Edison award is only granted to one US utilities company per year and was given to Sempra for their efforts to maintain wildfire preparedness and grid resiliency.

### 3. Political Risk

- Sempra is subject to numerous rules and regulations related to environmental protection within the state and federal levels. These relate to air quality, water quality and usage, conservation of natural resources, climate change, and more. As a large portion of Sempra's business takes place in California, it's progressive culture may promote new legislation or additional costs associated with greenhouse gas emissions, environmental monitoring, and the possible requirement of carbon taxes or the purchase of emissions credits. However, it is important to note that all utilities companies within the state of California will be subject to the same regulations.

## Valuation

The discount and EV/EBITDA multiples were weighted 50/50. This resulted in a one-year target price of 144.40 in hopes that their increase in FCF will be able to support higher dividend payments.

This valuation came about from a variety of different editions from a provided Bloomberg template. It was based off of EBITDA multiples given the nature of the future economic condition. In the table to the right, the realistic EBITDA multiples were performed with some degree of sensitivity. Historically, in recessionary periods, WACC for utilities has risen due to the rise in cost of equity. Right now, the WACC is 4.8%. Looking toward a recession that number should not decrease. Their current EV/EBITDA is at about 16.2. During a recession, that number could possibly rise. During the last recession the EV/EBITDA multiple continued to rise.

WACC (below)	14.7x	16.2x	17.7x
4.8%	-6%	12%	30%
5.3%	-10%	8%	25%
5.8%	-14%	3%	20%

Utilities companies usually have access to cheap debt, as EV is not expected to suffer as a result of a recession. Even in a recession with the magnitude of '08, there was only a one year decrease in EV before their '09 numbers were back above '07. With this information in mind, a 3% increase in price was set, with a continued increased dividend payout for a one-year total return of 6.08%. This is done with an estimated beta of .53.

The valuation was also weighted with the dividend discount model. Utility stocks are usually based on constant dividend payments. Sempra has increased dividends every year for the last ten years, even during '09. There's typically not rapid growth in utility stocks, however, Sempra has grown fast lately making their increasing dividends manageable during the recession. With Sempra's low cost of capital, using the Dividend Discount model it supports a higher target price.

## Peer Analysis

	Market Capitalization	1/08 - 1/10 Price Change	Operating Margin	CFO/Cap Ex Projection 2019
<b>Sempra</b>	34.7	-8.8%	22.9%	0.6
<b>Consolidated Edison</b>	27.6	-5.6%	20.7%	0.9
<b>Eversource Energy</b>	22.5	-16.4%	20.5%	0.7
<b>CenterPoint Energy</b>	15.2	-14%	9.9%	0.9
<b>PPL Corp</b>	22.3	-36.4%	36.9%	0.9

The premise of this stock pick is based off safety and security during recessionary periods. The best way to react to a recession is a reliable customer base, market cap and reliable infrastructure. Market cap shows a strong correlation between the '09 recession and ability to react well. A larger market cap gives a company the ability to support infrastructure payments. The utilities sector reacted much better during the recession due to the nature of the business.

Capital expenditures also serves a significant purpose in this peer analysis. Right now, the next years Cap ex plan is to spend a lot. This is due to a numerous factors, including; Sempra does not want to make large capital expenditures during a recession, as well as new safety plans involved in California based utility companies after recent wildfires. This year, there is expectations for huge capital expenditure plans that should create enough infrastructure to support Sempra through the recession. This will be followed off by a decrease in Cap ex and posting some sizeable FCF in the following years. The liquidity of Sempra is not projected to be an issue during these periods of high spending because of their recent write off of \$2.5 billion worth of their renewables for huge improvements to their ratios.

Another significant factor that should be emphasized is their operating margins and Cap Ex. plans. Their operating margins show they should produce enough cash to maintain the large investments and projects they have planned. They have also underestimated and not accounted for their capital expenditure plans. They have announced \$25 billion in investments and have potential for large returns, especially for an often-average paced utilities company. No need to worry of liquidity ratios, their divestiture plans of South America and renewables will bring in almost \$10 billion in current assets to balance out their balance sheet.

## Ownership of Shares

### Ownership Statistics

